Money and You: How you can get a higher grade on your credit report

by Lynn O'Shaughnessy

When we graduated from high school or college, most of us assumed that we wouldn't have to worry about a report card again. But anybody who carries a credit card is continuing to get graded. In fact, it's possible for computers to revise our grades many times a day.

For most of us, the only report card that matters now contains our FICO score. Mortgage lenders, auto dealers, credit card companies and even landlords check out our scores to determine our creditworthiness. How our scores are determined is somewhat mysterious, because they are dependent upon a black box formula that is punctured by very few peepholes.

Many Americans never glance at their FICO score unless they are in the midst of buying a big-ticket item. Even those who occasionally check their scores probably don't understand how crucial these numbers are.

While Americans seem to have no hang-up about electing presidents who are C students, lenders won't hesitate to penalize a consumer with average credit scores. If you have a so-so score - perhaps through sloppy credit habits - you could pay tens of thousands, and even hundreds of thousands, of dollars more in interest charges and lost financial opportunities over your lifetime.

"Your credit score permeates your financial life," says Liz Pulliam Weston, a financial columnist and author of "Your Credit Score, How to Fix, Improve and Protect the 3-Digit Number that Shapes Your Financial Future, 2nd edition." "The score makes a big difference."

You won't know whether your FICO credit score is in need of resuscitation until you know what the full range of scoring possibilities are. FICO scores begin at 300 (truly dreadful) and max out at 850 (probably Warren Buffett's score). Many lenders use 700 to 720 as the cutoff for bestowing upon borrowers the best interest rates and terms.

According to Weston, 58 percent of Americans have a FICO score higher than the 700 mark. About 13 percent of consumers have earned platinum-plated FICO scores between 800 and 850. Another standard cutoff is 620. If you can't manage a FICO score higher than that, lenders are going to plaster the scarlet letter on your forehead - "S" for subprime. The worst interest rates are reserved for these folks.

The scoring can be infuriating because you'll never know for sure why you're given a particular grade. There are some factors, however, that greatly influence your score. Here's how they roughly break down: payment history, 35 percent; balances, 30 percent; length of credit, 15 percent; last application for credit, 10 percent; and type of credit used, 10 percent.

This last one may need some explanation. The FICO formula will reward consumers who have a mix of credit, but Fair Isaac and Co., which created the FICO formula, prefers to remain vague about what this means. Generally, however, it's thought that the firm wants to see different categories of borrowing, such as a mortgage, credit cards and a car loan on a credit report, even if some of these debts have been paid off.

It's possible to boost a FICO score, but if you attack this challenge logically, you might fail. Using too much common sense could cripple your score. Here are some things you can do:

- Pay off debt differently. Consolidating your plastic debt onto one card can give you a psychic boost, but this strategy could ding your credit score. Why? What matters to the credit gods is how far you are from your credit ceiling on each card. So if the card that's absorbed all the debt has a supersized balance, you could be penalized. It's better to have smaller balances on a variety of cards rather than a monster balance on a single one.

To enhance your FICO score, pay down the cards that are closest to reaching the credit ceilings. Aim to at least get all your balances low enough so that none of them exceed 30 percent of their credit limit.

- Don't cancel cards. I always assumed that holding too many cards would wreck a credit score, but Weston insists that closing credit card accounts can never help your score and might maim it. Shuttering accounts will shrink your available credit and make any balances loom larger. And tearing up older cards can especially penalize you because the formula takes into consideration how long you've had them.

- Don't charge too much. If you pay off all your balances every month, your score might not be as high as you'd assume. Even if you write checks for your bills on the same day you receive them, chances are, your credit report will still show balances on your cards. The balance you owe on your card's closing date is typically what gets reported to the credit bureaus. So if you charge huge amounts every month, that's what the credit bureaus could see - not the prompt payments. And it's those misleading balances that FICO will probably be playing with.

The best way to avoid this - and I know this will sound perverse - is to eliminate the bill before you get it. Pay the bill online a few days before the closing date. Or here's another more satisfying idea: Let's storm Fair Isaac's corporate headquarters in Minneapolis and tar and feather the computers.

Finally, once you're ready to check your credit score, the easiest place to find it will be at www.myfico.com. Considering how we tend to be jerked around by the credit industry, you won't be surprised when I tell you that the service isn't free.

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