A LESSON PLAN TO UNDERSTANDING

Credit Scores

Provided by

VantageScore®

a higher level of confidence

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INTRODUCTION

A credit score is a three-digit number derived from a mathematical interpretation of the information in a person's credit files. Lenders report this information based on a person's credit-related activity, which includes things like mortgage payments, credit card balances and credit inquiries. This information also might include public records, such as tax liens and other information from government sources. The credit files are maintained by the three national credit reporting companies (CRCs): Equifax, Experian and TransUnion.

Lenders use credit scores in conjunction with other criteria such as income, employment status, and amount of outstanding debt, to help determine whether to approve loan applications and at what terms and interest rates. In addition, other businesses such as utilities, landlords and more may use credit scores to better understand if a person is likely to pay bills on time.

The purpose of this lesson plan is to help students understand how to make good decisions and manage credit wisely when they are confronted with credit-related choices in the future. The key is to understand the bigger picture: Every time a person uses credit, it has an impact on their credit files. This includes paying for groceries with a credit card or taking advantage of interest-free financing on a new car.

It's critical to understand that each person's credit history is completely unique, so the impact of the decisions a person makes when handling credit is unique to that person, but there are some general guidelines that apply universally. That's why it is so important to be a good credit manager and focus on making prudent decisions based on one's own financial situation.

GRADES

10-12

CONCEPTS

This lesson plan assumes that students have received some prior instruction on personal finance and credit. Students should have a general understanding of what credit is and how the process generally works. By the end of the lesson plan, students will be able to:

1. **Apply Basic Credit Score Knowledge**
    a. Understand how do credit-related activities affect a credit score?
    b. Understand how to improve a credit score?
2. **Apply General Credit Management Tips**

TIME REQUIRED

60 minutes

MATERIALS

- Web Access to CreditScoreQuiz.org
- Paper: "Assume the Role of Managing Your Credit Prudently and Watch Your Credit Score Improve" (**http://vantagescore.com/docs/VantageScore_Score_Impacts_Paper_July_2012_Final.pdf**)

PROCEDURE

ACTIVITY #1: Discuss basic credit fundamentals
ACTIVITY #2: Review "Common Myths About Credit Scores"
ACTIVITY #3: Review CreditScoreQuiz.org

RESOURCES

Having a good understanding of credit scores can help a person become a good manager of credit. The good news is that many resources are available online that provide valuable information. Visit the sites below to gain a better understanding about credit reports and credit scores.

Credit Reporting Companies

The three national credit reporting companies (CRCs) are: Equifax, Experian and TransUnion. These firms collect information about borrowing and repayment behavior from lenders and businesses that have extended credit to consumers. This information is compiled into a credit report for each consumer. Consumers can obtain annual free copy of their credit report once a year from each of the three companies. Consumers are also entitled to a free copy within 60 days of being denied credit from the CRC that supplied the lender with their report.

To learn more each company and to learn more about the credit reporting process, click below to view their websites:

Equifax (www.equifax.com)

Experian (www.experian.com)

TransUnion (www.transunion.com)

Free Credit Report Once A Year

By law, consumers are able to obtain a free copy of their credit reports once a year from each of the three national credit reporting companies by visiting annualcreditreport.com or by calling 1-877-322-8228.

Government

Several organizations within the federal government make information available about credit reports and credit scores, including the following:

Department of Housing and Urban Development (**http://portal.hud.gov/hudportal/HUD?src=/library/**)
Federal Trade Commission (**http://www.ftc.gov/bcp/menus/consumer/credit.shtm**)
Federal Reserve Board (**http://federalreserve.gov/creditreports/**)

Being A Good Credit Manager

A consumer-focused white paper, "Assume the Role of Managing Your Credit Prudently and Watch Your Credit Score Improve," written by VantageScore Solutions provides an information about credit scores, what activities impact a credit score and the steps consumers can take to improve their credit scores.

