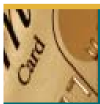

Credit Management: Using Credit Wisely

WELCOME AND INTRODUCTION 1

Credit has become a normal part of everyday personal financial manage- 2
ment for most Americans. Used appropriately it can be an excellent tool, but used the wrong way it can bring the financial wheels of your life to a grinding halt for a long, long time. To help with good credit management, topics in this module include:

- Wise and unwise uses of credit
- Credit Reports/Credit Scoring
- Establishing a credit history
- The cost of credit
- Choosing and using credit cards
- Warning signs of too much credit
- Recovering from over-indebtedness
- Sources of help

America seems to be a nation in love with debt. The statistics are telling 3
(2007):

- The median amount of credit card debt is $6,600 while the average is $9,900.
- 64% of cardholders have balances under $10,000, but 13% carry balances in excess of $25,000.
- 61% carry balances from month to month and 31% pay off balances monthly. (www.cardtrak.com/news/2007/6/1/Card_Debt).
- 48% of Americans are worried about the amount of debt they have and 54% do not have a financial plan (http://www.lendingtree.com/stm3/pressroom/PressReleaseDtl.asp?PRID=546).
- There are 88 million households using credit cards today.

- In 2005, personal bankruptcies topped a record 2 million.
- In 2006, personal bankruptcies dropped to 597,000 due to the new, stringent bankruptcy laws that went into effect. (www.abiworld.org).

Our entire economic system is largely based on credit. There is a lot of money to be made from it; interest on consumer purchases brings over $100 billion into the economy every year. The three largest banks in the United States, Bank of America, JP Morgan, and Citibank, posted 2006 profits from their credit card businesses of $6 billion, $3.2 billion and $3.8 billion respectively.

USING CREDIT

4 **Wise Uses of Credit**

Success or failure with money depends much more on appropriate behavior than it does on the amount of money one has. Using credit wisely is the result of good planning (a behavior). Conversely, inappropriate behavior, such as lack of planning or emotional spending, is usually the cause of unwise uses of credit that can lead to serious financial problems.

The best use of credit is for a planned purchase of assets – things that will grow or increase in value over time, like a home or an education. Credit is also useful for convenience – avoiding having to carry large sums of cash or as a management tool. But, it assumes you don't carry a balance month-to-month, or if you do, that you have planned for the monthly payments. Using credit to take advantage of sales or discounts when you don't have immediate access to your cash is a good use as well. The wise use of credit virtually always falls into one of these two categories— assets or convenience, and always includes planning (deliberate spending).

5 **Unwise Uses of Credit**

Unwise uses of credit revolve around behavior … poor or no planning, or emotional spending. Unwise uses include:

- *Impulse Buying.* Easy access to credit often leads to a "buy now, pay later" mentality. Impulse buying can occur when we are bored, nervous, sad, angry, or happy. During these times, consumers will often charge items they would never buy if they had to pay in cash.

In addition, consumers buying an item on impulse tend to pay about 1/3 more than they would if they first compared prices at other locations where the same item might be on sale. By nature, impulse items are not planned expenses.

- *Spending for Status.* Many people feel they need to spend to impress others. Advertising appeals to these emotions. Ads in the media for credit cards often portray the person using the card as having power or status. The message they are sending is that if you use their card, you will be able to do great things, have more fun, attract others, and be more successful.

- *Retaliatory Spending.* In a family where there is not a clear spending plan in place that partners agree on, each party has a common tendency to spend on themselves first. After all, they work hard, so why shouldn't they treat themselves to something nice occasionally? This can spin off into retaliatory spending: each partner buying (charging) more for themselves in order to "even the score" with the other.

- *Spending to Feel Good.* This feeling can become addictive. Like other addictive behaviors, the good feelings are only temporary; the debt "hangover" can last a long time. Individuals should always decide before charging any purchase if they are buying an item because they really need it or because they are under stress and want to feel better. People who spend to feel good or to get a "fix" sometimes won't even open their parcels or use the items because it isn't about the item purchased, it is about the feeling they get from the transaction.

- *Purchasing Consumables:* Credit becomes more dangerous when used to purchase consumables like food, clothing, entertainment and vacations – items that lose much or all of their value immediately after purchase.

- *Everyday Living Expenses.* Meeting everyday living expenses is perhaps the most dangerous use of credit. If you don't have the cash to pay for regular living expenses today, what makes you think that you will be able to pay for it next month?

QUALIFYING FOR CREDIT

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Three C's of Credit

Creditors look for an ability to repay debt and a willingness to do so – and sometimes for a little extra security to protect their loans. The factors they use to evaluate a borrower are summarized by the three Cs of credit:

Character, Capacity and Collateral.

- *Character:* Will you repay the debt? Creditors will look at your credit history: how much you owe, how often you borrow, whether you pay bills on time, and whether you live within your means. They also look for signs of stability: how long you've lived at your present address, whether you own or rent your home, and the length of your present employment.
- *Capacity:* Can you repay the debt? Creditors ask for employment information: your occupation, how long you've worked, and how much you earn. They also want to know your expenses: how many dependents you have, whether you pay alimony or child support, and the amount of your other obligations.
- *Collateral:* Is the creditor fully protected if you fail to repay? Creditors want to know what you may have that could be used to back up or secure your loan and other resources you have for repaying debt other than income, such as savings, investments, or property.

