

## Anya Kamenetz Generation Debt



### What You Need to Know About Credit Scores

by *Anya Kamenetz*

Very Good (18 Ratings)

Posted on Wednesday, August 27, 2008, 12:00AM

You've probably realized by now that your principal in high school was full of it when he or she warned you about your "permanent record." There is no such thing.

But there is, in a way. It has nothing to do with cutting class or smoking out by the football field. It's called your credit report, and it shows your current credit accounts, outstanding debts, and payment history going back for several years. Credit cards, student loans, auto loans: They're all there, and if you have a problem paying any other kind of bill or have an overdraft on your checking account, it will show up, too.

#### High Score

So why is this important? Well, credit reports yield [credit scores](#), a powerful little three-digit number ranging from 300 to 850. A bad credit score -- less than 620 is considered [subprime](#) -- will have you paying 10.99 percent interest on a car loan when your friend with squeaky-clean credit is paying 6 percent, or 29 percent on a credit card when your friend's card charges 12 percent.

[Credit scores](#) can also affect your rates for mortgages and home, auto, and life insurance.

And increasingly, bosses are conducting credit checks when they make [hiring decisions](#).

Credit scores are a great scam for the credit card industry. Without fail, when I give a talk on college campuses about the dangers of credit cards, someone in the audience asks, "But don't we need a credit card to build a [good credit score](#)?" And I have to say, well, yes. You need those credit cards to get a mortgage or an auto loan down the road. But you don't have to run up any balances! The most cautious thing to do is to use your credit cards to make a regular payment, like a cell phone bill, and then set up automatic bill paying online each month.

There are lots of businesses, some [fraudulent](#), offering to "repair" your credit. But as the [Federal Trade Commission](#) wants you to know, self-help is the best approach. Here's what you can do:

#### The Score Decoded

Requesting your credit reports and scores is a good way to start taking control of your money. There is one most common credit score used by banks to make decisions: the [FICO score](#), developed originally by Fair Isaac Corporation.

FICO scores, once again, range from 350 to 850. Three different [credit bureaus](#) combine information from credit card companies and banks to make credit reports: [TransUnion](#), [Experian](#), and [Equifax](#). Each of these bureaus may have slightly different information on you in their reports, which yields a different score. The Equifax score is seen by some as being most similar to what banks actually see when they pull your credit report.

By federal law, you are entitled to one free copy of your credit report each year from each of the credit bureaus. Go to [annualcreditreport.com](#) to request them. You will have to pay about \$7.95 a pop to see the scores as well.

To write this column, I pulled my [free credit report](#) from TransUnion. It's pretty easy to read, showing my name, Social Security number, and current address, as well as two previous addresses and the payment history for my credit cards: a Capitol One Visa, a Chase/Bank One Visa, and a Washington Mutual card that I've since canceled. I don't have any balances on the cards right now, and I have made nearly all on-time payments. But my credit score is only 705, shy of the "excellent" cutoff of 720.

This is primarily because last year I traveled out of the country, moved apartments, and forgot to pay a \$40 charge on my Capitol One Visa. The payment went overdue for 90 days, until Capitol One finally reached me on the phone. So now I am patiently repaying my cards on time each month, via automatic [direct debit](#), and waiting for my score to improve. On the advice of TransUnion, I'm also going to open another credit card to increase my available credit, which could help improve my score.

#### The Breakdown

Your credit score is based on several factors, many of which will hit Generation Debt harder than older folks.

1. Payment history -- the biggie, about 35 percent of a [FICO score](#). Also the no-brainer: Any late payments or overdrafts, like mine, will ding your credit score for several years.
2. Amount owed -- about 30 percent

This figure compares the amount you owe to your available credit. So someone who has a \$2,000 balance and a \$2,000 credit limit -- they're maxed out -- will look worse than someone who owes \$3,000 but has cards with \$30,000 worth of limits. This may hurt folks with large student loan balances. It's also the reason that you don't necessarily want to close accounts after you pay them off -- it's better to leave them dormant to raise your available credit.

3. Length of history -- about 15 percent

The longer your perfect record of on-time payments, the better your score -- so if you've only been out of school for a couple of years, your credit score won't be as high as it can be down the road if you keep it clean.

#### 4. New credit -- about 10 percent

Repeatedly shopping for credit -- either credit cards or bank loans -- can hurt your score because it makes you look desperate. I learned this the hard way when I got out of college. I had smugly avoided signing up for a student credit card. Well, suddenly I was a freelance writer's assistant, with no regular income. I applied for and was rejected from so many cards in the first few months out of school that I was told I couldn't file any more applications for six months. I finally got a [Capitol One](#) Visa with a \$300 limit. All of this probably hurt my credit.

Message: Confine your credit card shopping to 30 days, and, yes, get a student card if you're in school.

#### 5. Miscellaneous-- about 10 percent

This includes stuff like having a nice "mix" of credit cards, auto loans, and other types of credit.

##### **Mr. Fix-It**

First, make sure your report has no mistakes. The Public Interest Research Group found in 2004 that 79 percent of [credit reports](#) had some kind of mistake. One out of four had a serious error that could lead to denial of credit.

If you're young and have never requested it before, your credit report may contain information from someone else with the same name. Or there may be duplicate information.

[Evan Hendricks](#), an expert who wrote the book "[Credit Scores and Credit Reports](#)", told [Bankrate.com](#) that student loan borrowers especially have to watch out: "[Student loan](#) information will sometimes multiply like rabbits on the credit report because student loans are sold from one company to another, and the old company continues reporting and then the new company continues reporting it, and it might make it look like you have more loans than you actually do. Then if they're showing any late payments, you can get hit with double whammies on late payments as well."

If you have a mistake, you need to send a [dispute letter](#) to the credit bureau and ask them to "reinvestigate" it. Include copies of any supporting evidence like your drivers license. Keep records of everything in writing. You can also request that the bureaus include a note in your file to help explain any delinquencies -- e.g., you were taking care of a sick parent or were unemployed. "[Credit Scores and Credit Reports](#)" has all the info on how to do this for free, yourself.

If your credit report is accurate, do what I'm doing now. Set up automatic direct debit to pay all your bills on time, on the day they're due. Start paying down your credit card balances, starting with the highest-interest cards, paying at least \$10-\$15 over the minimum each month. But don't close any accounts -- remember, you need a high ratio of available credit to used credit.

Take courage. It doesn't happen overnight, but after seven years, most blemishes on your credit report -- even bankruptcies -- are erased by your most recent payment history. Take comfort in the fact that there isn't really a permanent record after all.