

Understanding Credit

By definition, the word “credit” has to do with trust. This is why credit impacts so many financial issues in our lives including the extension of a loan or credit card, how high an interest rate will be, or insurance coverage. Additionally, credit can impact a potential employer’s consideration of you as a candidate or a landlord’s sense of whether he or she should rent to you. Understanding how credit and credit reports work and keeping on top of these vitally important concerns can make your life easier and more secure.

The Three “C”s of Credit

Before credit bureaus existed and formal procedures were in place for lending, these fundamental issues helped creditors determine credit-worthiness of individuals. They formed the foundation of the reporting that is used today.

Capacity - Ability to repay debt (i.e. reliable income)

Character - Reliability in paying debt (i.e. payment history)

Collateral - Insurance for the creditor (i.e. valuables, home, bank accounts, etc.)

What is a Credit Bureau?

A credit bureau is a company that keeps credit history information about consumers and compiles it for prospective creditors to view. When you buy something, you may use some sort of credit. Whether this credit is through a credit card, in store credit, a bank, or a credit union, the information may be reported to a credit bureau.

The credit bureau takes the information they’re given and maintains a whole file about your credit history. Anyone who has a legitimate reason to view your credit history can pay a fee and get a copy of your credit report.



There are three major credit bureaus in the United States:

Experian

National Consumer Assistance Center
P.O. Box 2002
Allen, TX 75013
888.397.3742 *to report fraud*
888.397.3742 *to order credit report*
www.experian.com

Equifax

P.O. Box 740241
Atlanta, GA 30374
800.525.6285 *to report fraud*
800.685.1111 *to order credit report*
www.equifax.com

Transunion

Consumer Disclosure Center
P.O. Box 2000
Chester, PA 19022
800.680-7289 *to report fraud*
800.888.4213 *to order credit report*
www.transunion.com

By law, everyone is entitled to a **free copy** of their credit report from each bureau once a year. The first time you request your report, ask for all three. Moving forward, it may be beneficial to stagger your requests so that you can check on your report more frequently. Getting your credit score will require paying some kind of fee.

To receive your free credit report, you may contact the individual agencies or:

Annual Credit Report, P.O. Box 105281, Atlanta, GA 30348-5281
877.322.8228 • www.annualcreditreport.com

Read any fine print before you sign up for free credit score and report offers—most services that are advertised this way are only free for a limited time. Free trial periods expire fairly quickly, so unless you cancel your subscription to these services before the end of the promotional period, you'll ultimately end up committing to a premium (paid) monthly subscription that gives you access to your credit information.

Understanding Your Credit Report

Within your credit report, the credit bureaus break down information into four different categories:

1. Identifying Information. Your name, current and previous addresses, Social Security number, current and previous employers, and date of birth.

Review all personal information closely to make sure it's accurate. It's not unusual for there to be two or three spellings of your name or more than one Social Security number, resulting from a creditor incorrectly reporting the information. Other information might include your current and previous addresses, your date of birth, driver's license numbers, your employer and your spouse's name.

2. Credit History. Your history of bill paying with different creditors including retail stores, mortgage companies, banks, and finance companies.

Sometimes, the individual accounts are called trade lines. Each account will include the name of the creditor and the account number, which may be scrambled for security purposes. You may have more than one account from any given creditor. Many creditors have more than one kind of account, or if you move, they transfer your account to a new location and assign a new number. The entries may also include:

- When you opened the account
- The kind of credit involved (**installment**, such as a mortgage or car loan, or **revolving**, such as a credit card)
- Whether the account is in your name alone or with another person
- Total amount of the loan, credit limit, or highest balance on a credit card
- How much you still owe
- Fixed monthly payments or minimum monthly amount
- Status of the account (open, inactive, closed, paid, etc.)
- How well you've paid the account

3. Public Records. Tax liens, court judgments, and bankruptcies.

You want this section to be absolutely blank. Every credit bureau has a different name for it, but they all mean the same thing.

4. Inquiries. A list of people who have received your credit report or name and address to offer you credit.

Inquiries are divided into two sections. "Hard" inquiries are ones you initiate by filling out a credit application. "Soft" inquiries are from companies that want to send out promotional information to a pre-qualified group or current creditors who are monitoring your account. The soft inquiries are only shown on reports given to consumers.