Creditors use different combinations of these factors to reach a lending decision. Different creditors may reach different conclusions based on the same set of facts. One may find a borrower an acceptable risk, whereas another may deny the same borrower. Some develop their own rating system, while others use "credit scores" (explained later). Most all creditors, however, will use your credit report to help them make a lending decision.

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Credit Reports

Credit Reports

A credit report is a detailed account of the credit, employment and residence history of an individual used by a prospective lender to help determine creditworthiness. Credit reports also list any judgments, tax liens, bankruptcies or similar matters of public record entered against the individual.

The industry is dominated by three Credit Reporting Agencies (CRAs): Equifax, Experian, and Trans Union (also called "Credit Reporting Companies"). These CRAs maintain independent databases and compete with one another to sell information to lenders, insurance companies, and employers. For the most part, they don't share information with each other and so may not have identical information about an individual. If you have moved a lot, your information may be incomplete and you should request a copy from all three bureaus.

It is important to review your credit report at least once a year to verify that the information is correct and complete. Mistakes happen, and if undetected, could prevent you from getting future credit. Also, a lot of identity theft is uncovered by reviewing credit reports. The major credit bureaus all have websites and toll-free numbers where consumers can request a copy of their credit report. Information on how to do this is included in your "Credit Reports" handout. Under current law, every American with a credit history can get one free credit report a year from each of the big three credit reporting agencies. The reports are available on-line at www.annualcreditreport.com.

When you get a copy of your credit report, you will see that they all 8
include the following information in one form or another.

Identification and employment information: Your name, birth date, Social Security number, employer, and spouse's name are routinely noted. The CRA also may provide information about your employment history, home ownership, income, and previous address, if a creditor requests this type of information.

Payment history: Your accounts with different creditors are listed, showing how much credit has been extended and whether you've paid on time. Related events, such as referral of an overdue account to a collection agency, may also be noted. This data is also referred to as "trade lines".

Inquiries: CRAs must maintain a record of all creditors who have asked for your credit history within the past year, and a record of those persons or businesses requesting your credit history for employment purposes for the past two years.

Public record information: Events that are a matter of public record, such as bankruptcies, foreclosures, or tax liens, may appear in your report.

Accurate Negative Information: When negative information in your report 9
is accurate, only the passage of time can assure its removal. A CRA can report most accurate negative information for seven years and bankruptcy information for 10 years. (Inquiries and payments are reported for two years.) Information about an unpaid judgment against you can be reported for seven years or until the statute of limitations runs out, whichever is longer. There is no time limit on reporting information about criminal convictions; information reported in response to your application for a job that pays more than $75,000 a year; and information reported because you've applied for more than $150,000 worth of credit or life insurance. There is a standard method for calculating the seven-year reporting period. Generally, the period runs from the date that the event took place.

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Correcting Wrong Information: Under the Fair Credit Reporting Act (FCRA), both the CRA and the information provider (the person, company, or organization that provides information about you to a CRA) are responsible for correcting inaccurate or incomplete information in your report. To take advantage of all your rights under the FCRA, contact the CRA and the information provider if you see inaccurate or incomplete information. Dispute forms are included on websites or you can request a hard copy from the CRA.

1. Tell the CRA, in writing, what information you think is inaccurate. Include copies (NOT originals) of documents that support your position. Send your letter by certified mail, return receipt requested, so you can document what the CRA received. Keep copies of everything.

2. CRAs must investigate the items in question — usually within 30 days — unless they consider your dispute frivolous. They also must forward all the relevant data you provide about the inaccuracy to the organization that provided the information. After the information provider receives notice of a dispute from the CRA, it must investigate, review the relevant information, and report the results back to the CRA. If the information provider finds the disputed information is inaccurate, it must notify all three nationwide CRAs so they can correct the information in your file.

3. When the investigation is complete, the CRA must give you the written results and a free copy of your report if the dispute results in a change. (This free report does not count as your annual free report.) If an item is changed or deleted, the CRA cannot put the disputed information back in your file unless the information provider verifies that the information is, indeed, accurate and complete. The CRA also must send you written notice that includes the name, address, and phone number of the information provider.

4. If you request, the CRA must send notices of any correction to anyone who received your report in the past six months. A corrected copy of your report can be sent to anyone who received a copy during the past two years for employment purposes.

5. If an investigation doesn't resolve your dispute with the CRA, you can ask that a statement of the dispute be included in your file and in future reports. You also can ask the CRA to provide your statement to anyone who received a copy of your report in the recent past. Expect to pay a fee for this service.

Tell the creditor or other information provider, in writing, that you dispute an item. Be sure to include copies (NOT originals) of documents that support your position. Many providers specify an address for disputes. If the provider reports the item to a CRA, it must include a notice of your dispute. And if you are correct - that is, if the information is found to be inaccurate - the information provider may not report it again.

Your Credit Score 11

Credit scoring is a system creditors use to help determine whether to give you credit and how much to charge you for it.

