Credit Reports and Credit Scores

LESSON DESCRIPTION AND BACKGROUND

A person can't simply walk into a financial institution and say "Hi there, I'd like to have $14,000, please, to buy a new car." The procedure is more formal than that. It involves an application for credit, and no loan is issued without a favorable evaluation of the application by a loan officer. Loan officers often rely on a person's credit history and their ability to repay the loan, which is often determined by information in their credit report and credit scores.

This lesson explains what a credit report is and how to read one. Students are introduced to the information used by credit bureaus to calculate credit scores. Students learn about the financial costs associated with varying credit scores and how to improve one's credit. To learn about credit reports, the students play the role of loan officers, reviewing excerpts from the credit reports and credit scores of loan applicants. They evaluate each applicant's credit history and use the information to determine whether to grant the loan requested.

KEY ECONOMIC AND PERSONAL FINANCE CONCEPTS

- Credit

NATIONAL STANDARDS FOR FINANCIAL LITERACY

- **Standard 4 Using Credit, Grade 12, Benchmark 5** – Lenders make credit decisions based in part on consumer payment history. Credit bureaus record borrowers' credit and payment histories and provide that information to lenders in credit reports.
- **Standard 4 Using Credit, Grade 12, Benchmark 6** – Lenders can pay to receive a borrower's credit score from a credit bureau. A credit score is a number based on information in a credit report and assesses a person's credit risk.
- **Standard 4 Using Credit, Grade 12, Benchmark 13** – Consumers are entitled to a free copy of their credit report annually so that they can verify that no errors were made that might increase their cost of credit.

COMMON CORE STATE STANDARDS

- **CCSS.ELA-Literacy.CCRA.R.10** – Read and comprehend complex literary and informational texts independently and proficiently.
- **CCSS.ELA-Literacy.W.9-10.9, CCSS.ELA-Literacy.W.11-12.9** – Draw evidence from literary or informational texts to support analysis, reflection, and research.
- **CCSS.ELA-Literacy.L.9-10.6; CCSS.ELA-Literacy.L.11-12.6** – Acquire and use accurately general academic and domain-specific words and phrases, sufficient for reading, writing, speaking, and listening at the college and career readiness level; demonstrate independence in gathering vocabulary knowledge when considering a word or phrase important to comprehension or expression.

OBJECTIVES

The student will

- describe what a credit report is and how it is used.
- summarize the information used to calculate a credit score.

- explain how credit scores affect creditworthiness and the cost of credit.
- explain the factors that improve a credit score.
- determine the cost of financing based on credit scores.

TIME REQUIRED

Two 45-minute class periods

MATERIALS

- **Slides 13.1–13.4**
- **Exercise 13.1: Reading a Credit Report Prediction Guide**, one copy per student
- **Exercise 13.2: Reading a Credit Report**, one copy per student
- **Exercise 13.3: Your Credit Score and the Price of a Car**, one copy per student
- **Exercise 13.4: Evaluating Three Loan Applications**, one copy per student
- Classroom computer with internet access and projector
- Computer lab access

ADDITIONAL RESOURCES

Visit https://www.econedlink.org/resources/collection/fffl-9-12/ to find presentations, interactives and other great technology tools to enhance your teaching of this lesson.

PROCEDURE

1. Ask students to imagine that an individual has approached them and asked to borrow a substantial sum of money. Ask students what they would want to know about this person before they determine whether or not to lend the money. Discuss their responses briefly. ***(Answers will vary but might include: How much money does the individual earn? Has the individual borrowed money before; and if so, how many times? Has the individual paid back the money they borrowed on time?)***

2. Give each student a copy of **Exercise 13.1: Reading a Credit Report Prediction Guide**. Ask students to read the statements on the Prediction Guide and write "True" for all statements they predict are true.

3. Give each student a copy of **Exercise 13.2: Reading a Credit Report**. Ask students to read the article to confirm or reject their predictions. When finished reading, have students refer back to **Exercise 13.1**. Ask students to work in pairs to write "True" for all statements that have been confirmed by the author. Instruct students to correct any statements that may be false using evidence from the article.