You may have heard that a large number of inquiries can have a negative impact on your credit score, but you're probably OK. Some credit scoring models count multiple inquiries by the same company or within a short period of time only once or delay the reporting of inquiries from auto and mortgage lenders for 30 days.

What is a Credit Score?

Your credit score is a numerical forecast that gives lenders a sense of the likelihood of successful repayment of a loan.

Five Factors

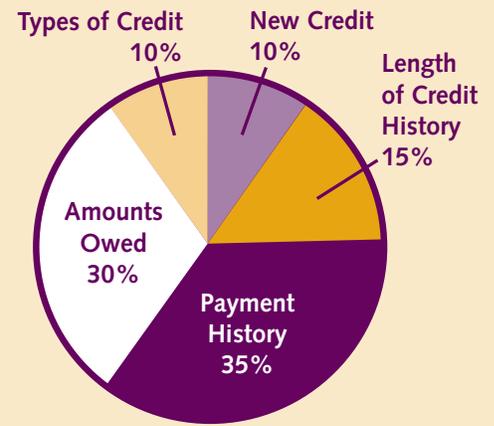
Credit scores are dynamic numbers that change based on five factors of financial activity. These factors are reviewed and weighted by importance to calculate risk. These are approximate percentages:

- 1. Payment History – 35%** - Late payments on bills such as mortgages, credit cards, or car loans can cause your score to drop. The more on-time payments you make increase your score.
- 2. Amounts Owed/Credit Utilization – 30%** - A ratio of current revolving debt (like credit cards) to total available credit; essentially, how much credit is being used at the time. You can improve your score by paying off debt and keeping balances low to lower this ratio. If your balances are more than 50% of your available credit, your score will be negatively affected.

3. Length of Credit History – 15% - This is what it sounds like. As long as you pay bills on time, the longer you have credit, your score should stay stable or improve.

4. Types of Credit – 10% - This refers to what kinds of credit you have managed. A combination of things like fixed loans and credit cards shows you have experience with multiple kinds of debt.

5. New Credit – 10% - Applying for a lot of credit in a short amount of time (especially for credit cards, retail store accounts, and personal loans), can be viewed as risky and lower your score. Only open new accounts when truly needed.



What is a credit score used for?

- Extending credit or trust
- Determining an interest rate
- Rentals
- Employment consideration
- Insurance
- Issuing a professional license
- Documenting credit repayment history

Credit Score Breakdown

Credit scores are like GPAs (grade point averages) – the higher, the better!

760-850	Excellent	
700-759	Good	
660-699	Fair	660 and below is Subprime
600-659	High Risk	
560-599	Higher Risk	
Below 560	Highest Risk	

Different financial institutions have slightly different breakdowns, but all are similar.

Be aware of the factors affecting your score.

How many of us really know (off the tops of our heads) what may negatively affect our credit scores? This list serves as a good reminder for those of us who need to be better organized about our day-to-day money management. Here are some factors that could weigh down your score:

- Being late on credit card bills and other consumer debt payments
- Owning over 50% of the limit of your credit lines
- Having a short credit history
- Applying for several credit lines during a short period of time
- Having charged off accounts
- Declaring bankruptcy

How to Improve Your Credit Score

1. Correct Errors. The first step to improve your credit score is to clear up any inaccurate information you find on your report. Are all the accounts that have been closed listed as closed? Do you show open balances that are incorrect?

If you find a mistake on your credit report – an account that isn't yours or a disputed amount – you'll need to fill out the form that comes with the report or follow the instructions on the explanatory sheet. Some credit bureaus also allow you to file a dispute online.

The process takes time because the creditors have 30 days to respond to a charge of a discrepancy. As long as a charge is in dispute, that dispute will show up on your report. Long-time lenders say it's common for reports to have errors. Some estimate that as many as 80 percent of all credit reports have some kind of misinformation.

2. Pay on Time. Try to get current on any past-due bills and make future payments on time. The longer you make timely payments, the more your credit score will improve.

3. Clear Up Debt. Try to pay off your debt instead of moving balances around. Every time you accept a new credit card, you are impacting the “new credit” consideration affecting your score.

