

Credit Reports

Have you checked yours lately?

CHECK ENGINE

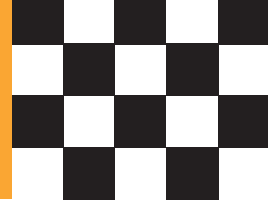
FUEL DOOR

Inside:

- Finding your way to your credit report
- Directions for credit report cleanup

ALSO INSIDE: How credit reports help navigate the hazards of hidden information

ON YOUR MARK: GET READY TO LEARN ABOUT CREDIT REPORTS!



"I'll gladly pay you Tuesday for a hamburger today." For those of you not old enough to remember, this classic statement was a favorite of the Wimpy character in the Popeye the Sailor Man cartoon series. You may have watched Popeye for years without recognizing the significance of Wimpy's proposition. Wimpy was proposing the most basic credit transaction.

When you receive money, goods or services now with an agreement to pay at a future date, you are receiving credit. Beyond eating hamburgers, credit can provide many important benefits to you. Credit can help you achieve your desired balance of spending and savings during your life. For example, you can use credit to purchase a car now and pay for the car over time while you are driving. Otherwise, you would need to save enough or have enough cash on hand to pay the entire purchase price up front, which could delay your ability to have a car to get to work or take that family road trip. The extension of credit is not without risk. Popeye viewers intuitively knew that there

was a very real possibility that Wimpy would not pay for the already eaten hamburger on Tuesday. In real life, unforeseen circumstances might affect the individual's ability to pay back lenders. So how do lenders account for different risks associated with credit transactions? Lenders price the risk of any credit transaction into the terms of the agreement. For example, riskier loans carry higher interest rates. Put another way, more creditworthy borrowers typically pay lower interest rates.

Lenders often determine a borrower's creditworthiness based on the information in their **credit report**. In this edition of the *5E Navigator*, you will explore this important document. Begin your journey by looking *Under the Hood* and inspecting why information about an individual's creditworthiness is important for borrowers and lenders. Then, hit the road but watch out for the *Curves Ahead!* The hazards of hidden information lurk around the bend. Keep an eye out for *Road Signs* that will point you to your credit report, and take a *Pit Stop* along the way to read about recent credit report developments. Once you get to your credit report, be sure to pull out your local *Road Map* for directions on how to check your report for accuracy and resolve any errors. And if you ever own a hamburger joint and are approached by Wimpy, ask to see his credit report before agreeing to extend credit to him.

UNDER THE HOOD: THE MECHANICS OF A CREDIT REPORT

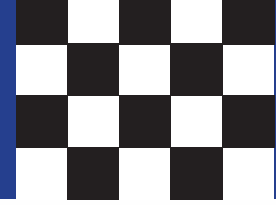
You plan to buy a new car and have your pick of two "identical" cars. Which one do you choose? Does it matter? Suppose the seller gives you the opportunity to look under the hood. Though identical on the outside, you find that one car has extensive damage and rust on the inside, things you would not have noticed without closer inspection.

This example demonstrates the problem where one party in a transaction has more information than the other. In this case, the person selling the cars has more information about the cars than you did. The seller actually knows what's under the hood.

The same logic can be applied to borrowers and lenders. As a borrower, you have good information about your own creditworthiness. You know the amount of debt you owe, your payment record and your past experience with credit. Without some way to discern this type of private information, it would be difficult for lenders to distinguish riskier borrowers from less risky ones. What if lenders did not have access to this private information? Let's hit the road and check out that scenario.



CURVES AHEAD: THE HAZARDS OF HIDDEN INFORMATION



MILE 1

Credit history is not available to lenders.

MILE 2

Lenders can not distinguish between risky borrowers and less risky borrowers.

MILE 3

Loans are priced based on average risk of ALL borrowers.

MILE 4

Everyone gets the same interest rate on loans.

MILE 5

The rate is only attractive to high risk borrowers.

MILE 6

The borrowers who accept the loan terms are the ones least likely to pay back the loan.

