Module 2: Understanding Credit

Understanding Credit

Your Credit Report, Your Score, and Your Plan to Improve Both

Credit touches nearly every part of your financial life — whether you can rent an apartment, get a loan, buy a car, or even qualify for certain jobs. Yet most people were never taught how credit actually works. This lesson changes that. By the time you finish reading, you will know exactly what a credit report is, how your credit score is calculated, how to get your reports for free, how to fix errors, and — most importantly — how to take concrete steps that can raise your credit score by 50 points or more within the next 12 months.

What You Will Learn in This Lesson

- ✓ What a credit report is and what it contains
- ✓ How to get all three of your free credit reports
- ✓ How your FICO score is calculated — and which factors matter most
- ✓ How to dispute errors under the Fair Credit Reporting Act
- ✓ How long negative items stay on your report — and when they fall off
- ✓ Proven tools to build or rebuild credit from any starting point
- ✓ A realistic 12-month plan to raise your score by 50 or more points

Section 1: What Is Credit — and Why Does It Matter?

Credit is borrowed money. When a bank gives you a credit card or a car loan, they are trusting you to pay it back. That trust is built — or broken — over time based on your behavior with money.

📖 **Credit Report:** The permanent record of your financial behavior. It lists every account you have opened, every payment you have made (or missed), and anyone who has checked your credit history.

📖 **Credit Score:** A three-digit number — usually between 300 and 850 — that summarizes your credit report. The higher the number, the better. Lenders use this score to decide whether to approve you and at what interest rate.

Why Your Score Matters: A Real-World Example

Two people both apply for a $20,000 car loan. Person A has a score of 750 and gets approved at 6% — monthly payment about $387. Person B has a score of 580 and gets approved at 18% — monthly payment about $508. Over 5 years, Person B pays $7,260 MORE for the exact same car. That is the cost of poor credit.

Section 2: What Is in Your Credit Report?

Your credit report is produced by credit bureaus — companies that collect and store financial data about consumers. There are three major credit bureaus in the United States: Equifax, Experian, and TransUnion. Each bureau may have slightly different information, which is why it is important to check all three.

Personal Information

Your name, addresses, date of birth, Social Security number, and employer. This section does not affect your score, but errors here can sometimes indicate identity theft.

Account History (Trade Lines)

This is the biggest section. It lists every credit account you have opened, including credit cards, car loans, student loans, mortgages, and personal loans. For each account it shows: the lender's name, when the account was opened, the credit limit or original loan amount, your current balance, and your payment history month by month.

- "OK" or a green dot means the payment was made on time.
- "30," "60," or "90" means you were that many days late.

Public Records

This section includes serious financial events such as bankruptcies. Judgments and tax liens were removed from credit reports in 2018, but bankruptcies still appear.

Inquiries

Every time someone checks your credit, it is recorded here. Hard inquiries happen when you apply for credit and can slightly lower your score. Soft inquiries happen when you check your own credit and do NOT affect your score.

Section 3: How to Get Your Free Credit Reports

By federal law, you are entitled to one free credit report from each of the three bureaus every year. The only official, government-authorized website is AnnualCreditReport.com. Since the pandemic, weekly free reports are available.

⚠ **Avoid Lookalike Sites**

Sites like FreeCreditReport.com or FreeCreditScore.com are NOT the official source. They often require a credit card and sign you up for paid subscriptions. The ONLY authorized free source is AnnualCreditReport.com — no credit card required.

How to get your reports: Go to AnnualCreditReport.com on a secure connection. Click "Request your free credit reports." Enter your personal information. Select all three bureaus. Answer identity verification questions. Download and save all three reports as PDF files.

How to Read Your Report

Focus on these three things first:

(1) Look at every account — is it actually yours?

(2) Check the payment history — do you see any late payments you believe were actually paid on time?

(3) Review your personal information — is your name spelled correctly? Are there addresses you do not recognize?

Section 4: How Your FICO Score Is Calculated

The most widely used credit score is called a FICO score. Your score is calculated using five factors, each with a different level of importance.

