Building Wealth

In the Classroom

Lesson 8

Build Credit—Understanding Credit Reports and Scores

Federal Reserve Bank of Dallas
Instructional objectives

You will:

• Distinguish between credit report and credit score.

• Describe the importance of monitoring credit reports.

• Describe how to access and interpret a sample credit report and score.

• Describe how to build credit.

• Discuss how character, capacity and collateral can impact rating and the ability to obtain credit.
Are there similar characteristics between grade-point average (GPA) and a credit score?
Which GPA score is better?

A

Cheyenne
High school student
GPA: 3.8

B

Noah
High school student
GPA: 2.7
Cheyenne’s GPA of 3.8 is higher than Noah’s 2.7.

Cheyenne
High school student
GPA: 3.8
Which credit score is better?

Olivia
College student
Credit score: 600

Luis
College student
Credit score: 750
Luis’ credit score of 750 is higher than Olivia’s 600.

Luis

College student

Credit score: 750
Similarities between GPA and credit score

- The higher the score, the better.
- The score is for one person.
Similarities between GPA and credit score

GPA is one piece of information colleges look at when determining acceptance.

Credit score is one piece of information creditors look at to determine a borrower’s ability and willingness to repay a loan.
What is a credit score?

Credit score is a number that predicts the likelihood that a debt will be repaid on time.
Credit score facts

Credit scores are derived from credit reports.

The higher your score, the less risk you represent.

The most widely used credit score is a FICO score.
FICO Credit Score Range

300–580 Poor
580–669 Fair
670–739 Good
740–799 Very good
800–850 Exceptional
How credit scores are calculated

- Payment history: 35%
- Amount of debt: 30%
- Length of credit history: 15%
- Credit mix: 10%
- New credit: 10%
What else do lenders look at?

- Credit reports
- Character
- Capacity
- Collateral
Credit Reports

What’s included?
What is a credit report?

A credit report is a statement that has information about your credit activity and current credit situation.

A credit report shows your:

- Bill payment history.
- Current debt.
- Other financial information.
What’s not included in your credit report?

Credit reports do not include your credit score.

Credit reporting agencies use your credit report to calculate your credit score.
How are credit reports used?

Credit reports help lenders decide if they’ll give you credit or approve a loan.

The reports also help determine what interest rate lenders will charge you.

Employers, insurers and rental property owners may also look at your credit report.
How can you check your credit report?

You can get a free report yearly from Equifax, Experian and TransUnion at the official site, annualcreditreport.com.

Equifax, Experian and TransUnion are credit reporting agencies, and they collect and maintain information in your credit report.

Checking your credit report regularly is important to verify that your personal and financial information is accurate.
Do you have a credit report?
How are credit reports created?

A credit report is first created when you open a credit account for the first time and when the creditor reports the information to a credit bureau.
Have you applied for a:

- Credit card?
- Loan?
- Credit account?

If you answered no, then you will most likely not have a credit report.
Three ways to build your credit

Secured credit card
requires a cash deposit that becomes the credit line.

Credit-builder loan
is a loan where the amount you borrow is held in an account while you make payments.

Retail store credit card*
is offered by stores such as gas stations, retail chains and department stores.

*Must be 18 to open a retail store credit card
Try it on your own

Use the information contained in handout 2 to review sections found in a credit report.
Importance of checking your credit report

Even if you have never used credit, it is possible that you have been a victim of credit fraud or identity theft.

This can happen if someone has taken credit out in your name or used your Social Security card without your knowledge.

Reminder

You can check your credit report annually for free at annualcreditreport.com.

If you do not have a credit report and are under the age of 18, you can have your parents call each credit reporting agency to manually check if your Social Security number has been reported.
Improve Credit

Explore three ways to improve credit
Three ways to improve your credit

1. Check your credit report.
2. Fix errors.
3. Know your credit score.
Character, Capacity & Collateral

How lenders determine a borrower’s creditworthiness.
Character

Will you repay the debt?

Character is information that lenders gather about a borrower’s willingness to repay a loan.

Creditors will look at:

- Credit history.
- How much you owe.
- How often you borrow.
- Payment history.
- Length of employment.
Can you repay the debt?

