

# Cornerstone Three:

## Building a Good Credit Rating



### Four Cornerstones of Financial Wellness





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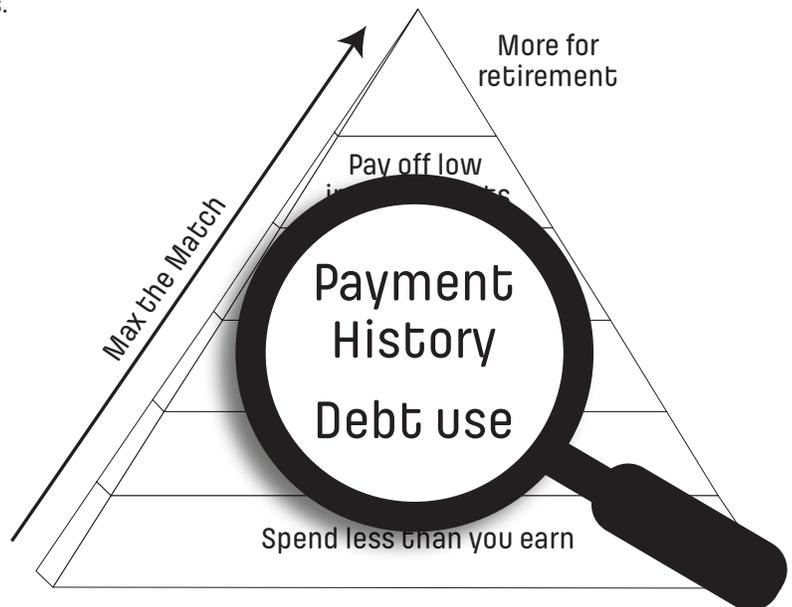
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## Introduction

A **credit report** is a record of your credit and loan account history. A **credit score** is an algorithm expressed as a three-digit number that determines how risky it may be to lend you money. Credit reports and scores are used for financial purposes, as well as employment background checks, insurance premiums, apartment approvals and even certain cell phone plans. A lower credit score may mean higher premiums and interest rates, affecting your ability to achieve your other financial wellness goals.

The goals for this section are to:

- **Share the background of credit reports and credit scores and address the inequity of credit.**
- **Know how to get a free credit report and be able to read it.**
- **Understand what makes a good credit score.**
- **Analyze the credit tools and products available.**



## The History of Credit

Credit and loans have been around for a long time. Loans for agricultural means were being used back as early as 3500 B.C. The origination of credit reporting is attributed to the early 19th century, when a group of tailors in England gathered to share information about customers who failed to pay.<sup>1</sup> That led to more groups collecting data, and a similar system was established in New York City. Eventually it became widespread, setting up the groundwork for future credit reporting systems in the United States.

When the automobile was created, it was difficult for the average person to buy one in cash. Wanting to increase sales, General Motors created the first installment plan in 1919. Other companies followed suit. In 1950, the first charge card was introduced. In 1964, creditors standardized credit applications. In 1970, the first Fair Credit Reporting Act (FCRA) was passed by Congress. By the 1980s, the three credit bureaus Equifax, Experian, and TransUnion became the nation's main system for credit reporting. In 1989, the FICO score was born and was marketed as an objective measurement based on facts and data. An explosion of consumer debt use occurred in the 1990s as a result. However, the FICO score algorithm was secret until the early 2000s, when public demand forced them to disclose the five main categories that affect it and provide consumers direct access to their score. In 2003, Congress updated the FCRA to make it a right for people to see their scores.<sup>2</sup>

## Inequity of Credit

The history of credit reporting and scores seems mundane, until one looks at the underlying motivations that created it in the first place. Founded in 1899, The Retail Credit Company from Atlanta gained a reputation of collecting more than just loan and payment history – but also political leanings, social and marital status and rumors.<sup>3</sup> People did not have the right to see their own report and businesses could deny them for being “morally lacking.” They grew to be one of the largest credit bureaus by the 1960s.

