

THE LEDGER

JAN 16 1991

Economic Education Newsletter

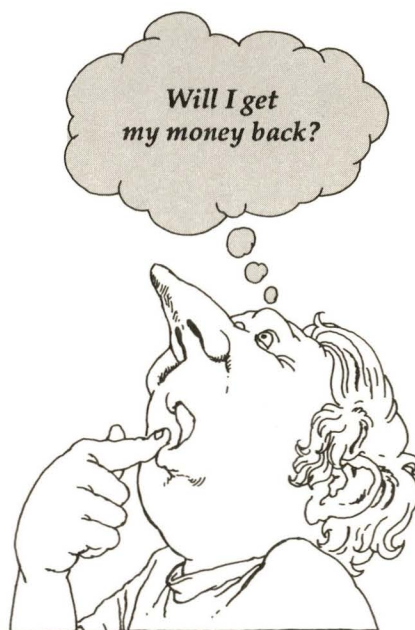
Checking the Files

Whether you're a fifth-grader lending lunch money to a classmate or a banker writing a \$100,000 mortgage for a homebuyer, your basic concern is always the same: *Will I get my money back?* No lender wants to get stuck with a bad loan, regardless of the amount.

In one way or another, lenders try to evaluate the risk associated with extending credit. The fifth-grade entrepreneur will probably think twice before lending money to a classmate who has been slow to repay past debts. A bank's mortgage officer will be less likely to approve a mortgage application from someone who declared bankruptcy last year.

Evaluating credit risk and granting credit have changed over the years. For one thing, going into debt has not always been as socially acceptable as it is today. Nationwide credit cards didn't become popular until the 1960s. Up to that time, people seemed more cautious about going into debt. The need to borrow money was often looked upon as a sign of weakness or a character flaw. Prudent people "lived within their means." (Try to imagine your grandparents going into debt to finance a February frolic in the Caribbean.)

Of course even years ago people didn't pay cash for everything. From approximately 1920 to 1960, there was a big increase in the use of installment credit to finance the purchase of homes, cars, furniture, and major appliances. And even before that, local merchants, grocers, and tradespeople sometimes granted credit to regular customers who usually settled their accounts at the end of every month.



Courtesy, Federal Reserve Bank of New York

By and large, the relationship between lenders and borrowers used to be more personal than it is today. A merchant's decision to grant credit was often based on first-hand knowledge of the customer's financial circumstances and family history.

That no longer holds true. Increasingly rare is the American whose cache of junk mail doesn't include an occasional application from an out-of-state bank for a credit card with a "pre-approved" \$2,500 (or \$5,000) line-of-credit. The accompanying form letters are usually signed by senior marketing executives who don't know you, don't know your family, and aren't at all troubled by the fact that they have never made your acquaintance.

More often than not, they are soliciting your business because you fit a demographic profile. They may never have seen your face or shaken your hand, but they are able to evaluate you as a credit risk by drawing upon information that is available to credit grantors across the country. Much of that information is held in the computerized data banks of credit bureaus.

Although a certain amount of mystery surrounds credit bureaus, the service they provide is straightforward and easy to understand. A credit bureau provides lenders with the information they need to evaluate your creditworthiness. (It's important to note that credit bureaus do not offer recommendations on whether or not to grant credit. That's up to the prospective lender.)

There are approximately 1200 local and regional credit bureaus in the United States. Most are linked by computer to three national credit bureaus: Equifax, TransUnion, and TRW Credit Data.

The information they dispense almost always takes the form of a credit report, which is essentially a summary of your payment habits and practices. Most credit reports contain information about loans, charge accounts, credit cards, bankruptcies, tax liens, and judgments.

Contrary to the impression sometimes conveyed in spy novels and thrillers, national credit bureaus do not maintain dossiers of personal information on private citizens. Personal information in your credit report is generally limited to your full name, current and previous

addresses, Social Security number, year of birth, employer, and spouse's first name (if you are married). Your credit report should **not** contain information regarding your race, religion, gender, salary, personal assets, checking or savings accounts, medical history, personal background, lifestyle, or criminal record.

Needless to say, citizens (and credit bureaus) are concerned that credit files remain confidential. The *Right to Financial Privacy Act* provides that customers of financial institutions have a right to expect that their financial activities will have a reasonable amount of privacy from federal government scrutiny. It establishes specific procedures and exemptions concerning the release of financial records to government authorities.

