Understanding Credit and Credit Reports

If you ever plan to take out a loan or you currently owe money to another party, you need to understand credit and credit reports. Credit is the ability of a borrower to receive something of value, usually money in exchange for the agreement to pay it back later. For example, when you buy a car, a bank (lender) provides the money to you (borrower). In exchange, the lender charges you interest. The interest charged is determined by several factors and heavily weighted on your credit report. Therefore, it is important for you to monitor your credit report. Let's take a minute to provide greater insight on credit and credit reports.

Categories of Credit

There are three categories of credit--open, revolving, and installment. An example of *open credit* is your electricity bill. The electric company provides you with electricity and expects you to pay your bill on a monthly basis. Sometimes open credit is referred to as "paid in full" as you are expected to pay the bill in full when you receive the monthly statement.

Revolving credit is most commonly associated with credit cards. Usually a predetermined amount, known as your credit limit, is established when you open the account. It is revolving as you borrow against that amount depending on your needs. There is also flexibility in paying towards your balance, although there is usually a minimum monetary payment. This monthly payment includes payment toward what is owed plus interest.

Installment credit has a fixed number of payments for a fixed amount of time. Car loans, house loans, and most student loans are usually paid in installments.

Secured vs Unsecured Debt

It is important to know if the money you borrow is secured or unsecured. Secured means the money is tied to an asset like a house or a car. If you don't make the payments as agreed, the lender can take back the item. An example is when a car is repossessed. An unsecured loan is your credit card. If you don't make your minimum payment on your credit card, the items you purchased are not taken back. When times are tight and you can't pay all of your bills, you may need to consider if the debt is secured or unsecured.

Advantages of Good Credit

So, why does your credit history matter? People with a good credit history are typically offered lower interest rates, better terms, and more options when it comes to borrowing money. To establish good credit, you need to make your payments on time and limit your overall amount of debt. Good credit can also impact your auto insurance rates, employment opportunities, cell phone plans, and others. Anytime you allow access to your credit report when filling out an application, it can impact the terms you are offered.

Monitoring Credit

There are three major bureaus that track how you use credit--*Experian*, *TransUnion*, and *Equifax*. When you fill out a loan application, that information is sent to one or more of the credit bureaus. The bureaus continue to monitor and track your debts. They track all of the details

of your loans such as monthly payments, how much you owe, and the original amount borrowed. The more you borrow money, the lengthier your credit report.

Components of Your Credit Report

Your credit report is comprised of four sections:

- *Personal information* is the first section. It includes your name, date of birth, social security number, previous names, and prior addresses.
- *Public records* include judgements against you through the court system. This is where you would find tax liens, property liens and bankruptcies.
- *Payment history* includes all of your open and closed accounts. Details of each account may include types of account, terms of account, date opened, original balance, and current balance. It shows how you have done repaying the debt and if your payment was 30, 60, or 90 days late. Basically, it is a snapshot of the account.
- *Inquiries* include those who have requested to look at your credit report. There a soft inquiries and hard inquiries. Soft inquiries are those pre-approved offers you get in the mail. They don't have an impact on your credit score but are part of your credit report. Hard inquiries occur when you fill out a loan application or open a new account. Filling out hard inquires can have a negative impact on your credit score.

Obtaining Your Credit Report

There is one free place to obtain your credit report by federal law--AnnualCreditReport.com. You are entitled to a free copy of your credit report from each of the three credit bureaus yearly. It can be requested by mail, phone, or online. The Consumer Financial Protection Bureau has great information about obtaining your credit report. Visit CFPB's website on credit reports and scores for more information.

Disputing Inaccuracies on Your Credit Report

Check your credit report at the three credit reporting bureaus, *Experian*, *TransUnion*, and *Equifax*, for any inaccurate information. Review the information carefully. The CFPB developed a checklist for your use. If you see errors, dispute the information and get it corrected. Send a written description of the error to the credit reporting company and the information provider in writing, include details about any information that is inaccurate or incomplete. Include copies of any documentation that will support your position. Keep all originals with your financial records.

How to Improve Your Credit Score

Improving your credit score takes time, but it can be done.

- Begin by paying your bills on time. If you're behind on payments, bring them current as soon as you can. Pay off debt and keep balances low on credit cards and other revolving credit.
- Open new credit accounts only as needed.
- Only close unused credit cards if they are costing you money in annual fees, or if you are tempted to use them for more debt.

- Avoid applying for new credit. Applying for new credit creates hard inquiries on your credit report, and too many hard inquiries can negatively impact your credit score.
- Verify that the information reported on your credit report is accurate.
- If there are errors, dispute the information and get it corrected right away. Incorrect information could lower your score.

Key Terms (definitions from myfico.com)

- **Credit Bureau:** A credit reporting agency that is a clearinghouse for information on the credit rating of individuals or firms.
- **Credit History:** A record of how a consumer has repaid credit obligations in the past.
- **Credit Report:** Information communicated by a credit reporting agency that bears on a consumer's credit standing. Most credit reports include: consumer name, address, credit history, inquiries, collection records, and any public records such as bankruptcy filing and tax liens.
- **Credit Score:** It broadly refers to a number generated by a statistical model which is used to objectively evaluate information that pertains to make a credit decision.
- **Creditor:** Lender, or someone to which you have financially indebted.
- **Installment Debt:** Debt to be paid at regular times over a specified period. Examples of installment debt include most mortgages and auto loans.
- **Line of Credit:** A form of revolving credit whereby the borrower can draw down only the amount needed, up to the amount of the credit limit.
- **Revolving Debt:** Debt owed on an account that the borrower can repeatedly use and pay back without having to reapply every time credit is used. Credit cards are the most common type of revolving account.

Resources:

https://www.annualcreditreport.com/index.action

https://www.consumerfinance.gov/consumer-tools/credit-reports-and-scores/

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JESSE M. KETTERMAN, JR.
jketterm@umd.edu

PATRICIA MAYNARD
pmaynard@umd.edu

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