

CREDIT

ACTIVITY 2



Credit Scores

RECOMMENDED TIME

Allow 50-60 minutes. Required time may vary depending on the audience.

OBJECTIVES

Participants will:

- Define credit scores and how they impact a consumer's ability to get credit, obtain a loan, get a job, etc.
- Recognize the factors that make up a credit score.
- Understand how credit scores fluctuate based on circumstances.
- Understand strategies to improve your credit score.

MATERIALS NEEDED

- Computer with LCD screen or overhead projector*
- Flip chart paper, white board or transparencies
- Copies of handouts

ADVANCE PREPARATION NOTES

Review the activity plan. Think about the audience, and decide whether to present the total activity or to use parts of this activity in combination with other activities.

For clarity, use print instead of script when writing on a flip chart, white board, or transparency.

The suggested dialogue in the delivery notes does not always mirror the wording on a transparency. Try to vary the dialogue, rather than reading transparencies verbatim.

This activity uses handouts. Have sufficient copies for all participants; a few extras provide good insurance.

Facilitators cannot be expected to know everything about credit scores. Be honest with all questions. If you do not know the answer to a question, be honest and explain, "I do not know the answer to your question. However, I will find the answer and get back to you." Be sure to write down the question and follow through when you commit to finding an answer.

* If an overhead projector isn't available, consider making photocopies of the overhead transparencies for handouts instead.

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ACTIVITY 2 - DELIVERY NOTES



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Presentation Opening

- Welcome the participants.
- Introduce yourself briefly.
- If this is the first meeting with the class or group, do a brief round of introductions by everyone.
- When introducing yourself, print your name where participants can see and refer to it during the session. Some people may be a little nervous and may not remember your name. Just as you want to use their names, encourage them to call you by your name.

Activity Overview

Review the topics for discussion in this activity:

- What is a credit score?
- The broad impact of credit scores
- How a credit score is calculated
- The fluidity of credit scores
- Ways to improve your credit score.

Write the term “**credit score**” on the board, flipchart, or blank transparency.

- Ask participants to define the term.
- Debrief participants by showing “**Overhead 1: What Is a Credit Score?**”

Talking points for Overhead 1:

A credit score is a number that tells a lender how likely an individual is to repay a loan, or make credit payments on time. When a lender requests a credit report and score from a credit reporting agency, the score is calculated by a scoring model – a statistical mathematical equation that evaluates many types of information from your credit report at that agency. By comparing this information to the patterns in thousands of past credit reports, scoring identifies your level of credit risk.

There are several different credit scoring models that are used today. Examples of different models include the FICO score, which was developed by Fair, Isaac and Company, Inc. and is used by many mortgage lenders; and the VantageScoreSM, which was developed jointly by the three national credit reporting companies.

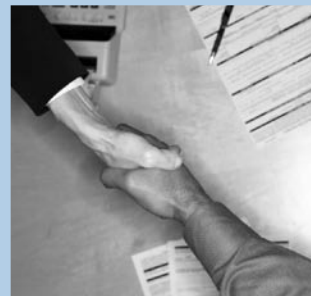
FICO scores, which are one of the most common credit scoring systems used by lenders, range between 350 and 850. With these scores, a higher number

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Overhead 1 What Is a Credit Score?

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means a better chance of having a credit or loan request approved. Most credit scoring systems consider a variety of factors, such as number of credit accounts, total credit available, amount of outstanding debt and late payment record.

The VantageScoreSM was created in 2006 as a more consistent way for the agencies to develop credit scores. In the past, each credit reporting company used its own formula to create its credit scores. The new system allows each company to use the same formula and create a more consistent credit score. The VantageScoreSM ranges from 501 to 990 and includes a rating system similar to an academic grading system (A-F grades). The higher the score, the more creditworthy a consumer is considered to be.

- Ask participants how their credit score impacts their life.
- Write down responses on flipchart paper.
- Responses may include: to get a loan, to get a job, to get an apartment, to get a mortgage loan, to get homeowner's insurance, and to get car insurance.

Discuss the broad use and impact of credit scores. In addition to banks and lenders, there are landlords, employers, merchants, and even insurance companies that are also using credit scores.

