9 things to know about your credit score and how it's calculated
Robert Powell
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A chalkboard hierarchy of credit scores represented by one to five stars, with the five-star box checked.
Getty Images

More and more Americans are checking their credit and understand how the scoring system works.

The percentage of consumers who have obtained at least one credit score over the past four years has risen to 57 percent in 2018, up from 49 percent four years ago, according to a survey released in June by the Consumer Federation of America (CFA) and VantageScore Solutions.

The survey also shows that people who get their score know much more about how the system works than do those who do not.

For instance, large majorities of people correctly identify three key factors used to calculate credit scores – missed payments (86 percent), high credit-card balances (81 percent) and personal bankruptcy (79 percent).

Even so, there are gaps in knowledge. Significant minorities incorrectly think that age (41 percent) and marital status (38 percent) are used in the calculation. And majorities wrongly believe that tax liens (64 percent), medical collection accounts less than six months old (62 percent) and civil judgments (63 percent) are used to compute scores.

So, should you fall into that knowledge-gap camp, here's what you need to know about how credit is scored and how to raise that score.

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Get a copy of your credit reports

Go to www.annualcreditreport.com and download a free copy from each of the three main credit bureaus.

“Credit scores are an important piece of a person’s financial puzzle, and people should make every effort to improve it to get the best rates,” says April Lewis-Parks, director of education and corporate communications for Consolidated Credit.

Next, review your reports and identify mistakes and/or information you feel is incorrect, Lewis-Parks says.

“If you believe something is inaccurate, by law you are allowed to dispute the item(s) with the credit bureaus to attempt to have it removed,” she says.

Do that by submitting a dispute letter, along with any documentation or proof that that the information is inaccurate. The bureau then asks your creditor or lender to verify the information provided, Lewis-Parks says.

“If it can’t be verified, then the item must be removed from your report,” she says. “Also, if an item appears on the credit reports from all three bureaus, you will have to make your dispute to each bureau separately," she says. "The bureaus do not communicate and share information with each other.”

Note that your credit score is calculated from your credit report.

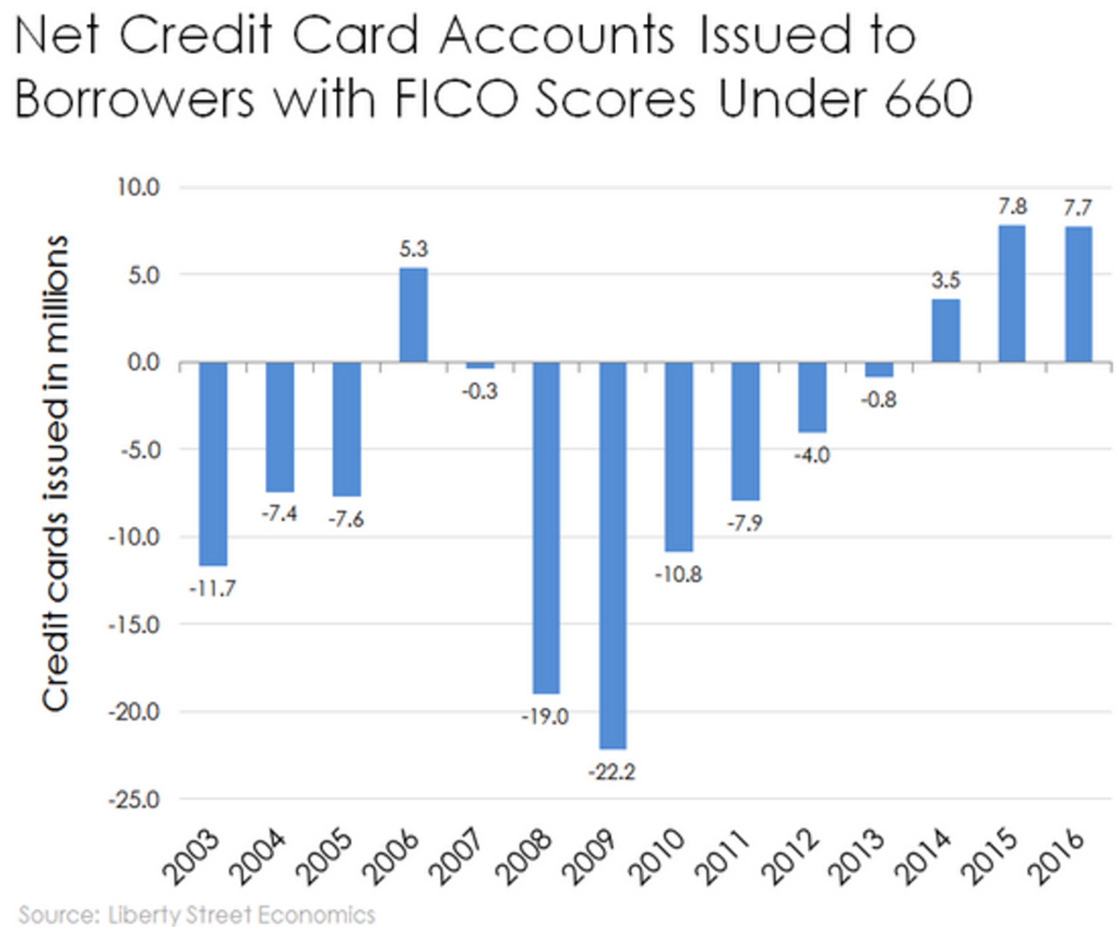

Chart of credit cards issued to people with credit scores below 660
Liberty Street Economics. Chart by author

