# Regions Next Step Podcast

**Credit Basics: Understanding Your Credit Score**

In this podcast, you'll hear about what a credit score means and what's most important to look for from Eric Smith - founder of The EKS Group, and creator of The Financial Literacy Coach and The Money Game Literacy Program.

You'll hear Eric's perspective on these topics:

- What a credit score is and how it is used
- The factors that influence your credit score
- How to improve your credit score

***Episode Transcript***

Narrator:

You're listening to the Next Step podcast, Understanding Your Credit Score, part of our Credit Basics Series presented by Regions Next Step, advice tools and resources to help you get closer to reaching your unique financial goals. Today we will hear from Eric Smith, Founder of the EKS Group and creator of the Financial Literacy Coach and the Money Game Literacy Program. With over 28 years of experience in the financial industry, Eric will be sharing his insights on understanding your credit score. Let's get into the discussion. Eric, there is so much we can talk about when it comes to credit scores. But first, what does a credit score mean to potential lenders, creditors and even employers?

Eric Smith:

Well, that's a good question. I would think that the best way to answer that is a three-digit score that tells how much risk you really represent to a potential lender. It's a three-digit number between 300 and 850. It's a model that captures your historical payment record and as a result of capturing that information often times lenders and people that are considering extending additional credit or even a potential employer will reference that and make a judgement about your integrity and your character and your ability to repay debt.

Narrator:

Okay, got it. So, what factors can influence your credit score?

Eric:

Well, there are several factors that can actually influence the score. First and foremost, how well you actually pay your bills. That is probably the most significant factor involved with lowering or raising the credit score. The way that you use credit, especially as it relates to revolving or that's commonly known as a credit card if you have typically more than 30 percent of a credit limit outstanding and you continue to keep it outstanding it has a negative effect on your credit score. Another factor that determines that score is the length of your credit history, how long have you actually been borrowing money, how long have you been demonstrating that you have the ability and the willingness to repay debt as you agree to and one of the other issues is the type of credit used. Ideally you want to have a variety of different credit products such as a credit card, maybe an installment loan or a mortgage and all those issues along with what we call hard inquiries and that's when a lender or a credit card company or someone that you apply to obtain credit from pulls your credit report and every time that somebody pulls that, when you're soliciting or asking for credit, that's called a hard inquiry and it has a negative impact on your score. And lastly, public records. That's oftentimes in the college market when I'm sitting down with college students, we will oftentimes see a collection item related to a copayment on an insurance policy. And oftentimes these will have a very negative impact on your credit score.

Narrator:

Wow. There are so many things that can affect your score. How can a young person who is just staring out build credit? I ask because it is a common misconception that no credit or limited credit doesn't affect your credit score. Can you talk to us about your credit score if you have no credit at all?

Eric:

Well, oftentimes there is no credit score if you have an -- what we call an empty credit file, if you've never borrowed money of any kind. Generally speaking, you would actually not have a credit score. And not having a score has a negative impact when you go to apply for credit, if you need to purchase a car, you need to borrow some money, but I do know that we're going to talk about some steps for establishing that credit. You know I don't like using the word bad or good when it comes to debt. I prefer to use the word responsible or irresponsible. And so I have three questions that I always try to ask and I suggest that people ask when they're determining whether that credit is responsible or irresponsible. And the first question is to ask does it produce a financial return that's greater than the cost of the debt. If you have to go borrow money -- let's just say that you're going to buy an investment piece of property, real estate, and the cost of that loan is 5 percent interest rate to borrow that mortgage but yet that investment property produces a 12 percent return. Then maybe I would consider that an example of responsible debt. The second one would be does the asset appreciate. An example of that would be the student loan debt that we often times are talking to students about. And oftentimes there's somewhat of a conflict as to whether that investment is even worth making anymore because of the inordinate amount of debt that students seem to have nowadays. Is it really

a good investment? And certainly, we can reference a lot of studies that show that it still is a good investment as far as making the argument that you have the ability in your life to make more money, generally speaking, as a result of obtaining a college degree. And third, the last question that I would suggest asking does it meet a need responsibly? Oftentimes when I talk to college students that get that first job offer, the next thing that they tend to do is go buy a brand-new car, no money down and finance it for seven years. Maybe a more responsible approach to that would be to have saved maybe ten or twenty percent and then finance it to a more moderate term. And if that were to be the case, then I would argue that maybe that's an example of responsible debt.

Narrator:

That's a great point. And probably a good course of action for a lot of people. Next, I think it would be helpful to talk about mistakes people make when managing their credit. What are some of the most common mistakes that you see? What do you recommend for improving on these?