ACTIVITY #1:
REVIEW BASIC CREDIT KNOWLEDGE

Before engaging in interactive Activities #2 and #3, below are some credit scoring fundamentals that can be reviewed to assess the students' understanding of the subsequent lesson content. Read this information aloud while the class reads silently, or alternatively, allow students to take turns reading the information aloud. This activity will review:

- ***What Is a Credit Score and How Is It Used?***
- ***What Influences a credit score?***
- ***How to improve a credit score***

What Is a Credit Score and How Is It Used?

A credit file is information such as a person's history of payment punctuality, the total amount of available credit, the total amount and type of debt a person has, the number of open and active accounts, and the longevity of a person's relationships with creditors. The information is compiled by the credit reporting companies (CRCs) – Equifax, Experian and TransUnion. Lenders and other organizations submit this information to them.

A consumer's credit score is typically a three-digit number, and it ranks a consumer's likelihood to pay his/her debts compared to all other consumers. A higher score means that a person is more likely to pay their debts. A lower score means that a person is less likely to pay their debts.

Mortgage lenders, auto lenders and credit card issuers may use credit scores to help determine whether a person can qualify for credit and what interest rate they might pay. In some states, home insurers may use credit scores to help gauge a person's risk level as a potential customer and to accurately price that risk in the form of a premium, which is the amount of money an insurer will charge for active coverage. Cell phone companies may use credit scores to help determine which plan a person may be eligible for and whether any security deposit is required. Electric utilities may use credit scores as they evaluate whether or not to require a security deposit and the amount of such deposit. Landlords may use credit information and scores to help determine the amount of the deposit that may be required for a particular property.

There are dozens of generic credit score models in the marketplace.

What Influences a Credit Score?

Generally speaking, there are a number of characteristics that contribute to credit scores and ways to build and maintain a good credit score. The next page showcases a table that generally describes those characteristics along with tips for good credit management.

Characteristic	Description	Maintaining a good credit score
Payment History	Repayment behavior (current, late or charged-off)	Pay all bills on time.
% of Credit Limit Used	Proportion of credit amount used/owed on accounts	Keep revolving balances low, under 30% of credit limits.
Total of Balances	Total amount of recently reported balances (current and delinquent)	Reduce the amount of debt owed.
Age and Type of Credit	Length of credit history and types of credit	A mix of accounts (credit cards, auto, mortgage) and a longer history will improve a credit score.
Recent Credit	Number of recently opened credit accounts and credit inquiries	Don't open too many new accounts too quickly.
Available Credit	Amount of credit available	Only open the amount of credit needed.

What ISN'T included in the most commonly used credit score models:

There are many misconceptions about credit scores and one of the most important of which is to understand what information the most commonly used credit scores do NOT use. Information that the most commonly used credit scores do not consider includes:

- Race
- Color
- Religion
- Nationality
- Sex
- Marital Status
- Age
- Salary, occupation, title, employer, employment history
- Where a person lives
- Where a person shops

How to Improve A Credit Score?

There are several ways to improve a credit score; however, the score is actually a reflection of a person's credit report. So it's more important to learn what's in the credit report and focus on that rather than obsess over the credit score.

Improving one's credit score can be achieved over time by regularly practicing these sound financial management techniques:

- ✔ Pay bills on time
- ✔ Apply for credit only when it's needed; do not open new accounts frequently or open multiple accounts within a short time span
- ✔ Keep outstanding balances low — a good rule of thumb is not to exceed 30% of available credit limit with each account
- ✔ Pay any delinquent accounts as soon as possible and then keep them current
- ✔ Everyone has the right to obtain their credit reports for free through the website annualcreditreport.com. This website also provides instructions for how to make corrections in the event that there is an error on the credit report.

ACTIVITY #2:
COMMON MYTHS ABOUT CREDIT SCORES

What isn't true about credit scores is just as important as what is true. In fact, there are a lot of popular misconceptions about credit scores. After completion of Activity 1, review the list of Myths/Facts below with the class. This activity digs deeper into some credit scoring essentials. This can be a simple hand-raise exercise to keep the class engaged in the subject matter.

