



Credit score basics

Tips for unlocking your credit potential

In the not-so-distant past, businesses relied on experience and intuition to make lending decisions, which left room for mistakes and personal bias. Today, most companies use credit scoring to help them analyze information so they can make more objective, consistent decisions — and make them more fairly and more quickly.

What is a credit score?

Credit scoring is a tool lenders use to analyze the information in a credit report to help them make lending decisions. Scoring models are computerized formulas developed by studying how millions of consumers actually repaid — or didn't repay — debt over time. These models are used to compare the information in your credit report with this proven track record to determine your relative risk — the chance that you may become delinquent on account payments or default on a loan. A credit score is a number that represents the results of that analysis.

How does credit scoring work?

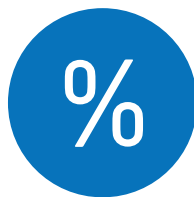
A credit report doesn't advise a lender to approve or decline an application. The lender must make that decision.

For many years, lenders reviewed credit reports and application information manually, using simple paper worksheets. They identified elements in credit histories — and sometimes other application information — that signaled lending risk by studying repayment patterns. Using a paper-and-pencil formula, a company might have denied your application because of a single late payment, regardless of other information in your credit history.



Payment history
Pay all your bills on time, every time.

Extremely influential



Percentage of credit limit used
Keep revolving balances low, under 30% of credit limits.

Highly influential



Age and type of credit
Maintain a mix of accounts (credit cards, auto, mortgage) over time to improve your score.

Moderately influential



Total balances/Debt
Reduce the amount of debt you owe.



Available credit
Don't apply for more credit than you need.



Recent credit behavior and inquiries
Don't open too many accounts too quickly.

Less influential

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Today, computerized credit scoring looks at the same information, but in a much more sophisticated manner.

Credit scores don't just consider the number of late payments. They also balance negative information against all other positive details in your credit history. So your application still may be approved despite a single late payment.

Credit scores also help businesses make good decisions about people with very different credit histories. For example, issues that indicate risk for a new credit user aren't necessarily the same as those for an experienced credit user with years of credit history. Credit scoring recognizes and accounts for such differences so lenders can assess risk accurately for every type of credit user.

Are there different kinds of credit scores?

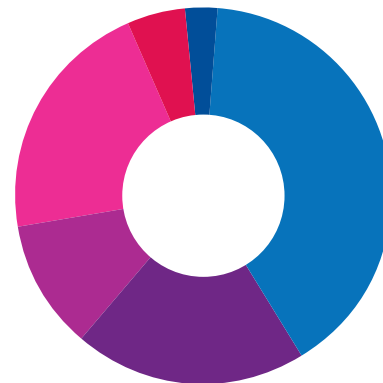
There are many different credit score models produced by a number of different companies. Experian's Decision Analytics business (which is separate from its credit reporting business) develops credit scores for lenders and other companies. There are other companies that specialize in creating credit scores as well. And some businesses, including lenders and insurance companies, develop their own credit scores based on their experience with customers.

Generic credit scores indicate general financial risk and may be used by many different companies. Custom scores are developed to predict risk for specific types of lending or for individual businesses. One credit score model may evaluate the repayment risk for retail debt. Another model may be used specifically for auto loan repayment. There even are credit scores used to help predict bankruptcy risk or the likelihood a person will make an insurance claim.

Usually, though, if one type of credit score indicates a person is low risk, other scores also will predict low risk because the same credit history information is used to make the calculations.

A pure credit score is based solely on the information from a credit report. Other scores are designed to use additional information. That information may be provided by consumers on their applications or may come from a business's actual experience with the consumer. For instance, mortgage risk scores may incorporate income and employment history from an application, or insurance risk scores may include previous claims records.

VantageScore® 3.0 characteristics contributions*



- Available credit: 3%
- Payment history: 40%
- Utilization: 20%
- Balances: 11%
- Depth of credit: 21%
- Recent credit: 5%

**Percentages are approximate and may vary depending on your specific credit history*

Is the number important?

The answer, of course, is “yes.” The score is important, but the number is meaningful only in the context of that particular score range and that particular business transaction.

