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REPAIRING YOUR CREDIT AFTER BANKRUPTCY: Part Two

In our previous article, we defined credit scores and the five factors that make up your credit score. In this article, we will go deeper on the five factors that affect your credit score.

The Fair Isaac Corporation, known as FICO, created the first credit scoring system in 1958. Your credit score is a numerical value used by a person who makes or arranges a loan to predict your credit behavior.

Recently updated, FICO 08 is being used by Experian and TransUnion. In FICO 08, minor credit delinquencies are not counted against you when your overall repayment history is positive.

While we hear much more about how credit scores are impacted negatively by our credit behavior, equally important is that your credit behavior can actually add to your score.

A higher credit score will be rewarded with lower interest rates, lower insurance rates and the savings goes on and on. A lower credit score translates into subprime interest rates.

Most scoring models include these five factors; however, the weight given to individual factors may vary. Remember, a FICO score takes into account all of these factors. In addition, both positive and negative factors will be considered. Your negative history can be rehabilitated through positive credit behavior over time. While a FICO report only considers what's on the credit report, the lender will review additional information such as your income, how long you have worked for your employer and the reason for the credit inquiry.

1. Payment history – This factor accounts for 35% of your credit score and includes a calculation for the number of delinquent accounts and the length of time that account remained unpaid as well as judgments, foreclosures and bankruptcy filings.

    - Keep in mind, the higher your score, the more points you lose for late payments. Late payments are factual information and can continue to appear on your credit report for up to seven years.

- This portion of your score includes information contained from adverse public records, including bankruptcy or other judgments or liens as well as the severity of the delinquency.

- Defaulting on a loan obligation is the most drastic move that a consumer can do to negatively impact their credit score. Being 30 days past due can cause you to take a 60 point decrease to your credit score.

2. Debt Utilization – This factor considers how much of your available credit has been used and accounts for 30% of your credit score. Lower debt utilization increases your credit score. Many people transfer balances from one card to another to get a better interest rate.

   - If the transfer results in higher debt utilization rate, going for that low interest rate can have a negative impact. It is much better to have a lower balance on multiple cards than to have a one card at its credit limit.

   - The bottom line is to be careful when you open and close credit accounts. Depending on their end result to your overall debt utilization, maneuvering for lower interest can do more harm than good.

   - Good rule of thumb is to keep your balances at 30% or less of the available credit.

As part of the CARD Act that went into effect last month, credit card issuers must now include a chart with your bills that shows how long it will take to pay off your balance if you only make the minimum payments. The chart will also display how much you need to pay each billing cycle in order to completely pay off your balance in three years.

3. Opening New Lines of Credit- This factor considers how many new lines of credit have been opened or requested in a specific time period. It accounts for 10% of your credit score and looks at how many inquiries for credit have been made, the timing of the last inquiry and the types of inquiries for credit.

   - Inquiries with denials of credit certainly lower your rating as can opening unnecessary lines of credit. Inquiries lower your score by at least 5 points.

- Lenders consider a person at their highest risk rate when they open a new line of credit because of the ability to create more debt. This effect can be minimized by maintaining a reasonable balance. Being granted credit lowers your score by at least 10 points.

- Also consider is the re establishment of positive credit after a negative credit history.

4. Length of your credit history-The length of your credit history accounts for 15% of your credit score and includes a review of how long the accounts have been opened, the type of accounts you have and how long they have been open and what has been the activity on the account since it has been opened.

    - Having multiple department store accounts with high balances may not be counted as a positive. Department store accounts typically encourage consumers to spend outside of their budgets and usually have the highest interest rates.

    - Accounts open for less than six months don't help your score, but accounts open for two years of more with great payment records can help.

    - This factor is one that may become more important depending on the age of the consumer. Obviously, if you are a person that doesn't use credit that often, this factor may weigh more heavily than other factors because there is no payment history or debt utilization to consider.

5. Types of Credit-What type of credit you have accounts for 10% of your credit score. The number of various types of accounts is a positive for your credit report. Various types of credit include installment accounts, mortgage accounts, department store accounts and consumer finance accounts.

    - Accounts of one type (all consumer finance accounts) may indicate that the consumer is a risky credit choice. Be responsible with the type of credit that you acquire. It makes a difference.

    - Having a diversity of types of credit is better than having only one credit account or only one type of credit account.

Late payments, maxed out credit cards, and bankruptcies are negative factors that take points away. A solid payment history and prudent use of available credit add points and together, these factors account for approximately 65% of your credit score. So pay on time and keep your credit balance low. Don't allow your credit balance to exceed 30% of your credit limit.

To register for an upcoming workshop, go to www.4realdirection.com, email, recept1@4realdirection.com or call Denise Brown's Legal Direction, 502.587.0331. Providing Balanced Counsel to individuals, families and businesses throughout Kentucky and Southern Indiana in bankruptcy and other debt relief options.