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Facts About Credit Rating



What You Need to Know

6 Facts about Credit Rating

More and more people have become increasingly dependent on their credit. Whether you need it for a loan or mortgage or for purchasing clothes and other services, there's no arguing the fact that credit occupies a big part of our lives.

This is all the more reason for you to understand credit reports, credit ratings, and scores. Here you will learn the six important facts about credit rating and some tips to help you get that loan you're applying for, improve your credit history, and other helpful hints for a better credit profile.

FACT #1: Creditors Rely on Credit Rating to Determine Credit Approval

Using credit is really just borrowing money that you promise to pay back within a specified period of time. Now, at the onset, you can see how important it is for the creditor that you are really going to pay back what you owe him.

But the problem is that there is generally no guaranty that the debtor – *you* – will pay back what you owe. At least, not to the creditor, there isn't, unless, of course, you added a mortgage to your loan to guaranty the credit. And even if there is such a guaranty, it would still be better for everyone involved if the debtor is able to pay his obligations on time.

This is why creditors are often very strict when screening loan applications. They want to find out whether the person is going to be a good investment by making his payments on time.

Now, one effective way for creditors to determine the likelihood of a person paying back the money he or she has borrowed is through the credit rating system or your credit score. It is a statistical method that is based on various factors that relate to income, employment, credit balance, payment habits, among others.

There are three main credit bureaus that issue credit scores, namely Equifax, TransUnion, and Experian. But don't expect that these agencies will give you consistent scores. Since each credit bureau uses different evaluation systems, each based on different factors, it is highly likely that your credit score issued by one bureau is different from those issued by the other two.

In addition, some lenders formulate their own evaluation procedures to calculate a person's credit score. They may also contact an independent credit reporting agency to issue credit scores that use evaluation systems different from those used by the credit bureaus.

There is no sure way to determine what factors a credit bureau is using to calculate your credit score. However, there are a few that remain more or less constant.

When calculating your credit scores, the following factors are often taken into consideration:

- Debt and payment history on credits, such as credit cards, student loans, consumer loans, car loans, among others
- Current debts
- Time length of credit history

- Credit type mix
- Frequency of applications for new credit or inquiries for new credit
- And other factors that may be taken into account, such as tax liens, judgments, and bankruptcies

All these factors can be determined from your credit report. A break down of all these factors shows that your credit rating is most affected by your propensity for paying off your debt as shown by your credit history or previous credit performance.

If your credit rating shows that you pay off your debts fairly quickly in the past, then your present credit rating could get a boost up from that. Additionally, maintaining low levels of indebtedness, refraining from constantly applying for additional credit, and having a long credit history will help your credit rating in the long run.

FACT #2: Factors Considered in Calculating Credit Scores

When you borrow credit, the lender will want to find out how likely you are going to repay what you owe. Hence, they contact any of the three national credit bureaus to get a copy of your credit score.

The credit score predicts, based on your past behavior, what kind of a borrower you are – whether you are the sort who makes repayments regularly or one who regularly misses following up on your obligations.

Typically, lenders will use your credit score to help them determine the following:

- What loan types you are eligible for
- Whether to approve your loan or not
- What your interest rate will be

The law does not mandate specific factors to consider in credit scoring systems. Therefore, credit reporting agencies are more or less free to consider whatever factors they may feel is important to determine how willing you are to pay your bills.

But while the law does not specify what factors to consider, it is however very specific about what may not be considered in a credit score. Credit reporting agencies, credit bureaus, and lenders are prohibited from considering the following factors in credit scoring systems:

- Race
- Religion
- Gender
- Marital status
- Nationality
- Age
- Receipt of public assistance

If there is one thing you need to remember about credit scores is that they reflect credit behavior patterns. This means that no one factor will be considered as the only cause of a “risky” score.

So even if you have a previous collection or a bankruptcy, there is a chance your credit score could still be around the neighborhood of “average,” which is actually good and entitles you to generally low interest rates.