4. Go over the answers in class. The italicized words in the statements below could be used to change the false statements to correct ones.

a. ***True.*** Your FICO score and your credit score are the same thing.

b. ***True.*** Your payment history and length of credit history combined make up 50% of your credit score.

c. ***False.*** Credit *card statements* are issued monthly, but credit reports can be requested (usually for a fee) at any time. You can request a free copy from each of the three major credit reporting agencies annually.

d. ***False.*** A credit score of 350 is considered *very low*. The median credit score is 723. A credit score of 850 is the highest possible score.

e. ***False.*** People with higher credit scores typically pay *lower* interest rates.

f. ***True.*** The Fair Credit Reporting Act allows you to receive one free copy of your credit report annually from each of the three major credit reporting agencies. This can be obtained at www.annualcreditreport.com. The free credit reports do not include your credit score. This can be obtained for an additional fee.

g. ***True.*** Potential employers, landlords, insurance companies and lenders may request your credit score.

h. ***False.*** Your *payment history* is the most important part of your credit score and makes up 35% of your credit score. Amount owed makes up 30%.

i. ***True.*** Your income is not included in your credit report or credit score. Earning more income may help you reduce the amount you owe, though.

j. ***False.*** One of the best ways to improve your credit score is to *pay your bills on time and reduce the amount you owe*. Each time you apply for new credit, the lender will request your credit report. These inquiries temporarily reduce your credit score.

5. Ask students to answer the questions at the end of the reading in **Exercise 13.2**. When students have finished, go over the answers in class.

a. Briefly explain the "3 Cs of Credit". ***(Capacity is your ability to repay debt, character is your likelihood of paying your debt, and collateral are assets that could be sold to pay off your debt.)***

b. What is a credit report? ***(A record of an individual's credit history.)***

c. Why is it important to check your credit report? ***(Answers will vary. Check for accuracy because credit reports may contain errors, which might increase your cost of credit.)***

d. How can you obtain your credit report for free? ***(The Fair Credit Reporting Act allows you to check your credit report annually from each of the major credit bureaus using www.annualcreditreport.com. You may also receive a free copy of your credit report if you are turned down for credit or are a victim of identity theft.)***

e. What is the difference between a credit report and a credit score? ***(A credit report details information from stores, credit card companies, banks, etc. about how much a person has borrowed, from whom, and whether the bills have been paid on time. A credit score is a summarization of all that information into one number, referred to as a FICO score.)***

f. Briefly summarize the information used to calculate your credit score. ***(Answers will vary, but should include information about payment history, amounts owed, length of credit history, types of credit, and new credit and inquiries.)***

g. Why is payment history the largest percentage of your credit score? ***(Answers will vary. FICO's research shows that a person's history tends to be the strongest predictor of whether that person will pay all debts they incur in the future.)***

h. What are some steps you can take to improve your credit score? ***(Answers will vary. Pay your bills on time, don't borrow more than you can pay back, contact lenders immediately if you have a problem, report lost or stolen cards, etc.)***

6. Display **Slide 13.1.** Review the terms credit and credit score with students. Explain that they will take an online survey called "Earning Credit" which will calculate a simulated credit score for them. When students sign in to take the survey, they will need to enter their name and their teacher's email address. Their responses to the survey will be used to calculate a simulated "Pre-Survey" and "Post-Survey" credit score for them. Explain that being responsible is the key to having good credit as an adult – paying bills on time, borrowing only amounts that can be repaid, etc. In high school, students demonstrate their responsibility by doing well in school and other ways. The survey questions focus on activities that represent some of these responsible behaviors.

7. Direct students to log in to "Earning Credit" at http://counciforeconed.org/earningcredit . Tell students to enter their name and teacher's email and then click "Let's Begin". They should write down their access code located on the introductory page for future reference.

8. Instruct students to take the Pre-Survey. Tell students to write down their credit score after they have completed it because it will be used later in the lesson. The survey includes the following questions.

a. What was your score on the most recent test in this class? (Note to teacher: an estimate is

OK. Teacher may need to help students recall the scores.)

b. In this class, how many assignments have you missed OR turned in late? (Note to teacher: an estimate is OK. Teacher may need to give grade book data to students).

c. At what age did you first save some of your own money? The savings can be from job income, gift money, or allowance. Savings can be in any place from piggy bank to bank savings account. (Note to teacher: the emphasis is on the student's own saving – not an account set up by the parents.)

d. In how many clubs/organizations are you involved this year? These may include school sports teams and clubs, community organizations, jobs, religious and/or political groups. (Note to teacher: emphasize that any activity can be counted, including a job.)

e. When was the last time you asked your parents for money not for a required school activity? This does not include money for necessities, such as lunch money or college application fees. It should include requests for money to purchase personal items, clothing, movies, and gas money.

9. Display **Slide 13.2.** Ask several students to share their credit scores. (*Scores may range from 300 to 850*). Explain that a lower score represents a higher risk to lenders, meaning they anticipate the borrower may be late on payments or fail to repay the loan. A higher score represents lower risk.