Information about you and your credit experiences, like your bill-paying history, the number and type of accounts you have, late payments, collection actions, outstanding debt, and the age of your accounts, is collected from your credit application and your credit report. Using a statistical formula, creditors compare this information to the credit performance of consumers with similar profiles. A credit scoring system awards points for each factor. A total number of points — a credit score — helps predict how creditworthy you are, that is, how likely it is that you will repay a loan and make the payments on time. Generally, consumers with good credit risks have higher credit scores.

You can get your credit score from the three nationwide CRAs, but you will have to pay a fee for it. Many other companies also offer credit scores for sale alone or as part of a package of products. Two well-known credit score companies are the Fair Isaac Company ("FICO" score) and Beacon.

The FICO score takes into account 5 areas of information and weights each category:

- 35% Payment History.
- 30% Amounts Owed.
- 15% Length of Credit History.
- 10% Types of Credit in Use.
- 10% New Accounts.

What Is a Good Credit Score? Credit scores vary depending on the product offered and the range of scores the creditor is using. Generally, however, the following is true for FICO scores: 12

700 and up: Considered excellent, about 60% of the US population falls within this credit range.

600-699: Considered good credit. May not qualify for the very best interest rate and terms. About 27% of the US population falls within this credit range.

500-599: Considered risky credit. May still qualify for a loan, but may have to pay at least two percentage points or more higher than the group in the excellent category. About 12% of the US population falls within this credit range.

400-499: Considered very risky credit, usually with foreclosures, liens and/or credit judgments in their reports. Will probably have to pay maximum rates allowed by law if given credit at all. About 1% of US population is in this range.

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ESTABLISHING A CREDIT HISTORY

Establishing Credit

Start building your creditworthiness early, so when you need credit you'll be able to get it. Lenders look for evidence of financial responsibility and stability. This can be achieved in several ways:

- Properly maintain a checking and savings account at a financial institution.
- Pay existing bills (such as rent and utilities) on time.
- Apply for a "savings secured loan." Credit Unions and Banks will give a loan up to the amount of money in a related savings (or share savings) account. The money in savings is frozen until some or all of the loan is paid off. Since the financial institution knows it will get its money even if you default, the rate on the loan is normally very low, usually only slightly more than the interest rate they are giving you on your savings. In a way, you are paying to borrow your own money, but the idea is to help you establish credit and a saving secured loan is an excellent tool with which to do that.
- A co-signed loan may be an option if you have little credit history and someone willing to co-sign for you. However, if you already have a good credit history, be very careful of co-signing a loan for a friend or a relative. Statistically, more than half of these types of loans end with the cosigner paying back part, most, or all of the money owed!

- A charge card from a local retailer or gas company is often the easiest type of credit card to get. Start small, with one card. Make small purchases and pay off in full at the end of the month. Be careful to avoid overspending as interest rate charges for these cards are normally high.

- Finally, after establishing a good credit history with other loans, a consumer will eventually qualify for a Visa or MasterCard from a major bank. There are over 6,000 different banks issuing these cards. Consumers must be aware that terms and rates will vary considerably, from so-called "secured" cards which often require a cash deposit and have low credit limits and high rates, to the "premium" cards (often called gold or platinum) targeted at consumers with the best credit ratings.

THE COST OF CREDIT 14

Credit Worthiness

Using someone else's money is going to cost you money in the form of interest and fees. The better your credit history is, the better your chance of qualifying for lower rates and fees. If you have a history of slow or no payments in your report, you may be denied credit or you may be charged more for the credit lenders are willing to give you, so pay your existing bills on time and maintain a spotless credit record.

Comparison Shopping

Credit is a product that you should shop for just like you would shop for a new car or a new home appliance. Since the amount of interest that can be charged on various types of credit differs from state to state, it is important to shop carefully. Try to get pre-approved by arranging financing for large items before you go shopping. This will help you get a firm fix on what you can afford to pay. Compare options from different lenders to get the best deal. Besides your own personal creditworthiness, the cost of credit is determined by a number factors such as where you borrow, how much you borrow, how long you take to repay and how interest is calculated. Let's take a look at each of these in a little more detail.

Where to Borrow 15

Where you borrow will definitely affect your cost.

- Credit Union– Owned by members, loans to members only, normally offer the most attractive rates.

- Commercial Banks – Offer a wide variety of products, average rates, for lower risk people.
- Savings Banks and Savings and Loan Associations – Focus on mortgages, often offer other services, similar to banks.
- Consumer Finance Companies – Accept higher credit risks, rates often high.
- Retail Merchants – In-store loans and credit cards, often have promotional introductory rates that rise rapidly after 90 to180 days. Rates are often unattractive. Whether you are buying a car, a TV, or anything else, normally the most expensive place to finance any consumer purchase is the place you are buying it. You pay for the convenience.
- *Predatory Lending:* Advance-fee loans, Payday loans, Sub-prime Mortgages, Title Pawn lenders, Rent-to-Own, Refund Anticipation Loans: JUST SAY NO! These types of lenders charge excessive interest rates and fees, wrap in unnecessary insurance, and often have pre-payment penalties. This is the most expensive money you can use. If you find yourself contemplating getting money from this type of lender, see your Command Financial Specialist or FFSC Financial Educator first.

