



Learn Everything You Need to Know About Credit Scores

Description

Which would you choose if you had to choose between disclosing your weight and your credit score to the entire world? If you're like 70% of Americans, you'd prefer to keep your credit score private.



It's no surprise: the world of credit ratings is perplexing and riddled with misinformation. As a result, what you think is helpful for your credit may work against it, and vice versa. That is why understanding how credit scores function is critical if you desire a solid credit score that will save you money over time.

What Exactly Is a Credit Score?

If you want to borrow money, create a utility account, or rent an apartment, you're asking someone to

believe in your capacity to pay your expenses on time. On the other hand, Lenders and landlords can't phone up every credit card issuer you've had since sophomore year and ask if you're good with money. Instead, they'll check your credit report.

If you had to sum up your entire financial life in one number, it would be your credit score. It's a three-digit number that indicates your borrowing and repayment history. Creditors believe you to be more trustworthy if you have a higher score.

Although you may chuckle at the thought of reducing your borrowing history to a single arbitrary number, creditors take it very seriously. A low credit score may entail paying exorbitant interest rates on credit cards and loans (assuming you're authorized at all). To open an electrical or cell phone account, you may be required to pay a deposit. And what about that ideal apartment you applied for? Instead, the landlord may give a tenant with higher credit the keys.

On the other hand, a high credit score entitles you to borrow money at the lowest possible interest rate. So you don't have to be concerned about losing out or having to pay more because you look financially reckless.

Credit Report vs. Credit Score

Despite their close relationship, a credit report and a credit score are not the same things.

Experian, Equifax, and TransUnion are the three major credit bureaus that collect your personal and financial information and assemble it into your credit report. Personal identifying information such as your name, address, and Social Security number, as well as open and closed credit card accounts, loans, invoices in collections, liens, and bankruptcies, are all detailed in credit reports. In addition, every year, you are entitled to a free credit report from each of the three main bureaus through AnnualCreditReport.com, the only federally recognized site that provides free credit reports.

Credit bureaus will calculate a credit score based on the information in your credit reports, which will then be shared with banks, lenders, and other organizations. And, sure, you have more than one credit report and credit score because there are many credit bureaus.

Credit Score Varieties

It may appear not easy to believe, yet you have dozens of credit ratings. They are, however, not all made equal.

FICO, short for Fair Isaac Corp., is the largest and most widely used provider of credit scores. Based on the information in your credit reports, FICO generates credit scores for the three credit bureaus. Because each agency collects and reports your information on its own, your FICO score will normally fluctuate between them.

“Even under the FICO moniker, there are multiple different models used for different purposes, such as comparing mortgage applications to credit card applications,” says John Ganotis, founder of the website Credit Card Insider. This implies you have different FICO scores with each of the three credit bureaus. According to Credit.com, it is estimated that there are more than 50 FICO scores alone.

Although FICO is the most well-known credit scoring model, it is far from the only one. “A little more than a decade ago, the three credit bureaus formed a joint venture and developed VantageScore, a competing model for FICO scores,” explains Lyn Alden, founder of Lyn Alden Investment Strategy a website that delivers market data to individual investors and financial professionals. She points out that VantageScore is now regarded as a “genuine” credit score utilized by lenders but with a smaller market share than FICO.

How Credit Scores Are Determined

Because each agency’s methodology is proprietary, the specifics of how credit scores are created remain mostly unknown. However, we do know that the FICO model is based on the following five major credit score factors:

- **Payment history (35% of the total):** Paying your payments on time is not just vital for avoiding late fees; it is also the most important aspect of your FICO score. Payment history accounts for more than a third of that total. Therefore, even one or two late payments can have a significant influence on your credit score.
- **Amounts owing (30% of total):** Another crucial component is the overall amount of debt you owe in contrast to your total accessible credit, which accounts for one-third of your FICO score. This is commonly referred to as your credit utilization ratio, and experts advise keeping it below 30%.
- **Credit history length (15%):** Lenders want to know you’ve been in the credit game for a while. The more credit history you have, the better.
- **Credit allocation (10%):** Your credit score is boosted by diversifying your accounts. This demonstrates your ability to manage various bills, such as credit cards, student loans, or a mortgage. Of course, your accounts must be in good standing, or they will have a negative impact on your FICO score.
- **New credit (10% of total):** Too many hard inquiries and new accounts in a short time may raise the possibility of struggling to pay your expenses. So, if you’re turned down for a credit card, don’t try again; instead, wait a few months and work on improving your credit. And, if you’re looking for a mortgage, vehicle loan, or student loan, do it within 45 days so that all of your inquiries are processed as one. Fortunately, this element only accounts for 10% of your FICO score, so creating a new account now and then will have no effect.