When a potential lender requests access to your credit file, the request is noted on your report as an "inquiry." Inquiries remain on the report for two years.

How information gets into your credit report is no mystery. You provide some of it yourself whenever you apply for a new account with a merchant or business. Credit clerks transfer the relevant data from your application to a computer tape, and once a month the accumulated information is forwarded to one or more of the national credit bureaus. Subsequent transactions, including late payments and missed payments, are also received and recorded by credit bureaus.

Closed charge accounts and accounts that have no current balance are carried on your file indefinitely, but there's a limit on how long negative information can be carried. In most cases, federal law requires

credit bureaus to delete adverse information from your file after seven years, with the exception of bankruptcy information, which may be reported for ten years. Other exceptions apply to credit reports issued in conjunction with insurance policies or credit applications for \$50,000 or more, or employment applications that involve annual salaries of \$20,000 or more.

By and large, the system seems to work well. Automated credit reporting enables a lender to process credit applications faster and more efficiently than might otherwise be the case. National credit bureaus also broaden geographical accessibility to information, which is no minor consideration in a big country with a highly mobile population.

All of which is not to say that the credit reporting system is perfect. According to an October 1990 article in *Consumer Reports*, "industry data on credit records challenged by consumers indicate that at least two million people each year become victims of mistakes."

Fortunately, federal regulations provide a mechanism for correcting those mistakes. Under the *Fair Credit Reporting Act*, if a prospective lender denied you credit within the past 30 days because of negative information in your credit report, the lender must provide you with the name and address of the credit bureau that furnished the report. You are then entitled to the prompt and free review of your credit file. If, upon investigation, the negative information proves incorrect, the credit bureau must change or delete it from your record, and anyone who has received a copy of your report within the past six months will be sent a corrected copy at your request.

(Even if the credit bureau cannot verify that negative information is incorrect, the law provides you with the option of appending a brief statement to your record to tell your side of the story.)

By this point you're probably thinking that today's system of evaluating credit risk sounds so much more impersonal than the way it used to be. And you're right. It is. But before you start feeling nostalgic for the days when lenders based their decisions on looking you in the eye and shaking your hand, you should probably reflect on the fact that the granting of credit is much less restrictive than it once was. Back in the "good old days" lenders were able to deny credit on the basis of race, religion, gender, or any number of other arbitrary grounds, and the prospective borrower had little, if any, recourse.

Today, automated credit reporting practices and federal legislation guarantee everyone equal and objective consideration for credit. The *Equal Credit Opportunity Act* prohibits discrimination against an applicant for credit because of age, sex, marital status, religion, race, color, national origin, or receipt of public assistance. Moreover, if a consumer is denied credit, the law requires that the applicant receive written notification of the denial. These legal guarantees, coupled with an efficient mechanism for reporting objective information, help to make credit accessible to a much broader range of citizens. All in all, that would seem to offset the loss of personal contact.

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Thank you to Equifax Inc. and TRW Credit Data Division for providing useful background information on credit bureaus and credit files.

THE LEDGER

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Board of Governors. Copies of this newsletter and a catalogue of other educational materials and research publications may be obtained free of charge by writing: Public Information Center, Federal Reserve Bank of Boston, P.O. Box 2076, Boston, MA 02106-2076, or by calling: (617) 973-3459.

The Updated Credit Profile Report

TRW's Credit Profile report is designed to display information in a standard, objective, easy-to-read manner. An illustration and description of a sample Profile report for a fictitious person follows.

- ① Name and address as recorded on automated subscriber tapes, including date of most recent update.
- ② Employment name and address as reported by a subscriber through an inquiry on the date shown.
- ③ A code designating the TRW or Credit Bureau office nearest the consumer's current address, for your use in consumer referrals.

- ④ Consumer's social security number.

- ⑤ Three columns indicating positive, nonevaluated, and negative status comments.

- ⑥ A (Automated) and M (Instant Update or Manual Form) indicate the method by which the credit grantor reports information to TRW.

- ⑦ Name and number of reporting subscriber.

- ⑧ Association code describing the legal relationship to the account.

- ⑨ Account or docket number.

- ⑩ Status comment reflecting the payment condition of the account as of the status date.

- ⑪ Date the account was opened.

- ⑫ Scheduled monthly payment amount.

- ⑬ Estimated monthly payment amount.

- ⑭ Date last payment was made.

- ⑮ Type and terms of the account.