1 <https://www.businessinsider.com/5000-year-history-of-consumer-credit-2017-8>

2 *Your Credit Score*, by Liz Weston

3 <https://www.wired.com/1995/09/equifax/>

## Inequity of Credit

Retail Credit was called out for their behavior in congressional testimony by Professor Alan Westin, which led to the creation of the Fair Credit Reporting Act. (For those curious, the Retail Credit Company rebranded itself in 1975 to Equifax.)

The Equal Credit Opportunity Act of 1974 finally prohibited “discrimination on the basis of race, color, religion, national origin, sex, marital status or age in credit transactions.” While this opened the door to new opportunities for everyone going forward, it did not erase the centuries of discrimination nor fully prevent it from still happening in the future.

This has created gender and racial disparities regarding access to financial institutions, being approved for credit and loans, and building up their credit score based on current models. Continued work is needed to increase access to credit.

The Consumer Financial Protection Bureau (CFPB) did a study<sup>4</sup> on credit invisibility – over 45 million people in 2010 had limited to no national credit history:

- **Over 45% of low-income neighborhoods are considered “credit invisible” or unscorable.**
- **Blacks and Hispanics are more likely than Whites or Asians to be “credit invisible.”**

A 2018 Federal Reserve study showed that for single adults ages 21 to 40, **women had a lower score than men by an average of 10 to 20 points.**

## The Fair Credit Reporting Act

There are three national credit bureaus that maintain credit reports on consumers – Experian, TransUnion and Equifax. They are private companies but are regulated by the FCRA. The purpose of the FCRA is to define the kind of data the bureaus can collect and restrict who can see the report and for what purposes.

### You have the right to see everything that is in your credit report:

- You can obtain a free copy of your credit report every 12 months at [annualcreditreport.com](https://annualcreditreport.com) with each of the three bureaus.
- You can also get a credit report if you have proof of being turned down for credit in the past 60 days, you are unemployed and looking for work or you have filed an identity theft report.
- Credit scores do not come with these credit reports. (See “Free Credit Scores: Pros and Cons.”)

### You have the right to an accurate file:

- If there is an error in your credit report, you have the right to ask the bureau to investigate and remove incorrect information (See “How to Fix Errors on a Credit Report.”)
- Most negative information must be removed after seven years and bankruptcies are listed for ten years. Positive information has no time limit – but after an account is closed, it may only be reported for up to 10 years.

### You have the right to privacy:

- No one can receive or view a copy of your credit report without your authorization. This includes employer background checks, insurance companies, applying for loans, etc.

**i** **Worth Repeating:** Access your free credit reports online at [annualcreditreport.com](https://annualcreditreport.com) every 12 months. If you are unable to access them online, you can call 877.322.8228, verify your identity and receive them by mail in about three weeks. You can also get your free credit reports in Braille, large print or audio format by calling and providing additional information to certify the accommodation.

4 [https://files.consumerfinance.gov/f/documents/BecomingCreditVisible\\_Data\\_Point\\_Final.pdf](https://files.consumerfinance.gov/f/documents/BecomingCreditVisible_Data_Point_Final.pdf)



## How to Read a Credit Report

**4. Inquiries Made to Your File:** This shows who has viewed your credit report usually in the past 12 months, but can stay up to two years. Looking at your own credit report will never lower your score and neither will account reviews by existing creditors you have. Your score lowers only when you apply for new credit too many times in a given year.

**Requests Viewed By Others**

We make your credit history available to your current and prospective creditors and employers as allowed by law. Personal data about you may be made available to companies whose products and services may interest you.

The section below lists all who have requested in the recent past to review your credit history as a result of actions involving you, such as the completion of a credit application or the transfer of an account to a collection agency, application for insurance, mortgage or loan application etc. Creditors may view these requests when evaluating your creditworthiness.

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**HOMESALE REALTY CO**  
**Address:** 200 S. MAINROAD BLVD STE ANYTOWN, CA 11111 (555) 555-5555  
**Date of Request:** 07/16/2012  
**Comments:** Real estate loan on behalf of 3903 MERCHANTS EXPRESS M. This inquiry is scheduled to continue on record until 8-2014.

