Ruminations on Credit Reports

As you may know, you can receive a free credit report annually from each of the nationwide consumer credit reporting agencies. Below I will explain why, how, and when you should review your credit report. I will also give a brief overview of credit scores.

Why? There are two primary reasons to review your credit report. First, many people find inaccuracies on their reports. While most of these are minor, occasionally there might be something significant enough to impair your credit. The ideal time to discover this is not when you are trying to secure a new home or job. Second, it will give you early warning of identity theft or fraud. While many people are concerned with computer hackers stealing their identity, the mundane methods are still the most prevalent. A salesclerk stealing a credit card number or a relative stealing a check and forging the signature may not make headlines, but they are still classified as "identity theft." Periodically checking your credit report will ensure that you quickly become aware of irregularities in your accounts.

How? There are a few ways to monitor and protect your credit. First, a number of services have sprung up that will notify you immediately if something looks suspicious. While these may give some peace of mind, they probably are not worth the fees for most people since you can get copies of your credit report for free and monitor it yourself. Similarly, you have no doubt seen many offers for credit protection insurance. Many people don't realize that consumers are only liable for the first $50 of fraudulent charges on their credit (not debit) cards. Thus, if you are being charged five dollars per month for the insurance, there would have to be fraudulent charges more than every ten months for this to make sense.

As an aside, many experts also recommend not putting outgoing mail (such as bills) containing checks in your mailbox. Criminals do sometimes steal the checks and "wash" (using chemicals) the writing (except the signature) off of the check giving them a signed blank check. It is recommended that outgoing mail with checks be placed in a mailbox that is only accessible with a key.

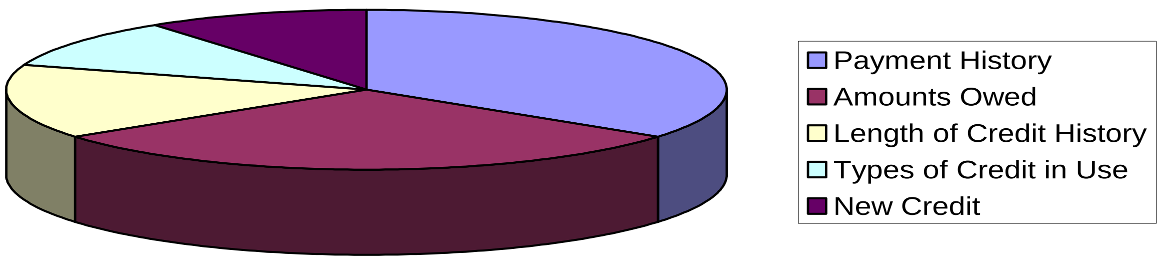
The easiest way to request your credit report is to go to www.annualcreditreport.com and follow the steps. Be aware that you will have to get the report from each of the three services separately. Also, to verify your identity, each of the services may ask you various questions ("What was your address in 1998?," "Into which range does your current mortgage payment with ABC Bank fall?"). If you do not have internet access, you may also request the reports by calling toll-free 1-877-322-8228.

When? Some people request all three credit reports simultaneously when it occurs to them, but do not have a regular schedule for doing so. Others request them all at once, but at a specific time each year (their birthday, or the first of the year for example). Probably the best way to do it (though it is slightly more cumbersome) is to stagger the reports throughout the year. Since there are three national agencies and each report can only be requested free once per year, requesting a report from a different agency every four months would most likely bring irregularities to light more quickly.

Credit Scores. A FICO score, the most commonly used credit score, is a score developed by Fair Isaac & Co. to predict the probability that people will pay their bills. It has also been used with success in the property and casualty areas of the insurance industry to predict claims (people with poor credit tend to file more claims). Lots of good information can be found in a 20-page booklet at: http://www.myfico.com/Downloads/Files/myFICO_UYFS_Booklet.pdf.

The specific algorithms used to produce the score are kept secret, but in general, the longevity of accounts, the percentage of available credit used, the length of time at your present residence, employment history, recent applications for credit, as well as the obviously negative credit information such as late payments, bankruptcies, charge-offs, collections, etc. are all factors that impact the score. Here is an approximate breakdown of the factors:

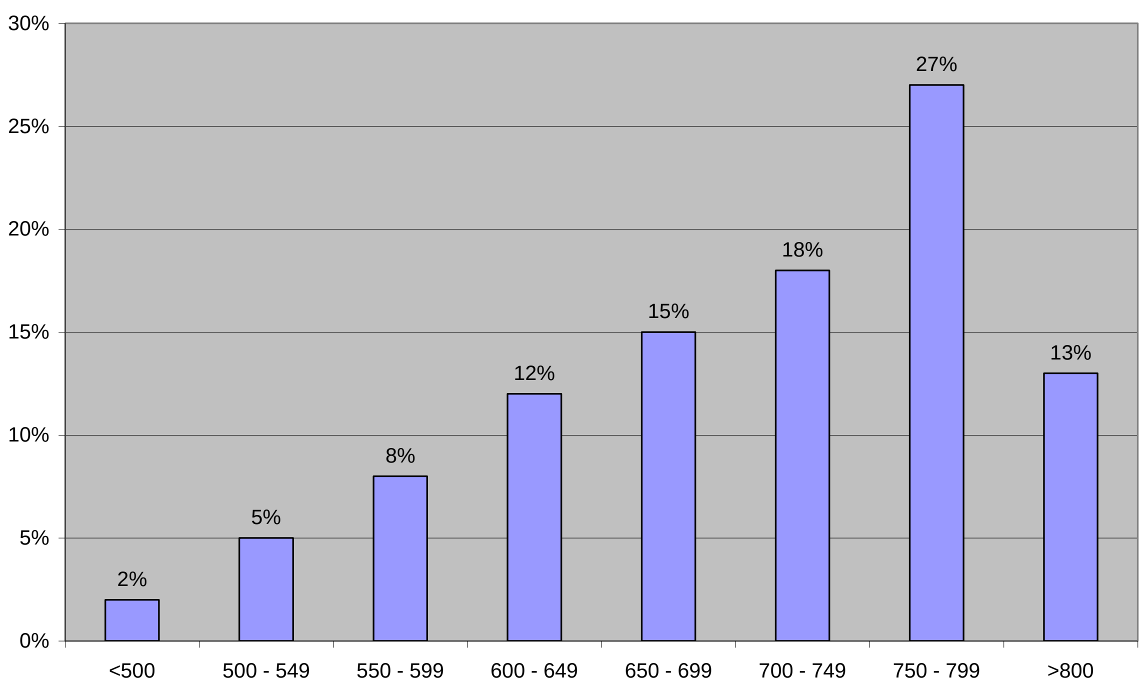
Credit Score Determinants



This scoring system can lead to some counter-intuitive results. Closing unused accounts can actually lower the score because the amount of credit used versus the amount available will increase. Also, from a scoring perspective, it is better to close a recently opened account rather than an older one.

Most items stay on your credit report for seven years. Credit scores range from a low of 300 to a high of 850, although there are very few people at the extremes. A score over 700-750 is considered "good" and will generally result in better financing options and rates. The breakdown of the scores in the U.S. is:

National Distribution of FICO Scores



Notes:

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