Understanding Your Credit Score

items needed

- Copies of OKMM's *Your Money Matters: Your Money, Your Way* guide for each participant
- Highlighters
- Blank paper
- Items that can be used as game pieces or tokens
- Internet access

opening activity/dialogue

- How many of you know your credit score? How did you learn your score?
- When was the last time you checked your credit report? How about your credit score?
- If you wanted to improve your credit score, how would you do it?

content

- Participants will need a firm understanding of basic money management concepts, such as monitoring their spending and planning for expenses, before they can successfully understand credit and take measures to improve their credit score. OKMM offers additional lesson plans that can help your students build a foundation for successful money management. To view the selection, visit the Resources page at OklahomaMoneyMatters.org. For a quick reference or a refresher, use the *Your Money Matters: Your Money, Your Way* guide. When facilitating the Understanding Your Credit Score lessons, pay special attention to pages 12-14 in the guide. Utilize the different aspects of Crystal's story to reinforce the importance of monitoring and managing credit and understanding each component of a credit score.

application

Due to the extensive nature of this topic, this lesson has been divided into five sections to allow for more flexible utilization. Each section concludes with an application exercise and bonus material that complements the lesson. You may choose to teach the entire lesson as a whole, or address the content in stages.

To request classroom copies of Oklahoma Money Matters' *Your Money Matters: Your Money, Your Way* guide, call 800.970.OKMM or email OklahomaMoneyMatters@ocap.org. To learn more about OKMM, visit our website, OklahomaMoneyMatters.org

OKMM
Oklahoma Money Matters

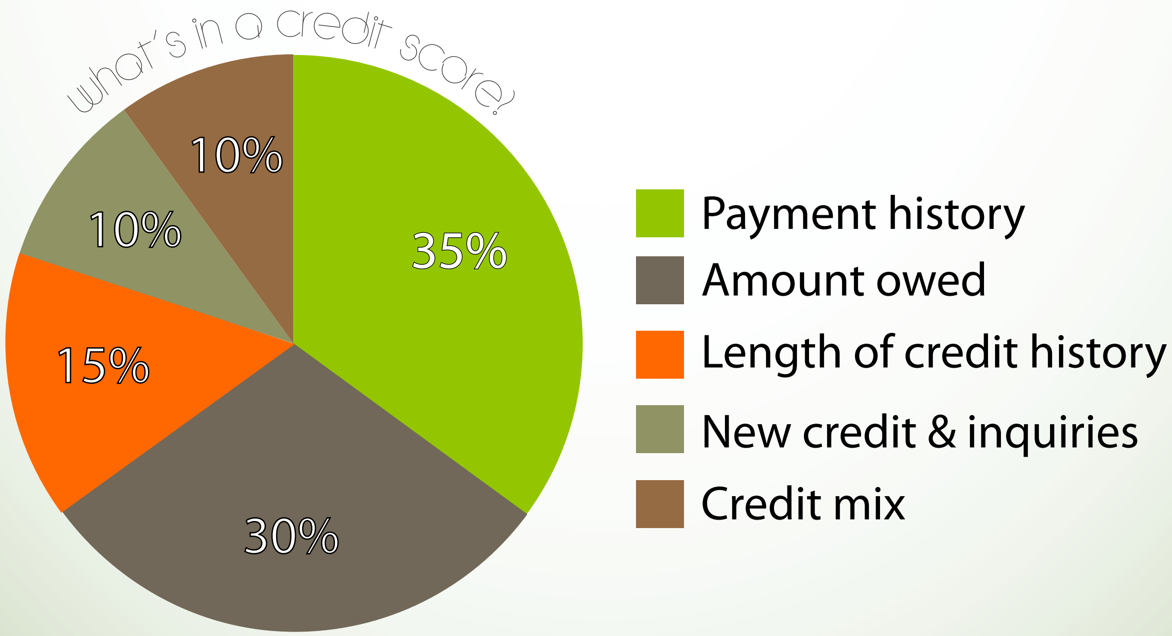
Credit Score Overview

what is a credit score?

The credit scoring system is a tool lenders use to help determine whether to extend credit to a customer. If a lender chooses to loan money, a credit score will also help determine the loan terms and the interest rate the customer will have to pay.