Businesses select a scoring service based on their specific needs and risk tolerance. They make their own rules to decide whether to approve or decline an application for a particular score — or in some cases, to charge different prices and fees depending on the risk the score represents.

But beyond a specific transaction, a credit score is just a random number. Without additional information to explain what it means, the score can't help you improve your creditworthiness. You need a credit report to provide the context that makes a credit score a valuable educational tool.

What is a good credit score?

There is no one “good” or “bad” credit score. Every credit scoring model has its own unique range of scores. Generally, a higher score represents lower risk. But in some models a low score represents low risk, so a low score could be better. Even when companies use the same credit score model, they often have different lending criteria, so the same score might be consider “good” at one company but “bad” at another.

How can I change my credit use to get a better score?

A credit score represents the information in your credit report. You can't improve your credit scores without addressing the information from your credit report that most affected the scores. That information is identified by risk factor statements, which are generated along with the score at the time it is calculated. The statements often are included in a declination letter sent by the lender when your application is declined. Addressing these factors should improve your creditworthiness — and your credit scores — over time.

When you pay a past-due debt, for instance, you probably won't see a huge improvement immediately. But you can demonstrate good credit management by keeping payments current after you pay off the past-due debt, which will result in better credit scores over time.

When you purchase a credit score and report from Experian, you get more than just a credit score. You'll also get a thorough explanation of the factors — both positive and negative — affecting the score and information on how you can improve it, along with a simulator that lets you see how it could be influenced by certain actions. Because of the information it includes, a credit score report can be a very good tool to help you improve your creditworthiness and, therefore, all credit scores.

Is a credit score part of a credit report?

Credit reporting companies are sometimes called “credit rating agencies,” but that name isn't accurate. Credit reports and credit reporting companies don't “rate” your credit. Credit scoring is a separate process from credit reporting.

A credit score is like the grade on a school paper. The grade represents the teacher's analysis of the information in the paper in much the same way that a credit score represents an analysis of the information in the credit report.

A credit score is calculated only when a credit report is requested. The lender selects which score is applied. The score represents the information in the credit report at that moment.

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How do I get a credit score?

Credit score reports are available for a fee from a number of sources, including Experian. Any score you receive through a consumer score disclosure service will explain what that number means in terms of general credit risk and describe the factors from your credit report that most influenced the score.

While the numbers you receive can vary greatly, the risk level they represent will be relatively consistent no matter which score was used or what number it produced.

You can obtain your Experian credit score online at www.experian.com or at www.annualcreditreport.com.

10 tips for managing your credit report to improve your scores

Establish a credit report: Your credit report provides the financial references creditors need to make lending decisions. The report's content is used to calculate your credit scores.

Always pay on time as agreed: Late payments are the first signs of impending credit problems. When you pay late, it's harder to get credit.

Have a mix of credit, but obtain and use a credit card: You decide how to use the card and repay the balance. That says more about how you make credit decisions than other types of loans, such as auto loans or mortgages.

Use caution when deciding to close accounts: Closing accounts reduces your available credit. That can increase your total balance-to-limit ratio, which is a sign of risk and can negatively impact credit scores.

Apply for credit judiciously: Recent inquiries indicate you may have taken on new debt that isn't yet shown as an account on your credit report. Many inquiries in a short time might suggest you're trying to take on large amounts of debt. Both issues signify risk.

Time is the key: It takes some time for your credit report to be updated, so balances can't be reduced overnight. And credit scores look not only at whether your bills are paid, but also at how long they have been current and how far in the past negative information appears. Your scores will improve after you've taken control of your credit, but it won't be immediate.

Demonstrate stability: Lenders may look beyond your financial transactions and ask how long you've had your job, how long you've lived in the same location and whether you've built other assets over time.

Have a plan: Know how you are going to repay the debt when you use your credit card or get a loan, and stick to that plan.

Put credit to work for you: Use credit as a tool to take advantage of low interest rates, convenient shopping, rewards programs and financial management. When you're in control, credit works for you.

Share your knowledge: Share what you've learned about credit with your friends and family so they can avoid pitfalls and mistakes you might have made.

For more information, please email us at consumer.education@experian.com.