Understanding Your FICO Score Transcript

Welcome to Money Talks, a series of podcasts developed by Oklahoma Money Matters, the financial literacy initiative of the Oklahoma College Assistance Program and the Oklahoma State Regents for Higher Education.

Chances are, if you've had to apply for a car or home loan recently, you've come face-to-face with your FICO score. This little three-digit number plays a big role in whether you can obtain financing and what type of interest rate you're eligible for. Yet, most people have no clue how it works, or how it affects them. Why don't we take a few minutes and sort through how the FICO system works? Your FICO score, calculated by the Fair Isaac Corporation, is a tool lenders use to judge your creditworthiness. Simply put, FICO grades your ability to pay back the money lent to you. It uses mathematical formulas to evaluate your past borrowing behavior and predict your future repayment habits. FICO scores range from 300 to 850. A higher score means lower interest rates and access to more credit. A lower score means you'll pay more to borrow and have access to less credit.

Lenders are wary of borrowers with a lower score. If they do approve a loan, it usually comes with a high price in the form of a high interest rate. Your FICO score consists of five main parts: your payment history, how much you currently owe, the length of your credit history, the amount of new credit available to you and the types of credit you have. Your payment history makes up the largest part of your FICO score at 35%. This piece of the score takes into consideration how often you make late payments, if you've had defaulted loans, or if you've ever declared bankruptcy.

This is why it's critically important to pay your bills on time, every time. 30% of your score is weighted on the amount of debt you owe. In this section, FICO takes into consideration your credit utilization ratio, which is the amount of credit you've used in proportion to the amount of credit available to you. For example, if you have a credit line of $10,000 and you currently have $6,000 charged to that account, your credit utilization ratio is 60% - you've used 60% of the credit extended to you. It's never a good idea to max out your credit cards. In fact, experts recommend keeping your credit utilization ratio below 30%, if possible.

Another 15% of your score is based on the length of your credit history. The longer you have had credit, the better this portion of your score will be. Lenders want to see that you've been paying your bills on time, over a long period of time. This shows you consistently pay and present a low risk of not repaying.

The amount of new credit you have or that you've applied for takes up 10% of your score. Opening or even just applying for numerous credit accounts in a short period of time can hurt your score.

It's best to have a mixture of revolving debt, like credit card accounts, and installment loans, such as mortgages, car loans or student loans. This section makes up 10% of your score.

Now that you know what your FICO score is all about, do your best to raise your score before you seek another loan. A lower score could cost you thousands more in interest over the life of a loan!

For more information on FICO scores, check out my fico dot com. Thank you for joining us on Money Talks! If you'd like more money saving tips, check out our website, Oklahoma Money Matters dot org. Until next time, make your money matter!