TYPICAL CREDIT SCORE RANGES

The scoring system considers five factors when determining a person's credit score. The following lessons explore each aspect of the credit scoring formula. While the exact formula for determining scores is an industry secret, the following information is based on general guidelines provided by the Fair Isaac Corporation (FICO).



SECTION 1: Payment History

35%

Lenders want to know how customers have handled credit accounts in the past. The **payment history** is one of the most important factors considered when calculating your creditworthiness.

Lenders look for late and missed payments, referred to as **delinquencies** on your credit report. They want to know:

- How late was the payment?
- How much money was owed?
- How recently did the late payment occur?
- How many late payments were there, altogether?

Negative factors include:

Bankruptcies	Wage garnishments	Lawsuits
Foreclosures	Liens	Judgements

To improve a credit score, start by improving the payment history, since it bears the most weight on a credit score. It's imperative to effectively manage credit accounts and make it a priority to pay all bills on time, every time. Make every effort to avoid late payments.

application

As a class, review what constitutes a good credit score. Explain that it's important to routinely check credit reports to ensure that accurate information is being reported. Then, if you have computer and internet access, instruct each student to pull his or her credit report using the steps listed below. Please note, some participants may experience a delay due to the verification questions that are asked. In this case, it may be necessary for the participant to contact each reporting agency to complete the request (Experian: 888.397.3742; Equifax: 800.685.1111; TransUnion: 800.888.4213).

1. Visit AnnualCreditReport.com and follow the instructions to access and print a free credit report from all three credit bureaus (Experian, Equifax and TransUnion).
2. Students should review the reports for any inaccuracies, such as misspelled names and/or incorrect addresses, places of employment, Social Security numbers, etc.
3. If errors are found, the student should follow the instructions on each credit report to file a dispute with the reporting agency.

::Bonus material::

Distribute copies of OKMM's *Financial Friday* Q&A article on how to check your credit report by visiting the Q&A Archive at OklahomaMoneyMatters.org and searching Credit Reports/Scores.

30%

SECTION 2: Amount Owed

Lenders consider the overall **amount of money owed** compared to the available credit limit; this is called the **debt-to-credit ratio**. When a large percentage of a person's available credit has been used, this can indicate that s/he is financially overextended and is more likely to make late payments or miss a payment altogether.

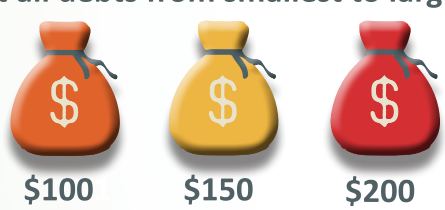
Paying off your account balances every month demonstrates that you're capable of handling credit responsibly. However, when you pay your bills can make a big difference, too. Even if you pay your credit cards in full, your credit report may show a balance owed, because you paid after the lender reported the account to the credit bureaus. To lessen the credit utilization ratio being reported, call your credit card companies to find out when they report to the credit bureaus and maintain a low balance during that time frame.

To improve your credit score, reduce balances owed on credit cards and installment loans. Your total debt-to-credit ratio should be **30 percent or less**.

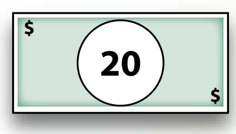
application

Create a debt pay-off plan by utilizing the **debt snowball**. Follow the steps below to gain momentum toward paying off your debt and improving your credit score.

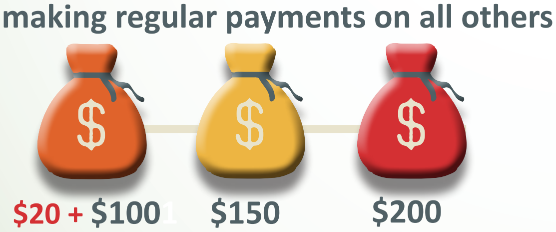
1 List all debts from smallest to largest



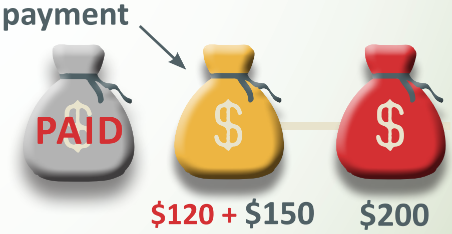
2 Commit extra money to debt repayment each month



3 Pay extra on the smallest debt while making regular payments on all others



4 Once a debt is paid, add that total payment amount to the next debt payment



Repeat this step until all debts are paid

::Bonus material::

Find additional debt reduction resources at OklahomaMoneyMatters.org under the Consumers tab and in the Debt Management section of the *Ask OKMM Archive*.

