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# Your Credit Score: How It All Adds Up [1]


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## 1. Introduction: What is a Credit Score?

Your credit score is simply a "snapshot" or numeric summary of your credit report [2] that creditors can use to help determine whether to give you credit. The Fair Credit Reporting Act [3] (FCRA) defines a "credit score" as "a numerical value or a categorization derived from a statistical tool or modeling system used by a person who makes or arranges a loan to predict the likelihood of certain credit behaviors, including default..."  A quick glance at your credit score gives creditors all they feel they need to make judgments about whether you will repay a car loan, mortgage or credit card debt.  Your credit score may also be used to decide the credit terms you are offered or the rate you will pay for the loan.

Credit scoring systems award points for each factor that helps predict who is most likely to repay a debt. The total number of points becomes your credit score.  Late payments, maxed out credit cards, and bankruptcies are negative factors that take points away. A solid payment history and careful use of available credit add points. Consumers who have a very low score --or no score at all-- may not get credit on any terms.  A low score can cost you thousands of dollars in added interest over the life of a car loan or mortgage.

## 2.  FICO or Vantage?

Fair Isaac, Inc., developed the FICO score as a credit scoring model in 1989.  Contrary to popular belief, you do not have just one FICO score.  There are many versions [4] of your FICO score.  The most commonly used is your FICO Score 8 [5].  The newest version is FICO Score 9 [6].

VantageScore Solutions [7], a combined effort of the three major credit bureaus (Experian, Equifax and TransUnion) provides an alternative to FICO.  VantageScore was introduced to the marketplace in 2006. Its latest scoring model is VantageScore 4.0 [8].

Your VantageScore is calculated differently [9] from your FICO score in two important ways:

- VantageScore considers recurring payments such as your phone bills and utility bills.
- VantageScore looks at 24 months of your account activity instead of FICO's six-month period.

In addition to FICO and VantageScore, many other companies have developed scoring models. Some models focus on specific types of loans like automobile loans or credit cards. Very often credit scores come bundled with offers to sell other products such as credit reports, credit report monitoring services or identity theft insurance.

Newer types of predictive consumer scores use thousands of pieces of data about consumers to predict how they will behave in the future.  These scores are based on non-traditional data not usually found in credit reports.  Consumers have no right to see these scores or even to know that they exist. These scores are largely unregulated by the FCRA.   For more information on predictive scoring, see the World Privacy Forum's report The Scoring of America: How Secret Consumer Scores Threaten Your

Privacy and Your Future [10] (April 2014).

### 3. Your Rights to Your Credit Scores

The Fair Credit Reporting Act (15 USC §1681) (FCRA) allows you access to some of your credit scores for a "reasonable fee". The FCRA only covers two kinds of scores. The "educational" score shows you how scoring works and how you rate as a credit risk. You may also get a "mortgage score," that is a score used in connection with residential real property loans.

**Will the credit score that I purchase be the same score that can be seen by lenders?**

Not necessarily. A September 2012 report [11] by the Consumer Financial Protection Bureau (CFPB) found that the credit scores can differ. When you purchase your credit score, be aware that a lender may be using a very different score in making a credit decision. The study found that one out of five consumers would likely receive a meaningfully different score than would a creditor. In fact, in January 2017, the Consumer Financial Protection Bureau fined [12] credit reporting agencies TransUnion and Equifax for falsely representing that the credit scores they marketed to consumers were the same scores lenders typically use to make credit decisions.

**Do I have a right to free credit scores?**

Generally, no. However, rules [13] adopted by the Federal Reserve Board and the FTC give consumers the right, in some cases, to receive credit scores when applying for credit or a notice that credit has been approved but that the consumer did not receive the most favorable credit terms because of the credit score. Called "risk based pricing" notices, the notices are required under the FCRA.

The law gives the right to receive a free credit score to anyone who has received credit at a rate higher than other consumers or whose credit rate is adjusted unfavorably because of a credit score. This means, for example, if your credit card company reviews your credit score and decides you represent a heightened credit risk because your score has dropped, the company can increase your interest rate. If this happens, you are entitled to a free credit score.

Many personal finance websites [14] allow consumers to obtain their VantageScore credit scores at no cost. Some credit card companies offer a free FICO score as a benefit.

**What is the best way to order my credit score?**

As mentioned above, many personal finance websites [14] allow consumers to obtain their VantageScore credit scores at no cost. Some credit card companies offer a free FICO score as a benefit. This would be the most cost-effective way to obtain your credit scores.

