K·STATE
Research and Extension

FACT SHEET

Know Your Credit

Introduction

Credit is a tool used by millions of Americans to accomplish their short- and long-term goals. When managed successfully, a home mortgage, car or student loan, and credit card account can bring many benefits, such as home ownership, a college education, or landing the job of your dreams. Poor management of credit can result in higher costs, lost opportunities, and added stress.

Using credit is only one of the tools in your toolbox for managing your financial life. Along with understanding the difference between needs and wants, setting financial goals, and following a spending plan, you will need to decide if using credit will help you meet your financial goals.

Learn how to use this personal financial resource to your best advantage.

Your Credit Report

Your **credit report** is defined by America Saves (*americasaves.org*) as an explanation of your credit history. The credit report states when and where you applied for credit, from whom you borrowed money, and who you still owe. Your credit report also shows if you've paid a debt in full and if you make monthly payments on time.

Lenders frequently review your credit report to decide whether to change the interest rate or credit limit on your credit card account or whether to extend a new credit card offer to you. Your application for a mortgage or to rent an apartment may be accepted or denied, based on your credit report. Utility companies may charge deposits based on your credit report. Many employers check credit reports before extending an offer for employment or allowing an employee to have a company-sponsored credit card for company business expenses.

Your Credit Score

The Consumer Federation of America and Fair Isaac Corporation (FICO) (*www.myfico.com/Downloads/Files/myFICO_YCS_Booklet.pdf*) defines your **credit score** as a number that helps lenders and others predict how likely you are to make your credit payments on time. **Your credit score is based on the information in your credit report.** When lenders talk about "your score," they may mean the FICO Score developed by the Fair Isaac Corporation, which is the most popular scoring system. Many lenders refer to their own scoring system, based on their specific lending criteria.

FICO scores range from 300 to 850, with the higher the number, the better the score. Most people score in the 600 to 700 range. In the eyes of most lenders, FICO scores above 750 are excellent, scores around 700 are good, and scores around 650 are fair. FICO scores below 600 indicate high risk to lenders. As a result, they may charge much higher interest rates or refuse to extend credit at all.

Lenders buy your credit scores from three national for-profit credit reporting organizations: Equifax, Experian, and TransUnion.

Credit scores are based on the credit history and information about an individual on file at each credit reporting organization at the time the score is determined. Scores change over time as payment

histories, outstanding balances, and amounts of available credit change. Creditors have their own unique scoring models and may not report payment activity to all three credit reporting organizations.

Credit scores affect whether you can obtain credit, as well as interest rates you pay for credit card purchases, auto loans, mortgages, and other kinds of credit. This can directly affect the total price you pay for a good or service. For most kinds of credit applications, higher scores mean you are more likely to be approved, and more likely to pay a lower interest rate on new credit.

More information is available at *https://consumer.ftc.gov/articles/did-lender-offer-less-favorable-terms-or-deny-you-credit*.

What Affects a Credit Score?

There are five commonly recognized factors that influence your credit score:

Payment History — 35 percent: Describes how consistently you pay your bills by their due date. It is the most important factor in determining your credit score.

Amount Owed — 30 percent: The amount of credit you owe your debtors compared to the total amount of credit available to you. This is known as your "credit utilization."

Length of Credit History — 15 percent: The length of time you have used credit. All open accounts in your name are considered.

New Credit — 10 percent: The number of recent credit inquiries and opened accounts.

Types of Credit — 10 percent: Creditors view a mixture of debt types favorably. A mixture such as a mortgage, a revolving account such as a credit card, and an installment loan for a car or student loan would be a mix valued by creditors.

Manage Your Credit Behavior

Pay your bills on time. Set up automatic payments to your lender. Put payment reminders on your calendar. Allow plenty of time for a payment to arrive through the mail and be processed by your lender. Understand the terms on your loan regarding payment dates, grace periods, and late fees.

