

Understanding & Improving Your FICO® Credit Score

Experian and the other bureaus are offering free weekly credit reports available to consumers via Annualcreditreport.com.

Use this link: <https://www.experian.com/help/annual-credit-report.html>

Terms and Definitions:

FICO®: An acronym that stands for “Fair Isaac Corporation.” They are a research firm that has developed the credit scores that are used by most lenders in the U.S.

Delinquency: A term used by lenders to reflect a borrower that is late on their loan payment. Lenders report delinquency to the credit bureaus in 30-day increments (e.g. 30-day, 60-day and 90+ day delinquency, etc.)

Trade Line: Lender-speak for an individual loan account that shows up on your credit report.

Installment Trade Line: Loans on your credit report that have a specific, fixed number of payments assigned to them (e.g. a car loan, first and second mortgages and personal loans).

Revolving Trade Line: Loans on your credit report that do not have a fixed number of payments assigned to them (e.g. credit cards, home equity line-of-credit loans and overdraft loans).

Underwriting: The process a lender goes through to decide on whether or not to approve a loan request. Many factors, including your credit score, go in to underwriting a loan request.

A “Hard” Credit Report Inquiry: When you go to a lender or other provider of a service (e.g. an apartment complex or cell-phone company) asking for a loan or service and they pull your credit report in order to make their decision.

A “Soft” Credit Report Inquiry: When a current lender, potential lender or service provider does a “behind the scenes” look at your credit.

FICO® Scores – The Basics

There are three national credit bureaus:

1. Equifax
2. Experian
3. Trans Union

If you look at all of your FICO scores on the same day they will usually vary between 0 and 50 points because not all lenders and not all collection agencies report their information to all three credit bureaus.

The purpose of FICO credit scores is to assist a lender in making a credit decision and to predict the likelihood of 90+ day delinquency over the next two years. FICO scores range from 300 to 850. The higher the score the better (i.e. a lender views you as lower risk).

Reasons Why You Want a Good (i.e. High) Credit Score

1. A good credit score significantly increases your chance of a lender approving your loan request. Many banks and some credit unions deny loan requests when a borrower has a credit score less than 600. If you cannot get approved for a loan at a bank or credit union, your loan options get real ugly, real fast.
2. Most lenders today use a credit score to price their loans. If you have a high credit score you are statistically proven to be lower risk and so you will receive lower interest rates on your approved loans. Lower rates on loans will save you hundreds or even thousands of dollars in reduced interest charges over the life of a loan.
3. Insurance companies use credit scores to evaluate the risk you represent and to set premium rates. They have determined that people that have high credit scores are more likely to take care of their homes and their autos.
4. Employers look at credit reports and credit scores in making hiring decisions.

Great References to Learn More About Credit Scoring

www.myfico.com - www.equifax.com - www.experian.com - www.transunion.com

All U.S. residents may receive **one free credit report** from the Trans Union, Equifax and Experian credit bureaus **once per year**. You can do this at **www.annualcreditreport.com**. To be on the lookout for identify theft, a smart strategy is to pull a credit report from one of the three credit bureaus every four months.

If you would like to pay to receive your FICO credit scores, you can do so at www.myfico.com. The cost for one credit report and one FICO score is somewhere in the range of \$19.95.

If you would like to opt-out of the pre-approved credit offers lenders send in the mail, you may do so by calling 888-567-8688 or online at www.optoutprescreen.com.

FICO® Scores - General Information

National Distribution of FICO Scores (Apr 2017)		FICO® Scores - General Formula Score Composition	
800 & Above:	20%	Payment History	35%
750 – 799:	19%	Amount you Owe (Capacity)	30%
700 – 749:	17%	Length of Credit History	15%
650 – 699:	13%	Types of Credit	10%
600 – 649:	10%	New Credit	10%
550 – 599:	8%	Total	100%
500 - 549:	7%		
Up to 499:	5%		

FICO® Credit Score Tidbits

Derogatory public records that pertain to bankruptcy will remain on a credit report for ten years.

All other negative information on a credit report will remain on the bureau for seven years.

All authorized user accounts on a credit report are included in older versions of the FICO score, but this is not the case in the new version, called FICO '08.

Student loans are part of your score when payments are due.

If you have co-signed for a loan and the account is on your credit report, then it is in your credit score.

What a FICO Score Ignores:

- Your race, color, religion, age, national origin, sex and marital status.
- Where you live, your salary, occupation, title, employer, date employed or employment history.
- Any interest rate being charged on any loan on your credit report.
- Whether or not you are participating in a credit counseling service of any kind.
- Certain types of inquiries. The score does not count “consumer-initiated” inquiries – requests that you make for your credit report in order to check its validity. It also does not count “soft” inquiries such as promotional inquiries made by lenders in order to make you a pre-approved credit offer; or administrative inquiries made by lenders to review your account with them. Inquiries that are marked as coming from employers are also ignored.