**Hard Inquiries:** These can be seen by other creditors. They appear when you have applied for a loan or credit card. It may lower your credit score if there are too many.

**Requests Viewed Only By You**

The section below lists all who have a permissible purpose by law and have requested in the recent past to review your information. You may not have initiated these requests, so you may not recognize each source. We offer information about you to those with a permissible purpose, for example, to:

- other creditors who want to offer you preapproved credit;
- an employer who wishes to extend an offer of employment;
- a potential investor in assessing the risk of a current obligation;
- Experian or other credit reporting agencies to process a report for you;
- your existing creditors to monitor your credit activity (date listed may reflect only the most recent request).

We report these requests **only to you** as a record of activities. We **do not** provide this information to other creditors who evaluate your creditworthiness.

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**MAIN BANK USA**  
**Address:** 1 MAIN CTR AA 11 BUFFALO, NY 14203  
**Date of Request:** 08/10/2012

**Soft Inquiries:** These requests are only for your information and no one else can see them. They have no effect on your credit score.



### Warning: Avoid “Credit Repair” Services:

These services are heavily advertised and will charge you large fees. But they cannot do anything more than you can do on your own for free! Many have been sued for fraud because they use techniques like file segregation (trying to change your identity) and mass disputes (trying to jam the dispute process). They promise fast and easy ways to repair your credit, which are not true. Even if the dispute is legitimate, it is not guaranteed that it will be fixed on the first try and may take multiple attempts. Disputing incorrect items on your own has the same chance of being fixed versus paying someone else.

**As mentioned in the other Cornerstones, seek out a reputable non-profit credit counseling agency for trusted advice.** Certified financial counselors can walk you through your report or pull one on your behalf, and provide you with resources and steps you can take on your own. Find one near you at [nfcc.org](http://nfcc.org) or our agency offers counseling nationwide at [lssfinancialcounseling.org](http://lssfinancialcounseling.org).

On the next page is how to fix credit report errors on your own.

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## How to Fix Errors on a Credit Report

According to a Federal Trade Commission (FTC) study<sup>6</sup>, one in five consumers had an error on at least one of their credit reports – and it's up to the consumer to spot errors and dispute them. This can lead to paying more in interest for loans and insurance. To fix errors, you will need to do it with each credit bureau if they all show the same error. Otherwise, you will need to dispute with whatever bureau is reporting the wrong information.

You can send disputes in writing or use each bureau's online system. Currently, doing it online may be easier and faster. You can go to their online portal and follow their instructions:

- Equifax: [equifax.com/personal/credit-report-services/credit-dispute/#](https://equifax.com/personal/credit-report-services/credit-dispute/#).
- Experian: [experian.com/disputes/main.html](https://experian.com/disputes/main.html).
- TransUnion: [transunion.com/credit-disputes/dispute-your-credit](https://transunion.com/credit-disputes/dispute-your-credit).

Documentation is still required either way so gather that first. Depending on the dispute, you may need to provide copies of collection payments and agreements, credit card or bank statements, birth or death certificates, copy of divorce decree and/or a police report and FTC complaint.

If in writing,<sup>7</sup> make your letter short and concise, detailing the items you want corrected. List what is incorrect and how it should be updated.

Here are some sample disputes:

- “The following accounts were paid in full and should show a zero balance.”
- “The following accounts were never mine and should be removed.”



Include your full name, date of birth, Social Security Number, address, phone and signature. Also include copies of the documentation as needed. Make sure to keep a copy for yourself.

**Once the bureau receives your online or written request**, the FCRA states it must contact the creditor of the disputed information within 30 days to verify. Allow up to six weeks for a written response.

**If you don't hear back after six weeks**, either check online or send a second request letter along with a copy of the first signed and dated letter. This time send it certified mail with a return receipt for additional proof. Remind them that the FCRA requires them to respond within a reasonable time period.

**If the bureau agrees with you that the information was incorrect**, they will remove or update the file and send you a letter that they have done so. You will receive a new copy of your credit report. Review the report to make sure the corrections have been made.