Credit Score Levels

According to Alden, the initial two versions of VantageScore had ranges that differed from the FICO score (501 to 990). The third is now based on the same 300-to-850 score range as FICO.

“While particular percentages have not been disclosed,” Alden notes, “VantageScore has stated that it weighs its credit score similarly to FICO, with payment history and credit utilization being the most

critical criteria.” These are followed by less essential criteria such as credit age, credit diversification, and new credit. “FICO and VantageScores for the same individual are usually similar in number,” she observes.

Each creditor has its idea of what constitutes good or bad credit. However, FICO considers the following ranges to be standard:

- Exceptional: 800 or above
- Excellent: 740-799
- 670-739 is acceptable.
- 580-669
- 579 and lower are considered poor.

According to FICO, the national average FICO credit score now exceeds 700, good news for many Americans.

However, keep in mind that various scoring models may employ other ranges. For example, according to a Los Angeles Times story, the Credit Optics assessment system by SageStream employs a scale of 1 to 999, with a score of 374 considered “very good.” Bank of America is one creditor that uses Credit Optics as a “supplemental score” while making lending choices.

But don’t be concerned about preserving the perfect credit score for every algorithm. For example, you’re usually in excellent condition if you have a decent FICO score because 90% of lenders use this scoring algorithm when evaluating applicants.

How to Get a Free Credit Score

Getting access to your credit score entailed paying for expensive and often useless credit monitoring services. However, many businesses have made efforts to provide consumers with the same openness that financial institutions have.

FICO Scores for Free

Because your FICO score is the one most commonly used by lenders, it’s the one you should be most concerned about. But, unfortunately, it’s also the hardest to come across for free.

Nonetheless, there are a few places you can go to get your FICO score for free each month: credit card companies. For example, Chase Slate cardholders can obtain their free monthly FICO score based on Experian data. In addition, Bank of America, in collaboration with TransUnion, provides free FICO scores to credit cardholders.

Some other financial organizations and companies offer free credit ratings, but these scores may not be what you think.

VantageScore and non-FICO Scores are available for free.

Most other free credit score providers will not disclose your FICO scores. They instead provide credit ratings based on different scoring methods, which can differ dramatically from your FICO score. The credit scores are intended for informational reasons and are not used by creditors.

Even if the scores aren't necessarily your true credit ratings, they might help you assess the overall health of your credit.

Customers and the general public can get free credit scores from several banks and credit unions. Customers of U.S. Bank, for example, can obtain free TransUnion educational scores through the TransUnion CreditView Dashboard. Capital One has a similar feature called CreditWise that gives you access to your TransUnion VantageScore 3.0.

Credit Karma is the most well-known website and application that offer free credit scores. This website offers TransUnion and Equifax credit reports and VantageScore 3.0 credit scores. Again, VantageScore isn't as widely used by lenders as FICO, but it uses a similar scoring algorithm and will provide you with an approximation of your credit score.

Trying to Get Good Credit

Working toward good credit might be overwhelming with so many different sorts and sources of credit ratings. However, if you take a step back and concentrate on the fundamentals, you may increase your credit score without much thought.

"Even though there are many distinct credit scoring models that create different ratings," adds Ganotis, "these varied models often include similar elements." "My recommendation to those who want to improve their credit scores is to focus on the basics of excellent credit rather than focusing over little variations in points on a specific credit score you're tracking." He claims that your credit score will improve over time if you do this.

These strategies, based on the five criteria that influence your FICO score, will help you build good credit over time:

- You must pay your bills promptly. When it comes to your credit score, the single best thing you can do is pay all of your payments on time.
- Maintain a credit usage rate of less than 30%. Actively utilizing credit cards is an excellent strategy to maintain a healthy credit score. Make sure you're not using more than 30% of your available credit at any given time. And, if possible, pay off the entire sum each month – you don't have to carry debt and incur interest costs to build good credit.
- Begin using credit early on. Don't put off using credit because your credit history is a somewhat important factor in your credit score. Even if you only use a credit card for \$20 every month, you will be making progress toward establishing a solid credit history. Also, keep in mind that FICO treats open and closed accounts the same way, so don't be hesitant to close a credit card account that's costing you money.
- Spread out your credit. Explore other credit choices, such as purchasing a car or consolidating credit card debt with a personal loan, when it makes financial sense. Paying off various credit types will help you improve your credit score.

- Reduce the number of new accounts you open. Allow some breathing room between account openings, so you don't appear needy for funds, as tempting as it is to chase every sign-up bonus and zero percent APR offer.

Credit ratings can be complicated, but good financial management does not have to be. Paying your bills on time, spending carefully, and borrowing exactly what you need should help your credit score skyrocket.

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