10. Ask students how the survey questions are relevant to their real credit score. **(*Students may object to some of the questions, saying their behavior in school is not the same as their behavior with money; others will note that reliability and responsibility are part of a credit history.*)**

11. Explain that each question on the survey was designed to simulate one of the factors used to assess risk and determine credit scores. Ask students what factors they think are included in determining actual credit scores. **(*Answers will vary; students may believe that income, age, race, educational level and other factors are included, but they are not.*)**

12. Display **Slide 13.3**, which lists the categories used to determine an individual credit score and explains how each survey question is related to these categories. Fair Isaac Corporation (FICO) does not release exact, specific information about how they calculate scores. This breakdown is based on general information they have released. Discuss the following topics.

- 35% Payment history—Consumers are rated on whether they make regular on-time payments on car loans, student loans, home loans and credit cards. Missing one credit payment may not have a significant impact—although record of this will remain on the credit report for up to seven years. Missing multiple payments is far more damaging. Test scores were used for this category because they represent a consistent long-term effort.
- 30% Managing your Debt—Consumers are rated on how large their credit balances are relative to their available credit; according to credit professionals, it's best to use less than 10% of available credit. Homework completion was used for this category because it represents your ability to keep track of obligations.
- 15% Length of Credit History—Consumers are rated on how long they have managed credit. Savings was used for this category because making the decision to save your own money represents a first step in financial responsibility.
- 10% Diversity of accounts—Consumers are rated favorably for having a variety of types of credit – credit cards, a car loan, a home loan, etc. Activities were used for this category because they represent balancing competing obligations.
- 10% Number of credit applications—Consumers are rated negatively if they frequently seek new loans and credit cards. However, if

they seek multiple estimates for a car loan, these are grouped together so they are not hurt by them. Asking your parents for money was used for this category because borrowing from parents is similar to borrowing from other sources.

13. Ask the following questions for review.

a. What is credit? (***Borrowing money to purchase goods or services with the understanding that you will repay it later.***)

b. What is a credit score? (***A single number that represents an individual's reliability or riskiness that is used for future loans.***)

c. What kind of factors go into determining a credit score? (***Payment history, debt management, length of credit history, diversity of accounts, number of credit applications.***)

d. Why do credit scores matter? (***Students may not be sure of this yet; this question is a segue to the next topic, but students probably understand that credit scores will affect the ability to obtain loans in the future.***)

14. Explain that credit scores are used in many different ways. They are often used by organizations to determine whether an individual can lease an apartment, get a job, qualify for insurance and receive loans or credit cards. Ask students if they would be more likely to lend their savings to a classmate with a score of 400, which represents higher risk, or a score of 700, which represents lower risk? ***(700, because this student represents lower risk and is more likely to repay the loan.)***

15. Tell students to imagine that they are preparing to borrow $20,000 to buy a new car. Direct students to log in to http://councilforeconed.org/earningcredit again. Instruct students to enter the access code they received for the Pre-Survey in the box under **Returning Students** (Note to teacher: Have the spreadsheet of credit scores available in case students have forgotten their credit scores. This is available on the Teacher Dashboard.) Tell students to locate the lowest interest rate they are eligible for according to the table below their credit score. Students should record this number to use in the next part of the lesson.

16. Give each student a copy of **Exercise 13.3: Your Credit Score and the Price of a Car**. Tell students to record their Pre-Survey credit score in Question 1, Part a, and the lowest interest rate they qualified for in Question 1, Part b.

17. Tell students to assume they have decided to borrow $20,000 to buy a new car. They should log in to https://www.bankrate.com/calculators/auto/auto-loan-calculator.aspx and follow the directions to complete Question 2 on **Exercise 13.3** to determine their monthly payment, total interest, and total cost of the loan, using their "simulated" Pre-Survey credit score. Assume that the principal (total amount borrowed) is $20,000 and the loan period is five years (60 months).

18. Divide the class into groups of 4-5 students, with each group having a variety of credit scores and interest rates. Tell them to follow the directions on the handout to complete the table in Question 3 and answer Question 4 on **Exercise 13.3**.

