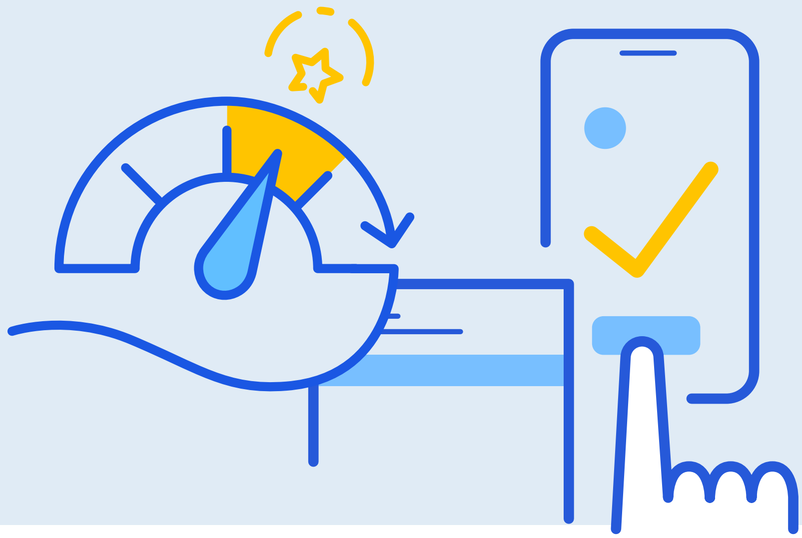
Your credit score matters. Here's why.

CreditWorthy by OneMain Financial



Sooner or later most people need to apply for credit. You may need a loan to replace your car, a credit card to manage your payments throughout the month, or a mortgage to buy your first home.

If you have not borrowed money before, a bank or lender has limited way of knowing how reliable a borrower you will be. Are you borrowing too much? Can you afford the payments? Will you make your payments on time? That's why, as you start to build credit, it's important you have to demonstrate that you can manage it reliably.

Lenders make their decision about whether to loan you money, as well as the interest rate they will charge, on your credit report and credit score. The better you manage the credit you have, the higher your credit score will be.

What is a credit score?

Your credit score is an estimate of your borrowing risk (in the form of a 3-digit number) that banks and other lenders use to decide how creditworthy you are. In other words, it's a measure of your history of borrowing and repaying that is used to predict your likelihood of repaying in the future. Lenders can pick from many different credit scores, and some lenders even make their own. However, the two most common credit scores are FICO and VantageScore. No matter the specific score used, they are generally calculated using the information in your credit report. Credit scores are an important indication of your financial reliability. The higher your score, the more likely you are to be approved for credit, and the better the terms offered tend to be. Scores usually range between 300 (poor) and 850 (exceptional). A score of 700 or above is generally considered a good credit score by most lenders.

How is your credit score calculated?

You might imagine that your credit score is based purely on your income, but it isn't. Your income is not recorded in your credit report. Instead, credit scores look at your history of borrowing and repaying money. Of course, the higher your income, the easier it should be to make on-time payments. But plenty of lower-income earners have good credit scores, and plenty of high-income earners have poor credit scores. It all comes down to how wisely you use the credit you have, rather than how high your income is.

Some lenders will use credits scores as just one factor in a larger analysis of your ability to use credit, whilst others may not use credit scores at all. Nevertheless, the majority of lenders rely on credit scores, so you should do everything you can to keep your own score as high as possible.

So how is your credit score calculated? Here are the 5 key factors used in most credit scores:

1

Account history

Your credit score considers how many separate credit accounts you have, as well as how many of them carry balances. As a rule, it's better to have more accounts without balances than with balances. The length of your credit history is also a factor in calculating your score. The longer you have had your accounts and have paid them on time, the better.

