



Consumer Tip May 2016: The Importance of Your Credit Score



How your credit score is calculated and the impact it can have on your life is a mystery to many. However, credit scores and the ways in which they're used are actually pretty straightforward. It's smart to be aware of this information to ensure your credit score remains as high as possible, especially if you plan to make a large purchase in the near future. Below are basic tips and information to give you a better understanding of your credit score.

What is a credit score?

A credit score is a number that reflects your credit risk level, with a higher number indicating lower risk. It is generated through statistical models using elements from your credit report. The three national credit reporting bureaus—Experian, Equifax and TransUnion—keep reports based on information they receive from companies that have extended credit to you. These reports include information such as your payment history, the length of your credit history, the types of credit you have and the amounts you owe. From that information, they derive your credit score, which can range from 300 to a perfect 850. The higher your score, the better interest rates you'll receive. Consumers with a credit score above 700 generally receive lower interest rates, and those with a credit score of 760 or higher will receive the lowest interest rates. A score of 660 or below is considered "subprime" and may disqualify you from bank credit. If you're thinking about buying a car or purchasing a home, your three-digit credit score will in large part determine your interest rate.

How is a credit score calculated?

Your credit score is calculated using this formula:

- 35 percent is based on your payment history. Do you pay your bills on time? Do you have any bankruptcies, liens or foreclosures on your record?
- 30 percent is based on your amount of debt, meaning the amount owed on available credit cards and installment loans.
- 15 percent is based on the length of time using credit, known as your credit history.
- 10 percent is based on the types of credit in use, including credit cards and installment loans.
- 10 percent is based on the number of new credit accounts or recent credit inquiries.

What are some ways a credit score is used?

Banks, mortgage lenders, auto dealers, credit card companies, retail stores and most any other lender will use a credit score to quickly summarize a consumer's credit history, saving the need to manually review an applicant's credit report as well as providing a better, faster risk decision. Depending on the amount of credit needed, additional factors such as an applicant's income vs. the size of the loan are also used. However, your credit score is the leading indicator of creditworthiness.

Your credit score can also play a role in situations you might not expect. These include utility companies assessing whether they will require a deposit and if so, how much; landlords determining how much will be required as a security deposit; cell phone companies potentially offering a flexible payment plan; and insurance companies reviewing whether to provide coverage, how much and at what cost.

How can you improve your credit score?

- Pay your bills on time. This is the single most important contributor to a good credit score.
- Be sure you don't have too much credit. Too many credit cards and installment accounts can negatively affect your credit score. Keep in mind that too little credit, or a complete lack thereof, can also negatively impact your score.
- Don't max out your credit cards and keep balances on your credit cards low. Experts suggest you keep your debt ratio on your credit cards under 50 percent.
- Don't open a lot of credit cards you don't need. Applications for credit show up as inquiries on your credit report, indicating to lenders that you may be taking on new debt. Instead, use the credit you already have to prove your ability to manage credit responsibly.
- Pay down those credit cards with the highest interest rates first.
- Carefully review your credit report and correct any errors immediately. You're entitled to a free credit report annually from the three major credit reporting agencies and can access these reports by using AnnualCreditReport.com.
- Time is your ally in improving credit so if you have a low score, get and stay on track to improve it.

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