Factor	Weight	What It Measures	Good Sign	Red Flag
Payment History	35%	Do you pay on time?	All on-time payments	Late/missed payments
Credit Utilization	30%	How much credit you use vs. your limit	Under 30% used	Over 50% used
Length of History	15%	How long you've had credit	Accounts open 5+ years	Closing old accounts
Credit Mix	10%	Variety of credit types	Cards + loans	Only one type
New Inquiries	10%	How often you apply for new credit	Few applications	Many recent apps

Payment History (35%)

This is the single most important factor. Every on-time payment builds your score. Every late or missed payment damages it — and the damage can last for years. Even one payment that is 30 days late can drop your score by 60–110 points.

Credit Utilization (30%)

> 🕮 **Credit Utilization:** The percentage of your available credit that you are currently using. Example: if you have a $1,000 limit and owe $400, your utilization is 40%. Aim to stay below 30% on each card. Below 10% is ideal.

This is one of the fastest factors you can improve — paying down a balance can raise your score within a single billing cycle.

Length of Credit History (15%)

Lenders like to see a long, stable track record. This is why you should be very careful about closing old credit cards. Even if you do not use a card anymore, keeping it open at zero balance helps keep your average account age high.

Credit Mix (10%)

Having different types of credit — both revolving credit (like credit cards) and installment loans (like car loans) — shows you can manage multiple kinds of debt responsibly. You do not need to take out a loan just to improve this factor.

New Inquiries (10%)

Every time you apply for new credit, a hard inquiry is added to your report. Exception: if you are shopping for a mortgage or auto loan, multiple inquiries within a 14-to-45-day window are typically counted as just one.

Section 5: Disputing Errors on Your Credit Report

Errors on credit reports are more common than most people realize. Studies estimate that 1 in 5 Americans has at least one error on their report. You have a legal right under the Fair Credit Reporting Act (FCRA) to dispute them.

Common Errors to Look For

- Accounts that do not belong to you (possible identity theft)
- Late payments that were actually paid on time
- Accounts listed as open that you closed
- Duplicate accounts showing the same debt twice
- Incorrect balances or credit limits
- Negative items that are too old to still be on your report

How to File a Dispute — Step by Step

- Gather your evidence: bank statements, payment confirmations, or any documentation proving the error.
- Go to each bureau's online dispute portal: Equifax (equifax.com/personal/disputes), Experian (experian.com/disputes), TransUnion (transunion.com/credit-disputes).
- Describe what is wrong — be specific. State the account, the error, and include your documentation.
- Submit. The bureau is required by law to investigate within 30 days.
- Check the results. If upheld, the error will be corrected. If denied, you can add a 100-word statement to your file.

> **Dispute with the Furnisher Too**
> The "furnisher" is the company that reported the information to the bureau — usually a bank or lender. You can and should also send a dispute directly to the furnisher in writing via certified mail. This creates a paper trail and triggers their own investigation obligation under the FCRA.

Section 6: How Negative Items Age Off Your Report

One of the most important — and most hopeful — things to understand about credit is this: negative information does not stay on your report forever. Time is on your side.

Negative Item	How Long It Stays
Late payments (30, 60, 90+ days)	7 years from the date of the late payment
Collections accounts	7 years from the date the account first went delinquent
Charge-offs (debt written off by lender)	7 years from the date of first delinquency
Chapter 13 Bankruptcy	7 years from the filing date
Chapter 7 Bankruptcy	10 years from the filing date
Hard inquiries	2 years (impact fades after 12 months)
Closed accounts in good standing	10 years (these actually help your score!)

> ⚠ **Do Not Confuse These Two Things**
> A debt being 'too old to collect' (past the statute of limitations) is different from it 'aging off your report.' A creditor may still try to collect an old debt even if it has fallen off your credit report. See Module 4 for more on statutes of limitations.

Section 7: How to Build or Rebuild Your Credit

Whether you are starting from scratch or recovering from past financial hardship, there are proven tools to help you build positive credit history.

Option 1: Secured Credit Cards

> 📖 **Secured Credit Card:** A credit card where you make a deposit upfront that becomes your credit limit. Example: deposit $300, receive a $300-limit card. Use it for small purchases and pay the balance in full each month.

