

# Good Credit:

## Its Impact on Borrowing Education Loans and on Your Financial Future



*This topic is one of several in the Access Group's Personal Finance and Debt Management Series.*

The Access Group is a nonprofit organization dedicated to providing access to education through affordable financing and related services. For more information, visit our Web site at [www.accessgroup.org](http://www.accessgroup.org).

### **Establishing and Maintaining Good Credit**

To finance their investment in graduate or professional education, most students must borrow money through a variety of education loan programs. Some of these loan programs are government sponsored and guaranteed, while others are privately supported. Most private education loans backed by lending institutions or guaranty agencies require a good credit history before the loan is approved. To evaluate the borrower's credit history, the lending institution will request a report from an authorized credit reporting agency. The information in your credit report may have a substantial impact on your eligibility to obtain private education loan funding. Many students use private education loans to fill the gap between the actual cost of attending graduate or professional school (minus the amount of institutional and federal aid they are receiving), and the amount they and their families can contribute. Therefore, it is important to maintain a good

credit history so that you can borrow the private educational loans you may need for a portion of your graduate or professional school costs.

### **Your Willingness to Repay**

Private education loans are viewed by lenders as a special type of consumer loan. Traditional types of consumer loans require that the borrower demonstrate the "ability to repay" a loan before the application can be approved. Most students, however, are unable to demonstrate an ability to repay the loan while enrolled because they either are unemployed or underemployed. Consequently, lenders of private education loans assume that you will have a future ability to repay the loan once you graduate.

In order to be approved for a private education loan, the borrower must meet the established credit criteria. These criteria typically focus on "willingness to repay" the loan rather than your current "ability to repay" it. Your willingness to repay the loan can be assessed

by examining your prior repayment behavior and other factors on your credit report. How these criteria are assessed can vary from one lender to the next, but whatever criteria are used, your credit history plays an important role in determining whether or not you will be approved for a private education loan.

### **Your Credit History**

Most students applying for private education loans today have already established a credit history. You have a credit history if you have at least one credit card, consumer loans such as auto loans, prior student loans, or any other form of personal credit. You also may have a credit history if you have rented an apartment, since many landlords now report the payment histories of their tenants to authorized credit reporting agencies.

Credit histories are derived from repayment records reported by creditors and other organizations (such as financial institutions, major retail stores, lenders, landlords, and utilities) to

authorized credit reporting agencies, such as the three national credit bureaus. These records are examined by lenders to determine if credit should be extended to you. The fundamental issue for the lender is your “willingness to repay the loan,” that is, the likelihood that you will repay the loan based on your past credit performance.

**Your Credit Report**

Your credit report is a summary of your credit history. Just as your *academic transcript* is a history of the courses you’ve taken and how you have performed in those courses, your credit report can be viewed as your *financial transcript* because it lists the credit you have obtained and how you have performed in managing that credit. It is maintained by an authorized credit reporting agency and sent to potential creditors, when requested. The following information is included on your credit report:

- *current and recent addresses*
- *employer information*
- *payment performance (both the number and frequency of payments)*
- *seven years of good and bad performance, including derogatory items such as bankruptcies, collection accounts, and defaults*
- *type of debt you have and the lending institution for each account\**
- *credit available, current balance, highest balance, monthly payment terms for each credit account*

- *irregularities and/or reports by vendors unable to locate a borrower and collect debt*

\* Education loans may be represented as *installment loans* that are either active or inactive, depending on the deferment or repayment status. Some credit reporting agencies also use descriptive factors that show them as education loans.

**Your Credit Score**

Credit scoring is a quick, accurate, and consistent method of determining the likelihood that you will repay your loans. It is an evaluation tool that determines how well you will manage credit, relative to other borrowers, based on your past credit performance.

The “credit score” is a snapshot that focuses on individual borrower behavior. Some examples of the factors used to calculate your credit score are:

- *promptness in paying bills*
- *number of credit cards*
- *total credit limit*
- *the amount owed on accounts*
- *other information in the credit report*

Note: Having multiple education loans and/or a large amount of education debt does not preclude your scoring well. People with small and large amounts of debt and with or without income can score well, provided they have properly managed their debt.

For your information, some examples of negative factors that affect the credit score are:

- *serious delinquency, derogatory public records, or collection accounts*
- *the proportion of revolving balances to revolving credit limits is too high*
- *the proportion of loan balances to loan amounts is too high*
- *too many new accounts*
- *too many accounts with balances*
- *insufficient time since account was established*
- *too many credit inquiries in the past 12 months*
- *too many finance accounts*

If you are denied credit, you have the right to know which factors reported on your credit history caused the greatest influence on your credit score. The lender that has denied you credit will notify you in writing about these factors, along with the name of the credit bureau that provided your credit report to the lender. You should obtain a copy of the credit report so that you can check the accuracy of the reported information.

*For more information about credit scoring, see the following Web sites:*

[www.fairisaac.com](http://www.fairisaac.com)  
[www.ftc.gov](http://www.ftc.gov)

**Credit Criteria**

In addition to the credit score, lenders may establish other criteria to determine if credit should be extended to a prospective borrower. These credit criteria, which may or may not be published by the lender, typically rely upon information supplied by the prospective borrower on his or her loan application, as well as upon data contained on the applicant's credit report. (The inset below contains examples of criteria lenders may use to determine creditworthiness.)