4. Keep Balances Low. Keep your balances low in relation to available credit limits. When a creditor is reviewing your credit report, they consider the percentage used of available limits. High balances (over 50%) that aren't “maxed out” can still have a negative impact.

5. Acquire a Variety of Credit. A combination of things with fixed monthly payments (like car loans or mortgages) and revolving loans (like credit cards) will demonstrate that you can manage a variety of types of credit.

6. Avoid Temptation. Most importantly, keep in mind that credit is not an extension of income. Credit can be a valuable tool in the case of an emergency or for convenience. However, it can be a temptation to live beyond our means.

Building Credit

If you're looking to improve your score because you have a limited credit history, then you can do a few things to build your credit:

- **Ask your bank or credit union** if you qualify for a credit card with a small balance.
- **Consider a department store card or a specialty gas credit card.** This kind of credit is easier to get.
- **Keep good credit management habits:** pay bills on time (missed payments stay on your report for 7 years!) and avoid maxing out your cards.
- **Secure loans of various types** such as revolving accounts (e.g. lines of credit, credit cards) and installment loans (e.g. home loans, auto loans, etc).

Reestablishing Credit

If your credit score has dropped, you may need to be prepared to do some of the following to obtain credit. Fortunately, with time and steady payments, these actions can also improve your credit. Remember: 35% of your credit score is payment history.

- Make a large down payment
- Be prepared to pay a higher interest rate
- Utilize a co-signer or co-borrower
- Use collateral to strengthen loan request
- Use automatic bill payment systems to ensure payments don't fall through the cracks
- Build and practice solid financial habits

Avoid credit repair scams

Your credit score isn't something you need to pay others to fix. You may be tempted to turn to someone else to help you resolve your problems, but many of these credit repair companies simply charge you a large fee for questionable advice (promises of "magically" fixing your credit, changing your Social Security number to have you start afresh, or "piggybacking" on someone else's credit are typical).

Despite all the promises that credit repair companies make about cleaning up your credit, the Federal Trade Commission notes that it's best if you oversee and manage your own credit. Credit repair is something we can do ourselves (for free), but in those cases where you feel the need for help, you can contact the National Foundation For Credit Counseling at 800.388.2227 or www.nfcc.org. They may be able to provide you counseling for no or little cost.

Credit Card Basics

Annual Percentage Rate (APR): Cost of credit expressed as a yearly interest rate.

Daily Periodic Rate or Daily Interest Rate: APR divided by the number of days in a year.

Grace Period: Time between the date of purchase and when interest starts being charged. If there is no grace period, interest accrues immediately.

Annual fees: Can be anywhere from \$15 to a few hundred dollars a year depending on the card.

Transaction fees & other charges: Fees for cash advance, late payments, balance transfer, or inactivity.

Customer service: 24-hour, toll-free telephone numbers and/or online services.

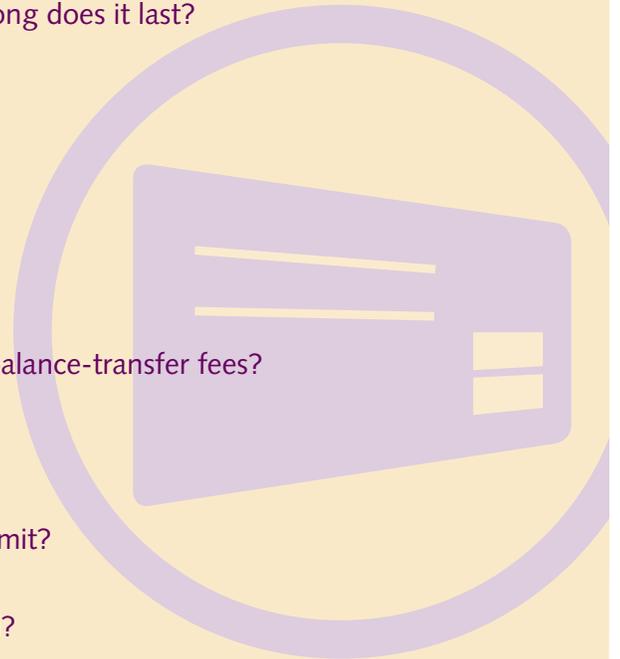
Other credit card benefits: Additional benefits that come with a cost (insurance, credit card protection, discounts, rebates and special merchandise offers).