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How Much to Borrow

How much you borrow has a big impact on total cost. A down payment can often result in substantial savings. The bigger the down payment, the less the total cost.

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How Long to Repay

Borrowing for a longer period lowers your monthly payment but results in higher cost. The shorter your repay period, the less the total cost.

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Minimum Monthly Payment

Beware of making only minimum payments. Base your payment on what you can afford, but always try to pay as much as possible. If you have a $1,000 balance on an 18% credit card and only pay the minimum, 2% of the balance for example, it will take 19 years to pay off and cost a total of $1,931. However, increasing the payment to 5% of the balance results in a 2 year payoff and $382 in interest paid.

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Minimizing Interest Charges

Calculating loan interest: Interest on loans can be calculated in a number of different ways:

- *Simple interest:* The finance charge is computed by applying a percentage rate to the balance outstanding during each payment period. This is the most attractive method. As you make payments, the interest charged decreases along with the loan balance due. Credit unions always charge simple interest; banks normally do also. Ask for it!
- *Add-on interest:* The finance charge is calculated on the amount financed and then added on to it. The sum total has to be repaid. No matter how many payments you have made, the interest charged will always stay the same.

Read all financing contracts carefully before signing! Example: $1000 at 12% for 1 year. Using simple interest you will pay $66 in interest. Using add-on interest you will pay $120 in interest.

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Choosing Credit Cards

Credit Card Tips

Know the Terms: Before choosing a credit card, familiarize yourself with these terms.

Annual Percentage Rate. The APR is a measure of the cost of credit, expressed as a yearly rate. It also must be disclosed before you become obligated on the account and on your account statements. The card issuer also must disclose the "periodic rate" - the rate applied to your outstanding balance to figure the finance charge for each billing period.

Grace Period. Also called a "free period," it lets you avoid finance charges by paying your balance in full before the due date. Knowing whether a card gives you a grace period is especially important if you plan to pay your account in full each month. Without a free period, the card issuer may impose a finance charge from the date you use your card or from the date each transaction is posted to your account. If your card includes a free period, the issuer must mail your bill at least 14 days before the due date so you'll have enough time to pay.

Annual Fees. Most issuers charge annual membership or participation fees. They often range from $25 to $50, sometimes up to $100; "gold" or "platinum" cards often charge up to $75 and sometimes up to several hundred dollars.

Transaction Fees and Other Charges. A card may include other costs. Some issuers charge a fee if you use the card to get a cash advance, make a late payment, or exceed your credit limit. Some charge a monthly fee whether or not you use the card.

Balance Computation Method for the Finance Charge. If you don't have a grace period or if you expect to pay for purchases over time, it's important to know what method the issuer uses to calculate your finance charge. This can make a big difference in how much of a finance charge you'll pay - even if the APR and your buying patterns remain relatively constant.

Examples of balance computation methods include the following.

Average Daily Balance. This is the most common calculation method. It credits your account from the day payment is received by the issuer. To figure the balance due, the issuer totals the beginning balance for each day in the billing period and subtracts any credits made to your account that day. While new purchases may or may not be added to the balance, depending on your plan, cash advances typically are included. The resulting daily balances are added for the billing cycle. The total is then divided by the number of days in the billing period to get the "average daily balance."

Adjusted Balance. This is usually the most advantageous method for card holders. Your balance is determined by subtracting payments or credits received during the current billing period from the balance at the end of the previous billing period. Purchases made during the billing period aren't included. This method gives you until the end of the billing cycle to pay a portion of your balance to avoid the interest charges on that amount. Some creditors exclude prior, unpaid finance charges from the previous balance.

Previous Balance. This is the amount you owed at the end of the previous billing period. Payments, credits and new purchases during the current billing period are not included. Some creditors also exclude unpaid finance charges.

Two-cycle Balances. Issuers sometimes use various methods to calculate your balance that make use of your last two month's account activity. Read your agreement carefully to find out if your issuer uses this approach and, if so, what specific two-cycle method is used.

If you don't understand how your balance is calculated, ask your card issuer. An explanation must also appear on your billing statements.

Here's how some different methods of calculating finance charges affect the cost of credit:

	Average Daily Balance (including new purchases)	Average Daily Balance (excluding new purchases)
Monthly rate	1 ½%	1 ½%
APR	18%	18%
Previous Balance	$400	$400
New Purchases	$50 on 18th day	$50 on 18th day
Payments	$300 on 15th day (new balance = $100)	$300 on 15th day (new balance = $100)
Average Daily Balance	$270*	$250*
Finance Charge	$4.05 (1 ½% x $270)	$3.75 (1 ½% x $250)

* To figure average daily balance (including new purchases): ($400 x 15 days) + ($100 x 3 days) + ($150 x 12 days)/30 days = $270

** To figure average daily balance (excluding new purchases): ($400 x 15 days) + ($100 x 15 days)/30 days = $250

	Adjusted Balance	Previous Balance
Monthly rate	1½%	1 ½%
APR	18%	18%
Previous Balance	$400	$400
Payments	$300	$300
Average Daily Balance	N/A	N/A
Finance Charge	$1.50 (1 ½% x $100)	$6.00 (1 ½% x $400)

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Other Costs and Features

Credit terms vary among issuers. When shopping for a card, think about how you plan to use it. If you expect to pay your bills in full each month, the annual fee and other charges may be more important than the periodic rate and the APR, if there is a grace period for purchases. However, if you use the cash advance feature, many cards do not permit a grace period for the amounts due - even if they have a grace period for purchases. So, it may still be wise to consider the APR and balance computation method. Also, if you plan to pay for purchases over time, the APR and the balance computation method are definitely major considerations.