SECTION 3: Length of Credit History

15%

The **length of your credit history** makes up **15 percent** of your score and reflects the overall length of your experience with the credit system. This portion of the equation reflects a track record of how you manage credit cards, loans and other borrowing.

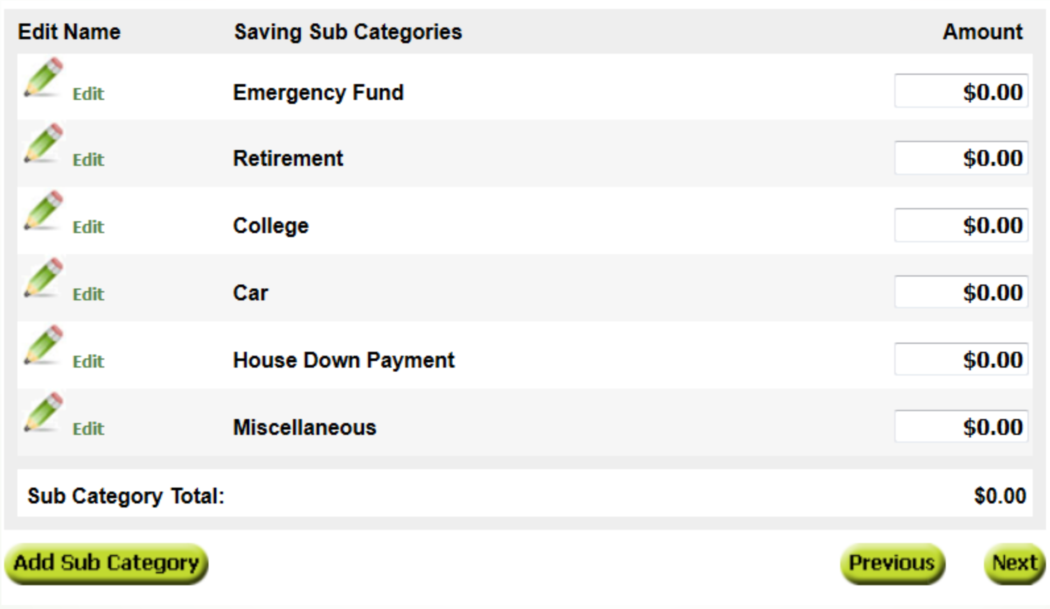
Closing accounts may temporarily lower your credit score

A longer credit history is considered favorable when determining your creditworthiness, because there is more information to evaluate. That is why credit experts typically advise people not to close old accounts. If you must close accounts, do it systematically and consider keeping your oldest account to maintain your reported length of credit usage.

Since this portion of the overall score calculation reflects time, there is **no quick fix** for improvement in this area. Patience, diligence, and discipline in managing your money and paying bills on time are the only solutions.

application

Although building or repairing credit takes time, you can take immediate steps to gain control of your financial situation by creating your personal spending plan using OKMM's interactive budgeting calculator at OklahomaMoneyMatters.org.



Edit Name	Saving Sub Categories	Amount
Edit	Emergency Fund	$0.00
Edit	Retirement	$0.00
Edit	College	$0.00
Edit	Car	$0.00
Edit	House Down Payment	$0.00
Edit	Miscellaneous	$0.00
Sub Category Total:		$0.00

Add Sub Category   Previous   Next

::Bonus material::

Incorporate OKMM's Budgeting Module for additional interactive classroom material. All self-paced learning modules can be accessed from the home page at OklahomaMoneyMatters.org.

SECTION 4: New Credit Inquiries

10%

Even though **new credit and credit inquiries** make up only **10 percent** of your overall score, authorizing new credit inquiries in a short period of time can have a large, negative impact on your credit score. This is especially true if you've been managing credit for a short time.

An inquiry occurs when a lender makes a request to view your credit report or credit score.