19. Display **Slide 13.4** containing Question 4 from **Exercise 13.3.** Ask students to share their answers.

a. What was the range of the credit scores in your group? ***(Answers will vary.)***

b. What was the range of the interest rates in your group? ***(Answers will vary.)***

c. How are your interest rate differences related to your credit score differences? ***(Lower credit scores result in higher interest rates.)***

d. How did these differences affect the total cost of the car for individuals in your group? (***Lower credit scores result in higher total cost of the car.)***

e. What behaviors caused some students to have lower credit scores? (***Missed assignments, low test scores, borrowing money.)***

f. What behaviors caused some students to have higher credit scores? ***(No missed assignments, high test scores, not borrowing money.)***

g. What could individuals with low "simulated" Pre-Survey credit scores do to improve these credit scores? ***(Turn things in on time, perform more consistently on tests, not borrow money from parents or friends.)***

h. Now think about the categories used to calculate an actual credit score. What kinds of behaviors would result in a low score, representing a high risk? ***(Late/missed payments, too much debt, no credit history, too many requests for credit.)***

i. What kinds of things can each individual do in the future to ensure that his or her real credit score is high? ***(Make payments on time, not borrow too much money, not have too many loans.)***

20. Explain that students will have an opportunity to obtain a new credit score and interest rate, based on their predictions about their own future behavior at the age of 30. Direct students to login to http://councilforeconed.org/earningcredit and take the **Post Survey**. This time, the site will provide both the estimated "future" credit score and interest rate simultaneously. Ask the following questions.

a. Did any of you have a higher credit score on the Post-Survey? If so, what impact did that have on your future eligibility interest rates? ***(The eligibility interest rate decreased.)***

b. Did any of you have a lower credit score? If so, what impact did that have on your future eligibility interest rates? ***(The eligibility interest rate increased.)***

c. What behaviors, in terms of the number of late payments, amount of consumer debt, age your first credit card or loan was obtained, applications for credit, types of credit accounts, and number of applications for credit in the past six months, helped you earn that higher or lower score? ***(Higher scores might result if students had few or no late payments, a lower amount of consumer debt, a credit history for several years, a higher number of types of credit, or a lower number of applications for new credit cards or loans. Lower scores might be because students had a high number of late payments, a higher amount of consumer debt, limited credit history, a low number of types of credit, or a higher number of applications for new credit cards or loans.)***

21. Tell students that they will now play the role of a loan officer at a financial institution. Give each student a copy of **Exercise 13.4: Evaluating Three Loan Applications** and have them work in pairs. Note that **Exercise 13.4** presents credit report summaries for each of three individuals who are applying for credit. The students will play the role of the loan officer and check a box that either grants or denies the credit request, based on the information presented.

22. Ask students to review the three credit applications and explain their decisions to grant or deny credit and the interest rate that is offered. Possible answers include the following.

- Janice Brown. (Credit score 450.) ***She should be denied. Her credit score is low and her credit record demonstrates difficulties paying her bills. 87% of borrowers with credit scores similar to hers have been delinquent in paying their debts.***
- Tito Sanders. (Credit score 770.) ***He should be approved. He has an excellent credit score and a very good credit record. He has handled credit responsibly in the past. Only 2% of the borrowers with scores similar to his have been unable to successfully manage their past credit. He qualifies for a low interest rate of 6.098 percent.***
- Maria Martinez. (Credit score 620.) ***She is a candidate for the "not sure" category. Her score indicates that she could have some difficulty managing credit, but her credit record so far seems OK. Nearly one-third of those with credit scores like hers have had delinquent accounts. She would probably qualify for a higher-interest loan (11.761 percent). If she improves her score***

she might be able to refinance the car at a lower rate.

23. To underscore the importance of having a good credit score, ask students to use the website https://www.bankrate.com/calculators/auto/auto-loan-calculator.aspx to compare Tito's cost (in interest payments) for a loan to Maria's cost, given their respective credit scores.

If Tito and Maria both were approved for a $15,000 four-year car loan, how much difference would their credit scores make in what they pay in interest over the life of the loan? ***(With an interest rate of 6.098 percent over four years, Tito would pay about $1,942 in interest. Maria's interest rate of 11.761 percent would make it much more costly for her to finance an auto purchase over the same time period. Her total interest cost would be about $3,875, or about twice the interest paid by Tito.)***

24. Conclude the lesson by placing students in small groups. Ask each group to create a list of steps that can be taken to establish or re-establish a good credit rating. Have each group report to the class. Answers may include the following:

- **Pay bills on time**
- **Borrow only what you must**
- **Try to pay more than the monthly minimum**
- **Apply for and use only a few credit cards**
- **Report lost or stolen credit cards immediately**
- **Stay employed**
- **Keep loans to a minimal percentage of your income**
- **Avoid bankruptcy**
- **Review your credit reports for accuracy**
- **Contact lenders immediately if you have any problems**