**If the bureau states the creditor still insists the information is correct**, they will send you a letter letting you know. You then can respond and ask the bureau to provide the name, address and phone number of the creditor listing the information so you can dispute the listing directly with the creditor. If the wrong information has caused significant issues you may want to seek legal advice from a consumer advocacy attorney at [consumeradvocates.org](https://consumeradvocates.org).

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<sup>6</sup> <https://www.ftc.gov/news-events/press-releases/2013/02/ftc-study-five-percent-consumers-had-errors-their-credit-reports>  
<sup>7</sup> [https://files.consumerfinance.gov/f/documents/092016\\_cfbp\\_CreditReportingSampleLetter.pdf](https://files.consumerfinance.gov/f/documents/092016_cfbp_CreditReportingSampleLetter.pdf)

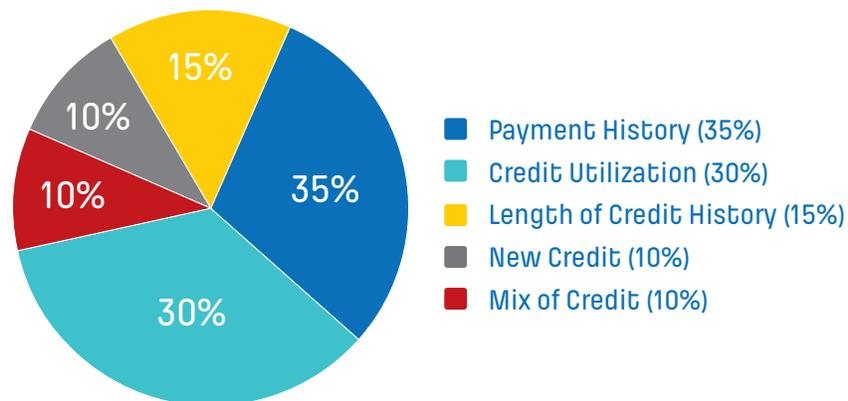
## What Is a Credit Score?

Credit scoring was created as a tool to help lenders determine how risky it is to lend money to people, using a weighted scoring model algorithm that uses the information reported with the credit bureaus. In addition to the three national credit bureaus, there is a private credit scoring company. Fair Isaac Corporation makes the FICO score, which is by far the most widely used system by creditors. There is also an alternative scoring model called VantageScore, created by the three credit bureaus.

Credit scores range from 300 to 850. The higher the score, the better the credit rating.



FICO has disclosed the basic structure of [what makes up their credit score](#):



The two biggest factors in achieving a good credit score are **on-time payment history** (your payment history within the past two years) and low credit utilization. **Credit utilization** is how much is owed on a revolving account in relation to its credit limit. As a result, credit cards can have a big impact on credit scores. You will want to stay below 30% of your credit limit to help your credit score. Anything above 50% can appear “maxed out” and could have a negative impact.

<b>ACCOUNT TYPE</b> Credit Card - Revolving Terms	<b>CREDIT LIMIT/ ORIGINAL AMOU</b> \$6,900	<b>DATE OF STATUS/ STATUS UPDATED</b> 02/2016
<b>TERMS</b> Bank Credit Cards	<b>HIGH BALANCE</b> \$4,053	<b>FIRST REPORTED</b> 10/2014
<b>ON RECORD UNTIL</b>	<b>BALANCE</b> \$1,340	<b>PAYMENT STATUS</b> Current
	<b>BALANCE UPDATED</b> 02/2016	<b>RESPONSIBILITY</b> Individual
	<b>MONTHLY PAYMENT</b> \$15	

**Example:** The credit limit is \$6,900. The balance is \$1,340. What is the credit utilization?  
 $\$1,340 / \$6,900 = 19.4\%$