CREDITORS MAY DO THIS FOR ONE OF TWO REASONS:

They want to determine if you're a candidate for a pre-approved offer, like insurance or a credit card. This type of inquiry is unauthorized and referred to as a "**soft inquiry**."

You've applied for credit and the lender is determining your creditworthiness. This type of inquiry is one you've authorized and is referred to as a "**hard inquiry.**"

A hard inquiry remains on your credit report for two years, although credit scoring only considers inquiries from the last 12 months. Some lenders, insurance companies and other businesses will perform soft inquiries as part of their regular account management process or to better market their products. Since credit scores are designed to count only inquiries that truly impact credit risk, soft inquiries don't impact your score.

Some credit inquiries are treated differently. Credit scores are typically not affected by multiple inquiries from auto or mortgage lenders when they occur within a short period of time. Shopping around for these types of loans to get the best deal is encouraged, so multiple inquires are often treated as a single inquiry and will have little impact on a credit score, assuming you follow through with the purchase.

Randomly applying for new credit can equate with higher risk.

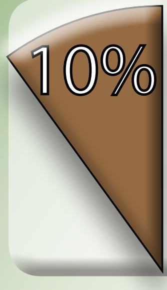
Carefully compare your options before applying for credit.

application

Lead your class through a group discussion using the *Credit Crunch Scenario Cards*. Instructions and cards are located on pages 11 and 12 of this lesson plan.

::Bonus material::

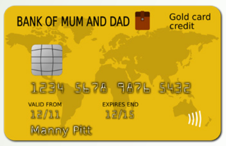
Explore the Consumers section at OklahomaMoneyMatters.org, which includes information about how to look past clever marketing to choose the best credit tool.



SECTION 5: Credit Mix

Your **credit mix** (types of credit used) makes up **10 percent** of your overall score. Scoring formulas consider your use of a combination of credit cards, retail credit accounts, installment loans, finance company accounts and mortgage loans.

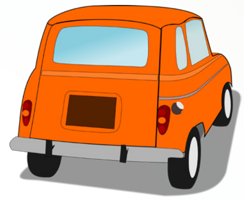
It's not necessary to have one of each type of credit account, and it's not a good idea to open accounts you don't need or intend to use. Choose your credit tools wisely.