As your credit behavior improves, so does your credit score. There is no quick fix to improving your credit score. Any short term improvements will not cause a risky score to improve dramatically. So instead of relying on quick fixes and instant solutions to poor credit scores, change your credit behavior by paying your bills regularly and on time and refraining from opening any new credit accounts.

FACT #3: Credit Rating is Indicative of Credit Behavior

Every time you apply for new credit, your credit rating gets checked. As mentioned earlier, lenders want to know how good a risk you are going to be when they do decide to lend you the money needed.

Any sort of credit application requires a credit rating check – credit cards, mortgages, or even a phone hookup. The financial theory is that increased credit risk means that a risk premium must be added to the price at which money is borrowed.

In simpler terms, this means that if you have poor credit rating, lenders will not turn you down at the onset but will lend you money at a higher rate than the one paid by someone with a better credit score. Higher rate, of course, is not a desirable outcome since how high an interest you pay determines how soon you can pay off the entire loan and how big a down payment you are required to pay.

Take the following scenario, for example:

A, with a credit score of 700 gets a rate of 5.61% on a loan. A pays \$862 every month. B, on the other hand, has a credit score of somewhere around 560. The lender offered him a rate of 8.53% and he accepted, so that he is now paying \$1,157 every month.

Do you see the difference? For the same loan amount, B ends up paying more every month than A does. This, of course, has a large impact on how much B is paying for the interest alone since the general rule is that payments will first apply to the interest before the principal, which is the actual loan amount borrowed.

FACT #4: Credit Scores Help Consumers

Since your credit rating or credit score is indicative of your credit behavior patterns, lenders typically use them to gauge the risk of having you as borrower. Just by studying your credit score, they will know right away how much they are willing to offer in terms of loan rates, interests, and monthly repayments. This actually helps speed up the approval process of a credit application.

Your credit score is not based on human judgment. It is not based on cultural or demographic differences among people. The guidelines used in determining your

credit score apply to everyone else's credit scores so that by using standard credits cores, lenders are able to treat each consumer objectively.

FACT #5: Your Credit Report is Key to Your Credit Rating

Your credit rating is a fragile thing. And since credit is very crucial these days, you really cannot afford any mistakes or errors that could negatively affect your credit rating, ergo, your chances of getting approved for additional credit.

To protect your credit from any damage, review your records at least once a year. The US Congress has recently amended the Fair Credit Reporting Act (FCRA) by including a provision that provides for the issuance of free credit reports to consumers from any of the three national credit bureaus – Experian, Trans Union, and Equifax.

You can get your copy of your free credit report by logging on to the AnnualCreditReport.com website and ordering a copy online. Alternatively, you can contact any of the numbers and email addresses provided in the Consumer Alert page of the Federal Trade Commission (FTC) website.

The free credit report may come from any or all three of the national credit bureaus. However, if you order directly with these bureaus, they may charge you a small fee. So to ensure that your free credit report remains free of charge, order yours from the website given.

Review your credit report and check for any errors. If you find any, contact the credit bureau that compiled the report. Under the law, the bureau is required to investigate your disputed items within 30 days, at no cost to you. After investigation, the credit bureau is further required to provide you with written

notice of the results of the investigation within five days, including a copy of your credit report if it has changed based upon the dispute.

FACT #6: Improving your Credit Score Improves Your Chances of Getting Approved

A high credit score means you are a “low risk” consumer. Lenders would be willing to offer you credit with low interest rates, monthly repayments, and down payments. Therefore, it is important that you improve your credit score or at least maintain it if you already have good credit rating.

Here are some tips to help you build your credit score:

- Make loan payments on time and for the correct amount.
- Avoid overextending your credit.
- Never ignore overdue bills.
- Be aware of what type of credit you have.
- Keep your outstanding debt as low as you can.
- Limit your number of credit applications
- A longer history of good credit is favored over a shorter period of good history.

Credit is very crucial to our every day lives. How you manage your credit affects your overall financial health. The facts and tips we have provided you will help you to either maintain or improve your credit score.

You are invited to pass this report along to as many people as you like, provided that you make no changes to it and that you give it away for FREE.

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