Take this quiz

To improve your credit knowledge, take this online credit score quiz www.CreditScoreQuiz.org that was developed and maintained by CFA, an association of more than 250 nonprofit consumer groups, and VantageScore, an independently managed company behind the VantageScore scoring model.

Learn the factors

There are many factors affecting your credit, and each represents a different percent of your score. They include:

- Payment history counts for 35 percent of FICO, a widely used score: To lenders, your history of payments indicates whether you'll make payments on time in the future. A FICO score is a three-digit number calculated from the credit information on your credit report at a consumer reporting agency at a particular point in time. It summarizes information in your credit report into a single number that lenders can use to assess your credit risk quickly, consistently, objectively and fairly. Lenders use your FICO scores to estimate your credit risk

- Amounts owed count for 30 percent of your FICO score. Plenty of available credit relative to the amount owed indicates to lenders that you manage credit responsibly.
- Length of credit history counts for 15 percent of your FICO score. The age of your oldest account indicates to lenders how much experience you have handling credit.
- Credit mix in use counts for 10 percent. Lenders will consider your mix of credit cards, retail accounts, installment loans, finance company accounts and mortgage loans.
- New credit counts for 10 percent of your FICO score. To lenders, opening too many new accounts in a short window of time could point to problems.

Note that your credit score can vary from provider to provider. Here are the credit score ranges used by major credit scoring models, according to credit.com:

- FICO score range: 300-850.
- VantageScore 3.0 range: 300–850.
- VantageScore scale (versions 1.0 and 2.0): 501–990.
- Experian PLUS score: 330-830.
- TransUnion new account score 2.0: 300-850.
- Equifax credit score: 280–850.

A view of a sign for the company Equifax on the floor of the New York Stock Exchange on 15 September 2017. The company recently disclosed that a data breach, discovered in July 2017, may have impacted as many as 143 million consumers in the United States. Equifax is one of the three main organizations in the US that calculates credit scores and has access to personal information including names, Social Security numbers, birth dates, addresses, some driver's license, and credit card numbers.
JUSTIN LANE, EPA-EFE

Develop a game plan

“Building – or rebuilding – credit scores can be done, but it does take some time,” says Kristen Holt, president and CEO of GreenPath Financial Wellness. “It’s best to have a plan ... and stick to the plan.”

What steps your plan should include.

Pay bills on time

According to Holt, this accounts for the largest percentage (35 percent) of your credit score. “If you fall past due, pay the bill as soon as you can,” she says. “Look into automatic payment options, so you won’t miss a payment.”

Keep card balances well below the limit

Holt suggests trying to use no more than 40 percent of your available credit lines. “In general, having credit cards and installment loans and making timely payments will raise your score,” she says.

And, if you want to pay down or pay off multiple credit cards, Holt suggests paying off the one that has the smallest balance first, then pay the accounts down or off one at a time.

Linda Jacob, a financial counselor with Consumer Credit of Des Moines, Iowa, and author of "No More Paycheck to Paycheck," advises against using more than one-third of your available credit on each card or line of credit. “As soon as you go over the one-third, it is affecting your credit in a negative way,” she says.

Pay off negative/collection balance on report

According to Holt, paying off old debt, such as credit cards, collection bills and medical balances, helps you avoid any further collection or legal action that could become more damaging to your credit.

“Negative marks on your credit can remain on your reports for up to seven years or sometimes more, so the sooner they’re resolved, the better,” she says.

Be patient. “It may take some time to see improvement, but in as little as six months you can see positive results,” Lewis-Parks says.

A woman holding about 10 credit cards in her hand and choosing one.
The Motley Fool

Keep inquiries to a minimum

“Opening and closing credit cards can also impact your score,” Lewis-Parks says. “When you apply for new credit, the lender makes a hard inquiry on your credit report, which might shave a few points off your score.”.

Lewis-Parks also says people may want to close credit-card accounts that they have paid off, but it’s not always the best idea. “Credit-scoring models like FICO compare your total credit card balance to your credit limit to come up with your credit utilization ratio,” she says. “The more credit you use in relation to your credit limits, which can occur if you close an account, the lower your credit score will be.”

Have a nice credit mix

If you only have a car loan, apply for a credit card as well. You want to have a variety of credit, Jacob says.

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