Get A Handle On How Your Credit Score Is Calculated

Every now and then there are seminars at various places in major cities to explain to consumers how credit works and how their credit score is calculated. It is surprising to note the typically poor turnout at such events, since most people figure they already know as much as they need to know on the topic.

The truth is that they could not be more wrong in that assumption. How your credit score is calculated changes every now and then, and what was true 5, 10 or more years ago is totally different today. The vast majority of consumers do not realize what components are used to calculate their credit score, and making payments on time for your existing credit cards is only a small part of the whole equation.

The bottom line use of a credit score is that it is a number calculated by the credit reporting agencies that is supposed to summarize the amount of credit risk or credit worthiness that an individual or business has. Lenders use the credit score number to determine whether or not to approve a loan or new line of credit, and if approved, to determine the interest rate that will be assessed.

True, one of the main criteria used to compute the score is the number of accounts that the person has open, the length of time they have been open, how often they have gone over their credit limit, and do they have a history of making on time payments.

But there are two things that most people do not realize. There are three major credit reporting agencies, and they do not share information. Some of your creditors report to one of them, others report to another one, and some big ticket items such as your mortgage lender probably report to two of them or perhaps all three. The key here is that none of them have a true complete picture of your credit history, and it is up to you to correct their misconception.

The other thing most people do not realize is that the majority of consumer credit reports contain errors. This is not done purposely or maliciously, but errors creep in since much of this is a manual process, and those errors once introduced will remain there forever until YOU get them corrected. They do not "auto correct" over time.

There are various things you can do, in addition to ensuring that the errors on your credit report are corrected or removed, that will serve to raise your credit score. For example, since one of the criteria is how close your outstanding balance is to your credit limit, you could call and request a higher credit limit, and once approved, then that same outstanding balance is a lower percentage of your limit, which gives you a higher score.

Another myth is that you get a better score by transferring all your debt onto one credit card. Not only is that untrue, that can actually hurt your score by lowering it, since then you have less credit open and the one you do have open is much closer to your limit.

There are many things you can do to improve your credit score, and you need to understand the facts about what factors are important and what are not. Do not depend on urban legend or old wives tales to make that determination, since a higher credit score can favorably impact you in many different areas of your life.

About the Author

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