CLOSURE

1. Ask students the following questions for closure.

a. What is a credit report and how is it used? ***(A credit report is a record of an individual's credit history. The information on a credit report is used to calculate a credit score and may be used by stores, credit card companies, banks, etc. to determine if a person is credit worthy. Individuals can use a credit report when turned down for credit, to check for mistakes, or if a person has been victim of identity theft.)***

b. What information is used to calculate a credit score? **(Payment history, amounts owed, length of credit history, types of credit, and new credit and inquiries.)**

c. How do credit scores affect a person's cost of borrowing? **(People with low credit scores indicate a greater risk and therefore are charged higher interest rates for borrowing. People with high credit scores indicate less risk and are charged lower interest rates.)**

d. What can a person do to improve their credit score? **(Pay bills on time, borrow only what you must, try to pay more than the monthly minimum, apply for and use only a few credit cards, report lost or stolen credit cards immediately, keep loans to a minimal percentage of your income, etc.)**

ASSESSMENT

1. The average credit score in America in 2018 is 695. In 2014 it was 693, and in 2010 it was 687. How has the general trend for credit scores since 2010 affected the creditworthiness of American borrowers?

a. The general trend is a decrease in credit scores, so the creditworthiness of American borrowers has improved.

b. The general trend is a decrease in credit scores, so the creditworthiness of American borrowers has worsened.

c. The general trend is an increase in credit scores, so the creditworthiness of American borrowers has improved.

d. The general trend is an increase in credit scores, so the creditworthiness of American borrowers will has worsened.

2. The states with the highest average credit scores are Minnesota (709), Vermont (702), and New Hampshire (701). The states with the lowest average credit scores are Mississippi (647) and Louisiana (650). How might residents of Mississippi and Louisiana improve their credit scores?

a. Apply for more credit cards.

b. Pay bills regularly and on time.

c. Only pay the minimum payment.

d. Cancel all credit cards immediately.

3. The average American has 3.0 credit cards with an average total credit card balance of about $6,000 (US dollars). What effect might this information have on an American's credit score?

a. An American will probably have a lower credit score.

b. An American will probably have a higher credit score.

c. The number of credit cards does not affect credit score.

d. The amount owed on credit cards not affect credit score.

4. The average Canadian has 2.2 credit cards with an average total credit card balance of about $3,032 (US dollars). What effect might this information have on a Canadian's credit score?

a. A Canadian will probably have a lower credit score.

b. A Canadian will probably have a higher credit score.

c. The number of credit cards does not affect credit score.

d. The amount owed on credit cards not affect credit score.

5. Based on the information in questions 3 and 4, who will most likely qualify for a lower interest rate, an American or a Canadian? Explain your answer. ***(A Canadian will most likely qualify for a lower interest rate, all other things being equal. The Canadian has a lower overall balance. Also, because Canadians have fewer credit cards on average, it is likely that the Canadian has access to less debt and therefore is a lower risk.)***

SLIDE 13.1

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Credit – The opportunity to borrow money or to receive goods or services in return for a promise to pay later.

Credit score – A single number assigned to a person used by lenders to predict the **risk** that borrowers will not repay.

Credit Reports and Credit Scores

SLIDE 13.2

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COUNCIL FOR Economic Education
You're never too young to learn about money

Your Credit Score

Low 300

High 850

Credit Reports and Credit Scores

SLIDE 13.3

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COUNCIL FOR Economic Education
You're never too young to learn about money

Information used to calculate a credit score

- 35% Payment history
- 30% Managing your debt
- 15% Length of credit history
- 10% Diversity of accounts
- 10% Number of credit applications

Credit Reports and Credit Scores

SLIDE 13.4

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Group Discussion Questions

a. What was your credit score?
b. What was your interest rate?
c. How are your interest rate differences related to your credit score differences?
d. How did these differences impact the total cost of the car for individuals in your group?
e. What behaviors caused some students to have lower credit scores?
f. What behaviors caused some students to have higher credit scores?
g. What could individuals with low simulated credit scores do to improve these credit scores?
h. Now think about the categories used to calculate an actual credit score. What kinds of behaviors would result in a low score, representing a high risk?
i. What kinds of things can each individual do in the future to ensure that your real credit score is high?

Credit Reports and Credit Scores

Reading a Credit Report Prediction Guide

In the column labeled "Your Prediction," write "True" for each of the statements below that you predict are **True**. Share your predictions with a partner. Then, read the article "Reading a Credit Report" to confirm or reject your predictions and write "True" for each confirmed statement under the column labeled "Confirmed by the Author." Correct any statements that may be **False** using evidence from the article.