Myth: ***There's only one credit score used by lenders.***

Fact: Actually there are dozens of credit scores that are used by lenders. Some scores, known as "generic" scores are sold to lenders and consumers. Lenders also use "custom" scores developed by their own employees to suit their specific lending strategies. Two generic models used by lenders and sold to consumers are VantageScore and FICO. Generally speaking, all generic credit scores are interpretations of a person's credit report. The source of a person's credit reports are Equifax, Experian and TransUnion.

In order to determine what the credit score means, a consumer should understand the model's scale. Scores using the FICO scale, which range from 300 to 850, are usually considered good if they are over 700. And scores using the VantageScore scale, which range from 501 to 990, are usually considered good if they're over 800. But the most important point is that, when one gets a score, one should look to see where it falls on the scale of that scoring system. Numerical scores using the VantageScore scale, for example, will be associated with a letter grade — A, B, C, D, or F—similar to grades given in school. For example, a statement may appear as: "Your VantageScore is 880, B."

Myth: ***Credit scores are used by employers.***

Fact: Credit scores are not used by employers; however, in some states employers may use information in a prospective employee's credit report. Employers use a special form of credit reports that hide social security numbers, account numbers, and other personal information that is not pertinent or allowable in the employment screening process.

Myth: ***The decision to grant a loan is based solely on the credit score.***

Fact: No, a credit score is just one part of a number of factors that lenders examine in a process called "underwriting."

Underwriting is the analysis and decisioning process used to evaluate a credit application. Underwriting criteria vary and are driven by a lender's business; among the criteria beyond credit scores that a lender may consider are:

- **Down payment**
- **Income**
- **Employment history**
- **Cash on hand**

Myth: ***Credit scores are free.***

Fact: Generally speaking, credit scores are sold and can be purchased from the three national credit reporting companies; Equifax, Experian, and TransUnion. Recently, however, some consumers can receive their credit score for free as a result of new regulations.

As a result of these new regulations, after applying for credit, some borrowers will receive a notice from lenders that includes their credit score, in addition to the following information:

- **The range of possible scores under the model used.**
- **The key factors that adversely affected the credit score of the consumer in the model used.**
- **The date the credit score was created.**
- **The name of the person or entity that provided the credit score.**

Borrowers that are likely to receive these notices are those that are turned down for credit, or do not receive the best available terms offered by the lender, as a result of information in their credit file.

Myth: ***As soon as a person pays off their credit card debt, their credit score will get better.***

Fact: The amount of debt a person has in relation to the amount of credit he or she has available is a significant contributor to a credit score; however it is only one of several factors. While a person's credit card and other loan balances may be low as a result of a recent payment, due to the lenders' reporting cycles, it may take some time for the payments to be reflected in that person's credit score. Additionally, any negative factors in a credit file, such as late payments in the past, while continue to be reflected in a credit score.

Improving a credit score can be achieved over time by regularly practicing these sound financial management techniques:

- **Pay bills on time**
- **Apply for credit only when it's needed; do not open new accounts frequently or open multiple accounts within a short time span**
- **Keep outstanding balances low — a good rule of thumb is not to exceed 30% of a card's available credit limit with each account**
- **Pay any delinquent accounts as soon as possible and then keep them current**

Myth: ***If a person disputes something on his or her credit report, their credit score can get worse.***

Fact: Consumers are encouraged to regularly check their credit report; disputing any record in the report will not lower a credit score. Checking a credit report is considered a "soft inquiry" and is not a factor in a credit score. In fact, a credit score can actually get better if inaccurate information is successfully removed.

Everyone has the right to obtain their credit report for free through the website www.annualcreditreport.com. This website will also provide instructions for how to make corrections to any errors on a credit report.