- ⑯ The original loan amount (ORIGL), credit limit (LIMIT), historical high balance (HIBAL), or original amount charged to loss (C/OAM), represented in dollar amounts.

- ⑰ Balance owing, balance date, and amount past due, if applicable.

- ⑱ The applicant's payment history during the past 24 months. The code reflects the status of the account for each month, displayed for balance reporting subscribers only.

C	—	Current
N	—	Zero balance reported/current account
1	—	30 days past due
2	—	60 days past due
3	—	90 days past due
4	—	120 days past due
5	—	150 days past due
6	—	180 days past due
— (Dash)	—	No history reported for that month.
Blank	—	No history maintained; see status comment.

Subscriber Number

Applicant's Name

Current Address

Previous Addresses

Social Security Number

Year of Birth

Type, Terms and Amount

Employment

Updated Credit Profile

TCAL
 RTS 3122250XIJ CONSUMER JOHN .S. 10655 B 9152,
 P-6613 S 92708,235 E 14202,S-548603388,Y-1944,T-18010005,
 E-AJAX HARDWARE/2035 BROADWAY/LOS ANGELES CA 90019

PAGE 1

8-88 JOHN Q CONSUMER

10655 BIRCH ST

BURBANK CA 91502

DATE 10-10-88

TIME 11:04:45

PORT HP26

A60 CONSUMER

SS# 548603388

4-88 AJAX HARDWARE

2035 BROADWAY

LOS ANGELES CA 90019

ACCOUNT PROFILE		SUBSCRIBER NAME/COURT NAME		SUBSCRIBER IF COURT CODE		ASSN CODE		ACCOUNT NUMBER/DOCKET		PAYMENT PROFILE	
POS	NON	NEG	STATUS COMMENT	STATUS DATE	DATE OPENED	TYPE	TERMS	AMOUNT	BALANCE	BALANCE DATE	AMOUNT PAST DUE
A			MOUNTAIN BANK	1139999	2	ORIGL	3562401973				
			CURWAS30-3	2-88	9-85	SEC	60	\$43000	\$22227	9-26-88	CCCCCCCC1C1C
						SCH	MONTH	PAY	\$717	LASTPAY	8-88
A			HILLSIDE BANK	3149999	5	ORIGL	29144508119				CCCC-CCC
			CURR ACCT	9-88	12-87	AUT	48	\$6300	\$5148	9-15-88	
						SCH	MONTH	PAY	\$132	LASTPAY	8-88
A			HEMLOCKS	3319999	1	HIBAL	986543184026				CC
			CURR ACCT	10-88	8-88	CHG REV	\$600	\$440		10-05-88	
						EST	MONTH	PAY	\$44		
A			BAY COMPANY	3319999	1	LIMIT	46812391013				NNNNC21CCNNC
			CUR WAS 60	4-88	10-Y	CHG	REV	\$1500	\$0	9-21-88	CCC1CNNNC1CC
						CHG	REV	\$200		LASTPAY	4-88
M			BOWERS	3369999	1	C/OAM	212250				
			CHARGE OFF	4-87	7-81	CHG	REV	\$200			
A			GARDEN FINANCE	3509999	1	ORIGL	24187010				18
			DELINQ 120	9-88	3-87	UNS	24	\$2200	\$1400	9-17-88	321CCCCCCCCC
						EST	MONTH	PAY	\$100	LASTPAY	5-88
A			WISTERIA FINANCE	3549999	4	SEC	12	\$500			
			PD SATIS	11-87	10-86	SEC	12	\$500			
A			HILLSIDE BANK	3149999							
			INQUIRY	11-18-87		AUT	48	\$6300			
M			CO SPR CT SANTA ANA	3019999							
			JUDGMENT	10-19-86				\$1200		07505853	
										ALLIED COMPANY	
<p>>>>> CHECKPOINT >>>> SS# IS 054860338/OTHER FILE IDENT: MID INIT IS Q</p> <p>1-86 JOHN Q CONSUMER</p> <p>6613 SADDLEBACK ROAD</p> <p>ORANGE CA 92708</p>											
A			WYATT FINANCE	3519999	1	REPO	29416413				
				1-86	7-83	AUT	36	\$7500			
M			GROVE CREDIT UNION	3789999							
			INQUIRY	4-09-88		H/I	12	\$3700			
<p>-----END -- TRW</p>											

Confidential

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- ⑲ Inquiries indicate a request for the applicant's credit information — inquiring subscriber; date of inquiry; and type, terms and amount, if available.