After 12–18 months of responsible use, many secured card issuers will upgrade you to an unsecured card and return your deposit. Look for secured cards with no or low annual fee that report to all three credit bureaus.

Option 2: Credit-Builder Loans

A credit-builder loan is a small loan ($500–$1,500) designed specifically to help you build credit. The money is held in a savings account while you make monthly payments. When the loan is paid off, you receive the money — and you now have a perfect payment history on your report.

Option 3: Becoming an Authorized User

If a trusted family member or close friend has a credit card with a long, positive history, ask if they will add you as an authorized user. The entire history of that account is added to your credit report. You do not even need to use the card.

> **The Golden Rules of Credit Building**
> Rule 1: Always pay on time — even if you can only pay the minimum.
> Rule 2: Keep your balances below 30% of your limit on every card.
> Rule 3: Do not apply for too many new accounts at once.
> Rule 4: Do not close old accounts.
> Rule 5: Monitor your progress — check your free reports regularly.

Section 8: Your 12-Month Credit Improvement Plan

Here is a realistic, step-by-step plan designed to improve your credit score by 50 or more points over the next year. Your results will depend on your starting point and how consistently you follow through.

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My 12-Month Credit Improvement Plan

Month 1 — Pull and Audit All Three Reports

- ☐ Download all three credit reports at AnnualCreditReport.com
- ☐ Read each report carefully — look for errors, unrecognized accounts, incorrect late payments
- ☐ List every item you want to dispute
- ☐ File disputes online with each bureau for every confirmed error

Months 1-3 — Attack Your Credit Utilization

List each credit card, its balance, and its limit. Calculate utilization (balance ÷ limit). Target: get every card below 30%.

Credit Card / Account	Balance Owed	Credit Limit	Utilization %
	$	$	%
	$	$	%
	$	$	%
	$	$	%
	$	$	%

Month 2 — Open a Secured Card (If Needed)

Secured card I will apply for:	Deposit amount:	Monthly charge I'll put on it:

- ☐ Set up automatic full-balance payment so I never miss a due date
- ☐ Confirm card reports to all three credit bureaus before applying

Months 3-12 — Build My Perfect Track Record

- ☐ Set up automatic minimum payments on ALL accounts — never miss a due date
- ☐ Keep all card balances below 30% of their limits (10% or below for best results)
- ☐ Do not apply for any new credit unless absolutely necessary
- ☐ Do not close any old accounts
- ☐ Check my credit score monthly using Credit Karma or my bank's free tool

Month 12 — Review and Recalibrate

Starting credit score (Month 1):	Credit score today (Month 12):	Point improvement:

Errors successfully removed:	My goals for the next 12 months:

The Golden Rules: (1) Always pay on time. (2) Keep balances below 30%. (3) Don't apply for too much new credit. (4) Don't close old accounts. (5) Monitor regularly.

Lesson Summary

- Your credit report is a permanent financial record maintained by three bureaus — Equifax, Experian, and TransUnion.
- Your FICO score is calculated from five factors: payment history (35%), utilization (30%), length of history (15%), credit mix (10%), and new inquiries (10%).
- You can get all three credit reports free at AnnualCreditReport.com — no credit card required.
- You have a legal right to dispute errors under the Fair Credit Reporting Act. Disputes must be investigated within 30 days.
- Most negative items age off your report after 7 years; bankruptcies after 10 years.
- Secured cards, credit-builder loans, and becoming an authorized user are proven tools to build or rebuild credit.
- A consistent 12-month plan focused on on-time payments, low utilization, and error removal can realistically raise your score by 50+ points.

Next Steps and Action Items

Take these steps in order — each one builds on the last.

1. Go to AnnualCreditReport.com today and download all three of your free credit reports.
2. Read each report carefully. List every error, unrecognized account, or incorrect late payment you find.
3. File disputes online at each bureau's dispute portal for every confirmed error — include documentation.
4. Calculate your credit utilization on every card. If any card is above 30%, make paying it down your first financial priority.
5. If you have no open credit accounts in good standing, research secured credit cards at your local credit union.
6. Set up automatic minimum payments on all accounts so you never miss a due date.
7. Track your credit score monthly using Credit Karma or your bank's free monitoring tool.

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