Myth: ***The fewer credit cards a person owns, the higher their score.***

Fact: Credit reports are a reflection of an individual's credit activity. Accordingly, there are potentially countless scenarios where the number of credit cards owned may impact a person's credit score. Prudent handling of personal finances is the best way to manage debts. Therefore, it is generally a good idea to have a limited number of credit cards for long periods of time that have low balances and are kept in good standing.

Myth: ***Shopping for a loan hurts a credit score.***

Fact: Consumers are encouraged to shop for the best loan rates and conditions. Accordingly, many credit score models do not penalize multiple inquiries made within a short period of time. When several inquiries are made within a shortened timeframe, it is assumed that the consumer is shopping around for a rate and not opening up multiple lines of credit.

As an example, the VantageScore model uses a 14-day rolling window in which all credit inquiries are de-duplicated. All inquiries within that window are considered one inquiry regardless of the type of account. So regardless of whether the credit inquiry is made in response to a mortgage, auto or credit card application, it will be counted only once during that 14-day window. Other models have their own timeframes for the de-duping window.

Myth: ***Student loans do not impact credit scores.***

Fact: It's important that before taking out student loans, borrowers and their guarantors understand that student debt is just like any other loan in that it's critical to not borrow any more than is necessary, and that payments must be made on time until the loan has been paid off.

However, student loans aren't always a drag on a consumer's credit scores. Like all loans, student loans can also positively impact credit scores. This is because generic credit score models reward a history of on-time payments as it demonstrates the borrower's ability to manage credit.

By contrast, missing a payment will negatively impact a consumer's credit scores.

Myth: ***Only banks and lenders use credit scores.***

Fact: Banks, credit card companies, and other lenders use credit scores to assess a borrower's loan eligibility and set loan/credit terms.

Some types of credit scores are also used by other entities like insurance carriers to help predict losses in order to accurately price home and auto policies. This means that a consumer would be more likely to pay a fair policy rate and not have to subsidize the cost for higher risk policyholders.

Additionally, landlords may use credit scores to determine if they want to enter into an agreement with a consumer. The better a credit score, the more likely consumers will receive favorable terms.

Myth: ***A low score doesn't really impact the interest rates a borrower might pay.***

Fact: Credit scores are one of a number of factors that determine how much interest a borrower might pay during the course of a loan. In fact, on a typical auto loan from a bank, a borrower with a low credit score would likely be charged a higher interest rate and likely pay at least $5,000 more over the life of the loan.

Myth: ***Only information about loans is sent to the three national credit reporting companies.***

Fact: The three national credit reporting companies, Equifax, Experian and TransUnion, collect information on the credit use of more than 200 million Americans and make it available in credit reports. The three CRCs receive more than 36 billion information updates to consumer credit files each year. In addition to loan and payment information, credit files may include tax liens, rent payments, utility and cell phone payments, and collection accounts.

Myth: ***Race and age are factors in a credit score.***

Fact: One of the most important misperceptions about credit scores is what information is NOT used. The most commonly used credit score models do not consider:

- Race
- Color
- Religion
- Nationality
- Sex
- Marital status
- Age
- Salary, occupation, title, employer, employment history
- Where a person lives
- Where a person shops

Myth: ***A person that always pays bills on time doesn't need to check his or her credit report.***

Fact: All consumers should be diligent about checking their credit reports for errors regardless of their credit score or if they always pay their bills on time. It is especially important to check a credit report after a name change or address change. Consumers can obtain a free copy of their credit reports once a year from each of the three national credit reporting companies at annualcreditreport.com, or by calling 1-877-322-8228.

Each of the three major credit reporting companies - Equifax, Experian and TransUnion — has a system in place for addressing errors contained in consumer credit files. Consumers should contact the company that provided the report in question.

Equifax	**Experian**	**TransUnion**
www.equifax.com	**www.experian.com**	**www.transunion.com**

Myth: ***The more loans a person has, the higher their credit score.***

Fact: It's not the amount of loans that generates a good score — it's the borrower's credit habits that dictate the score. In other words, a credit score can be impacted positively by taking out only a certain number of sensible loans and keeping them in good standing without missing payments.