You'll probably also want to consider if the credit limit is high enough, how widely the card is accepted, and the plan's services and features. For example, you may be interested in "affinity cards" - all-purpose credit cards sponsored by professional organizations, college alumni associations and some members of the travel industry. An affinity card issuer often donates a portion of the annual fees or charges to the sponsoring organization, or qualifies you for free travel or other bonuses.

Special Delinquency Rates may also apply. Some cards with low rates for on-time payments apply a very high APR if you are late a certain number of times in any specified time period. These rates sometimes exceed 20 percent. Information about delinquency rates should be disclosed to you in credit card applications or in solicitations that do not require an application.

To save on the cost of credit cards, ask questions like these so you can make comparisons.

- Is there an annual fee, and if so, how much? Can it be waived?
- What is the interest rate on any balances? If there is a low, introductory rate, how long is it good for? What rate will be charged after the introductory period?
- What is the grace period on purchases—the time you have to pay before any interest is charged? There are cards with a zero grace period.
- What are the terms for a cash advance? Most cards charge a higher interest rate for cash advances and the interest starts to accrue immediately.

- What additional fees apply, such as late payment, over credit limit, cash advances, and others? Are there other hidden charges, such as a rise in the interest rate in the event of a late payment?

- One easy way to save money is to call your existing credit card company, tell them you plan to switch to a lower interest rate card, and ask what they can do for you. In many cases they will lower your interest rate to keep you as a customer. This is often effective if you have been a client with an account in good standing for a year or more, carry a balance, and are being charged over 14%.

- If you pay off your balance each month, get an account with a low or no annual fee. If you carry a balance, look for low APR and low or no fees.

- Avoid high priced add-ons such as credit life, credit disability, or credit unemployment insurance.

MILITARY CARDS 22

Military Star Card

The Military Star Card is a credit card that can be utilized at all military exchanges. This is a regular credit card and the government does not run the program. This card allows you to make purchases and defer payment over time just like any other credit card. The application process and screening is similar to other credit cards and finance charges will be assessed if the bill is not paid in full each month. The interest rate is a variable one, which means it will change with changes in overall interest rates. These debts are considered debts owed to the government. This means it is easy for them to reach into your paycheck to get the money you owe. There is also a uniform purchase plan available under the Military Star Card. Under this plan, you can purchase uniforms and uniform related items, pay for them over time, and no interest will be charged.

Government Credit Cards 23

Government credit cards may be issued to service members on an as-needed basis as determined by the command. If you are issued a Government Card it is important to remember that this is not for you to use for your personal expenses, only for command approved and authorized expenses. In most cases, you are supposed to get prior approval for purchases and they will be directly billed to the government. You need to be very clear on this point. For those issued travel cards, you may charge expenses for official trips and be reimbursed for approved expenses by your command. You must then pay the bill. The government isn't held liable when service members fail to pay overdue debt. There have been many instances of abuse by service members getting cash advances or making unapproved charges. These cards are ultimately your responsibility and failure to pay will be reflected on your credit report and cause you problems at the command. Bank of America says the percentage of delinquent accounts is significantly higher for military cards than comparable corporate charge cards. In fact, federal law now requires the Department of Defense to establish guidelines and procedures for disciplinary actions to be taken for improper, fraudulent or abusive use of official government charge cards.

Navy Cash Card

The Navy Cash program is a debit card system that gives sailors access to their home banks and credit unions while onboard ship. The card's PIN-protected "electronic-purse" chip on the front holds up to $1,000. The debit function, operated by MasterCard through a magnetic strip on the back, can hold an unlimited amount and can be used on shore. Sailors also can transfer money to and from their financial institution with the card.

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DEBT: HOW MUCH IS TOO MUCH?

Calculating your Debt-to-Income Ratio

Debt-to-Income Ratio

Calculating your debt-to-income ratio is an important part of avoiding excessive debt. This number tells you what portion of your income goes to pay debt each month. The handout "Debt-to-Income Ratio" helps you calculate the amount. Once you calculate your ratio, you can look at the scale (at the bottom of the handout) to see if you are taking on too much debt. Lenders will want to know this figure before they decide whether or not to give you a loan. Your Command Financial Specialist has a great budgeting program called the Financial Planning Worksheet that will automatically calculate your debt-to-income ratio, as well as other useful data that helps you build wealth, not debt.