What Makes for a Good Credit Card?

The best rates are offered to consumers with good credit. Knowing your score puts you in the driver's seat.

Don't sign up for any credit card until you have asked some key questions:

- Is there an introductory interest rate? What is it and how long does it last?
- After that, what will my interest rate be?
- Is there an application fee?
- Are there processing fees?
- Is there an annual fee?
- Is there a late fee?
- Is there an over-the-limit fee?
- Is there an inactivity fee?
- Are there any other fees, like account termination fees or balance-transfer fees?
- When and how can a variable rate be changed?
- What is the grace period before interest is applied?
- How will I be informed of any changes in my contract?
- Will the company inform me if I am about to go over my limit?
- If I go over my limit, what happens?
- What is the company policy if I have trouble paying my bill?
- May I pay my bill online?
- Is there a default rate for being late?



The best credit cards have:

- No Annual Fee
- No Inactivity/Low Balance Fee
- Low Interest Rate (under 15% is a good rule of thumb)
- No Balance Transfer Fee
- No/Low Cash Advance Fee
- Locally Owned by Your Financial Institution
- No Penalty Default Rates

Maintaining Good Credit

Moving forward, keep your credit score high with these tips:

- Pay bills on time
- Borrow only what you can repay
- Read & understand credit agreements
- Notify creditors if you cannot meet payments
- Keep track of your store receipts & bill statements
- Know what is on your credit report
- Pay down credit cards
- Find the best rates and terms when securing new credit

Resources

Office of Consumer Affairs and Business Regulation

617.973.8700 (General Information)

617.973.8787 (Consumer Hotline)

Toll-free: 888.283.3757 (MA)

E-mail: consumer@state.ma.us

www.mass.gov/Consumer

Office of the Attorney General

(Consumer Complaints and Information)

617.727.8400 (Consumer Hotline)

E-mail: emailcomplaints@state.ma.us

www.mass.gov/ago

National Foundation for Credit Counseling

Toll-free: 800.388.2227

www.nfcc.org

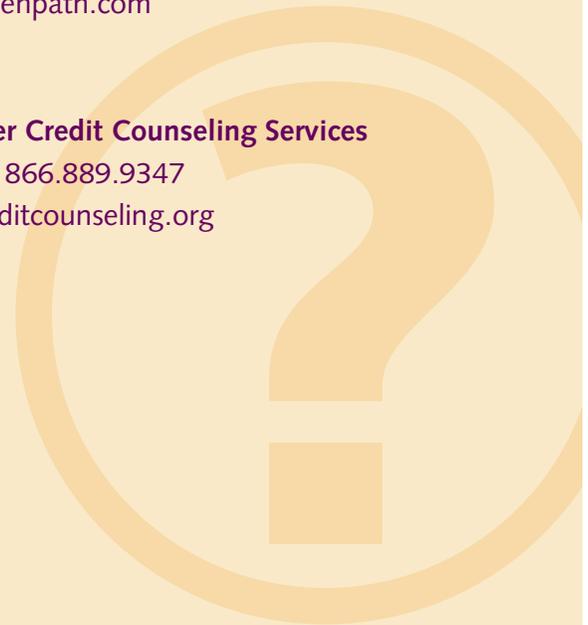
GreenPath Financial Wellness

www.greenpath.com

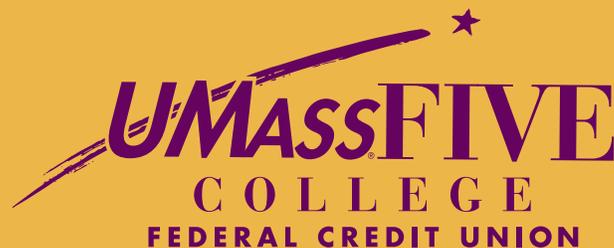
Consumer Credit Counseling Services

Toll-free: 866.889.9347

www.creditcounseling.org



If you have any questions or concerns about this topic, please call us at 800.852.5886 or drop by any branch for assistance. Any UMassFive representative will be happy to help you.



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