Myth: ***Anyone can submit information to credit reporting companies.***

Fact: There is a rigorous process that data furnishers go through in order to be able to report data to the credit bureaus. Data furnishers are audited in order to be sure information is as accurate as possible.

Myth: ***The only reason scores differ from one credit reporting company to another is that there are errors in my report.***

Fact: Errors contribute to inconsistencies, but there may be several reasons scores differ amongst the three national credit reporting companies. One contributing factor is that some credit scores are generated using a system in which different models are installed at each of the three credit reporting companies to account for the different ways the three companies store the data. Because the credit scoring models are different, it can contribute to the result where a consumer receives three different credit scores.

Another factor is that the credit data is provided to each of the national credit bureaus on different timeframes and every piece of data is not provided to all three national credit bureaus. As a result, even if the data is completely accurate, a consumer could see his or her scores vary. This is another reason why it's important to check credit reports annually.

Myth: ***Credit repair companies are always helpful in correcting errors and taking other measures to improve a person's credit score.***

Fact: Experts agree that credit repair companies often overpromise, charge high prices, and perform services, such as correcting credit report inaccuracies, that consumers could do themselves by just contacting the lender and the credit bureaus. Federal laws prohibit credit repair companies from charging fees upfront, and consumer advocates agree that consumers should think twice before paying these companies more than several hundred dollars total.

ACTIVITY #3:
CREDIT SCORE QUIZ

As part of their educational initiative, the Consumer Federation of America and VantageScore Solutions launched

www.creditscorequiz.org

a consumer-focused website that allows consumers to test their knowledge about credit scoring, and receive the correct answers for each question as they progress through the quiz. The website is completely free and does not display any advertising nor is any personal data collected. Useful resources and real-time nationwide results are provided. Both the online quiz and a corresponding brochure are also available in Spanish at www.creditscorequiz.org/Espanol.

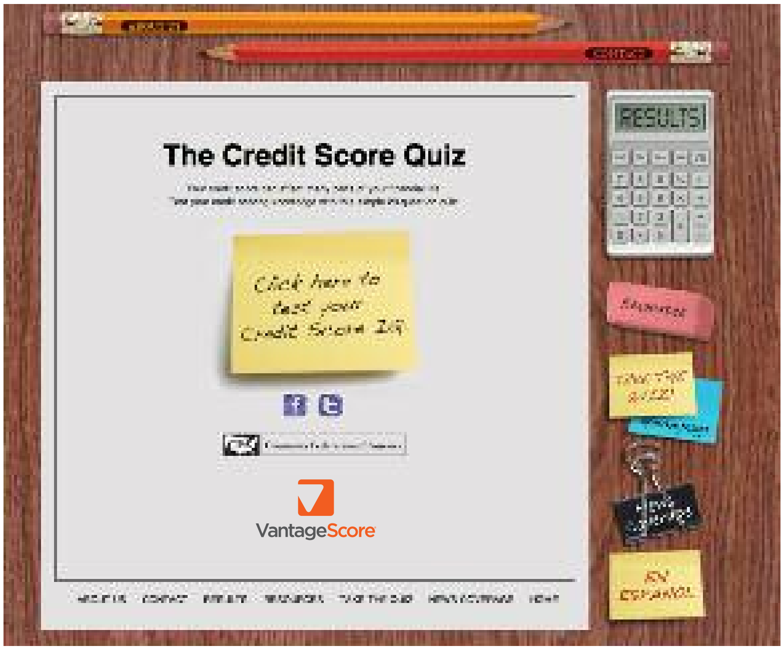
After going over Activities #1 and #2, the class should be prepared to be "quizzed" on the lesson plan. The CreditScoreQuiz can be taken online or hard-copies can be obtained from the "Resources" section of the CreditScoreQuiz website.

English language brochure:

http://www.creditscorequiz.org/index.php/resources

Spanish language brochure:

http://www.cuestionarioparaelpuntajedecredito.org/index.php/recursos



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