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Warning Signs

Credit cards make spending easy and may encourage you to spend more than you can repay. Even if your debt-to-income ratio is still below 20%, be on the lookout for some of these warning signs:

- Not being able to pay off most credit cards each month, being able to afford only the minimum monthly payments on credit cards.
- Finding that more income each month is being committed to debt repayments.
- Falling behind on payments and receiving late notices.
- Having no money after paying bills and needing to take a cash advance to buy groceries or meet other regular monthly expenses.

Other Indicators 26

Other general indicators of difficulties that can be caused by or lead to credit problems include:

- Less than one month's take home pay in savings.
- Dependent on spouse's job or part time job to make ends meet every month. Many couples depend on two incomes periodically. However, with no cushion, what happens when it's time to move?
- Debt-to-income ratio of over 20%.
- At or near credit limits on credit cards most of the time.

Critical Point 27

Things are reaching the critical stage when an individual or family is:

- Rotating bills – paying some this month, some next month.
- Borrowing or getting cash advances to make payments – using credit to pay credit.
- Being denied additional credit due to problems on credit reports.
- Hiding bills or being dishonest with family members about debts.
- Seeking additional debt from predatory lending sources, like payday loans or refund anticipation loans.
- Relying on a debt consolidation loan to reduce payments enough to meet monthly living expenses.

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RECOVERING FROM DEBT

If you find yourself teetering on the brink of financial destruction, all is not lost. There are options for you.

Take Charge

Develop a workable budget and a spending plan. Do what is necessary to establish a positive monthly cash flow. Prioritize debts. Major items like your mortgage and car payment should normally be top priority.

Use a Power Payment Plan

After budgeting to get a positive cash flow, ensure minimum payments are made on all monthly bills, then apply all remaining available funds to whichever debt has the smallest balance. When the smallest balance is paid off, apply the money used for that payment to the next bill on your list and keep the others the same. Again, when that bill is paid off, apply all the money used for the payment to the next bill on your list. In this manner you will "power pay" down your debt. Your Command Financial Specialist has both a computerized budgeting program and power payment plan that make setting up a personal debt payment plan easy and flexible.

Talk to your Creditors

- Stay in contact with your creditors; let them know if there is a problem. If a friend owed you money and was avoiding you or not returning phone calls, you would think he or she was trying to "stiff" you. Businesses are the same way. Just talk to them.
- Be honest about what you can or cannot pay.
- Once you have determined how much you can pay to a creditor, approach them with a plan. Be careful of promising more than you can deliver.
- Change your behavior. Spend time thinking about how you got into debt to begin with … are you living beyond your means? Are you satisfying all your wants and sacrificing all your needs? Are you an emotional spender or an impulse shopper? Should you not use credit at all? Again, your CFS or FFSC Financial Educator can help you figure out what to change so that your behavior moves you in the direction of building wealth, not drowning in debt.

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Beware of …

Turning to a business that offers help in solving debt problems may seem like a reasonable solution when your bills become unmanageable. Be cautious. Before you do business with any company, check it out with your local consumer protection agency or the Better Business Bureau in the company's location.

Credit clinics/Credit Repair Services: Many charge up-front fees promising to "clean up your credit report" fast and get you out of debt. They cannot do anything for you that you cannot do for yourself. You see the ads in newspapers, on TV, and on the Internet. You hear them on the radio. You get fliers in the mail. You may even get calls from telemarketers offering credit repair services. They all make the same claims:

> *"Credit problems? No problem!"*
>
> *"We can erase your bad credit-100% guaranteed."*
>
> *"Create a new credit identity-legally."*
>
> *"We can remove bankruptcies, judgments, liens, and bad loans from your credit file forever!"*

Statements like these are simply not true and can even result in breaking the law and prosecution. Only time, a conscientious effort, and a plan for repaying your debt will improve your credit report.

Debt consolidation loans: At best, these are a temporary fix. Debt consolidation loans are not always bad. However, they will not work without also changing behavior. Studies consistently show that over 70% of all consumers that take out bill consolidation loans have a higher debt-to-income ratio 18 months later than when they first took out the loan.

The Last Resort: Bankruptcy

Ads promising debt relief may in reality be offering bankruptcy.

> *"Consolidate your bills into one monthly payment without borrowing."*
>
> *"STOP credit harassment, foreclosures, repossessions, tax levies and garnishments."*
>
> *"Keep Your Property."*
>
> *"Wipe out your debts! Consolidate your bills! How? By using the protection and assistance provided by federal law. For once, let the law work for you!"*

While the ads pitch the promise of debt relief, they rarely say relief may be spelled b-a-n-k-r-u-p-t-c-y. And although bankruptcy is one option to deal with financial problems, it's generally considered the option of last resort. The reason – it has a long-term negative impact on your creditworthiness. A bankruptcy stays on your credit report for 10 years and can hinder your ability to get credit, a job, insurance, or even a place to live. What's more, it can cost you significant attorneys' fees, and both financial counseling and financial education are mandatory for discharge. Still, it is a legal procedure that offers a fresh start for people who can't satisfy their debts. People who follow the bankruptcy rules receive a discharge — a court order that says they don't have to repay certain debts.

