Your Credit Score

Your credit score is the three-digit number that lenders obtain from a credit bureau in an attempt to sum up your credit risk. Your credit score gives lenders a snapshot of your credit and debt situation and plays a big part of whether or not credit will be granted, as well as the terms and conditions of your loan or credit card. Your credit score is determined solely by the information found in your credit report relating to past and current credit accounts, and public records such as liens and bankruptcies. When you apply for credit, lenders take into consideration your credit score, as well as your income, length of time at your current employment, and the type of credit you're applying for.

Your credit report contains identifying information about you, including your name and names used in the past, your address, your social security number, date of birth, and employment information. Things that do not affect your credit score include your income, race, religion, sex, age, marital status, and employment status. It's important to check your credit report at least annually to be sure that your credit score is calculated based on accurate information. Some creditors only report to one or another of the three credit bureaus, so you need to check your report with all three to get your complete credit report. It's very possible to have information in your report that is outdated or inaccurate, an account that belongs to someone else with the same name, or even fraudulent accounts opened by an identity thief. Nobody can find inaccuracies in your credit report but you, so be sure you take the steps to protect your credit rating. Go to www.annualcreditreport.com to get your free credit report from all three credit bureaus. The credit reports will be free, but you will have to pay for your credit scores. You can purchase your credit scores from the site at the same time you order your free credit reports.

The FICO score, developed by Fair, Isaac, and Co., is the industry standard; 75% of lenders and 23 out of 25 credit card issuers base their decision on your FICO score. Each of the three major credit reporting agencies: Experian, Equifax, and Trans Union has their own exact method for computing your credit score, but their credit scoring methods are all based on the FICO scoring model. Due to each credit bureau integrating their own scoring method, and the possibility that their report does not contain your complete credit history, your credit score is likely to be slightly different with each credit reporting agency. Experian uses the *Fair Isaac Score*, and credit scores range from 330-830. Equifax developed the *Beacon Score,* ranging from 340-820. Trans Union's system is called *the Empirica* Score, and scores can range from 150-934. Higher is better with all scoring methods, and a credit score of about 700 is the American average.

Fair, Isaac, and Co. does not disclose the exact method of computing your FICO score, but they do let us know the approximate weight that various factors carry in determining your credit score.

35% of your FICO score is based on your payment history. Your credit score can be lowered by late payments, collections and bankruptcies; how much it can be lowered is dependent on the severity of the delinquencies

and how recent they are. Your score can be raised by showing a long history of on-time payments.

30% of your FICO score is based on your utilization of available credit. If you have very high balances on your revolving credit accounts, such as credit cards, this can lower your credit score. Keeping a low balance shows you can manage your debt levels and generally increases your credit score. It's good for your credit score to keep your revolving balances under 30% of the credit limit, but even less than that is better. Closing your unused accounts can hurt your credit score if you have balances on other accounts, because it raises the amount of credit you are using compared to the amount of credit you have available to you.

15% of your FICO score is based on the length of your credit history. This factor includes the age of your oldest and newest account, and the average age of your other accounts. Closing your oldest accounts can hurt your credit score if you don't have a long credit history, as well as opening several new accounts in a short period of time. If you are new in the credit market, it will take time to establish proof of responsible credit use. Showing a long history of on-time payments and responsible credit use raises your credit score.

10% of your FICO score is based on how much new debt you've taken on. Recent inquiries on your credit report, as well as new accounts are factored in. Suddenly applying for lots of credit and running up new debt raises a red flag, and can lower your credit score; it may look like you've come across financial difficulty and are using credit to make ends meet. Using credit wisely and consistently after trying to overcome a negative credit history can raise your credit score.

10% of your FICO score is based on the types of credit used. Though it's not a key factor in your credit score, your credit score could be affected by whether you have mortgages, installment loans, and revolving credit accounts. This portion of your credit score may have more weight for someone with a limited credit history. The number of each type of credit account can affect your score, though we aren't given a magic number for how many is too many.

In addition to the classic FICO scoring method, Fair, Isaac, and Co. developed its NextGen FICO scoring method in 1999. The NextGen FICO is called the *Pinnacle Score* at Equifax, the *FICO Risk Score, NextGen* at Trans Union, and the *Experian/Fair Isaac Advanced Risk Score* at Experian. The NextGen FICO was designed to better identify a person's true credit risk while giving less weight to factors that are not thought to have as much bearing on a person's likeliness to repay. Under the new scoring model, many people have a better credit score, making it easier for them to get loans and better rates. Though Fair Isaac touts this new scoring model as a breakthrough in the credit scoring system, many lenders are hesitant to use it due to unfamiliarity with

the new system, as well as a lack of time-tested proof that the new scoring model is indeed better than the tried and true classic FICO system. You will probably see a gradual shift in the use of the NextGen FICO credit score in the future, but for now, the majority of lenders still go with the original FICO scoring model because it's what they know.

Sources:
MyFico.com
FairIsaac.com

About the Author

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