Credit reports provide a way to reduce hidden information and help navigate the hazards illustrated above. Access to your credit report allows the lender to price the loan based on your specific likelihood of paying back the loan. Borrowers with better credit history get better credit terms and this provides an incentive to maintain good credit history. This mitigates the problem in which borrowers would be less likely to pay back the loan if they knew that prospective lenders could not view their credit history. Credit reports are thus a means to facilitate the flow of information that enables credit markets to function more effectively.

ROAD SIGNS: FINDING YOUR WAY TO YOUR CREDIT REPORT

WHAT



What is a credit report?

A disclosure document that provides you with all the information in your credit file maintained by a credit reporting agency.

WHEN

When can I request a free credit report?

You can request a free credit report every 12 months from each of the nationwide credit reporting agencies at AnnualCreditReport.com.

You can request reports from all three agencies at the same time or stagger the requests throughout the year.

WHO

Who are the major credit reporting agencies?

Equifax, www.equifax.com
Experian, www.experian.com
TransUnion, www.transunion.com

WHERE



Where do I request a free credit report?

Visit AnnualCreditReport.com for information on requesting your credit report by phone, mail or secure website.

AnnualCreditReport.com is the official site to help people obtain their free credit report.

WHY

Why is it important to check my credit report?

It is helpful to check for accuracy and protect yourself from fraud or identity theft.

If you apply for credit, insurance, employment or to rent a home, chances are your credit report will be evaluated.

PIT STOP:

A RECENT ADDITION THAT MAY ADD FUEL TO YOUR CREDIT REPORT

Did you know that lenders and creditors now have access to your rental payment history? In 2010, Experian acquired RentBureau, a credit bureau for the rental industry. Experian is now able to take the residential rental payment data from RentBureau and put it in your credit report. Currently, about one-third of the American population rents according to the U.S. Census Bureau. Having rental payments included in your credit report can be advantageous if you have limited credit history and you are seeking to build a stronger credit file.

ROAD MAP:

DIRECTIONS FOR CREDIT REPORT CLEANUP

Checking your credit report regularly can help you spot any errors or fraudulent activity sooner rather than later. Use the directions here to fill the potential potholes in your report.

1. If you find an error contact both the credit reporting agency that provided the report and the company that provided the inaccurate information. Before you call or initiate a dispute online, gather supporting documents such as a copy of your credit report that contains the disputed information and copies of other relevant documents such as account statements.
2. Follow up your phone calls with dispute letters. Mail the letters return receipt so you can document when they have been received. For an example of a dispute letter, visit www.ftc.gov. Keep copies for your records.
3. Allow 30 days for the credit reporting agency and the company that provided the information to investigate the claim.
4. When the investigation is complete, the credit reporting agency will provide you results in writing.
5. Request the credit reporting agency notify all who received your report in the past six months of the error.

If you suspect errors on your credit report may be the result of fraud or identity theft, visit www.ftc.gov/idtheft for directions.

INTERSECTION: THE FEDERAL RESERVE AND CREDIT REPORTS

The healthy functioning of credit markets is key to a healthy economy — the principal goal of the Federal Reserve. The Fed supports the flow of credit and promotes a healthy economy through monetary policy, supervising and regulating banks, and providing services in our nation's payments system. Credit reports support the flow of credit by reducing hidden information between lenders and borrowers.

The Fed also encourages financial literacy by providing current, reliable information, including resources about credit reports. These resources can help people make informed financial decisions that contribute to their well-being.

For more information, visit:

www.richmondfed.org/education
www.federalreserve.gov/consumerinfo
www.federalreserve.gov/creditreports
www.federalreserveeducation.org

MISSION

The *5E Navigator* provides reliable information and tools to help people make informed choices about important personal financial decisions. The information in the *5E Navigator* is collected and developed by the Economic Education and Community Development team at the Federal Reserve Bank of Richmond to serve as a topical financial education resource for financial literacy practitioners, educators and the public.

www.richmondfed.org/publications

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