**Exercise:** What would be the credit utilization if the balance was \$5,000?

**Length of credit history** rewards the age of the oldest account and the average age of all accounts.

**New credit** considers how many new accounts were opened and how many times you applied for credit over a period. **Mix of credit** rewards different kinds of

debt – loans, credit cards, mortgages, student loans, car loans, etc. These three credit score factors generally come together over time and help your score the longer you have your accounts. **Remember, you can work to improve your score, no matter where it stands.**

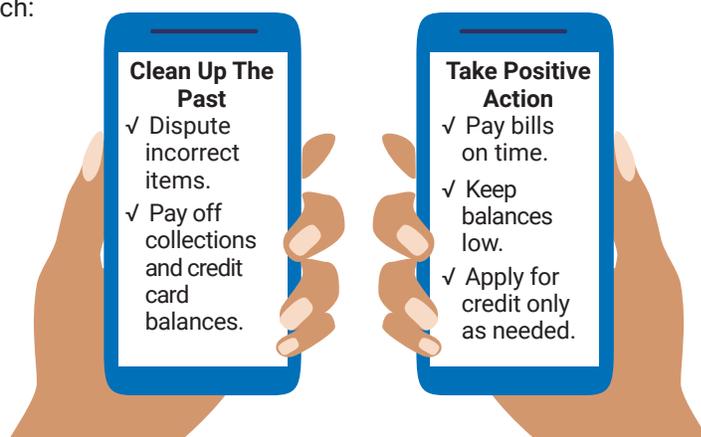
## Reasons Your Score May Be Lowered:

- Serious delinquency and bankruptcy OR collections listed.
- Delinquent payment on accounts and number of accounts with late payment.
- Time since delinquency paid is too short.
- Ratio of balances to credit limits is too high.
- Lack of recent revolving account information.
- Too many accounts with balances.
- Too many new credit accounts in the last twelve months.
- Too many finance company accounts.
- Length of positive credit history is too short.

There generally is always a reason listed, so try not to focus too much on the smaller parts of the credit score. If you work on the main two (on-time payment history and debt utilization) and don't take out an excessive amount of debt, the rest should fall into place.

## How to Improve Your Credit

We recommend a two-handed approach:



### Will Paying Collections Improve My Score?

Taking care of the collection debts will not immediately make your credit score better, but it will prevent it from getting worse. Think of it as a hole in your credit bucket. Once paid off, your bucket is not automatically filled, but it won't leak going forward.

(Judgments aren't part of your credit score but can prevent approval for housing.)

### For those with no open credit – establish positive credit history:

- Open a **secured credit card** at your local bank or credit union. Put an amount (say \$300) into a savings account and your credit limit is equal to that. Only charge \$10 to \$20 and pay it off in full every month. This shows good payment history and “self-control.”
- Have someone with good credit either co-sign on a credit card or add you as an authorized user on their card. (This takes a large amount of trust, so use caution.)
- Get a credit builder loan if you don't have the savings or desire for a credit card right now.

### For those with existing open credit cards and active loans:

- Re-establish positive payment history over the next 24 months if there have been past due payments reported.
- Pay down credit card balances so they are under 30% of the credit limit. Eventually, pay off the credit cards completely and keep them open.
- If you use your credit card and pay it off in full, only use 10% to 30% of your credit limit for the month. You never know when they report the balance to the credit bureaus, so there is no distinction whether it is paid off in full or not.

**Patience is Needed – It Can Take Up to a Year or Two to Improve Your Credit. You Can Do It!**

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## How To Improve Your Credit

**“Shopping Window” for Car and Home Loans:** There is a 14-day to 45-day window to apply for auto loans and mortgages, depending on the scoring model. This means you can apply with multiple lenders and it won't affect your score with each application, just the one window of time. This protects you from predatory lenders dropping your score on purpose.

**i Please Note: Your credit score should not control your overall financial wellness.** Credit scoring models reward having and using different kinds of debt. Reducing access to credit or paying off a loan may drop your score a little bit in the short-term, but if it benefits you long-term, that's okay!

## Free Credit Scores: Pros and Cons

You can get your credit reports for free, but you must pay FICO directly to see your score at [myfico.com](https://www.myfico.com). FICO charges a monthly fee for access and monitoring. However, there are now opportunities to access a free credit score service offered by several credit cards and websites.