However, if you want to obtain a specific credit score that is not available free, you can purchase it from FICO or one of the three credit bureaus. Whether you purchase a credit score through one of the credit bureaus or through the Fair Isaac, Inc., these websites provide a confusing array of packaged products from multiple reports and scores from all three credit bureaus, as well as credit monitoring services. It can, in short, be difficult to determine exactly how to purchase a stand- alone credit score without committing yourself to a "free" trial or purchase of products for which you have no need.

You can purchase your score is through one of the national credit bureaus:

- Experian, www.experian.com [15]
- TransUnion, www.transunion.com [16]
- Equifax, www.equifax.com [17]

You can also purchase your FICO score through www.myfico.com [18].

**Will I know how the credit bureau arrived at this score?**

When you request your "educational" credit score, it should come with a notice that tells you:

- That the credit scoring model may be different than the credit score that may be used by lenders.
- The range of possible scores under the model used.
- The key factors (limited to four) that adversely affected the credit score.
- The date the credit score was created.

**Can I dispute a low credit score?**

No. The dispute process outlined in the FCRA applies to your credit report, *not* your credit score. Since your score is based on data in your credit report at any given time, correcting errors in your credit report should improve your score. The Federal Trade Commission provides information on how to dispute data in your credit report [19].

## 4. What Factors Determine My Credit Score?

The exact formulas of the FICO, VantageScore and other scoring models are trade secrets. However, Fair Isaac has identified five factors [20] and the importance given to each factor. They are:

- Payment history - 35%
- Amounts owed - 30%
- Length of credit history - 15%
- New credit - 10%
- Types of credit used - 10%

VantageScore and other scoring models include most of the same factors. However, the weight given to individual factors may vary.

**Why do I have a different score from each credit bureau?**

There may be a number of explanations for varying scores. Not all lenders report to all three credit bureaus. A late payment reported by a credit card company to only one bureau would lower your score on that bureau's credit report. Even slight deviations could end in a different score.

**How do the types of loans I have affect my credit score?**

Major bank credit cards with good payment records are better for your score than a department store card. Loans or credit established with a finance company, even when you have a good payment record, do not carry as much weight as a major bank card. A major bank card says you are in the mainstream of credit where credit limits can reach the stratosphere with a good payment record.

**Does my credit card company have to report on-time payments to the bureaus?**

There is nothing in the FCRA that requires any company to report either positive or negative information. If a company you do business with does not report to at least one of the three national credit bureaus, contact the company and ask that your good record be included in your credit report. If companies you do business with refuse to report to one or more of the credit bureaus, take your business elsewhere.

**Does my credit card company have to report my credit limit to the credit bureaus?**

Some companies that report on-time or late payments may not, in the past, have reported the maximum credit available. The ratio of credit used to credit available factors into your score. Without the maximum credit limit, scoring models often substituted the high balance used on your credit card. Such a practice creates a misleading impression about your use of credit. For example, your credit limit may be $10,000 and the most you have ever charged is $3,000. Although a 30% ratio of credit used to credit available is acceptable, without the credit limit, scoring models could only calculate $3,000 as your available credit. As a result, your score would identify you as one who maxed out their credit cards, signaling you as a poor risk for many lenders.

Under rules [21] adopted by the Federal Trade Commission (FTC) and federal banking agencies, reports to a credit bureau must also include your credit limit. The rules impose standards of accuracy and integrity on companies that report to credit bureaus. If, when reviewing your credit report, you find that your credit limit has not been reported, contact the creditor and request that this be rectified.

**Will closing old credit accounts increase my score?**

No. In fact the opposite may be true. Scoring models look at both your current use of credit and the length of time you have used credit. Older accounts even with a zero balance establish your history as a credit user.

**Does it improve my score to pay off my credit card balance every month?**

Not necessarily. Points are given or taken away based on the amount of available credit used. Certainly, using the maximum amount on your credit card and paying only the minimum each month can lower your score. But, using a large percentage of your available credit each month, even when you pay the bills faithfully, can detract points if you are carrying a high balance at the time your credit history is scored.

Remember, the credit score is a snapshot of your credit report on any given day. Most credit card companies and other lenders report to the credit bureaus every 30 days. If your credit report is scored right before your monthly credit card bill is due and you've used a significant portion of your available credit, your score will go down.

**Does my credit score include only negative information?**

No. The number of accounts shown on your credit reported as "never late" or "paid as agreed" have a positive effect on your credit score. It just seems like the calculation is based only on negative factors.

Often negative information is reported without a corresponding report of positive information. Utility companies are a good example of this. You are not likely to get positive points for paying your electric bill on time, but the utility company late payments will negatively impact your score.

