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The Automatic Millionaire

by David Bach

Nine Steps to a Great Credit Score

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Do you know your credit score? Unfortunately, if you're like most American's the answer is probably no. Only 33 percent of consumers know their scores, according to a recent survey published by the Government Accountability Office.

But that's O.K. -- for now. Because if you implement the nine simple action steps I list in this column, you will not only know your credit score, but be on your way to improved credit as well. And this could save you tens, if not hundreds of thousands of dollars over your lifetime.

Why Your Credit Score Matters

You might be surprised to know that from the time you got your first credit card or took out your first student loan, you've been compiling what's known as a credit history. And it's your credit history, along with your income, assets, and liabilities, that ultimately will dictate how much you will pay for your mortgage, car loan, insurance premiums, and perhaps even where you live or who employs you.

That's because lenders have long used your credit history and what's now known as a credit score (or FICO score), to determine whether to lend you money and how much interest to charge you. For example, here's how your credit score could affect your monthly payments for a \$200,000 mortgage: \$1,264 each month with a 750 score; \$1,520 with a 650 score. That's a total penalty of \$92,160 for less-than-stellar credit for a 30-year loan!

Employers are also using your credit score to determine whether or not they should hire you. Insurers are using them to determine your premiums. And some utility companies use this score to determine how much you must pay them before they will turn the power on.

Understanding Your Financial GPA

When you were in high school, did anyone ever bring up the subject of credit scores? Probably not. The only score that mattered was your GPA - your grade-point average.

Given the importance of your credit score, it's funny how little time our schools spend teaching us about simple things that really matter in the world.

The score is the first thing lenders will look at when you approach them for a loan. That's why the first thing you must do is know your own credit score and understand how the credit agencies develop these scores in the first place.

In 1989, a company called Fair Isaac developed today's scoring system to give lenders a shortcut for judging loan applicants' creditworthiness. The company holds onto its secret formula like gold, but what we do know is that it involves at least 22 pieces of data about you that it gets from the three credit bureaus (Equifax, Experian, and TransUnion). It uses this data to figure your FICO Score, which will range from 300 to 850 (anything over 700 is really good). The score is supposed to help predict whether you're likely to pay bills on time and whether you're a good or bad credit risk.

I know all this may sound pretty scary, especially when this number can have such a big impact on your financial future. But there are ways to turn your credit score into your ally and use it to save you thousands of dollars.

A Better Way to Score

There are lots of tips and tricks to improving your credit score over time. But these nine simple steps will get you started and greatly help improve your credit. Just remember, it can take a few months for these actions to take effect, so if you're planning on applying for a big loan soon, I recommend you get started at least four months in advance for the best results.

1. Get your own credit report, and find out your score

Go to AnnualCreditReport.com, and you can request your credit report from each of the three credit agencies once per year free. While these reports are great for showing you all of the details, they don't actually tell you your FICO score. If you're willing to spend about \$45, you can go to MyFico.com and get a full package that includes all three credit reports and your FICO score.

2. Identify mistakes, and repair errors

Twenty-five percent of credit reports have errors serious enough to cause consumers to be turned down for a loan or job, according to a survey by the U.S. Public Interest Research Group. That's 1 in 4 people who could be affected by inaccurate credit scores! Once you run your report, make sure you double-check every detail and account to make sure it's accurate. If you find an error, it's important to make sure your identity has not been stolen. You can put a 90-day fraud alert on your file to protect yourself while you clean up any mistakes. Then follow the directions listed on your credit reports to fix any other problems you find.

3. Negotiate with debt collectors first

Dispute errors or problems directly with lenders first, but make sure to negotiate everything in writing. And be sure to get a letter from the lender or debt collector saying that they will delete problems on your credit report before you pay any bill in collection. Use this leverage to your advantage.

4. Control your spending, and reduce your debt

Generally, the lower your account balances on credit cards and loans, the better your credit rating. Try to get all of your credit card balances below a 30% debt ratio to improve your overall score. You can also contact your credit cards to see if they will increase the amount they're willing to let you borrow, but my recommendation is you work to reduce your debt load overall rather than give yourself the opportunity to slip deeper into the red.

5. Limit credit-card applications

Every time you apply for a new credit card, your report will be marked with a lenders' inquiry note that could have a negative impact on your score. Anytime you apply for a department store card or even a bank loan, your report will be marked. A few of these inquiries are O.K., but it's best to keep them to a minimum.

6. Don't cancel your old accounts

If you close your old accounts, you're shutting down your credit history, which could hurt your score. It's best to pay old accounts off, consolidate them when they're with the same company, and just let them rest. Just be sure to cut up old credit cards to protect yourself from identity theft.

7. Ask lenders to report your credit limit

Ask your banks and credit-card companies to list your credit limit if it's missing on any accounts on your credit report. If you don't, Fair Isaac may assume that those accounts are maxed out even if you haven't borrowed to the limit. This simple step could improve your score by as many as 50 points!

8. Sign up for automatic bill payment

The best way to never miss a due date again is to set up automatic bill payment. Repeatedly paying your bills late is one of the main ways you can hurt your credit score. However, you have to be careful to read your statements because many of the credit-card companies are changing their payment schedules. The key is to make sure you never fall behind.

9. **Monitor your report**

Remember, your credit score can be improved over time. You should begin to monitor your credit reports at least once per year and repeat these steps every time you pull your reports.

By paying attention to your credit score and implementing these simple steps, you'll be on your way to a higher financial GPA and a score that could save you thousands annually.

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