You may have heard that a large number of inquiries can have a negative impact on your credit score, but you are probably OK. The vast majority of inquiries are ignored by the FICO scoring models.

For instance, the model has a buffer period that ignores inquiries within 30 days of getting a mortgage or a car loan. It also counts two or more “hard” inquiries in the same 14-day period as just one inquiry. You could have 30 auto or mortgage inquiries in a two week period of time and it only counts as one.

Hard inquiries are listed on your credit report for 24 months, but only the inquiries from the most recent 12 months are included in the FICO score calculation.

Capacity is King!

Almost as important to FICO scores as how you pay your bills is the credit utilization of your various loan accounts (i.e. capacity).

How Important is Capacity of Credit Cards?

Many people consolidate credit card balances and close out the credit card accounts, hoping to improve their FICO credit score. Here is an example of how this move affects a FICO score:

Before Consolidation	After Consolidation
<ul style="list-style-type: none">• Eight credit cards• \$40,000 in limits• \$10,000 in balances• 75% available capacity	<ul style="list-style-type: none">• Two credit cards• \$10,000 in limits• \$10,000 in balances• 0% available capacity
(\$30,000 available ÷ by \$40,000 in limits)	(\$0 available ÷ by \$10,000 in limits)

In this example the person is no further in debt, yet their credit score will drop dramatically because they have removed all of their available capacity on their credit cards.

If you reduce the available capacity on your revolving lines of credit loans, you lower your credit score. Therefore, you should not close your revolving loan accounts. If you are closing out your credit cards for non-use, you are reducing your available capacity – and your own credit score!

Items that Hurt a FICO® Score

- Late payments and derogatory public records. When assigning points lost for payment history issues, the FICO model looks at Dollar Amount, How Recent, Frequency & Severity.
- A low level of “percent available” on individual revolving accounts and total revolving accounts.
- Closing revolving accounts.
- Having a lender remove or lower the limit on a revolving account or if the lender does not report the limit on a revolving account.
- Multiple new accounts in a short period of time.
- Settling for less than full balance (because the settled date is more recent then the original date).
- Having loans at “second tier” finance companies.

Strategies that Will Improve a FICO® Score

- Ensure your credit bureau data is accurate & dispute legitimate errors.
- Focus on bringing currently delinquent loan accounts current. Don't allow your current loans to go delinquent while using your cash flow to pay on old collection accounts.
- Comparison shop for mortgage and auto loans within a 14-day period of time to minimize the impact of inquiries.
- Pay off and close second-tier finance company loans.
- Pay down the credit cards first that are near their limits (assuming the interest rates are about the same).
- Pay down total revolving balances, but do not close these accounts.
- Move revolving balances to installment debt; but again, do not close the revolving accounts.
- Keep credit card balances as low as possible and limits as high as possible.
- Minimize inquiries and new accounts.

Impact of Negative Credit Over Time	Percent Negative Impact
0 to 12 Months Back:	93%
12 to 24 Months Back:	60%
24 to 36 Months Back:	44%
36 to 48 Months Back:	33%
Longer than 48 Months:	22%

Negative credit will stay on your credit report for seven or ten years, but the negative impact fades quickly out of the score.

How Lenders Use FICO® Scores

What does all of this Mean for You?

Sample:

\$25,000, 60-Month New Car Loan Purchase

Credit Tier	APR	Monthly Payment	Total Interest Paid
A+	5.75%	\$475	\$4,327
A	6.25%	\$484	\$4,669
B	8.00%	\$513	\$5,888
C	11.25%	\$547	\$8,236
D	14.25%	\$598	\$10,498
E	17.00%	\$616	\$12,651

A+ to E-paper difference in payment: \$139 a month.

A+ to E-paper difference in total interest paid: \$8,324!

Sample:

\$250,000, 30-Year First Mortgage Loan

Credit Tier	APR	Monthly Payment	Total Interest Paid
A+	5.75%	\$1459	\$275,216
A	6.25%	\$1539	\$304,145
B	6.75%	\$1622	\$333,738
C	7.25%	\$1705	\$363,959
D	8.50%	\$1922	\$442,022
E	9.50%	\$2102	\$506,768

A+ to E-paper difference in payment: \$643 a month.

A+ to E-paper difference in total interest paid: \$231,552!

And Finally...

Those that understand interest earn it.

Those who don't, pay it!

To contact Experian to dispute Credit Report errors, call 888-397-3742 or www.experian.com. Fax: 972-390-3809

or use this link for information on how to fix errors: <https://www.myfico.com/credit-education/credit-reports/fixing-errors>