## 5. Do Credit Report Inquiries Lower Your Score?

An inquiry is created whenever someone accesses your credit report. The fact that your credit information was accessed will be noted on your credit report with the date, name of the company that requested it, and the type of inquiry.

There are two types of inquiries that can occur on your credit report -- hard inquiries and soft inquiries. While both types of credit inquiries enable a third party, such as you or a lender, to view your credit report, *only hard inquiries can negatively affect your credit score*.

**What is the difference between a soft inquiry and a hard inquiry?**

Soft credit inquiries are credit inquiries where your credit is not being reviewed by a prospective lender. This includes checking your own credit, promotional offers by credit card companies, and inquiries made by businesses with whom you *already* have a credit account.

Hard credit inquiries are inquiries where a potential creditor is reviewing your credit because you've applied for credit with them. This includes credit checks when you've applied for a loan, mortgage or credit card.

**How does a hard inquiry effect my credit score?**

According to Fair Isaac, for many people, one additional hard credit inquiry [22] may not affect their FICO score at all. For others, one additional inquiry would take less than 5 points off their FICO score. However, inquiries can have a greater impact upon consumers with few accounts or a short credit history.

**I'm shopping for a new car or mortgage and have applied to several lenders. Will these inquiries lower my score?**

According to Fair Isaac, all inquiries within a 45 day period for a mortgage, an auto loan or a student loan as a single inquiry [22]. Thus, a little shopping for the best interest rate should not hurt your credit score.

## 6. Getting Started with Credit

If you don't have a credit history, it's hard to get a loan, a credit card or rent an apartment. Some people shun credit, choosing instead to live on a cash-only basis. Perhaps self-discipline, a bad experience with credit, or even family tradition have steered you away from credit cards or installment loans. Others, especially recent graduates just starting out, have not had a chance to establish a credit history.

A traditional credit score calculation is nearly impossible without a credit file. Having just a few notations in your credit file can result in a "thin" file, equally impossible to conform to the standard scoring models.

**How can I build my credit when I'm starting out?**

There are several steps that you can take to help build your credit when you don't have a credit history:

- Become an authorized user on another trusted person's account. Note that some banks do not report authorized users to the credit bureaus. Be sure to check with the card issuer.
- Get a loan or credit card using a co-signer. The co-signer is responsible for the full amount owed if you don't pay.

- Apply for a credit builder loan. Credit builder loans are small loans made by some credit unions designed to help consumers establish credit.
- Apply for a secured credit card.  Your credit line is backed by a cash deposit you make upfront.  The deposit amount is usually the same as your credit limit.
- Gasoline company and retailer cards are often easier to qualify for than bank-issued credit cards.

Once you have obtained credit, be sure to make payments consistently on time. Do not use all of your available credit. In fact, try to keep your use of available credit under one half the limit.

**I pay my bills on time, but in cash. Can I ever hope to get credit?**

Fair Isaac has developed a scoring model designed to score credit risk through "non-traditional" data obtained from various data vendors. This, the company claims, will make credit easier for the nearly 25% of the population that either has no credit file or too little information to benefit from traditional scoring models. The kinds of accounts covered in what Fair Isaac calls the FICO Expansion Score [23] include deposits with a bank, records with payday lenders, and purchase payment plans.

**Will my credit score increase when my credit limits go up?**

Not necessarily. Scoring models take into account how you use your available credit. Maxing out your credit cards or using all the available credit will deduct points from your score. The amount of credit you have available is not a scoring factor.

## 7. Tips for Improving Your Credit Score

- **Pay your bills on time.** Delinquent payments and collections can have a major negative impact on a credit score.
- **Pay off debt** rather than moving it around.  Shuffling of balances could be especially harmful to your score if you close established accounts and open new accounts to consolidate your debt.
- **Low balances** are a positive factor in scoring models. Don't use all your available credit.
- **New credit** applications can detract from your score. Multiple applications can have a devastating effect on your score, especially around the time you are shopping for major purchases like a car loan or mortgage.
- **Don't apply** for a lot of credit cards in a short period of time.  Opening many new accounts to obtain one time promotional interest rates, store discounts, or airline miles can hurt your credit score.
- **Old accounts** (even those you haven't used for a long time) can help your score. Scoring models look at not just how to use credit today but also how long you have used credit.
- **Ask your lender what scoring model it uses.** With many different scoring models available, it is easy to get confused. A number score alone will not tell you where you stand.
- **Monitor your credit report** and dispute errors. Errors in your report will usually translate into a low score.

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