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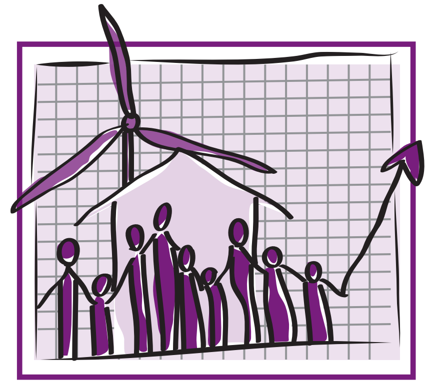

Credit Scores

Fact Sheet No. **9.142** Consumer Series | **Finance**

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A credit report and a credit score are two different financial documents. A credit score is a three-digit number, ranging from 300 (lowest) to 990 (highest). Lenders use the scores to determine whether to grant credit, what terms are offered, and the interest rate to be paid. Credit scoring systems deliver faster, more accurate, and more impartial decisions than individual people can make. A credit score is based on information from your credit history that a company that collects. The three national credit reporting companies (credit bureaus) are Equifax, Experian, and TransUnion. The information in a person's file at each credit reporting company may be different. Credit reporting companies are required to provide free credit reports annually when a person asks for one. However, credit reports generally do not include a credit score so consumers may have to pay a fee to get their credit score.

Types of Credit Scores

There are two types of credit scores, generic scores and lender-based scores. For many years the best known type of credit score has been the FICO score. The FICO name comes from the company that developed the model, the Fair Isaac Corporation. The FICO score (www.myFICO.com) is an example of a generic score. FICO scores range from 300 to 850. VantageScore (www.vantagescore.com) is another generic credit scoring model. VantageScore was created by the three major credit reporting companies (credit bureaus), Equifax, Experian, and TransUnion. The VantageScore ranges from 501 to 990.

Consumers may get an estimated credit score from a variety of websites. These estimates are usually not the score that lenders will use. Often these websites charge a fee for this estimate or they offer them free in exchange for signing up and paying for a monthly credit monitoring service. The Dodd–Frank Wall Street Reform and Consumer Protection Act (Pub.L. 111-203, H.R. 4173) was passed in July, 2010. It requires that a consumer receive a free credit score if they are denied a loan or insurance due to their credit score.

What Factors Determine a Person's Credit Score?

For a credit score to be calculated, each of the three credit bureaus must have at least one account which has been open for six months or more. In addition, each credit bureau must have information about at least one account that has been updated in the past six months. Each credit scoring formula uses similar information. These are the types of information used to calculate a credit score. The percentage in parentheses below shows how important each type of information is to the FICO credit score:

1. Whether you pay your bills on time or have any collection actions against you (35%).
2. The amount of your outstanding debt (30%).
3. Length of time you have had credit (15%).
4. Type of accounts you have (e.g. credit cards, auto loans, mortgages) (10%).
5. How recently you have requested or opened new credit (10%).

A credit score takes into consideration all these categories of information, not just one or two. No one piece of information alone will determine your score.

Negative events will cause credit scores to drop. Negative events are things like:

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Quick Facts

- A credit score is a 'snapshot' of an individual's credit history at a particular point in time. Each individual's financial behaviors are constantly being reported and recorded.
- A credit score considers both positive and negative information in an individual credit report. Late payments will lower the score, but establishing or re-establishing a good track record of making payments on time can raise a credit score over time.
- There are two types of credit scores, generic scores and lender-based scores.
- The accuracy of the information at all three credit reporting companies can have a big influence on your credit score. Get free copies of your credit reports regularly and check to see that the information is accurate.
- Credit repair companies are usually not helpful to consumers. These companies often over-promise, charge high prices, and perform services that consumers could do for themselves.

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- Several requests for credit in a short period of time;
- Majority of accounts at their limit ('maxed-out');
- Frequent late payments and accounts in collections; and
- Charged-off debts (debts written off as uncollectable) or declaring bankruptcy.

Interpreting Your Credit Score

There is no single 'cut-off' credit score used by all lenders. High credit scores usually mean lower interest rates. Lower interest rates can mean thousands of dollars of savings over the course of a large loan like a car loan or a mortgage. For example, a credit score of less than 600 can mean an auto loan interest rate two to three times higher than that offered to a person with a credit score over 720. For someone with a $350,000 home mortgage, a 200-point difference in credit score can mean as much as $100,000 difference in the total amount of interest paid for a 30-year fixed rate mortgage.

New Regulations

In July 2011, the Adverse Action Rule section of the Dodd–Frank Wall Street Reform and Consumer Protection Act (Pub.L. 111-203, H.R. 4173) took effect. This rule will make consumers more aware of their credit scores. In the past, most consumers were not aware when their credit score made them pay a higher interest rate. Under the Adverse Action Rule, in some situations lenders who deny credit or are charging a higher interest rate are required to send a risk-based pricing notice to the person who applied for credit. The adverse pricing notice will include these items:

- The credit score used in making the credit decision;
- The range of scores that would have led to a lower interest rate;
- The key factors that adversely affected the credit score of the consumer;
- The date on which the credit score was created; and
- The name of the person or entity that provided the credit score.

Some companies design their systems so that applicants with scores not high enough to pass easily or low enough to fail absolutely are referred to a credit manager who decides whether the company or lender will extend credit. Referrals can result in discussion and negotiation between the credit manager and the would-be borrower.

Important Facts

- A consumer's financial behavior influences their credit score. It is especially important to make payments on time, apply for credit only when it is needed, keep balances under 25% of the limit on each credit card, avoid opening several credit accounts at the same time, take steps to avoid late payments, and keep all accounts current.
- Closing accounts can lower your credit score for a period of time.
- Raising a low credit score takes time. Making late payments on a couple of loans may have a negative impact on a credit score for a year or more.
- How accurate the information is at all three credit reporting companies can have a big influence on your credit score. Get free copies of your credit reports regularly and check to see that the information is accurate.
- Credit repair companies are usually not helpful to consumers. These companies often over-promise, charge high prices, and perform services that consumers could do for themselves.
- It is important to shop around for the best credit terms when taking out a loan. This is especially true for consumers with low credit scores.
- Credit scores are not just for credit cards and loans. In all but a few states (CA, HI, MD), insurance companies use a specially-formulated credit score to issue policies (or not) and set premium rates. They claim that policyholders' bill-paying histories can predict their risk-taking behaviors in the future.
- A credit score is a 'snapshot' of an individual's credit history at a particular point in time. Each individual's financial behaviors are constantly being reported and recorded. A credit score considers both positive and negative information in an individual credit report. Late payments will lower the score, but establishing or re-establishing a good track record of making payments on time can raise a credit score over time.

Consumer Financial Protection Bureau

Free access to credit scores

https://www.consumerfinance.gov/about-us/blog/check-our-new-list-see-if-your-credit-card-offers-you-free-access-one-your-credit-scores/

For More Information

- 9.141, Credit Reports
  www.ext.colostate.edu/pubs/consumer/09141.html
- Credit Reports and Credit Scores
  Federal Reserve Board
  www.federalreserve.gov/creditreports/
- New Rules About Credit Reports
  Federal Reserve Board
  www.federalreserve.gov/consumerinfo/wyntk_notices.htm