Discuss the following example of how credit scores can impact how much you pay for car insurance:

To most, it seems that credit histories and driving records have little in common. Insurers, on the other hand, have found that using credit scores to predict how likely someone is to pay premiums has helped them cut their losses. They don't use the same score that banks and lenders use. Instead, they use an insurance score, which is generated based on a slightly different formula. According to the American Insurance Association, having a good insurance score does not necessarily mean you are a good driver or a more responsible homeowner. However, research has shown that consumers with better insurance scores generally file fewer claims and have lower insurance losses. Insurers' use of credit histories to determine rates is under scrutiny nationwide.

Ask participants whether they know what factors make up a credit score. As participants name each of the five components listed below, write it on flipchart paper and then discuss it using the following talking points.

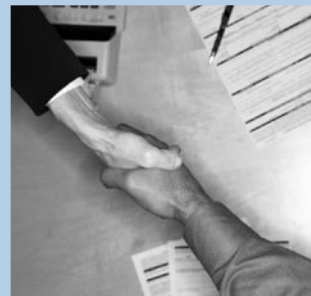
Show **"Overhead 2: What Makes Up a Credit Score?"**

Different credit scoring models may use slightly different formulas to determine what makes up a credit score. However, the following information from Fair, Isaac and Company offers a useful guide for understanding how credit scores are compiled.

Overhead 2
What Makes Up
a Credit Score?

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Talking points:

- Payment History accounts for 35% of your credit score – Some of the factors included in this category are: account payment information; the presence of adverse public records such as bankruptcy, judgments, or lawsuits; how long payments are past due; and the amounts that are past due.
- Amounts Owed account for 30% of your credit score – Some of the factors included in this category are: how much you owe on your accounts, the number of accounts with balances, and the proportion of balances to total credit limits.
- Length of Credit History accounts for 15% of your credit score – Some of the factors included in this category are: the time since accounts were opened and the time since account activity.
- New Credit accounts for 10% of your score – Some of the factors included in this category are: the number of recently opened accounts and the number of recent credit inquiries.
- Types of Credit Used account for 10% of your score--Some of the factors included in this category are: the number and types of accounts that you have open (credit cards, retail accounts, installment loans, mortgage, consumer finance accounts, etc.)

Distribute **“Handout 1: Credit Score Scenarios”** to participants.

Have them review the handout individually.

Stimulate a group discussion about the fact that credit scores fluctuate based on current circumstances. Ask participants what things Dwight and Elena did to improve their scores (e.g., paid bills on time, paid off card balances, used cards sparingly). What did they do to lower their scores (e.g., maxed out credit cards, paid bills late)? Remind participants that it’s never too late to take steps to improve your credit score.

[Note: You may want to focus on only one of the credit score scenarios to save time. If you will only focus on one scenario, select the one that participants will relate to most closely.]

Divide the group into teams of two to three. Ask the teams to think about ways to improve their individual credit scores. Have them write down their suggestions.

After a few minutes, call time. Distribute **“Handout 2: Improving Your Credit Score.”** Ask the teams whether they came up with any of the suggestions listed on the handout.

Now that participants have a better understanding of how to improve their credit scores, ask them whether they learned anything new about strategies

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Handout 1

Credit Score Scenarios

Handout 2

Improving Your
Credit Score

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to improve their credit scores.

Closing

In closing, remind everyone that their credit score has a significant impact on many aspects of their lives. There are specific things they can do that will improve their credit score. It might take time to improve the score, but it's worth the effort.

Thank everyone for their participation, and encourage them to return for additional sessions. If such sessions are planned, you might provide a "sneak preview" of any activity to come.

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ACTIVITY 2 - OVERHEAD 1



WHAT IS A CREDIT SCORE?