Your Prediction		Confirmed by the Author
_________	a. Your FICO score and your credit score are the same thing.	___________
_________	b. A credit report indicates how well a person has managed credit in the past.	___________
_________	c. Credit reports are issued monthly, so you know how much money to pay toward your credit card bill.	___________
_________	d. A credit score of 350 is generally considered to be good.	___________
_________	e. People with higher credit scores typically pay higher interest rates for credit.	___________
_________	f. The Fair Credit Reporting Act allows you to receive a copy of your credit report for free.	___________
_________	g. Potential employers and landlords may check your credit report.	___________
_________	h. The amount of money you owe is the most important part of your credit score.	___________
_________	i. Your income is not considered when calculating your credit score.	___________
_________	j. One of the best ways to improve your credit score is to apply for additional credit cards.	___________

Reading a Credit Report

Your ability to qualify for a loan depends on a credit report. A credit report is a record of an individual's personal credit history. It is probably a good indicator of the applicant's character and whether he or she will repay borrowed money as agreed.

When someone applies for a loan, the lender will order a credit report to see how well the applicant has managed credit in the past. A credit report will tell, in detail, how much the person has borrowed, from whom, and whether the bills have been paid on time.

Credit reports are compiled by credit bureaus, which regularly collect information on millions of consumers. Credit bureaus get information from a variety of sources, including stores, credit card companies, banks, mortgage companies, and medical providers. When you fill out an application for credit, the information on that application is also sent to a credit bureau.

What Are Lenders Looking For?

Lenders look for certain qualities in loan applicants. These qualities are called the "3 Cs of Credit": capacity, character, and collateral. A discussion of each follows.

Capacity – Capacity refers to the loan applicant's ability to repay the debt in question. The basic question is "Have you been working regularly in an occupation that is likely to provide enough income to support your use of credit?" More particular questions might address the following.

- ✔ Do you have a steady job?
- ✔ What is your salary?
- ✔ How reliable is your income?
- ✔ Do you have other sources of income?
- ✔ How many other loan payments do you have?
- ✔ What are your current debts?
- ✔ Do you pay alimony or child support?
- ✔ Can you afford your lifestyle?

Character – Questions will be asked to determine whether you are honest and reliable—thus likely to pay debts. Here are some examples.

- ✔ Have you used credit before?
- ✔ Do you pay your bills on time?
- ✔ Do you have a good credit report?
- ✔ Can you provide character references?
- ✔ How long have you lived at your present address?
- ✔ How long have you been at your present job?

Collateral – Collateral refers to assets that could be sold to pay off your loan in the event that you can not do so. Collateral serves as a type of insurance for the creditor. Questions related to collateral may include the following.

- ✔ Do you have a checking account?
- ✔ Do you have a savings account?
- ✔ Do you own any stocks or bonds?
- ✔ Do you have any valuable collections or jewelry?
- ✔ Do you own your own home?
- ✔ Do you own a car?
- ✔ Do you own a boat?

The Importance of a Good Credit Rating

A *good* rating on a credit report means that, in the past, bills have been paid on time. A *poor* rating indicates overdue payments or bills that have gone unpaid.

It is extremely important to build and maintain a good credit history. A good credit report can often make the difference between getting a loan or being turned down. In addition, potential employers and landlords will often check an applicant's credit report before making a final decision about offering a job or a renting out an apartment.

Credit Reports May Contain Errors

Mistakes can and do sometimes occur on credit reports. For example, a credit report may contain information about a different person with the same name as the applicant, or paid accounts may be listed incorrectly as unpaid. The law provides individuals with a means of requesting and reviewing their credit reports and having mistakes corrected. Under the Fair and Accurate Credit Transactions Act you have the right to get a free copy of your credit report from each credit bureau annually.

The official site established by the three credit reporting agencies (Equifax, Experian, and TransUnion) for free reports is www.annualcreditreport.com. The Fair Credit Reporting Act also allows you to receive a free copy of your credit report if you are turned down for credit or are the victim of identity theft.

What's My Score?

Credit reporting agencies summarize much of the information in your credit report into one credit score. The formula for computing credit scores was developed by Fair Isaac Corporation; the scores are commonly referred to as FICO scores. The scores range from 300 to 850, with the median score being 723. People with lower scores are more likely to be denied credit or charged higher interest rates. People with scores of 770 or higher will receive the best rates for loans. Scores of 640 or more will qualify applicants for fairly good rates. People with scores of 600 or less will have difficulty getting a loan. These people probably need credit counseling.

