

THE GREAT FICO® DEBATE

You've probably heard by now that the higher your credit score, the more likely you are to get approved for a home loan, auto loan, or any other type of credit account. In fact, 90% of banks use your FICO® score to determine your eligibility for a line of credit.

FICO® is an acronym for Fair Isaac Corporation. Bill Fair and Earl Isaac founded this method of evaluating credit worthiness in 1956, and it has been a part of our lives ever since. In fact, all three major credit reporting agencies (Experian, Trans Union, and Equifax) use this score in their credit reporting practices.

Many people are confused by how their credit scores are determined and what they actually mean. Here's a very synopsis about credit reports and how your scores are calculated.

Your FICO® score is determined by these factors:

- 35% of your score is determined by your history of paying your bills on time. (Late payments are considered those payments that are 30 days or more past due.)
- 30% of your score is determined by the ratio of the amount of debt you carry in comparison to your credit limits. (Keeping your balances at least 30% below your total credit limits keeps your score higher. Maxing out your credit cards decreases your scores.)

- 15% of your score is determined by the length of your credit history.
- 10% of your score is determined by the type of credit you use, such as consumer finance, revolving accounts, and installment payments.
- 10% of your score is based upon the number of recent searches or requests for your credit score. (You are not penalized for checking your own score.) It's assumed that if you apply for several loans or lines of credit at once, you may be short on cash, thus making you a credit risk.

Credit scores range from 300 (very poor) to 800 (excellent credit rating). Knowing your credit score is important and easy to get. In fact, you are entitled to a free credit report each year by calling 1-877-322-8228 or by going to <http://www.annualcreditreport.com>, the only government-sanctioned credit reporting agency-operated website.

The great debate arises between the necessity of maintaining good credit in today's society versus paying everything with cash. Unfortunately, if you save your money, pay for everything with cash, have a nice-sized bank account, and don't apply for lines of credit, your credit score is non-existent. In other words, the only way to build your credit is to obtain debt and stay in debt.

The good news is that if you're responsible with your money, save for what you want, and pay for everything in cash, you'll save money by eliminating

interest rates, late fees, and the other accruing charges that keeps us a slave to our debt. By doing so, you'll have the money you need to buy what you want when you want it. This is considered ideal.

On the other hand, a low credit score (or lack thereof) can have an unfortunate effect in other areas of your life. Did you know that almost all auto insurance companies use credit scores to determine your policy premiums? They even use it to determine whether they'll even issue you a policy. The same goes for many homeowners insurance policies.

If your credit is bad, you can expect to pay up to 50 percent more for your auto insurance premiums. Why? Because statistically, people with low credit file more claims. In other words, the insurance company is looking at your potential to file a claim—statistically speaking—when issuing a policy or determining your premium rates.

What's even more discouraging is the fact that a bankruptcy in the past could potentially exclude you from getting homeowners insurance. It's not always a factor, but in some cases it does play a part in getting coverage. I know that my personal bankruptcy prevented me from getting renters insurance more than a decade ago.

Another kick in the pants for people with low credit scores or a personal bankruptcy in their pasts has to do with today's hiring practices. More and more

employers are using credit scores in the hiring process. Many employers believe that the way you take care of your finances is a reflection of how you may take care of your responsibilities on the job. Although Section 525 of the Bankruptcy Code prohibits employers from denying employment based only on a history of bankruptcy, they can use your credit history to screen you for a job. Even if an employer discriminates against you because of a past bankruptcy, it's difficult to prove.

So, the debate continues. Do you stay in debt to keep your credit score high or do you pay off your debt and risk an increase in insurance rates or discrimination on the job?

The good news is that most insurance carriers do not refer to credit scores when they renew your policies, so getting out of debt should not affect the premiums you are currently paying. Also, if you're not paying interest rates, late fees, or paying every last dime of your paycheck to someone else, you'll have more cash in your pocket. Chances are that if you do encounter higher rates based on the fact that you're not charging anymore, you'll still save money because you're not using other people's money to live your life.

If you just can't stand the idea of giving up your FICO® score, by all means remain debt free by paying off all your balances each month. People tend to spend

at least 15% more when they use plastic, so keep track of your expenditures and stay within your budget.