Eric:

Well, I think that one of the first mistakes that people tend to make is that they really don't address the behavior aspect of what created the debt to begin with. If you're not intentional about how you plan your money, meaning that you perhaps don't do a budget every month, you're not intentionally spending your money before you get it, if you're that type of person, you tend to be very reactive and usually when we're reactive to things in life like unexpected expenses, like a transmission or a hot water heater that goes out, we tend to be very reactive and we look around for ways to obtain money that sometimes aren't exactly the most responsible way to do that. But I would go back and say, hey, you know, before we look at obtaining additional credit, let's really take a look at the behaviors and how are we handling money now. If we -- or just getting another credit card so that we can continue the zero percent shuffle, as I like to call it. I've met so many people along the way that have tons of credit card debt and their answer for that is not to really find a repayment plan but is to find the next zero percent interest rate card that they can do a balance transfer on. And so, maybe that provides a little bit of relief on a temporary basis, but it really has done nothing to address the overall issue of the financial mismanagement because they haven't really planned sufficiently. And everything kind of goes back to how do we intentionally plan how we're going to handle the money. And credit really is an extension of that. Another thing that I think that we tend to do or people tend to do is that we don't really understand the consequences or the impacts of not meeting, let's just say, a credit card responsibly, not meeting that obligation. And oftentimes people just feel like that there's no consequence or hey I want to have something now. The instant gratification of our society. I don't want to work and I don't want to save for it. I want it now. And I'm willing to compromise. I saw a great quote the other day that discipline is deciding between what I want now and what I want most in life. And so, I just thought that was a great quote that summarizes a lot of -- to be honest with you, even the way I've spent money in the past. If you tend to be an impulsive spender, you're going to want what's in front of you. I want it now. But really that probably is not in the best interest of what

my long-term financial goals are. But I would say that you've got to understand that all that debt has got to be paid back. It needs to be paid back as agreed and if you aren't able to do that, then there are going to be negative consequences in your life.

Narrator:

That's some great insight. It really is about finding that balance. Now what are some ways you can positively influence credit score factors?

Eric:

Great question. The first factor is obviously how do you pay the bills. Are you paying your bills on time? That is the largest factor that contributes to a credit score. Secondly, how are you using that credit? Do you have the credit cards maxxed out? If you want to improve the credit score, one common suggestion is to keep those credit card balances below 30 percent of those credit card limits. And so, the last factor I would say that would be involved is really consider the debt that you're taking on. Can you pay it back reasonably? If you go out and you only make $30,000 and you go and you apply for three credit cards with $10,000 credit limits and you go because you have a lifestyle spending issue and you max those cards out, do you really ever have a chance of paying that debt back? And for a lot of people the answer is no. Because a lot of the debt, unfortunately, in our country and our society is lifestyle debt. Because everybody or people tend to want it now. And as a result, they're willing to compromise and leverage their financial future to have that thing, whatever that thing is now.

Narrator:

You've used the term lifestyle debt a couple of times. Could you explain what that means?

Eric:

Lifestyle debt is -- let's just say, let me give you an example. Maybe that's a better way of explaining that. Let's just say that I haven't been intentional as far as spending or budgeting and as a result I really managed to save zero money. But let's just say that I get a preapproved credit card offer and because of that I'm able to obtain and open up a credit card with a $2,000 credit limit. And let's just pretend that I'm a college student and spring break is right around the corner. Well, instead of working really hard to save money, because I have that credit card I really don't have to do that now and so I use that credit card debt to go to the beach and have a great spring break. That's a great example of lifestyle debt. Let's just say again that I wasn't intentional in my planning of money. I wasn't saving any money and all of a sudden, it's time to go back to school and my kids have got to go back to school and I really haven't saved any money over the summer. But yet, that department store is willing to offer a store card to help me take care of that purchase. Well, maybe that is not exactly the

best way to handle that. Maybe if I had planned a little bit better, maybe I wouldn't have to borrow quite as much money on that credit card.

Narrator:

Thank you, Eric. Lastly, are there other tips you might offer people looking to understand and improve their credit scores?

Eric:

Yes, there is. We mentioned the keeping your credit card balances below 30 percent. That's referred to as the utilization rate on revolving debt or credit card debt. You would certainly want to do that. Another possibility would be to apply for a secured credit card. It sounds a little counter intuitive to say, hey, how do we fix our credit by getting more credit but in some cases that sometimes is a solution just as long as we have the behaviors in check. Another thing to consider would be if you're getting ready to make a purchase or apply for a mortgage or car loan, you generally would not want to close out credit cards because closing credit cards tends to have a negative impact, at least short term, on your credit score. Additional things such as paying the debt down. As you reduce the amount of debt, it actually has a positive impact on your credit score. So, if you're someone who's struggling with trying to get a credit score up, first of all, first and foremost make certain that you make all those payments on time as agreed. If by chance you can't make it by the due date, whatever you do, try to make it within that same month so that it doesn't report on the credit bureau. But those are a couple factors that I would say that I would recommend.

Narrator:

Really great stuff. Thank you again to Eric Smith for joining us to discuss how to understand your credit score. That concludes this credit basics podcast. You can find additional information about credit and more online at [www.regions.com/nextstep](http://www.regions.com/nextstep). No matter your goals, regions will help you with each step you want to take. Thank you for listening.

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