The following chart shows how lenders use FICO scores to evaluate loan applicants. For example, the chart shows that 8 percent of borrowers have FICO scores of 550 to 599, and approximately half of them either didn't pay back money they owed or were more than 90 days late in making their payments. In contrast, 27 percent of borrowers have a score of 750 to 799, and only 2 percent of them were delinquent.

FICO Scores: Measure Credit Risk

How Borrowers Rank		Delinquency Rates by FICO Scores	
Up to 499	2%	Up to 499	87%
500 to 549	5%	500 to 549	71%
550 to 599	8%	550 to 599	51%
600 to 649	12%	600 to 649	31%
650 to 699	15%	650 to 699	15%
700 to 749	18%	700 to 749	5%
750 to 799	27%	750 to 799	2%
800 +	13%	800 +	1%

Source: Fair Isaac Corporation

Who Uses Credit Scores?

Lenders aren't the only ones who use credit scores. Insurance companies use them in their evaluations of a new client's risk. A person with a low credit score may not be able to buy insurance or will be charged a higher premium. Landlords also request credit scores when evaluating new tenants. People who have difficulty paying their bills may not be able to pay their rent on time. Finally, some employers use credit scores when screening new applicants for jobs. Employers seeking to fill jobs which require the handling of cash, or jobs paying salaries over $100,000, are especially likely to request a credit score for the applicant.

What Information Is Used to Calculate My Score?

- **Payment history (35%)**
  The most important part of a credit score is your repayment history. More than a third of your score is based on whether or not you have paid your bills and whether you have paid them on time. Most people are never late in paying their bills. So, if you are ever a late payer, even a few times, it will hurt your score.

  How late you are (whether it's 30, 60, or 90 days) makes a difference, too. An account that was late 90 days or never repaid will hurt your score more than one that was late 30 days.

- **Amounts owed (30%)**
  The second most important factor is the amount of debt you currently owe. This measure is based on your current level of debt compared to your income. It also includes a measure of how much credit you are currently using out of the amount of credit that is available to you. Many lenders will not make loans to individuals who are already spending 25 percent of their gross income to repay debt. They feel that the borrower will not have enough discretionary income to make additional payments, reliably, on a new loan. For example: A person who owes money on school loans, a car loan, a mortgage, and lots of credit card payments, totaling 50 percent of his or her take-home pay, probably wouldn't be able to handle any more debt.

  In addition to the actual amount of debt you currently owe, lenders will look at how you are currently using of the credit available to you. If you have two credit cards with a total credit limit of $10,000 and a balance of $5,000 (a ratio of 5,000/10,000 or 50%) you will be more likely to qualify for a loan than someone who has a $1,000 credit limit with a balance of $900 (900/1,000 or a ratio of 90%).

- **Length of credit history (15%)**
  The length of time that you have had credit affects your credit score. Sometimes people are encouraged to keep old accounts open with no balance just to help their credit score.

- **Types of credit (10%)**
  Lenders like to see a mix of installment loans and credit cards. However, it is much more important to pay all of your bills on time than to have variety in your credit profile.

- **New credit and inquiries (10%)**
  Each time you apply for credit, the lender will request your credit report. These requests, sometimes called inquiries, temporarily reduce your credit score. Applications for new credit following recent late payments are viewed more negatively because they are seen as a sign that you are trying to borrow to pay current debt rather than to buy a new asset.

However, there may be times—when you are shopping for a car, perhaps—when you will apply for credit at several places during a short period of time (say, 30 days) to see where you can get the best offer for a loan. These inquiries are viewed differently; they don't affect your credit score as negatively as several independent credit applications throughout the year.

What can you do to earn a good credit score or improve your score? Pay your bills on time and limit the amount of debt you take on. These two factors account for 65 percent of your credit score!

Ways to Establish and Keep a Good Credit History and Improve Your Credit Score

There are several steps you can take to establish and maintain a good credit history.

- ✔ Always pay your bills on time.
- ✔ Never borrow more than you can comfortably pay back.
- ✔ Borrow only the amount you need.
- ✔ Know how much you owe at all times.
- ✔ Contact lenders immediately if you expect to have a payment problem.
- ✔ Develop good saving habits so that you can handle financial emergencies without borrowing.
- ✔ Report lost or stolen credit cards immediately.
- ✔ Never give your credit card number or other personal information over the phone or on the internet unless you initiated the transaction.
- ✔ Open a checking account and a savings account.
- ✔ Do not apply for too many credit cards. Even if you don't use them, the credit limits are taken into consideration when you apply for credit.