**Default and the Consequences of Failure to Repay**

Your education loans represent both an important investment in your future and a serious financial commitment that must be repaid. The terms and conditions of each loan, and your rights and responsibilities as a borrower, should be stated clearly in the promissory note for the loan. Default occurs when you fail to meet the terms of the promissory note.

More specifically, you can be considered in default if you fail to make payments according to the repayment agreement or meet other terms of the promissory note. One or more of the following consequences could occur if you default on your loan:

- *The lender or holder of your loan may declare the entire unpaid balance, including interest, immediately due and payable.*
- *The lender, holder, or guaranty agency may report the default to your school.*
- *You may be unable to receive assistance from federal student aid programs.*
- *You may become ineligible for various repayment options, deferments, and other benefits.*
- *You could pay all charges and other costs, including reasonable attorney's fees, permitted by law for the collection of your loan.*
- *The lender or holder of the loan may assign the promissory note to a guaranty agency, at which time all*

*amounts due will be payable to the guaranty agency.*

- *The lender, holder, or guaranty agency may report the default to one or all three national authorized credit reporting agencies.*
- *The lender and/or government also may take legal action against you.*
- *State and federal income tax refunds may be withheld.*
- *Wages may be garnished or offset.*

Education loans are serious financial obligations. As the borrower of an educational loan, you legally are obligated to repay your loan once you leave school; there are no money-back guarantees on education loans.

You must repay your loan even if:

- you do not complete your degree;
- you are dissatisfied with the quality of the education you receive;
- you do not get a job once you graduate; or
- you do not practice the profession in which you received training.

**Credit Criteria**

Below are some examples of criteria that lenders may use to determine if credit should be extended to a prospective borrower:

- number of accounts rated 60 or more days delinquent
- number of accounts that have been delinquent 90 or more days
- declarations of bankruptcy
- number of inquiries to an authorized credit reporting agency within a defined period of time

Consequently, you should borrow the minimum amount necessary to achieve your educational objective. Remember that every dollar you borrow while in school will reduce your disposable income after graduation and during repayment.

**Check Your Credit**

Before applying for private education loans or if you are ever denied credit, you should request a copy of your credit

report from a local agency or from one of the national credit reporting agencies. Review the report carefully, paying particular attention to the number of accounts, total account balances, and the timeliness of payments.

Should you find any derogatory information that appears to be incorrect, you should contact the credit reporting agency. Unfortunately, errors can occur in your credit report. Common reasons for errors are: inconsistent reporting by creditors, wrong or misplaced dates, wrong amounts, double reporting, incorrect reporting due to common names, parents and students having the same address and name, and incomplete reporting of demographic information. Items that are reported in error can be corrected, but it can take several months to have the corrections made.

You have the right to question the accuracy of items reported on your credit report if you believe them to be incorrect. The credit reporting agency then must investigate any item you believe to be in error on your report within a reasonable period of time. Any errors that the agency finds must be corrected within a reasonable time period (normally within 30 days); any information on the report thought to be in error that cannot be verified as correct by the agency must be deleted from your record. If the item in question is found to be correct, you have the right to add a personal statement on your credit report explaining what happened to cause the negative item.

### How to Get a Copy of Your Credit Report

It is a good idea to request a copy of your credit report on an annual basis because of the role it plays in your ability to obtain credit. You can request a copy of your credit report by sending a written request (*typed or printed*) to one of the three national credit reporting agencies at the addresses listed in the box at right.

Your request must be signed and should include the following information:

- *full name, including generation (for example, Jr., Sr., I, II, III)*
- *spouse's first name (if married)*
- *current address (including zip code)*
- *any previous addresses for the past five years (including zip codes)*
- *social security number*
- *date of birth*
- *current employer (if unemployed, note that)*
- *daytime telephone number*

You also should include a photocopy of documentation showing proof of your **current address**, such as a recent billing statement from a major credit card company, a recent utility bill, or your valid driver's license.

Most credit reporting agencies will charge you a fee for your credit report. These fees can vary by your state of residence. Thus, you should call the credit reporting agency to verify the fee before you

mail your request. Submit the fee by check or money order made payable to the company from which you are requesting the credit report. ***You are entitled to a free copy of your credit report if you have been denied credit within the past 60 days.***

#### Major National Credit Reporting Agencies

Equifax  
P.O. Box 740241  
Atlanta, GA 30374-0241  
(800) 685 - 1111

Trans Union  
2 Baldwin Place  
P.O. Box 1000  
Chester, PA 19022  
(800) 888-4213

Experian (*formerly TRW*)  
600 N. Central Expressway  
Allen, TX 75012-2014  
(800) 397-3742

#### More Information About Credit

The following resources can provide more information about maintaining good credit:

Consumer Credit Counseling Service (CCCS) *This nonprofit organization has offices in most major cities. CCCS can help you repair your credit and resolve problems with your creditors as well as help you better understand your credit history. Call (800) 388-2227 for the office nearest you.*

Federal Trade Commission (FTC) *For help with credit reporting problems, call (202) 326 - 2222. The following brochures are available from the FTC: "Choosing and Using Credit Cards," "Credit Repair Schemes," and "Fix Your Own Credit Problems."*