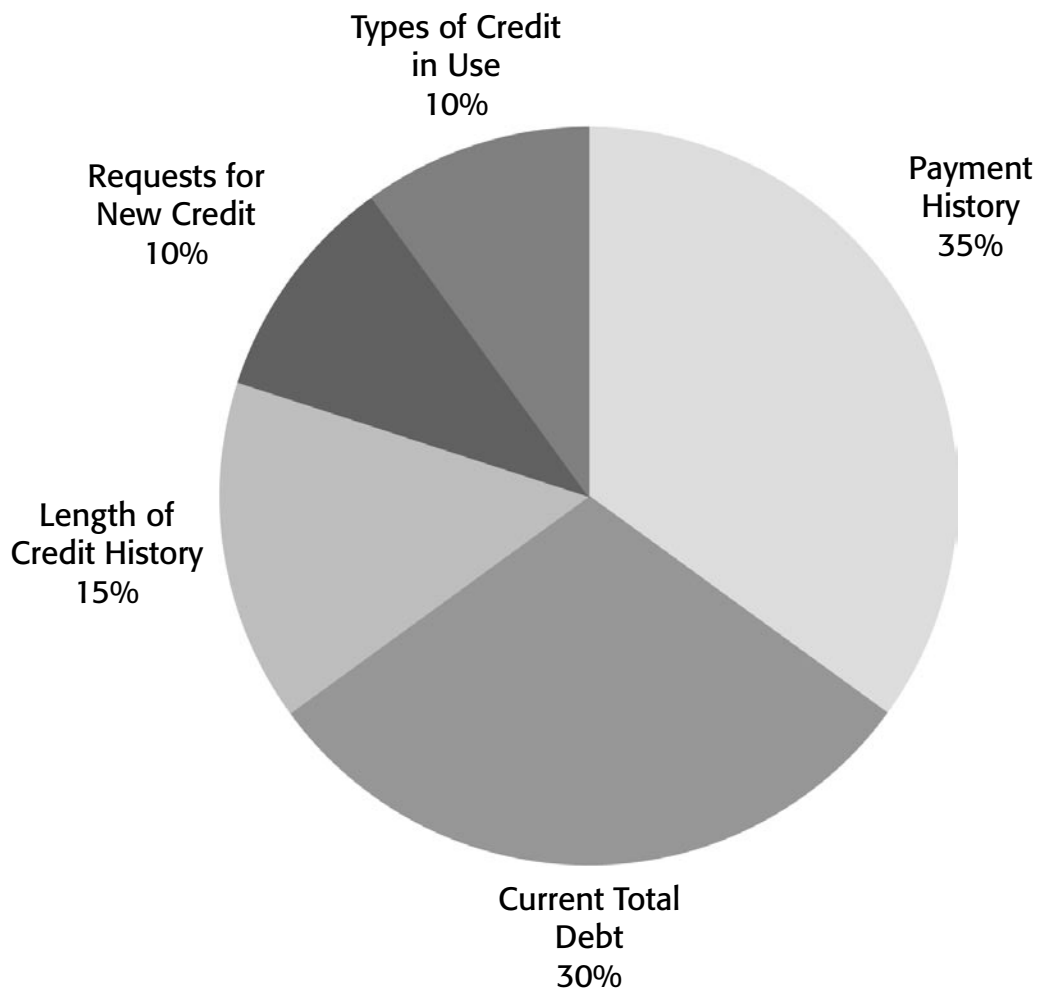
- A credit score is a number that helps a lender predict how likely an individual is to repay a loan, or make credit payments on time.
- A credit score is a number that changes as the elements in a credit report change. For example, payment updates or a new account could cause scores to go up and down.
- A credit score has broad use and impact: Your credit past is your credit future.
- FICO[®] scores, one of the most common credit scoring systems, vary between 350 and 850.
- VantageScoreSM, a new credit scoring system developed by the three credit bureaus, ranges from 501-990.

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ACTIVITY 2 - OVERHEAD 2



WHAT MAKES UP A TYPICAL CREDIT SCORE?



Source: Fair Isaac and Consumer Federation of America, 2005.

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ACTIVITY 2 - HANDOUT 1 - PG. 1



CREDIT SCORE SCENARIO #1

Dwight is a 28-year-old construction worker. He works hard and tries to manage his money well. Over the past few years, Dwight has had difficulty finding stable work. During periods of unemployment, Dwight used credit cards to pay for everyday expenses. Dwight has two credit cards, but unfortunately he has not managed his credit well and his credit rating is poor. Dwight is committed to improving his credit. Dwight's story is hypothetical, but what happens to his credit rating is a realistic example. Here is how his credit management decisions affect his credit rating.

Behavior or Action	Dwight's Credit Rating
2004	
Dwight has been out of work for six weeks and by March, both of his credit cards are maxed out. He misplaced one credit card bill and forgot to pay it, so his payment on the account, including late fees, is \$100 and 30 days past due.	F
In April, Dwight has an opportunity to work at a well-paying long-term job. However, he needs a car in order to drive to and from the job site, which is 20 miles away. To buy a car, he needs a loan. He applies with two lenders who look at his credit score and credit record. The first lender denies his loan request. The second offers a loan, but at an extremely high interest rate of 24%. Dwight decides to carpool with another employee until he can save enough money to buy a car.	F
Dwight makes up his late payment and pays just the minimum amount due on time on both cards for the rest of the year	C
2005	
Dwight is committed to improving his credit. Each month, he pays \$50 more than the minimum payment on each credit card. He also decides to stop using his credit card so frequently for the rest of the year.	B
2006	
Dwight is making good progress to improve his credit. But sometimes he makes impulsive decisions and uses his credit card for things he doesn't really need. He decides to take his credit cards out of his wallet to limit the urge to use them spontaneously and by June, he pays off almost all of his debt. Because he has also paid his bills on time for a solid two years, his credit is now excellent.	A