It will give you an idea if you are heading in the right direction which can be motivating.

It may prepare you for what a lender might tell you, so there are no surprises.



While it may be free for you, the service may make money off of referring you to credit cards and loan products you may not need.

They are not 100% accurate so can be misleading.

### Why is My Free Score Not 100% Accurate and Why is it Different Between Lenders?

FICO has sold their scoring models to financial institutions since the original one in 1989. Over 90% of lenders use them, and FICO offers scoring models specifically for auto, mortgage and credit cards.<sup>8</sup> Unfortunately, not all financial institutions upgrade to the newest model right away. As a result, there are **countless variations** between the three bureaus and versions of the score. Also, the algorithms are constantly calculating, so if a payment is recorded or a credit card balance is updated, that can make a difference.

Some of the free credit score services use their proprietary scoring model, or the Vantage Score, and it may only be based on one of the three credit bureaus – you get the point. Use the free scores to see how you are doing, but do not panic if your score drops a little now and then. If you are trending in the right direction over time, then rest assured you are doing the best you can.

**When it's time for an auto or home loan, compare lenders and the credit score they use.** This may make a difference if you are on the line between fair and good, or good and excellent credit. If you have reported collections, the newest FICO model and VantageScore no longer lowers your score if you pay them off in full. If this helps get you a better interest rate, that may save you a lot of money. You may also want to wait and work on improving your score if you have no time constraints.

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<sup>8</sup> <https://www.myfico.com/credit-education/credit-scores/fico-score-versions>

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## Credit Boost and Other Trends

One major criticism of the current FICO scoring models is that they do not factor in on-time monthly bill payments automatically like rent, utilities, cell phone plans, etc., even if credit scores are required in the first place for approval. This ends up excluding millions of Americans from having a credit history. There are alternatives and products available that are attempting to address that issue.

**VantageScore:** An alternative scoring model that claims they can create a credit score sooner than FICO. Consumers have a score after a month or two of opening a credit account, as opposed to six months with FICO. They also state they can create a credit score for those with limited reported history because they factor in reported rent payments and ignore paid collections. It is much easier to get a free VantageScore than a FICO one, but it is still not commonly used by lenders. If you find a lender who uses this score, you might have more opportunities if your account history is still new or considered “thin.”

**Experian Credit Boost:** Experian offers a free service to have your online streaming, phone and utility payments be reported **on your Experian credit report only**. You give them permission to connect to your bank account and access your personal information. Then you verify what history you want added to your credit file. Only positive payment history is included, and it must be paid by your bank account. Anything paid by credit card or through a payment app and prepaid cell plans cannot be included.

This would only be beneficial if your lender or insurer used a scoring model based off Experian data only. The average improvement is 13 points – so it’s up to you if that’s helpful. This credit boost is also not widely accepted yet – some lenders may view those added accounts as part of your debt load, hurting your debt to income ratio. (Also, you’ll be invited to upgrade to a paid monthly subscription which doesn’t improve your score any faster.)

**Rent Reporting:** Many landlords and property management companies will offer to report your rent payments to the credit bureaus, or you can find a reputable service to do it on your own. If you have a solid history of on-time payments, this could help establish your credit. The newest, but not the most common version of FICO and the VantageScore accounts for positive rental history.

- **If You Want to Self-Report:** Compare the upfront and monthly costs of the service, and what credit bureaus they will report to. Also, your landlord must be willing to verify your payments.
- **If Your Landlord Already Uses a Rent-Reporting Service:** Ask if there are fees charged, how soon will it appear on your credit report, and what credit bureaus they report to.

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**i One Final Word:** It may be tempting to pay for a service that seems like a quick credit fix. However, if you can build your credit in a no-cost or low-cost manner, paying little to no interest is usually better in the long run. Connect with a bank or credit union for credit builder products.



**888.577.2227**

**[LSSFinancialCounseling.org](https://www.LSSFinancialCounseling.org)**

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