Capacity is the information lenders gather about a borrower’s ability to repay a loan.

Creditors ask for:

• Your occupation.
• How long you have worked.
• Income.
• Expenses.
• Assets.
Collateral

Is the creditor protected?
Collateral is protection for creditors in the event they are not repaid.

Collateral is a real asset such as:

- Savings.
- Property.
- Investment.
What can’t be used?

Lenders are **not allowed** to consider certain information when approving credit such as:

- Race.
- Color.
- Religion.
- National origin.
- Marital status.
- Age.
- Receiving money from public assistance.
- Sex.*

* Currently, the law supports arguments that the prohibition against sex discrimination also affords broad protection from discrimination based on a consumer’s gender identity and sexual orientation.
Use the following statements to determine whether the statement would reflect positively or negatively on a person’s credit score.
Credit cards are charged to the maximum limit. Does creditworthiness increase or decrease?

Increase

Decrease
Credit cards are charged to the maximum limit.

Creditworthiness will decrease.

Maxing out your credit cards not only hurts your credit, but can make keeping up with payments difficult, especially with interest charges adding up.
Bills are paid on time.

Does creditworthiness increase or decrease?
Bills are paid on time.

Creditworthiness will increase.

Making payments on time every month will help to improve your credit score. Credit scoring models weigh payment history more heavily than any other scoring factor.
Recently applied for many credit cards.

Does creditworthiness increase or decrease?
Recently applied for many credit cards.

Creditworthiness will decrease.

Too many accounts can indicate increased risk and can decrease your credit score.
Filed for bankruptcy.

Does creditworthiness increase or decrease?

Increase

Decrease
Filed for bankruptcy.

Creditworthiness will decrease.

Your payment history is the most important factor in determining your credit score, and filing bankruptcy means that you won’t be paying covered debts in full as you initially agreed. As a result, filing bankruptcy will decrease your credit score.
All credit cards are maxed out.

Does creditworthiness increase or decrease?

Increase

Decrease
All credit cards are maxed out.

Creditworthiness will decrease.

In the eyes of most lenders, a person who constantly charges all the money they can—hitting or going over their credit limit on a regular basis—is more likely to have difficulty repaying that money.
Credit score is a number that predicts the likelihood that a debt will be repaid on time.

A credit report is a statement that has information about your credit activity and current credit situation.

Credit scores range between 350 and 850.
You can **build your credit** using a secured credit card, credit-builder loan or retail store credit card.

You can get a free report yearly from Equifax, Experian and TransUnion at the official site, [annualcreditreport.com](http://annualcreditreport.com).
In addition to credit score and credit report, lenders also look at a borrower’s **character, capacity and collateral**.

**Character** is information that lenders gather about a borrower’s willingness to repay a loan.

**Capacity** is the information lenders gather about a borrower’s ability to repay a loan.

**Collateral** is protection for creditors in the event they are not repaid.
Sources

SLIDES
10, 22–33, 36, 38, 40, 42

Experian
https://www.experian.com/blogs/ask-experian/credit-education/score-basics/what-affects-your-credit-scores/
https://www.experian.com/consumer-products/check-credit-report.html
https://www.experian.com/blogs/ask-experian/how-credit-cards-can-affect-your-credit-score/
https://www.experian.com/blogs/ask-experian/how-credit-cards-can-affect-your-credit-score/
https://www.experian.com/blogs/ask-experian/credit-education/score-basics/what-affects-your-credit-scores/

FICO
https://www.fico.com/25years/
**Sources**

**SLIDES**

14, 17, 20, 22-24, 33

**Consumer Finance Protection Bureau**

https://www.consumerfinance.gov/consumer-tools/credit-reports-and-scores/answers/key-terms/


https://www.consumerfinance.gov/consumer-tools/credit-reports-and-scores/answers/key-terms/


**Possible Finance**

https://www.possiblefinance.com/blog/credit-builder-loan/

**Credit Karma**

https://www.creditkarma.com/credit-cards/i/credit-card-utilization-and-your-credit-score
Building Wealth

In the Classroom

Up Next: Lesson 9

Take Control of Debt—Choosing the Right Loan

Federal Reserve Bank of Dallas
Have you explored buildingwealth.org?