

The Importance of Credit Reports & Credit Scores

In Frank Capra's classic 1946 film, *It's a Wonderful Life*, Building and Loan manager George Bailey (James Stewart) explains to his customers how financial systems function; illustrating that the money you save is not kept in a box, it is, for instance, invested in your neighbor's home. While that is a simplistic and incomplete explanation, it's an effective way of explaining the basics of financial systems. It's also a good explanation of why responsible lending practices are so important – money lent is never abstract – it's someone's hard earned savings and that investment must always be protected. That's how we community bankers see it.

Irresponsible lending and ill-considered borrowing can cause upset in financial systems, as we have seen with the sub-prime lending debacle. And while mortgage lending by third party lenders is not nearly as regulated as bank lending, the concept is much the same. One difference between sub-prime lending practices and those of responsible lenders is that responsible lenders traditionally take into consideration credit scores and refer to credit reports while making determinations of credit worthiness.

The three main Credit Bureaus: *TransUnion*, *Equifax*, and *Experian* maintain credit report files and credit scores on any individual who has a borrowing history. A *credit report* is nothing more than an ongoing history of all reported credit extended to an individual. Reports contain information such as a lender's name, date and amount of credit extended, high and low balances, payment history and other similar information.

An individual's *credit score* is a number that is symbolic of the determined credit-worthiness of the particular individual and based on calculations of lending risk extrapolated from information reported by lenders. Many aspects of financial health and habits are considered in determining a credit score: Documented outstanding debt, payment history, duration and extent of credit history, and types of outstanding debt. Examples of information that may negatively impact a credit score includes: Too many credit applications in a short period of time, and credit balances close to the credit limit.

A credit score exists to protect both the lender and the borrower by providing objective statistics from which to determine credit-worthiness. Borrowers who are responsible and have a proven track record of repayment, and deemed a safer credit risk, are rewarded a high credit score, which normally translates into preferential loan rates and terms. Borrowers who have been less responsible, have insufficient history, or too much debt receive lower scores, often resulting in less appealing rates and terms. While lenders do not typically enjoy declining credit

applications, it does neither the lender nor the potential borrower any favor by permitting risky, ill-advised loans to be made.

Fortunately, consumers have access to both their credit reports and credit scores and we strongly recommend taking advantage of the free credit reports available once each year from each of the major credit bureaus. Reviewing your credit report will help you understand how lenders may see your credit-worthiness, but even more importantly, reviewing your credit report regularly can help you catch potential fraud resulting from identity theft. Request a free annual credit report by calling 1-877-322-8228 or by visiting www.AnnualCreditReport.com. Your credit score is not typically included in your credit report; however, for a small fee a consumer may request a report containing a credit score.