The consequences of bankruptcy are significant and require careful consideration. Other factors to think about: Effective October 2005, Congress made sweeping changes to the bankruptcy laws. The net effect of these changes is to give consumers more incentive to seek bankruptcy relief under Chapter 13 rather than Chapter 7. Chapter 13 allows you, if you have a steady income, to keep property such as a mortgaged house or car, that you might otherwise lose. In Chapter 13, the court approves a repayment plan that allows you to use your future income to pay off your debts during a three-to-five-year period, rather than surrender any property. After you have made all the payments under the plan, you receive a discharge of your debts.

Chapter 7, known as straight bankruptcy, involves the sale of all assets that are not exempt. Exempt property may include cars, work-related tools, and basic household furnishings. Some of your property may be sold by a court-appointed official — a trustee — or turned over to your creditors. The new bankruptcy laws have changed the time period during which you can receive a discharge through Chapter 7. You now must wait eight years after receiving a discharge in Chapter 7 before you can file again under that chapter. The Chapter 13 waiting period is much shorter and can be as little as two years between filings.

Both types of bankruptcy may get rid of unsecured debts and stop foreclosures, repossessions, garnishments, utility shut-offs, and debt collection activities. Both also provide exemptions that allow you to keep certain assets, although exemption amounts vary by state. Personal bankruptcy usually does not erase child support, alimony, fines, taxes, and some student loan obligations. Also, unless you have an acceptable plan to catch up on your debt under Chapter 13, bankruptcy usually does not allow you to keep property when your creditor has an unpaid mortgage or security lien on it.

Another major change to the bankruptcy laws involves certain hurdles that you must clear before even filing for bankruptcy, no matter what the chapter. You must get credit counseling from a government-approved organization within six months before you file for any bankruptcy relief. You can find a state-by-state list of government-approved organizations at www.usdoj.gov/ust. That is the website of the U.S. Trustee Program, the organization within the U.S. Department of Justice that supervises bankruptcy cases and trustees. Also, before you file a Chapter 7 bankruptcy case, you must satisfy a "means test." This test requires you to confirm that your income does not exceed a certain amount. The amount varies by state and is publicized by the U.S. Trustee Program at www.usdoj.gov/ust.

Identity Theft

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An identity thief is someone who obtains some piece of your sensitive information, like your Social Security number, date of birth, address, and phone number, and uses it without your knowledge to commit fraud or theft.

Skilled identity thieves use a variety of methods to gain access to your personal information. For example, they may get information from businesses or other institutions by:

- Stealing records or information while they're on the job.
- Bribing an employee who has access to these records.
- Hacking these records.
- Conning information out of employees.
- Rummaging through your trash, the trash of businesses, or public trash dumps in a practice known as "dumpster diving".
- Getting your credit reports by abusing their employer's authorized access to them or by posing as a landlord, employer, or someone else who may have a legal right to access your report.
- Stealing your credit or debit card numbers by capturing the information in a data storage device in a practice known as "skimming." They may swipe your card for an actual purchase or attach the device to an ATM machine where you may enter or swipe your card.
- Stealing wallets and purses containing identification and credit and bank cards.

- Stealing mail, including bank and credit card statements, new checks, or tax information.
- Completing a "change of address form" to divert your mail to another location.
- Stealing personal information from your home.
- Scamming information from you by posing as a legitimate business person or government official.

How Identity Thieves Use Your Information: Once identity thieves have your personal information, they may:

- Go on spending sprees using your credit and debit card account numbers to buy "big-ticket" items like computers that they can easily sell.
- Open a new credit card account, using your name, date of birth, and Social Security number. When they don't pay the bills, the delinquent account is reported on your credit report.
- Change the mailing address on your credit card account. The imposter then runs up charges on the account. Because the bills are being sent to the new address, it may take some time before you realize there's a problem.
- Take out auto loans in your name.
- Establish phone or wireless service in your name.
- Counterfeit checks or debit cards, and drain your bank account.
- Open a bank account in your name and write bad checks on that account.
- File for bankruptcy under your name to avoid paying debts they've incurred or to avoid eviction.
- Give your name to the police during an arrest. If they are released and don't show up for their court date, an arrest warrant could be issued in your name.

Protecting Yourself: Managing your personal information is key to minimizing your risk of becoming a victim of identity theft.

- Keep an eye on your purse or wallet, and keep them in a safe place at all times.

- Don't carry your Social Security card.
- Don't share your personal information with people you don't know. Identity thieves are really good liars and could pretend to be from banks, Internet service providers, or even government agencies to get you to reveal identifying information.
- Read the statements from your bank and credit accounts. Look for unusual charges or suspicious activity. Report any problems to your bank and creditors right away.
- Tear up or shred your charge receipts, checks and bank statements, expired charge cards, and any other documents with personal information before you put them in the trash.

How to tell if you're a Victim of Identity Theft: Monitor the balances of your financial accounts. Look for unexplained charges or withdrawals. Other indications of identity theft can be:

- Failing to receive bills or other mail signaling an address change by the identity thief.
- Receiving credit cards for which you did not apply.
- Denial of credit for no apparent reason.
- Receiving calls from debt collectors or companies about merchandise or services you didn't buy.

