

How Does Credit Work?

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Credit can take [many forms](#), but at its core, it's a mechanism for short and long term borrowing that lends convenience to everyday commerce, helps cover cash flow shortfalls and enables the realization of major life events, e.g., buying a house or car, if you can't afford them in cash.

The credit system is ultimately quite simple, too. Whenever you apply for a loan or line of credit, the financial institution extending the credit — typically a bank or credit union — will review your creditworthiness and ability to repay the amounts you wish to borrow. If you're approved, your newly opened account will be added to [your credit report](#).

Each month, lenders and creditors will relay your payment activity and other information on each of your credit accounts to the major credit bureaus. Depending on your performance, that information will help you build either a track record of financial responsibility or a bad reputation. That resulting credit history then serves two main purposes:

1. It becomes the basis of [your credit score](#), which in turn acts as a numerical indicator of your money management [skills](#).
2. It allows lenders, employers, landlords and insurance companies to judge your trustworthiness when evaluating applications.

The better your credit history and the higher your score, the less risk you pose to lenders and the [more money you stand to save](#) on everything from finance charges to insurance premiums. This, of course, might lead to a chicken or egg conundrum as it relates to credit if you're borrowing money for the first time. More specifically, how do you obtain the very credit needed to build credit if approval depends on credit history, which you do not yet have?

[Secured credit cards](#), and [student credit cards](#) if you have an active college or university email address, are a great way to establish credit. Because secured cards require users to place a refundable security deposit that doubles as their credit line,

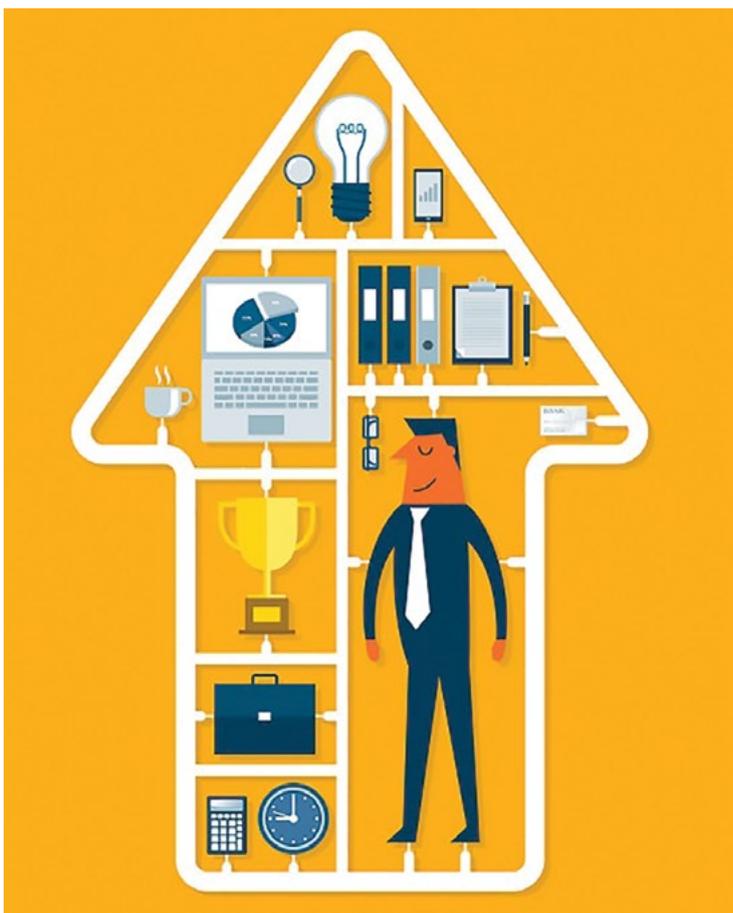


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issuers are able to approve financially unproven applicants. And given that secured cards report monthly account information to the major credit bureaus, responsible use will result in a rising credit score.

To learn how long it will take to develop a good financial track record, check out our article on the [credit-building timeline](#). You can also track your progress by signing up for a [free WalletHub account](#). WalletHub is the first and only website to provide free credit scores and full credit reports that are updated on a daily basis.