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Ignorance is not bliss when it comes to knowing credit score

By Sandra Block
USA TODAY

From Alabama comes reassuring news that Chucky, the 1,000-pound zoo alligator who escaped during Hurricane Ivan, has been captured. That means you can stop worrying about finding a giant reptile in your bathtub and move on to other concerns. Here's a good place to start: your credit score.

Your credit score influences everything from the interest rate on your mortgage to your car insurance premiums, yet many Americans don't worry enough about their scores. A recent survey by TrueCredit.com found that only 10% of Americans know their score. Another survey released last week by the Consumer Federation of America found that many consumers harbor some dangerous misconception about their scores.

The knowledge vacuum is troubling, consumer advocates say.

"The cost of not knowing your score and its significance could be not only denial of credit, but also difficulty obtaining needed services and even a job," Stephen Brobeck, executive director of the CFA, said last week.

Credit scores are compiled by the three major credit agencies, Experian, Equifax and TransUnion, based on information provided by creditors. Most scores are based on a formula developed by Fair Isaac, a research firm. They're designed to measure the likelihood you'll repay a loan, based on your record of repaying debts in the past. Some common fallacies about credit scores include:

▸ Your credit score is like your golf score: the lower, the better.

Actually, a high score indicates a borrower is a low risk; a low score signals trouble. If your score is below 600, you can expect to pay above-average interest rates on a loan, if you can get one at all.

Borrowers with scores above 700 usually qualify for relatively low rates. If your score is above 760, you probably qualify for the lowest rates.

▸ You can improve your credit score by marrying well.

Married couples don't get a combined credit score, so you can't improve your number by marrying someone with a 780.

"When you get married, you're not mixing your credit history," says David Chung, interim president of CreditXpert, which sells credit-management products.

However, lenders will look at both scores if you apply jointly for a loan, such as a home mortgage, says John Danaher, president of TrueCredit.com, a subsidiary of TransUnion.

▸ Earning more money will improve your score.

The amount of money you make doesn't affect your credit score. Your score is based entirely on your history of repaying your debts, Chung says. If you're behind on your bills, your score will suffer, no matter how much you earn.

"I could be a multimillionaire, but if I don't pay my bills, the bank doesn't care," Chung says. "They didn't get their money — that's all they care about."

Your occupation, age and employment history don't affect your credit score, either. However, individual lenders may consider those factors, along with your credit score, when deciding whether to give you a loan.

▸ There's little you can do to improve your score.

Actually, there's a lot you can do, although it may take time.

About 40% of consumers surveyed by the CFA didn't realize they could raise their scores by paying off a large balance on a credit card. A disturbing 28% mistakenly believed they could improve their score by maxing out on their credit cards.

Most credit scoring calculations look at the amount of your outstanding debt compared with your credit limits. Borrowers who have maxed out on their credit cards are considered riskier because they may have trouble making payments. The formula rewards borrowers "who are using credit but using it responsibly," Danaher says.

Paying your bills on time will also go a long way toward improving your credit score. Your score is adjusted as new information comes in.

If you pay your bills on time, your score could improve in as little as three months, Danaher says.

▸ You can get your credit score for free.

Sadly, that's not true. A federal law enacted last year will allow consumers to get a free copy of their credit reports once a year. The rollout will start in December on the West Coast, expanding to cover all parts of the country by September 2005. But unless you're applying for a home mortgage, you'll still have to pay to get your score.

All three credit reporting agencies will sell you a copy of your credit report and score. You can purchase all three reports and scores from Fair Isaac, www.myfico.com, for $38.85.

To test your knowledge of credit scores, go to www.consumerfed.org/score.

Ignorance is not bliss when it comes to knowing credit score

Objectives:

Students groups will:

- examine the article, "Ignorance is not bliss when it comes to knowing credit score."
- identify the benefits of maintaining a high credit score.

Concepts:

- Bill payment
- Resources
- Credit score
- Problem solving
- Credit history
- Cause & effect

Preparation:

- Organize the class into small groups.
- Give each student a copy of the article, "Ignorance is not bliss when it comes to knowing credit score."
- Ask students to read the article and briefly discuss the attached questions. After, have individuals complete the graphic organizer.

Activity at a glance:

- Grade level: 9-12
- Subjects: personal finance, economics, language arts
- Estimated time for this activity: 45 minutes

Materials:

- Reading: "Ignorance is not bliss when it comes to knowing credit score" (one copy per student)
- Graphic organizer

Ignorance is not bliss when it comes to knowing credit score

Discussion:

What is the purpose of a credit score? Why has this measure been chosen to describe the habits of consumers? Why is marital status irrelevant in the calculation of a credit score? Why would people think that by maxing out a credit card, they would receive a better credit score? Do you believe that you can maintain a good credit score?

Activity:

FICO scores are your credit rating. (The score is named after the company who developed the process — the Fair Isaac Corp.) Most lenders base their approval to extend loans on these scores. There are three credit bureaus: Experian, TransUnion and Equifax. Each bureau looks at the following components to determine the FICO score: bill payment history, types of credit used, amount of new credit, total money owed, and length of credit history. The bureaus believe FICO scoring to be highly predictive of future payment risk.

Review the information below. Then, complete the graphic organizer on the following page.

Payment History (35% of Score)	This number keeps track of whether you have been making your payments on time.
Amounts Owed (30% of Score)	How much you owe and to whom you owe it.
Length of Credit History (15% of Score)	A longer, positive history will increase your score.
New Credit (10% of Score)	Opening several new accounts or having many inquiries into your credit history in a short period of time will affect your chances of qualifying for credit.
Types of Credit Used (10% of Score)	If you have a lot of lenders who are classified as "D" or subprime (i.e., they loan money at high-interest rates to consumers with bad or no credit), you may be placed in a high-risk category, even if your payment history is perfect.

Activity extensions:

- Ask each student to provide three reasons why a college student could get a low credit score. Then, have them list the steps that the college student could take to improve his or her credit score.

- Ask students to test their knowledge of credit scores by taking the Consumer Federation of America quiz: "Do you know the score on credit scores?" It's available online at www.consumerfed.org/score.

Additional resources:

- Goodpayer.com offers information on credit basics. The site dicusses good credit and its benefits, and explains how to read and understand credit reports. Visit www.goodpayer.com to learn more.

Credit score graphic organizer: Decide whether each of the following characteristics is indicative of a person with a high or a low credit score. Then, list each trait in the appropriate box.

Characteristics of credit history:

- Pays bills 30 days late.
- Pays bills on time.
- Creditors charge this consumer the lowest rates.
- Has been denied credit.
- Has maxed out his credit line on all of his credit cards.
- Pays off debt.
- Frequently opens new credit card accounts.
- Does not make loan payments on time.
- Makes loan payments on time.
- Cell phone company feels very comfortable selling their services to this person.

Person 1 — credit score of 700	Person 2 — credit score of 500
1. ______________________	1. ______________________
2. ______________________	2. ______________________
3. ______________________	3. ______________________
4. ______________________	4. ______________________
5. ______________________	5. ______________________