Navy Mutual

Understanding Credit

Credit is the amount of money that a lender allows you to borrow with the understanding that you will repay the lender in the future. It is what allows you to have a credit card, buy a car or home without having to make one massive cash payment, obtain loans for higher education, and even open accounts with utility companies.

There are many types of lenders that can offer you credit, including banks, retailers, vehicle and mortgage lenders, and educational facilities. Before offering you credit, and when deciding how much credit to offer you, they take into account your credit score, which is a numerical representation of the likelihood that you will completely repay borrowed funds in a timely manner.

There are three main credit reporting agencies in the United States: TransUnion, Experian, and Equifax. These agencies gather information about you and issue reports. When a lender pulls your credit report, they will gain access to information about how much credit you have already been given, how much of that credit you use, and your payment history. Though similar, your reports from each of the agencies will not be identical; not every lender reports to all three of them.

What is a credit score?

Your credit score is a number between 300 and 850 that represents your historic responsibility in handling the credit you are granted. The higher your score, the more likely it is thought to be that you will pay your bills on time and in full. A high score also makes it easier for you to open additional lines of credit and qualify for a higher credit limit (the amount of money that you are permitted to borrow). A low score may result in your being declined for new lines of credit or being offered higher interest rates.

There are many different formulas that can be used to calculate your credit score. The FICO (Fair Isaac Corporation) model is one of the most widely used models. However, there is also the VantageScore model and others that use slightly different algorithms. Thus, you may see variations in your credit score from report to report depending on which model is used.

Typically, an excellent credit score is one that is above 800 and a poor score is one that is less than 580. In 2021, the average FICO score in the United States was 714.

Your credit score depends on multiple factors:

- **Your payment history:** This is generally the most influential factor in determining your credit score. On-time payments help your score, while late and missed payments are a detriment.
- **How many and what types of accounts you have open:** There is a difference between having a single large mortgage and a dozen different credit cards; reporting agencies take into account the type(s) of active credit and the number of outstanding loans that you have when determining your score.
- **How much credit you use vs. how much credit you have access to:** This is called your "credit utilization ratio," and it represents the percentage of credit that is available to you. Experts recommend keeping this under 30%.
- **How long you have had a credit history:** People with no history of credit utilization represent an unknown for a lender, while it is easier to predict the spending and payment behaviors of someone who has been using credit for a long period of time. A longer credit history generally helps your score, provided you have responsibly handled the loans that you have received.

Your credit score may also change with the frequency of credit reports that are being pulled. If you apply for a large number of credit cards in a short amount of time, for example, your score may decline when each of those lenders checks your report. Each time a lender pulls a report, it represents the potential that you will be issued new credit – and there normally will not have been enough time to determine if you are handling that credit wisely. If you open several new lines of credit over a longer period of time, your score is less likely to be affected.

Note that checking your own credit report or score does *not* have an impact on your credit worthiness. Furthermore, credit inquiries from within the same industry within a 45-day period only count as one "look" from a lender. For example, if you are shopping for the best mortgage rate, you might apply with three companies. If these are all submitted within 45 days, it will only count as one inquiry.

Are there different types of credit?

There are three different types of credit.

- **Revolving:** You apply for a line of credit and receive credit with a stated limit. You may use the credit up to that limit, but you cannot make any purchases beyond it. As you make payments, you regain the ability to use your credit. As you are only required to pay a minimum balance, anything remaining is rolled over to the next month, with interest.
    - Credit cards are an example of revolving credit.

- **Installment:** You take out a loan and have to pay it back within a set period of time in a set number of equal payments, with interest.
    - Student loans, mortgages, and car payments are examples of installment credit.
- **Open/Service:** Open or service accounts have a balance that you must pay in full each month. These accounts typically do not charge interest.
    - Utility accounts and cell phone contracts are examples of open credit.

How do credit scores change?

Credit scores naturally change over time as your financial situation changes.

- **Factors that may increase your credit score:** Making payments on time, maintaining a low (less than 30%) credit utilization ratio, diversifying your credit sources (e.g., using a credit card for purchases and paying down a car loan at the same time)
- **Factors that may decrease your credit score:** Missing payments, making late payments, canceling credit card accounts, applying for new lines of credit, maintaining a high (greater than 30%) credit utilization ratio

Federal law allows you to get a free copy of your credit report every 12 months from each credit bureau and AnnualCreditReport.com. This allows you to stay on top of any changes to your score – and catch identity theft early. Beware of using other "free" websites; predatory sites will sell your information to creditors in exchange for providing a report or score.

What is identity theft and what should I do about it?

Identity theft occurs when a third party gains unauthorized access to your personal information (e.g., your name, birthday, Social Security Number, online passwords, and other identifiers). Your compromised information may be used to open up new lines of credit or receive benefits in your name. Identity theft can be exceptionally disruptive, both personally and financially.

Keeping an eye on your credit report can help you catch identity thieves. If your report shows new lines of credit that you do not recognize or a drop in your credit score (resulting from failure to pay bills due on the new lines of credit), you may be a victim of identity theft and credit fraud. Military members are eligible for free electronic credit monitoring services that can alert them of mistakes or problems with their credit.

If your credit report shows something suspicious, your first step is to report the fraud to the companies where new lines of credit have been opened. You can also submit a police report with your local law enforcement agency and an identity theft report with the Federal Trade Commission, and place a fraud alert on your credit report. A fraud alert placed with one agency will extend to the others and notifies anyone who pulls your credit report that you may have become a victim of identity theft.

You may elect to place a credit freeze or lock on your credit reports – this restricts access and limits the thief's ability to open new lines of credit in your name. You can also use OptOutPrescreen.com to remove yourself from marketing lists and eliminate pre-approved offers that can make you vulnerable to identity theft and unsavory credit terms. Combined, these steps can prevent an identity thief from doing further damage.

Credit allows you to make purchases that you might otherwise not be able to make by giving you access to funds that you can borrow. To maintain a good credit rating, you

must repay loans as their terms and conditions dictate. It is important to stay on top of your credit by making timely payments and keeping your utilization (particularly of revolving credit) low, and watching out for signs of identity theft. If you have questions about how to responsibly use credit or financial security, our accredited educators are available at 888-298-4442.