

# How to Clean Up Your Credit History

Chatting up your credit score isn't exactly a popular topic. In fact, you probably don't even discuss this with your spouse. But you ought to.

As an adult, your credit score is the most important gauge of your performance — at least in terms of your financial life. Your “FICO” score determines whether you get a loan or credit card and the interest rate that you will pay.

Since many prospective employers check your credit history, your credit rating can also determine whether you get the job you want. It will affect whether you get car insurance and the size of your premiums because, for reasons no one can adequately explain, individuals with low credit ratings are more likely to file claims.

## **Making the Grade**

Your credit score is simply a mathematical way for others to get a sense of how big a financial risk you are based on how you handle money. Five factors make up your score: your payment history, the amounts you currently owe, the length of your credit history, new credit you've applied for, and the types of credit you use.

Moreover, although “FICO” is the generic term used to describe your credit rating, you actually have *three* different ones. That's because each of the national credit bureaus — Experian, Trans Union, and Equifax — uses the mathematical formulas developed by the Fair Isaac company and then computes its own “score” based on the data about you in *its* files. Since this is usually not identical, your credit rating will vary from one credit bureau to another.

## **Payment Histories**

As you might expect, the most important factor is your past behavior with credit. But your “Payment History” entails more than whether you paid your bills on time. It will list in detail every credit account you have had and whether you were ever late with a payment.

Your payment history will also show any bills that are past due as well as the length of time, any liens against you — current as well as in the past — and whether you have filed for bankruptcy. It will also reflect positive actions you have taken such as re-establishing an on-time payment track record.

Negative information can stay in your credit history for seven years. A bankruptcy will remain on your record for 10 years.

Likewise, closing an account you've paid off can also hurt you because it reduces the total amount of credit you have available and increases something called your "credit utilization" ratio.

To compute this, prospective lenders compare the amount of money you actually owe — overall as well as for each account — to the total amount of credit for which you are *eligible*. This tells them whether you are overextended in the amount of credit you're using and, thus, a bigger risk for default. The higher the number, the worse you look.

For instance, say you decide to take advantage of one of those "balance transfer" offers that flood your mailbox because the new account carries a lower interest rate, but also a lower credit limit, than the one you currently have.

Once the transfer is complete, you close the first card because you think (wrongly) that lenders will see you as being prudent by removing a temptation to overspend.

Instead, you've probably hurt your credit rating in two ways:

- 1) The lower limit on your new card raises your credit utilization ratio because you're using up more of your available credit — both for that account as well as overall.
- 2) You have caused the new credit card company to make an "inquiry" into your credit file to determine whether to approve you for this account.

If the interest rate difference is significant, a better strategy would be to keep the first card and simply not use it. You'll still generate a credit inquiry, but your credit utilization ratio won't be damaged.

### **Credit Histories**

Lenders want to know how long you've been handling credit. That's the reason, all other things being equal, a 25-year old buying his first condo might pay a higher mortgage rate than a 55-year old purchasing her fifth house.

It's also why you should not close an old, inactive account: although you might feel a sense of accomplishment or closure, you could be shooting yourself in the foot by shortening the length of your credit history.

While "New Credit" only counts toward 10 percent of your score, this can be enough to throw you into an entirely different — i.e. "higher-risk" — category. Prospective lenders get nervous when they see that you've been applying for a lot of new credit in a short period of time.

Every time you apply for credit, the prospective lender asks for a report of your credit history. Every inquiry — even if you are ultimately turned down — counts against you. (Inquiries that *you* make to, say, check the accuracy of your file, and those initiated by companies interested in offering you unsolicited credit do not count.)

Pulliam-Weston is the author of “Your Credit Score” and “Deal With Your Debt,” the two books we’re giving away (see instructions at the end of this column). She says, “Every time you open an account it can take almost 5 points off your credit score.” That could be just enough for a lender to increase the interest rate you would otherwise get or to refuse you credit completely.

It’s another reason you want to refuse those tempting “Open an Account, Save 15 percent” offers from department stores. Not only do these cards carry high interest rates and exorbitant late fees (after all, they have to recoup that 15 percent “savings” they just gave you), you’re also dinging your credit rating.

Lastly, creditors want to know the *types* of credit you have had experience with, such as bank credit cards, store credit cards, mortgages, auto loans, and so forth.

### **I Want My FICO!**

Although “FICO” is the generic term used to describe your credit rating, you actually have *three* different scores. That’s because while all the national credit bureaus — Experian, Trans Union, and Equifax — use the mathematical formulas developed by the Fair Isaac company to compute your credit score, the information collected about you by each bureau is not identical. Since the inputs are different, so are your scores.

To confuse things even more, each credit bureau gives its brand of “FICO” a different name. Experian, for instance, calls it your “PLUS” score.

If you want to know what your credit score is, you generally have to pay for it. The only place where you can get all three scores is [www.myfico.com](http://www.myfico.com). \$45 also buys you a report containing all of the information in your credit history. Be prepared for *pages* of data on accounts you probably forgot you ever had.

Regardless which credit bureau computes it, your FICO score will range from 300 (fuggedabout a loan!) to 850 (please borrow this money!). The 40 percent of us who have credit scores of 750 or higher get the best terms — lowest interest rate, highest credit limit, etc.

If your FICO score is below 600, you’ve got homework to do. The good news is there are concrete steps you can take to improve your credit rating. Many of these are obvious: pay your bills on time; if you’re behind in your payments, get and stay current; don’t open new accounts thinking this will raise your score; keep credit card and other “revolving” debt to a minimum.

### **Know What’s in Your File**

Above all, take advantage of the federal law that allows you to get a copy of your credit report from each of the three credit bureaus once every 12 months — for *free*.

Caution: The only way to be absolutely certain that you will not be charged for this information is to use the Web site, [phone](http://www.annualcreditreport.com) number, or address established by the Federal Trade Commission for this purpose.

Official FTC:

Web site: <http://www.AnnualCreditReport.com>

Phone Number: 1-877-322-8228

By Mail: Annual Credit Report Request Service

P.O. Box 105281

Atlanta, GA 30348

Last summer the FTC cracked down on more than 125 copycat Web sites (one was named “freecreditreport.com,” another was called annual-credit-report.com) that duped consumers into paying for additional services they didn’t want, such as credit monitoring.

Getting your hands on a copy of your credit report will allow you to review what’s in your file to see if it contains errors.

It probably does. “Minor errors,” says Pulliam-Weston “are fairly frequent.” These include such things as misspelling your name and accounts that aren’t yours. If you find negative information that is more than 7 years old and doesn’t pertain to a bankruptcy “you should definitely dispute it because it should be gone” from your file, according to Pulliam-Weston.

If you dispute an error in the files of one credit bureau don’t assume this information will be shared with the other two. You’ve got to notify each credit bureau separately.

I know all this sounds like a hassle. It can be. However, once you get your credit record in order, the process of reviewing your file once a year should become a fairly quick process. And if you qualify for a lower interest rate, it can put hundreds of dollars in *your* pocket instead of in the hands of your creditors.

**By Gail Buckner, CFP**