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ACTIVITY 2 - HANDOUT 1 - PG. 2



CREDIT SCORE SCENARIO #2

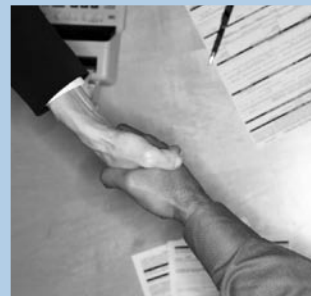
Elena and husband David have been married for 7 years, but are now in the process of getting a divorce. They have recently agreed on a divorce settlement. David takes one of the cars and the responsibility for its loan. He also takes two of their four credit cards, and agrees to pay 50 percent of the monthly mortgage payments.

Elena is a fictitious person, but what happens to her credit rating is a realistic example. Here is how her credit management decisions affect her credit rating in our hypothetical story.

Behavior or Action	Elena's Credit Rating
2005	
After the divorce in May, David finds it hard to make ends meet. As a result, he charges both of his credit cards to nearly their limit. Elena doesn't realize her name is still on the card accounts David is using.	B
David's financial problems continue to worsen through July. His credit cards are still charged to the limit, and David cannot afford to make even the minimum payments some months.	C
Since Elena's name is still on the credit accounts that David is using, the bank calls her in August when David misses payments. Elena decides to call and ask him to roll over the balances on both cards to a new card that he opens in his name only. David agrees to do this and Elena's score improves.	B
2006	
Elena pays her bills on time and keeps her two card balances low. This helps improve her credit rating. The fact that the two missed payments are getting older on her credit file means that they have less impact on her score.	A
Elena's mother needs minor surgery in March, but does not have insurance. Elena agrees to pay for the surgery with her credit card. She charges one of her cards to the limit to pay for the surgery.	C
Elena wants to buy a more reliable car, so in April she asks her bank about auto loan rates. Unfortunately, her credit score is too low to qualify her for their best rate. Elena decides to improve her credit first and then apply for a loan so she can get the best rate.	C
By July, Elena has paid down both of her credit card balances. She ordered a copy of her credit report and credit score. She learns that her score has improved so she applies for a car loan and is approved for a good rate.	B

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IMPROVING YOUR CREDIT SCORE

- **Pay bills on time.** The best thing you can do to improve your score is to pay your bills on time. You can begin to improve your credit history immediately by making at least the minimum payments on time. Delinquent payments and collections can have a significant negative impact on your score.
- **If you have missed payments, get current and stay current.** The longer history you have of paying your bills on time, the better your score will be.
- **If you have been managing credit for a short time, don't open a lot of new accounts too rapidly.** New accounts will lower your average account age or the length of time you have the account. People who have had accounts for longer periods of time and have paid them on time tend to have higher scores. Additionally, if you open up several new accounts rapidly, it will appear that there is a risk of you utilizing all of this new credit. Thus, this additional credit could lower your score.
- **Correct mistakes.** Your credit score is a reflection of the information in your credit report. If your credit report contains negative information, it will negatively impact your credit score regardless of whether or not the information is accurate. Review your reports from all three credit bureaus for accuracy once a year, as well as several months before applying for a loan. If you discover inaccuracies in your report, follow the procedure to correct the information.
- **Do your rate shopping for a loan within a focused period of time.** Some scores, such as FICO scores, distinguish between a search for a single loan and a search for many new credit lines, in part by the length of time over which inquiries occur. For example, some scores count all rate inquiries for car loans or mortgage loans in a two-week period as one inquiry.
- **Keep balances low on credit cards and other "revolving credit."** High outstanding debt can negatively affect a score.
- **Pay off debt rather than moving it around.** The most effective way to improve your score in this area is by paying down your revolving credit. In fact, owing the same amount but having fewer open accounts may lower your score.
- **Remember, it's okay to request and check your own credit report.** When you request your own report, it is considered a consumer inquiry. This won't affect your score, as long as you order your credit report directly from one of the credit-reporting agencies or through an organization authorized to provide credit reports to consumers.