Keep your credit utilization below 30 percent of available credit. Pay off debt, but keep accounts open, especially if they have high credit limits. Use the accounts you have without opening additional

accounts. Another consideration is your credit card debt rate. To determine your debt rate, divide your total monthly credit card payments by your monthly take-home pay. The University of Illinois Extension Fact Sheet series "Credit Card Smarts" (*web.extension.illinois.edu/creditcardsmarts/decide_how_much_credit_is_too_much.cfm?2*) states "the average American has a credit card debt rate of around 12 percent" but recommends keeping the credit card debt rate at 10 percent or below.

Time is on your side. The longer your credit history, and the older each account is, the better. Keep older accounts open to show a long credit history, unless there are other factors, such as an annual fee, that add to the cost of credit. In addition, older detrimental information, such as a missed payment, has less influence on your credit score than more recent information.

Acquire new credit thoughtfully. Don't open several accounts within a short time of each other. Make payments on new accounts promptly. Applications for a mortgage, credit card, auto loan, or student loan result in "hard inquiries" to your credit. Hard inquiries will likely lower your credit score; however, when shopping for a mortgage or car loan, the effect may be minimized when several inquiries are made within a two-week period. "Soft inquiries" are made by prospective employers or by creditors to extend a pre-approved offer for a credit card or insurance and do not affect your credit score.

Mix it up. Make all payments to your creditors a priority. Have some account activity on each credit card periodically to maintain the account.

Accessing Your Credit Report

The three national credit reporting agencies are required by the Fair Credit Reporting Act to provide a consumer with a free copy of his or her credit report each year. You may obtain your free credit report at *www.annualcreditreport.com* or call 1-877-322-8228. Requesting your credit report from a different credit reporting agency on a rotating basis every four months allows you to review your credit history frequently and regularly without charge. If you request your **credit report** from a single credit agency more than once during a 12-month period or if you want to learn your **credit score,** you will be charged for that information. Charges are minimal, usually less than $10. A short video about obtaining your credit report can be found at *https://consumer.ftc.gov/consumer-alerts/2019/02/its-showtime-ftc*. Scroll down to the video called "Your Source for a Truly Free Credit Report?"

Reviewing Your Credit Report

Checking the accuracy of information on your credit report will be your next step. Make sure your name is spelled correctly and your social security number is accurate. Be sure you have knowledge of all accounts listed and balances are accurate. There should not be any inquires made by creditors you are unfamiliar with.

What if you find inaccurate or incomplete information on your credit report? The Federal Trade Commission (*www.ftc.gov*) recommends specific actions you can take to repair an inaccurate or incomplete credit report yourself. Tell the consumer reporting company — in writing — what information you think is inaccurate. A sample letter for corresponding with the credit reporting agencies and creditors can be found at "Rebuilding Your Financial Situation and Credit History" at this link *https://www.canr.msu.edu/mimoneyhealth/Home-ownership/startingover*.

Instead of hiring a company to investigate or repair information on your credit report, consider using free qualified expert resources, and do it yourself. Michigan State University Extension has a publication called "Rebuilding Your Financial Situation and Credit History" at this link *https://www.canr.msu.edu/mimoneyhealth/Home-ownership/startingover*.

All accurate information will remain on your report for seven years. Bankruptcy information remains for 10 years.

A Warning About 'Impostor' Websites

The Federal Trade Commission website warns against "impostor" credit report websites at *https://consumer.ftc.gov/articles/free-credit-reports*.

Websites that claim to offer "free credit reports," "free credit scores," or "free credit monitoring" are not part of the Fair Credit Reporting Act. The "free" product may come with strings attached. For example, you may have to pay a monthly charge unless you cancel before a trial period ends.

Some "impostor" sites use terms like "free report" in their names. Others have URLs that purposefully misspell *www.annualcreditreport.com* in the hope that you will mistype the name of the official site and be directed to their site, so they can attempt to sell you something or collect your personal information.