2

Credit utilization ratio

Your credit score is influenced by how much of your available credit you are using. For example, if you add up the credit limits on all of your cards and they total $5,000, and then you add up the balances you owe and they total $2,500, then your credit utilization ratio is 50%. Generally, a lower ratio is better for your credit score. You should ideally aim to keep your utilization ratio to less than30%.

3

Payment history

Your credit score considers how reliably you have made credit repayments in the past. If you have missed payments, or made payments late, then it can lower your score. However, a history of making your payments on time will usually help your score over time. That's why the single most important thing you can do to improve your credit score is to make your payments on time each month.

Tip: You can usually set up automated payments from your bank account to your credit accounts to protect you from forgetting do it manually – just make sure you have enough money in your bank account to cover those payments.

4

Credit application history

How often you apply for credit can also impact your credit score. Each time you apply for a credit card or loan, the lender will request your credit report, and a note will be made of their inquiry. Each request by a lender is called a 'hard inquiry' and too many hard inquiries can reduce your overall credit score.

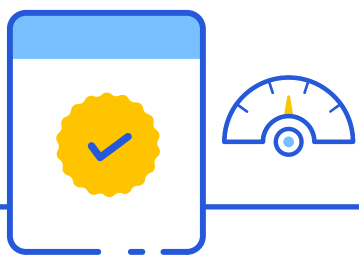
5

Types of credit used

Not all credit is regarded equally, and your credit score considers the types of credit you have, including mortgage, auto loan, and credit cards. A healthy mix of credit types can help boost your credit score.

Keep in mind that credit scores are a composite of multiple factors, so a strong performance in one area doesn't guarantee a great score if you're weak in other areas. Similarly, credit scores are also a blend of information from multiple accounts, so it's difficult to say if your good behavior on one account will translate into a boost in your score if you are falling behind on other accounts.

How does your credit score affect your finances?



A good credit score makes it more likely that you will be approved for new loans and credit cards. It also should help you earn the best interest rates on those loans and cards, so you'll save money over time. However, a poor credit score can make it hard to get approved for any credit at all.

Let's look at how your credit score can impact your financial health.

Wayne

Wayne's score: 480

Wayne started out as an electrician's apprentice this year, and recently moved into an apartment with a friend from high school. He managed to take out a credit card when he was 18, a card he has already maxed out and for which he has missed several payments. He has applied several times for additional credit cards and short-term loans, but the applications are always turned down.

A credit score between 300 and 579 is considered poor. People with low scores may only be offered credit with unfavorable terms, such as high interest rates or low loan amounts. If your score is particularly poor, you may not be offered credit at all.

Mia

Mia's score: 640

Mia is nearly 30 and works in sales for an engineering firm in her home city. Although she earns a decent income, she is still paying back loans from when she was a student. Meanwhile, she is also trying to save for a down payment on her first home. Her borrowing sometimes feels a little out of control, and she misses the occasional credit card payment due date.

A credit score between 580 and 669 is considered fair. Borrowers with average scores often qualify for credit, but at higher interest rates. The total amount you can borrow may also be restricted, you may be asked to secure a personal loan with collateral, or you may have to make a larger down payment for a home or auto loan.

Liz

Liz's score: 720

Liz is the same age as Mia, and they started at the engineering firm at about the same time. Unlike Mia, Liz managed to cover some of her student debt by taking on a part time job while in college. She has always been careful with her money, paying bills the day they are due, and making automated credit card payments on the due date each month. She checks her credit score regularly and is routinely pre-approved for credit cards and loans with low interest charges.

A credit score between 670 and 739 is considered good, and between 740 and 800 very good. People with high scores usually qualify for credit at more favorable terms and should have an easier time obtaining credit when they need it. An exceptional credit score (800 to 850) results from being strong across all the major factors: a well-established history of reliable payments across several credit types, a low credit utilization ratio, and few recent credit applications.

Takeaway

Growing your credit score is an extremely important part of building your financial health. The more effectively you manage credit, the better access you will have to borrowing in the future, and the easier it is to get competitive terms that work for you.