CREDIT CARD

MORTGAGE LOAN

RETAIL CREDIT



AUTO LOAN

STUDENT LOAN

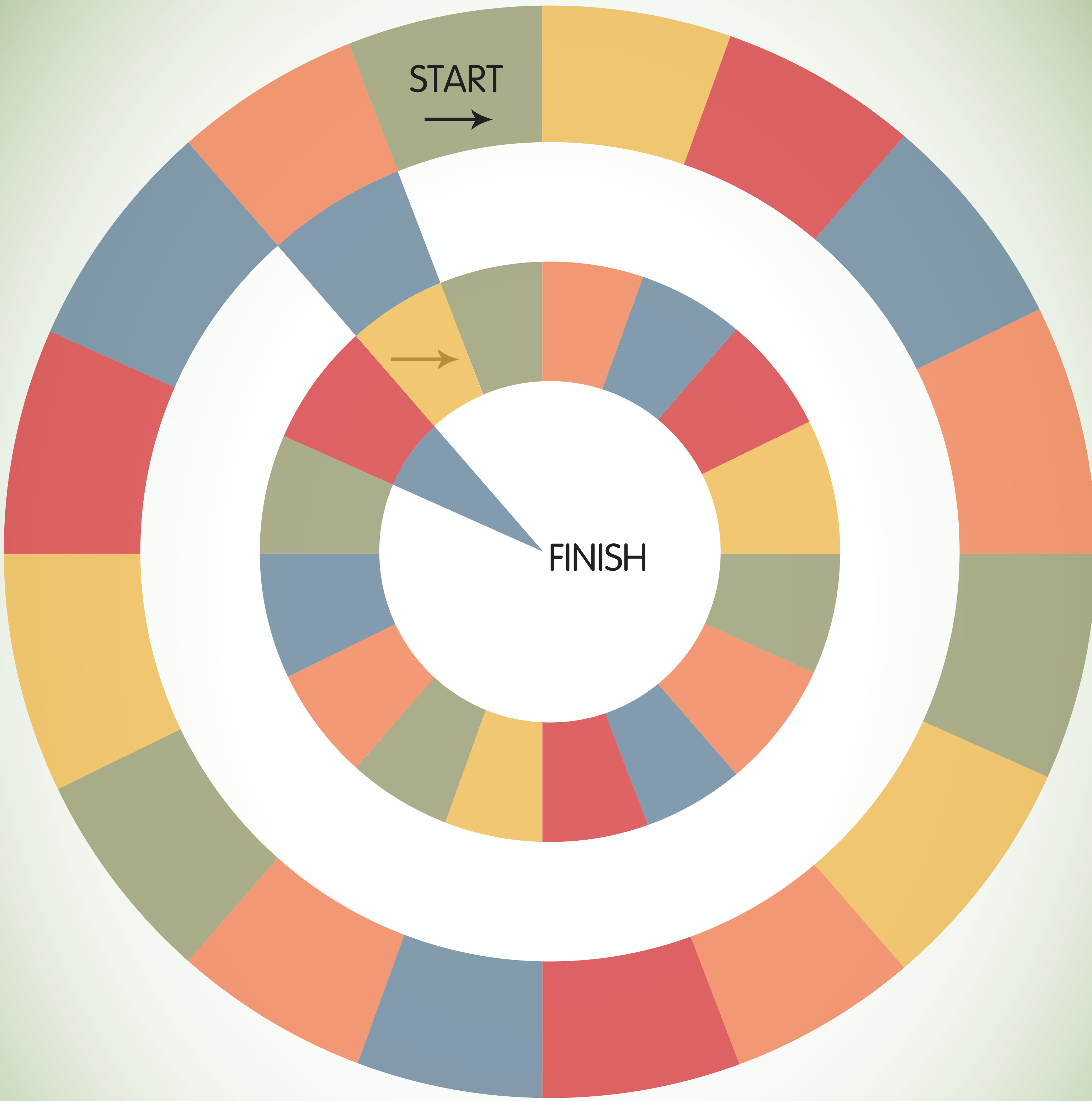
Is it wise for consumers to close accounts they don't use? Not necessarily, because closing accounts can shorten the perceived length of your credit history, negatively impact your debt-to-credit ratio, and temporarily lower your credit score. However, if having an open account is a temptation to spend unnecessarily, then the temporary impact of closing the account is worth it. Think carefully about the pros and cons of maintaining or closing an account before making a decision. If you do choose to terminate an account, do it strategically and remember that closing an account will not magically make the information disappear from your credit report. A closed account and its payment history will remain on a user's credit report for seven to 10 years.

application

It takes more than the right mix of credit tools to strengthen your credit report; it also takes a mix of money management skills, such as comparing credit options, monitoring your spending, and making sure your payments are made on time, every time. Credit users need to think - and act- strategically to maintain a positive credit record. Play the "Game of Credit Life" to reinforce the concepts of improving a credit score through effective money management strategies. The game board and money decision cards* are located on pages 8-10 of this lesson plan. The game can be played as a group or individually. If playing as a group, use the method of your choice to determine the order in which the players will take turns. Assign each player a token that will represent them on the game board. On their turn, each player should draw a money decision card from the pile and move forward or backward as indicated on the card. The first player to reach the finish line wins.

**Print the money decision cards on separate sheets of paper.*

::The Game of Credit Life::



Each player begins with their token at the start position. On your turn, draw a money decision card from the pile, read the statement and move forward or backward as indicated on the card. Tokens should always move clockwise around the game path. Once you've completed a full turn around the outer circle, use the bridge tile to move to the inner circle. The first player to complete both rings and reach the finish line wins.

::The Game of Credit Life::

You set up a savings account and make automatic deposits each pay period.

Move ahead three spaces.

You made your minimum credit card payment on time.

Move ahead one space.

You created a spending plan that works for you.

Move ahead two spaces.

You decreased your overall debt-to-credit ratio.

Move ahead three spaces.

You established an emergency savings fund.

Move ahead three spaces.

You tracked your monthly expenses and found ways to add more money to your savings.

Move ahead two spaces.

You borrowed student loans wisely by only accepting what you absolutely needed to pay school expenses.

Move ahead three spaces

You reviewed your payment options and communicated with your lender.

Move ahead three spaces.

Your car broke down and you don't have an emergency fund.

Go back two spaces.