What to Do If Your Identity's Been Stolen: If you suspect that your personal information has been used to commit fraud or theft, take the following four steps right away. Follow up all calls in writing; send your letter by certified mail and request a return receipt so you can document what the company received and when. Keep copies for your files.

1. Place a fraud alert on your credit reports and review your credit reports. Contact any one of the nationwide CRAs to place a fraud alert on your credit report. Fraud alerts can help prevent an identity thief from opening any more accounts in your name. The company you call is required to contact the other two, which will place an alert on their versions of your report, too.

   Equifax: 1-800-525-6285; www.equifax.com

   Experian: 1-888-EXPERIAN (397-3742); www.experian.com

   TransUnion: 1-800-680-7289; www.transunion.com

In addition to placing the fraud alert on your file, the three CRAs will send you free copies of your credit reports and, if you ask, they will display only the last four digits of your Social Security number on your credit reports.

2. Close the accounts that you know or believe have been tampered with or opened fraudulently.

   Contact the security or fraud department of each company where you know or believe accounts have been tampered with or opened fraudulently. Follow up in writing, and include copies (NOT originals) of supporting documents. It's important to notify credit card companies and banks in writing. Send your letters by certified mail, return receipt requested, so you can document what the company received and when. Keep a file of your correspondence and enclosures.

   When you open new accounts, use new Personal Identification Numbers (PINs) and passwords. Avoid using easily available information like your mother's maiden name, your birth date, the last four digits of your Social Security number or your phone number, or a series of consecutive numbers.

3. File a report with your local police or the police in the community where the identity theft took place.

   Get a copy of the police report or, at the very least, the number of the report. It can help you deal with creditors who need proof of the crime. If the police are reluctant to take your report, ask to file a "Miscellaneous Incidents" report, or try another jurisdiction, like your state police. You also can check with your state Attorney General's office to find out if state law requires the police to take reports for identity theft. Check the Blue Pages of your telephone directory for the phone number or check www.naag.org for a list of state Attorneys General.

4. File a complaint with the Federal Trade Commission.

   By sharing your identity theft complaint with the FTC, you will provide important information that can help law enforcement officials across the nation track down identity thieves and stop them. The FTC also can refer your complaint to other government agencies and companies for further action, as well as investigate companies for violations of laws that the FTC enforces.

   You can file a complaint online at www.consumer.gov/idtheft.

If you don't have Internet access, call the FTC's Identity Theft Hotline toll-free: 1-877-IDTHEFT (438-4338); TTY: 1-866-653-4261; or write: Identity Theft Clearinghouse, Federal Trade Commission, 600 Pennsylvania Avenue, NW, Washington, DC 20580.

For more information, see ID Theft: What's It All About or Take Charge: Fighting Back Against Identity Theft at ftc.gov//idtheft.

Talk to a Professional 31

If your debt problem is significant enough that you can't figure out a repayment plan on your own, seek help from a professional debt management program. These agencies aim to help people pull themselves out of debt by using an approved debt-repayment plan. This is a plan developed for you that is personalized to your repayment capabilities. It is a creditor-approved arrangement that allows you to repay unsecured debt at reduced interest rates. You must agree to take on no new debt and to make one monthly payment to the agency that they in turn send to your creditors.

In order to avoid some of the "Non-profit" Debt Management Programs that aren't really non-profit, find a reputable agency through www.aiccca.org and www.nfcc.org. You can also check with your local bank and credit union for debt management programs offered there.

Sources of Help 32

You have a variety of resources at your disposal.

- For further information and assistance, your first stop should be your Command Financial Specialist.
- Your Fleet and Family Support Center.
- Navy Legal Services can provide assistance in a dispute over a bill or contract. They strongly encourage service members when making any major purchase to come in with a copy of the contract before signing it. They can also help you with any defenses you may have under federal or state laws, such as the Truth-in-Lending Act, the Servicemembers Civil Relief Act, the Equal Credit Opportunity Act, FACTA, the Fair Debt Collections Practices Act, the Fair Credit Billing Act and the new Military Lending Act.
- Your local Defense Credit Unions often have financial counselors available who provide a range of services to members, up to and including full-scale debt management programs.

- Non-profit Consumer Credit Counseling Agencies also provide low- or no-cost financial counseling and debt management.

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SUMMARY

With all the money companies stand to make by extending credit, it is no wonder it has become a regular part of our financial life. Managed correctly, credit, whether loans or credit cards, can be a great tool. Abused, they can lead to higher costs, denials, and even bankruptcy. Keep in mind these healthy tips for using credit wisely:

- Have a working budget or financial plan, keep it up-to-date, and live within your means.
- Calculate your current debt-to-income ratio and keep monthly payments at 15 to 20% of your net income or less.
- Plan all credit purchases; make sure they fit in your budget.
- Shop around for any credit; it is just like any other product you would buy. Look for the best deal.
- Check your credit report annually and keep it spotless.
- Use all of your available resources to help you plan and to help you get out of debt.
- Remember, financial success is more about behavior than it is about money. If you're in financial distress, figure out why and change your behavior so you can build wealth, not debt.