The CARD Act

The Credit Card Accountability, Responsibility, and Disclosure (CARD) Act of 2009-2010 is considered by many industry experts to be the single largest reform imposed on the credit card industry (a.k.a. Public Law 111-24). Major provisions of the CARD Act:

- Restrict promotion and issuance of credit cards to those under 21. *https://personal-finance.extension.org/credit-card-rules-for-young-adults/*
- Ban "universal default." (Credit card issuers can no longer raise a customer's interest rate to a penalty or default rate — often 24 percent to 32 percent — because of late payments to another creditor on an unrelated account.)
- Control how late fees can be charged.
- Require credit card companies to disclose on the billing statement how long it would take to pay off the existing account balance and the total interest cost if only required minimum payments are made.
- Regulate various aspects of communication between the credit card company and account holders.

A summary of the CARD Act is provided by Experian at *https://www.experian.com/blogs/ask-experian/what-is-the-credit-card-act-of-2009/*.

Choosing a Credit Card

When choosing a new credit card, there are important considerations. Credit card offers must disclose the annual percentage rate (APR), the length of the grace period, all other fees and charges, and the method for computing the balance for billing on the account. This information must appear in an easy-to-read box called the "Schumer Box," named for Sen. Charles Schumer, who sponsored the 1988 law requiring this disclosure. The disclosed information is important because it can help you determine what a particular credit card account may cost, based on how you will use the card.

Credit card companies may offer a rewards program as an enticement for using their card. If you want a rewards program, look for one that allows you to earn at places where you already shop, and redeem rewards in various ways, including cash, travel credits, and gift cards. Be aware that a low interest rate, reasonable fees, and no annual card fee may give you more value than a rewards program.

Useful publications on this subject include University of Florida Extension's *You and Your Credit: Credit Card Basics* (*edis.ifas.ufl.edu/fy1065*) and the University of Illinois Extension Fact Sheet series "Credit Card Smarts" (*https://web.extension.illinois.edu/creditcardsmarts/Choose_best_credit_card.cfm*).

Cost of Credit

There is a cost associated with buying on credit, even though many people don't realize it. If you pay $500 for an item with a credit card, then make only minimum payments each month (typically 4 percent of the balance) and don't charge anything else to the account, it will take nearly three years to complete paying for the item. With an 18 percent annual percentage rate (APR) you will pay over $130 in interest. So, the next time you think about buying an item, consider whether you would really want to pay 25 percent more for it, as in this example.

PowerPay (*www.powerpay.org*) is a useful website developed by Utah State University Extension. With a few simple data entries, you can see the true cost of an item, or build your own debt elimination plan.

The Hidden Cost of Credit

Research has validated the phenomenon of a "credit card premium," or the willingness to pay more for an item when it is purchased with a credit card instead of cash. In one study, auction participants who were told they could pay with a credit card submitted bids for basketball game tickets that were nearly twice as high as the average cash bid. Another study correlated more impatient behavior with lower credit scores.

A way to counteract this phenomenon and avoid impulse credit card purchases might be to leave your credit card at home instead of carrying it in your wallet. Consider using a credit card wrapper showing your goals for spending, which could prompt you to evaluate if the impulse purchase fits your spending goals before actually making the purchase. Avoid Internet auctions or TV shopping channels to reduce your susceptibility to the "credit card premium."

Revised by

Elizabeth Kiss, Ph.D., Professor and Extension Specialist, Department of Personal Financial Planning, Kansas State University
dekiss4@ksu.edu

Thanks to the original author:
Valeria Edwards, M.S., Family and Consumer Sciences Agent, retired

Publications from Kansas State University are available at: *bookstore.ksre.ksu.edu*

Date shown is that of publication or last revision. Contents of this publication may be freely reproduced for educational purposes. All other rights reserved. In each case, credit Elizabeth Kiss, Ph.D., *Know Your Credit, Fact Sheet, Revised* Kansas State University, September 2023.

Kansas State University Agricultural Experiment Station and Cooperative Extension Service

K-State Research and Extension is an equal opportunity provider and employer. Issued in furtherance of Cooperative Extension Work, Acts of May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture, Director of K-State Research and Extension, Kansas State University, County Extension Councils, Extension Districts. **MF3081 rev.** **September 2023**