What is a Credit Score?

A credit score is a number that is used by lenders to predict how likely you are to pay back a loan on time. Companies use credit scores to make decisions such as whether to offer you a loan or a credit card and to determine the interest rate you receive. This is called risk-based pricing. The risk being “likelihood of repayment” and pricing being “interest rate charged” based on the risk. The most common or known credit score is called a FICO score.

FICO stands for the Fair Isaac Corporation. FICO is a method for calculating credit scores based on information collected by credit reporting agencies. Today, most lenders use FICO scores when deciding whether to offer you an extension of credit.

Like all credit scores, FICO scores depend on the contents of your credit reports. There are three major agencies that collect credit data -- Experian, Equifax, and TransUnion. Because the credit reporting data at each agency can be different, your FICO scores may be different depending on which agency’s data is used to calculate it.

FICO scores range from 300-850. Usually, a higher score makes it easier to qualify for a loan and may result in a better interest rate. Like all credit scores, FICO scores can change over time according to your credit behavior.

Why is my FICO Score important?

In general, having good credit can make achieving your financial and personal goals easier. It could be the difference between qualifying or being denied for an important loan, such as a home mortgage or car loan. And, it can directly impact how much you will have to pay in interest or fees if you are approved.

For example, the difference between a 670 FICO Score and a 720 FICO score on a 30-year, fixed-rate mortgage over the lifetime of the loan, could save you over $26,000 in interest payments. That is extra money you could be putting toward savings or other financial goals.

Additionally, credit scores can impact non-lending decisions, such as whether a landlord will agree to rent you an apartment. Your credit reports can also impact you in other ways. Some employers may review your credit reports before making a hiring or promotion decision. And, in most states, insurance companies may use credit-based insurance scores to help determine your premiums for auto, home and life insurance.

What Is a Good FICO Score?

Generally, a credit score of 700 or above is considered good. Credit Scoring at financial institutions may resemble the following:

- Scores between 800 to 850 are considered EXCEPTIONAL.
- Scores between 740 to 799 are Very Good.
- Scores between 670 to 739 are Good.
- Scores between 600 to 669 are Fair.
- And scores below 600 are considered Poor.

The average FICO score in the United States for 2020 is “710” or Very Good.

What affects your Credit Score?

Common factors can affect your credit scores, and these are often split into five categories:

- Payment history. Making on-time payments on your credit accounts can help your scores. But missing payments, having an account sent to collections or filing bankruptcy could hurt your scores.
- Credit usage: How many of your accounts have balances, how much you owe and the portion of your credit limit that you are using on accounts such as credit cards.
- Length of credit history: This category includes the average age of all your credit accounts, along with the age of your oldest and newest accounts.
- Types of accounts: Also called "credit mix," this considers whether you are managing both installment accounts (such as a car loan, personal loan, or mortgage) and revolving accounts (such as credit cards and other types of credit lines). Showing that you can manage both types of accounts responsibly generally help your scores.
- Recent activity: This considers whether you have recently applied for or opened new accounts.

What information will not affect your Credit Score?

- Your race, color, religion, national origin, sex, or marital status.
- Your age.
- Your salary, occupation, title, employer, date employed or employment history. (Keep in mind, however, that lenders may consider this information in making their overall approval decisions.)
- Where you live.
- Soft inquiries. Soft inquiries are usually initiated by others, like companies making promotional offers of credit or your lender conducting periodic reviews of your existing credit accounts. Soft inquiries also occur when you check your own credit report or when you use credit monitoring services from companies like Experian. These inquiries do not impact your credit scores.

Do I need to know my FICO Score?

Checking your credit score was once an arduous task. But today, there are many ways to check your credit scores, including a variety of free options.

Your bank, credit union, lender or credit card issuer may give you free access to one of your credit scores. Experian also lets you check your score based on your Experian credit report for free.

Checking your credit score right before you apply for a new loan or credit card can help you understand your chances of qualifying for favorable terms—but checking it further ahead of time gives you the chance to improve your score, and possibly save hundreds or thousands of dollars in interest.

Keeping track of your score can help you take measures to improve it, so you will increase your odds of qualifying for a loan, credit card, apartment, or insurance policy—all while improving your financial health.

Higher scores can make creditors more confident that you will repay your future debts as agreed. But creditors may also set their own definitions when evaluating consumers for extending credit. In part, this may depend on the types of loans they want to attract.

Knowing your score can help determine if this is the loan or rate for you. If you have excellent credit and they are offering a higher rate than other lenders, you may want to talk to more than one lender for a quote (this is wise on all your lending needs).

What can I do to improve my Credit Score?

To improve your credit score, focus on the underlying factors that affect your scores. At a high level, the basic steps you need to take are fairly straightforward:

- Make at least your minimum payment and make all debt payments on time. Even a single late payment can hurt your credit scores and it will stay on your credit report for up to seven years. If you think you may miss a payment, reach out to your creditors as quickly as possible to see if they can work with you or offer options.
- Keep your credit card balances low. Your credit utilization rate is an important scoring factor that compares the current balance and credit limit of revolving accounts such as credit cards. Having a low credit utilization rate can help your credit scores. Having your credit cards at their maximum available may adversely impact your credit score.
- Open accounts that will be reported to the credit bureaus. If you have few credit accounts, make sure those you do open will be added to your credit report. These could be installment accounts, such as student, auto, home, or personal loans, or revolving accounts, such as credit cards and lines of credit.
- Only apply for credit when you need it. Applying for a new account can lead to a hard inquiry, which may hurt your credit scores a little. The impact is often minimal but applying for many different types of loans or credit cards during a short period could lead to a larger score drop.

Why did my Credit Score change?

Your credit score can change, and it is not uncommon for scores to move up or down throughout the month as new information gets added to your credit reports.

- For example, a late payment or new collection account will likely lower your credit score.
- Conversely, paying down a high credit card balance and lowering your utilization rate may increase your score.
- Some actions might have an impact on your credit scores that you did not expect. For example, paying off a loan might lead to a drop in your scores, even though it is a positive action in terms of responsible money management. This could be because it was the only open installment account you had on your credit report or the only loan with a low balance. After paying off the loan, you may be left without a mix of open installment and revolving accounts, or with only high-balance loans.

- Perhaps you decided to stop using your credit cards after paying off the balances. Avoiding debt is a good idea, but lack of activity in your accounts could lead to a lower score. You may want to use a card for a small monthly subscription and then pay off the balance in full each month to maintain your account's activity and build its on-time payment history.
- Also, a single event is not "worth" a certain amount of points—the point change will depend on your entire credit report.
- A new late payment could lead to a large point drop for someone who has never been late before, for example, as it may indicate a change in behavior and, in turn, credit risk.

What to do if you do not have a Credit Score?

Credit scoring models use your credit reports to determine your score, but they cannot score reports that do not have enough information. For FICO Scores, you need:

- An account that's at least six months old.
- An account that has been active in the past six months.

If you are not scorable, you may need to open a new account or add new activity to your credit report to start building credit. Often this means starting with a credit-builder loan or secured credit card or becoming an authorized user.

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