- ⑳ Public Record: Court name, court code, docket number, type of public record, filing date, amount, and judgment creditor. This information may include bankruptcies, liens and/or judgments against the applicant.

- ㉑ Profile report messages alert the subscriber about a credit applicant's social security number, name, address, generation, or year of birth. See back of page for further explanation.

Courtesy, TRW Credit Data Division

Multi-Media

U.S. Monetary Policy and Financial Markets, book, published by the Federal Reserve Bank of New York, 231 pages.

This book offers an in-depth description of how monetary policy is developed by the Federal Open Market Committee and the techniques employed to implement policy at the Open Market trading desk. It describes the tools and the setting of policy. Also included is an account of a day at the trading desk, from morning information gathering through daily decision making and the execution of an open market operation.

In addition, the book places monetary policy in a broader context, examining the evolution of Federal Reserve monetary policy procedures from their beginning in 1914 to the end of the 1980s. It indicates how policy operates most directly through the banking system and the financial markets and describes key features of both. Finally, the book turns its attention to the transmittal of monetary policy actions to the United States and throughout the world.

Copies of *U.S. Monetary Policy and Financial Markets* are available from the Federal Reserve Bank of New York. The postpaid cost is \$5.00 per copy in the United States (\$10.00 for copies mailed outside the U.S.). Orders should be sent to: Public Information Department, Federal Reserve Bank of New York, 33 Liberty Street, New York, NY 10045. Checks must accompany orders and should be payable to the Federal Reserve Bank of New York in U.S. dollars.

A Guide to Business Credit for Women, Minorities, and Small Businesses, brochure, published by the Board of Governors of the Federal Reserve System.

This newly revised and retitled brochure is designed to assist women, minorities, and small businesses in obtaining start-up or additional financing. It helps to de-mystify the commercial credit process and provides guidance on how to prepare the necessary loan application documentation. Within the guide, the reader will find some

sources for technical assistance and recourses to take if a credit application is not approved.

Free copies of the brochure are available through Publications Services, MS-138, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

Home Mortgages: Understanding the Process and Your Rights, brochure, published by the Board of Governors of the Federal Reserve System.

This recent publication describes a mortgage, tells how to shop for one and what to look for, outlines the application process, and advises a potential homebuyer how to register complaints if the consumer thinks that he or she may have been discriminated against. To help a consumer make this determination, the brochure lists some common discrimination practices and states some of the laws that provide consumers with protection regarding home ownership.

Copies of the brochure are available through Publications Services, MS-138, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

The Fed: Our Nation's Central Bank, video, 13 minutes, produced by the Federal Reserve Bank of San Francisco.

This new videocassette uses computer graphics and live footage to give viewers an up-to-date look at the Federal Reserve. The video examines the roles of the Fed in setting and implementing monetary policy, promoting safety and soundness in the financial system, helping individuals and businesses make and receive payments safely and quickly, and acting as fiscal agent for the U.S. government.

The 13-minute video is geared to high school and general adult audiences and is available for free classroom use in three formats: ½" VHS, ¾" U-Matic, and ½" Beta. For more information, contact the Public Information Department, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco, CA 94120; phone (415) 974-2163.

New England Update

Q & A

We think we've identified a need for a new publication to explain the basics of banking to students in the upper elementary school grades. But we'd like your input before we forge ahead.

At this point, we're leaning towards a question-and-answer format to address the ten most common questions that kids have about banking. That's where you come in.

Please send us your thoughts on the matter. Better yet, survey your students, and ask them what questions they would like our new pamphlet to cover.

We welcome everyone's ideas. Send your comments to: Editor, *The Ledger*, Public Services Department, Federal Reserve Bank of Boston, P.O. Box 2076, Boston, MA 02106-2076.

More "Money Fun For Everyone"



The Public Services Department of the Federal Reserve Bank of Boston will host a free program on Thursday, December 27 at 9:30 a.m.

The two-hour program will feature a storytelling session for the younger children, a slide show on genuine and counterfeit currency for the older children, a look at the Bank's Money Department, a view of Boston and Boston Harbor from the Bank's 31st floor, and light refreshments. Children of all ages are welcome, but each child must be accompanied by an adult.

Participants must register for the program in advance. For reservations please call (617) 973-3452, Monday through Friday, 9:00 a.m. to 4:00 p.m.