You took out a payday loan when there were better options available.

Go back two spaces.

::The Game of Credit Life::

You're delinquent on your student loan payment.

Go back three spaces.

You paid your full credit card balance this month.

Move ahead three spaces.

You applied for credit at the mall to save 10 percent on your purchase.

Go back two spaces.

You missed a bill's due date and were charged a late payment fee.

Go back two spaces.

You loaned money to a family member instead of paying one of your own bills.

Go back one space.

You completed your annual credit report review.

Move ahead two spaces.

You are a victim of identity theft.

Go back three spaces.

You made your credit card payment more than 30 days late.

Go back three spaces.

You cosigned a loan for someone who doesn't make it a priority to pay bills on time.

Go back three spaces.

You gambled at the casino without budgeting for it as part of your entertainment spending.

Go back one space.

::Credit Crunch::

Items Needed

- Copies of the *Credit Crunch Scenario Cards* located on pages 14-15 of this lesson plan

Application

Now that participants are familiar with some credit basics, divide them into small groups and distribute the *Credit Crunch Scenario Cards*. Ask the groups to review their scenario(s) and discuss their options. Each group should come to a consensus regarding their answers and be prepared to share the reasoning behind their decision with the entire group. You can use the facilitator's notes that follow each scenario to guide discussion and clarify answers.

Credit Crunch Scenario Cards

Scenario 1: Negative marks on credit reports

Susan filed for bankruptcy which resulted in a serious negative mark on her credit report. Consequently, it has been difficult for her to obtain credit.

What are some financial steps Susan can take to demonstrate that she's learned from her financial mistakes and is ready to be a responsible borrower?

- ☐ Get a secured credit card
- ☐ Spend less than she makes and create a spending plan that works for her situation
- ☐ Apply for as much credit as she can
- ☐ Make all of her bill payments on time
- ☐ Establish an emergency fund so she doesn't have to rely on credit to cover an unplanned expense

Facilitator notes: All but one of the suggested steps will help Susan demonstrate her creditworthiness.

- A secured credit card functions like a prepaid credit card, where a portion of the deposit becomes the user's credit limit. When used responsibly, a secured credit card could help Susan rebuild her credit profile because her on-time payments will be reported to credit reporting agencies.
- Crafting a spending plan can help Susan manage her income and expenses. By planning for her monthly fixed and variable expenses, she can take proactive measures to live within her means - and she can take care of business without feeling restricted.
- A large portion of Susan's credit score is determined by her payment history. To get back on track and improve her creditworthiness, Susan should make it a priority to pay all of her bills on time.
- Establishing an emergency fund will help Susan stick to her budget. Life happens and unexpected emergency expenses will occur, but with a little money set aside, Susan won't have to take money from another spending category to handle an emergency.

Scenario 2: No established credit history

Carrie has decided she's ready to buy her first home. However, she doesn't have any established credit and is having trouble receiving approval for a mortgage due to her lack of credit history.

What are some strategies Carrie can use to establish a credit history?

- ☐ Request a copy of her credit report
- ☐ Make all bill payments on time
- ☐ Buy a new car to show that she has money
- ☐ Become an authorized user on someone else's credit account
- ☐ Open a credit card account in her name

Facilitator notes: All but one of the suggested strategies can help Carrie establish credit.

- Carrie should request a free copy of her credit reports using AnnualCreditReport.com, read through each report to become familiar with the information and ensure that everything listed is accurate.
- Carrie should make all her bill payments on time, including utility and cellphone bills. Normally these accounts aren't reported to credit bureaus, but if they become delinquent, they will be reported and negatively impact her credit report.
- If Carrie has a connection to someone with a positive credit history she could ask them to add her as an authorized user on their account. She will not own the account, or be held responsible for it, but the account's payment history will be reflected on her credit reports. This is only beneficial if the account is in good standing.
- Carrie could establish credit by opening a credit card account. She should look for a card with a low, fixed interest rate, keep her available balance low and make all payments on time, otherwise she could accrue too much debt and negatively impact her credit.

Scenario 3: Maxed out credit limit

Jackie has maxed out all of her credit cards. Even though she manages to make her minimum payments each month, her accrued debt level has hurt her credit score.

What can Jackie do to improve her credit utilization ratio?