Questions

a. Briefly explain the "3 Cs of Credit".

b. What is a credit report?

c. Why is it important to check your credit report.

d. How can you obtain your credit report for free?

e. What is the difference between a credit report and a credit score.

f. Breifly summarize the information used to calculate your credit score.

g. Why is payment history the largest percentage of your credit score?

h. What are some steps you can take to improve your credit score?

Your Credit Score and the Price of a Car

1. Log in to http://councilforeconed.org/earningcredit. Enter the access code you received for the Pre Survey in the box under **Returning Students.** Record the following information.

   a. Pre-Survey credit score _______ b. Lowest interest rate you would be eligible for ________

2. Assume you decide to borrow $20,000 to buy a new car. Log in to https://www.bankrate.com/calculators/auto/auto-loan-calculator.aspx to calculate the monthly payment and total cost of the loan, using the interest rate from your "simulated" Pre-Survey credit score. Assume that the principal (total amount borrowed) is $20,000 and the loan period is five years (60 months). Record the following information.

a. Estimated Monthly Payment ________ c. Total Interest Paid ____________

b. Total Principal Paid ___________ d. Total Cost of Loan ____________

3. Use the information from Questions 1 and 2 from each member of your group to complete the table.

Column 1	Column 2	Column 3	Column 4	Column 5	Column 6	Column 7
Student	**Credit Score**	**Interest Rate**	**Estimated Monthly Payment**	**Total Principal Paid**	**Total Interest Paid**	**Total Cost (Add Column 6 to Column 7)**
A				$20,000		
B				$20,000		
C				$20,000		
D				$20,000		
E				$20,000		

4. Answer the following questions.
   a. What was range of credit scores in your group?

   b. What was range of interest rates in your group?

   c. How are your interest rate differences related to your credit score differences?

   d. How did these differences affect the total cost of the car for individuals in your group?

   e. What behaviors caused some students to have lower credit scores?

   f. What behaviors caused some students to have higher credit scores?

   g. What could individuals with low "simulated" pre-survey credit scores do to improve their credit scores?

   h. Now think about the categories used to calculate an actual credit score. What kinds of behaviors would result in a low score, representing a high risk?

   i. What kinds of things can each individual do in the future to ensure that his or her real credit score is high?

Evaluating Three Loan Applications

Listed below are three loan applicants who are interested in buying a new car. Based solely on the information provided and their credit score, determine whether you would approve or decline their loan requests. There is no specific credit score for which lenders would deny a loan automatically, based only on a score. However, the credit score does provide useful information about the credit-worthiness of the individual. If you decide to make a loan to the applicant, assign an interest rate appropriate for the applicant's score. Check your response and then write the reason for your decisions. Interest rates typically assigned to various credit scores are provided on the following page.

Status codes given at the end of the reports.

JANICE BROWN				**Credit Score 450**		
Company name	**Months reviewed**	**High credit**	**Terms**	**Balance**	**Past due**	**Status**
Sears	2	2,016	24	838		R3
Dept. of Educ.	7	1,507		1,507	158	I5
Dept. of Educ.	2	512		512	512	I5
ABC Credit Card	8	3,000	29	1,363		R1
Record of Month	6			28	38	O3

________**Approve** ________**Decline** ________**Not Sure** ________**Interest Rate**
Reason for decision:

TITO SANDERS				**Credit Score 770**		
Company name	**Months reviewed**	**High credit**	**Terms**	**Balance**	**Past due**	**Status**
Hometown Bank	24	11,000	60	5,350		I1
ABC Credit Card	6	2,500	36	0		O0
Dept. of Educ.	5	2,000	24	1,380		I1
XYZ Credit Card	12	3,000	24	495		R1

________**Approve** ________**Decline** ________**Not Sure** ________**Interest Rate**
Reason for decision:

MARIA MARTINEZ				Credit Score 620		
Company name	**Months reviewed**	**High credit**	**Terms**	**Balance**	**Past due**	**Status**
Hometown Bank	13	7,200	48	5,800		I1
ABC Credit Card	7	2,000	24	488		R1

________**Approve** ________**Decline** ________**Not Sure** ________**Interest Rate**

Reason for decision:

<u>Status Codes</u>

Type of account

O = Open

R = Revolving

I = Installment

Timeliness of payment

0 = Approved, not used

1 = Paid as agreed

2 = 30 days past due

3 = 60 days past due

4 = 90 days past due

5 = 120 days past due

7 = Making regular payments under wage earner plan

8 = Repossession

9 = Seriously delinquent/bad debt (paid or unpaid; charged off account)

FICO SCORE	APR
720-850	6.098%
690-719	7.644%
660-689	9.059%
620-659	11.761%
590-619	15.478%
500-589	16.202%