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What Are Credit Scores?: Financial Risk and You

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There comes a time in every young adult’s life where they start to wonder why nobody will shut up about credit scores. “How important can this *credit score* thing be if it hasn’t had any effect on my life so far? Why can’t I just keep avoiding it and not have to deal with having a good or a bad one?” – these are fair and legitimate questions. The answers could very well be that’s the way it is now because everybody just sort of agreed to let it operate that way. But as long as understanding credit scores and their effect on you is important, I might as well digress:

In its purest form, a credit score is a number that **rates your trustworthiness to repay loans and debt**. Scores can range from 300 to 850, but typically anything under 600 is regarded as bad, and “good credit” is often defined as a score well into the 700s. The exact ranges can change depending on who’s assessing the score, but suffice it to say, the bigger, the better.

What is much more concrete, though, is how the score is calculated. The rubric goes like this:

* **35% is your payment history**: as in your history of paying debts on time or not
* **30% is amounts currently owed**: literally just how much you owe on loans at the time the score is assessed
* **15% is the length of your credit history**: the idea being the longer your credit history, the better idea of how trustworthy you are
* **10% is the types of credit**: that is to say if your debts are spread diversely across loans for things like credit cards, home and auto bills
* **10% is for recent credit inquiries**: meaning both your recent attempts to get new credit loans and your attempts to find your credit score

With this score, any entity you could ever want credit or a loan from (not just banks and financial services, but also car dealerships, mortgage lenders and even prospective employers who could be trying to see how good you are with money) makes a decision on whether or not they can trust you to pay back what they loan you. For example, a better credit score can get you a better interest rate on a loan, and a bad one can get you a worse one.

**That’s why a credit score matters**. If you have bad credit, it’s based on factual data from your past financial exploits, and lenders will have a legitimate reason to believe they won’t get their money back from you. But what if you have no credit history whatsoever? Then you’re a wild card. They don’t know what to think about you. It’s not even that they distrust you, they just don’t have any reason to trust you. You could go either way and they don’t want to take that sort of risk. All the places you may need a loan from will also see you accordingly.

**But it’s not the end**. Credit scores do indeed factor very, very heavily into whether you get approved for loans or other things that require proof of financial responsibility. But they’re fundamentally just a tool to make a decision and not a lens through which they’re forced to approve or deny you. You could even be denied a loan even with good credit if something else isn’t lining up.

So, here’s some good news: **there are ways to build (and rebuild) your credit**. This can be done slowly and steadily by repaying any existing loans and bills on time, and in full, and letting time run its course. A more expedient way to go about it is to apply for a special type of credit card called a **secured credit card**. These exist specifically for people to build credit from the ground up, whether it be built where bad credit once stood or on a space that has always been empty. Secured credit cards are called that because they have limits that guide you away from further financial ruin. More importantly, these cards have a credit limit equal to a security deposit you pay when you open the card, that way if you don’t pay your bills, the bank still gets its money back. This secured card is opposed to a classic “unsecured” card which has no limit, and the abuse of which has landed many in terrible debt and worse credit. Also note, if you’re a good cardholder with your secured account and pay your bills on time, you can get the collateral back in due time and even qualify for an unsecured card. You may also be eligible for a **student credit card** which works in much the same way as a facilitator to get you started on your credit journey.

So, go. Go out and seek your fortune. Go and get yourself a credit card and spend as you see fit. Go and find out what financial freedom really feels like. Just be sure you know what you’re doing with your card and what you plan to do to pay it back in the future. Otherwise, your future, well, it might not be so fortunate after all.