- ☐ Ask her credit card company for a higher credit limit
- ☐ Apply for more credit cards
- ☐ Pay more than the minimum payment amount due each month
- ☐ Close her credit card accounts

Facilitator notes: Two of the proposed options could help Jackie improve her credit utilization ratio.

- If granted an increased credit limit, Jackie's credit utilization ratio will go down. However, this option must be used with caution. If she can't control her spending and again uses all of her available credit, she will still have the same problem and more debt to repay.
- If Jackie pays more than the required minimum monthly payment, then she can reduce her total debt level and improve her credit utilization ratio, which will improve her credit score.
- While not an option on the scenario card, it would also be a good idea for Jackie to start tracking her spending habits and create a spending plan that will allow her to live within her means and stop relying so heavily on credit.

Scenario 4: Defaulted accounts

Max fell behind on his payments and began ignoring the statements and phone calls from his creditors. Eventually the creditors turned his accounts over to a collection agency. Credit bureaus see collection accounts as a sign that Max isn't a reliable borrower and his credit score will decrease because of it.

What can Max do to rehabilitate his credit after an account has been turned over to a collection agency?

- ☐ Create a spending plan that will help him pay his bills on time
- ☐ Track his spending habits
- ☐ Contact his creditors to negotiate more comfortable monthly payments
- ☐ Continue to ignore collection calls and notices
- ☐ Use his income tax refund to negotiate settlements with his creditors.

Facilitator notes: Four of the proposed options could help Max repair his defaulted credit accounts.

- Max should create a spending plan, also known as a budget, so that he can allocate money to pay his expenses and avoid overspending. He should carefully evaluate his income and expenses and take measures to begin paying off his debt.
- Max should track his spending habits for at least one month. Keeping receipts and writing down each transaction can help him monitor his expenses and identify realistic categories and dollar amounts when crafting his spending plan.
- Once Max completes the steps listed above, he should have a better idea of how much he can allot to paying down his debt. He should contact his creditor to negotiate monthly payments that he can afford.
- Max can use his tax refund and any other windfall money he might receive to jump-start his debt reduction efforts. Once his accounts are paid as agreed, his credit score should begin to improve.

::Credit Crunch Scenario Cards::

Scenario 1: Negative marks on credit reports

Susan filed for bankruptcy which resulted in a serious negative mark on her credit report. Consequently, it has been difficult for her to obtain credit.

What are some financial steps Susan can take to demonstrate that she's learned from her financial mistakes and is ready to be a responsible borrower?

- [ ] Get a secured credit card
- [ ] Spend less than she makes and create a spending plan that works for her situation
- [ ] Apply for as much credit as she can
- [ ] Make all of her bill payments on time
- [ ] Establish an emergency fund so she doesn't have to rely on credit to cover an unplanned expense

Scenario 2: No established credit history

Carrie has decided she's ready to buy her first home. However, she doesn't have any established credit and is having trouble being receiving approval for a mortgage due to her lack of credit history.

What are some strategies Carrie can use to establish a credit history?

- [ ] Request a copy of her credit report
- [ ] Make all bill payments on time
- [ ] Buy a new car to show that she has money

Become an authorized user on someone else's credit account

Open a credit card account in her name

::Credit Crunch Scenario Cards::

Scenario 3: Maxed out credit limit

Jackie has maxed out all of her credit cards. Even though she manages to make her minimum payments each month, her accrued debt level has hurt her credit score.

What can Jackie do to improve her credit utilization ratio?

- ☐ Ask her credit card company for a higher credit limit
- ☐ Apply for more credit cards
- ☐ Pay more than the minimum payment amount due each month
- ☐ Close her credit card accounts

Scenario 4: Defaulted accounts

Max fell behind on his payments and began ignoring the statements and phone calls from his creditors. Eventually the creditors turned his accounts over to a collection agency. Credit bureaus see collection accounts as a sign that Max isn't a reliable borrower and his credit score will decrease because of it.

What can Max do to rehabilitate his credit after an account has been turned over to a collection agency?

- ☐ Create a spending plan that will help him pay his bills on time
- ☐ Track his spending habits
- ☐ Contact his creditors to negotiate more comfortable monthly payments
- ☐ Continue to ignore collection calls and notices
- ☐ Use his income tax refund to negotiate settlements with his creditors.