Managing Credit & Debt

Presenter:
[William Cheeks, ABBA Associates Inc.]

Jump$tart Teacher Training Program
Managing Credit & Debt
EIGHT TOP FINANCIAL WORRIES OF AMERICANS

Affording Retirement
Affording Medical Emergencies
Affording Accustomed Standard of Living
Affording Normal Healthcare Cost
Affording Normal Monthly Bills
Affording Children College Tuition
Affording Mortgage/Housing Cost
Affording Minimum Credit Card Payments
1. What is the one thing you wish you had learned early on about managing credit & debt?  
   (or)  
   When did you make your first credit purchase and for what?
Seminar Topics

• Explore strategies to use credit and manage debt
  – Why & how people borrow
  – Advantages & disadvantages of using credit
  – How individual credit impacts society
  – Elements that impact credit/FICO scores
  – When & why credit history is shared
  – Credit application & review process
  – Consequences of high & low credit scores
  – Consequences of excessive debt
  – Strategies to manage credit use and reduce debt
  – How to address credit reporting errors
  – Consumer rights related to credit
Myth Busters

• To improve credit, get rid of debt and cut up cards.

• Never use a credit card-always use cash.

• It's OK to charge it; if you can't afford it, just pay minimum.

• It's OK if you are late making a payment if you paid more than minimum the previous month.
Myth Busters (cont.)

• There is no problem making your credit payment online through your financial institution the day it is due.

• It doesn't cost anything to use a credit card if you pay your bills on time.

• The best cards are the ones that offer 1% back on what you spend.

• You need to give permission for someone to look at your credit.
What is credit?

• Obtaining goods or services and paying for them at a later date under agreed upon terms
• Credit cards, mortgages and car loans
• Service contracts: cable television, telephone, utility service
• Your financial references
The credit cycle

You pay lender

Credit reporting companies share with new lenders

Lender updates records

Lender shares history with credit reporting companies
Credit Terminology

- Credit limit/line of credit
- APR – annual percentage rate
- Compounded interest
- Average daily balance
- Grace period
- Late payment fee
- Finance charge
- Annual fee
Credit Agreement = Legal Obligation

- Rights & responsibilities of both parties
- Enforced by law
- Promise to carry out parts of agreement
- Description of subject matter (exchange)
- Credit terms & conditions
- Default & remedies
- Effective date; Expiration date
- Identity of parties
Types of Credit

• Debt for items that may increase in value
  – Mortgage Note
  – Line of Credit
  – Student Loan

• Consumer Debt – items do not increase in value
  – Revolving Account
  – Installment Loan
  – Payday Loan/Cash Advance
5 C’s of Credit

Character
Capacity
Capital
Collateral
Conditions
Tips for Utilizing Credit

• Don’t max out your available credit
• Don’t open multiple accounts in short period to boost your score
• Don’t close old credit card accounts
• ALWAYS pay your accounts on time
Payment Cards

• Credit Cards
  – General Purpose cards
    • Visa
    • MasterCard
    • Discover
    • American Express
  – Proprietary (store) cards

• Debit cards (linked to a checking account)

• Prepaid Cards/Stored value cards
A Word on Credit vs. Debit Cards

(Visa and MasterCard logos)

Credit Cards
- Versatile, widely accepted payment card product
- Allows for payment in full each month
- Also, can revolve a purchase balance for many months
- Cardholder required to make a minimum monthly payment

Debit (Check) Cards
- A versatile widely accepted payment card product
- Linked directly to cardholder’s checking account
- Used like a check
- Purchase is deducted directly from cardholder’s checking account
The Bad

- High interest rates
- Fees
  - Late
  - over the limit
  - cash advances
  - etc etc etc
- Maybe too convenient
- Debit cards - less protection if lost or stolen
The Ugly

Too much debt
  – Fees and late payments increase amount owed
  – Stress/Depression
  – Judgments can result if not successfully challenged
  – Bankruptcy stays on your credit report for 10 years
Tips for Using Credit Cards Responsibly

1. Understand the credit card terms
2. Don’t be a “revolver”
3. Pay more than the minimum
4. Say “NO” to cash advances
5. Pay on time
6. Stay well within your credit limits
7. Monitor your interest rate
8. Review your monthly statements
Managing Debt

1. Assess your debt situation
2. Set priorities for getting out of debt
3. Calculate repayment options to get out of debt
4. Identify ways to avoid or correct debt problems
Debt Load

• Consumer Debt Guideline:
  – <10-20% of net income

• 28/36 Rule:
  – debt <28% of gross monthly income
  – total debt service (inc. house payments & utilities) <36% gross income
Cost of Borrowing

• Installment loans
• Mortgage note
• Revolving accounts
Your Debt Management Strategy

• Use what you have learned to
  – Predict how your financial goals will be affected by your existing credit history
  – Identify at least one new strategy to employ to make a positive impact on your credit rating
  – Identify at least one strategy to incorporate credit and debt management concepts into the classroom
Scenario: What do you think?

Megan plans to take out a small personal loan for a week-long vacation. She recently graduated from college and has signed a contract to begin a new job in a month. Before starting her full-time job, Megan has arranged to spend time with friends for an impromptu vacation. She will charge her airfare, hotel, and rental car on her two credit cards. She intends to cover the other travel expenses with the $2,000 loan and $250 cash she has on hand.
Credit Report Impact

YOUR CREDIT FILE
(Credit Reporting History)

- Purchasing a Home or Renting an Apartment
- Getting Utilities
  - Gas Company
  - Electric Company
- Acquiring a:
  - Cell Phone
  - Home Phone
- Getting A Loan
- Auto, Life, Fire Homeowners Insurance
- For Sale
- For Sale
- Cell Phone
- Home Phone
- Purchasing A Car
- Gas Company
- Electric Company
Credit reports and financial services make the world go round
What is a Credit Report?

It’s a detailed record of your history of borrowing money and paying it back.

Report card about your credit standing

Used by lenders, insurance companies, landlords, and employers to determine whether you have good financial habits

Credit reports are provided by credit bureaus based upon information provided to them by creditors on a voluntary basis.
Who Are the Credit Bureaus?

There are three major credit bureaus:
Free Credit Reports

You are entitled to one free copy of your credit report from each of the three credit bureaus annually.

- www.annualcreditreport.com
- 1-877-322-8228
- Annual Credit Report Request Service
  PO Box 105281, Atlanta, GA 30348-5281
- Credit Score does not come automatically with free report
New Trends

- **Emerging Credit Score Model**
  - Targeted to the approximately 45 million Americans who are outside the credit system.

- **Rental Data**
  - RentBureau

- **FICO 9**
  - Newest scoring model puts less weight on paid collection debt and medical bills.
What is on a Credit Report?

Here is what is contained in your credit report:

- Identification and employment information
- Account information and payment history
- Collection accounts
- Public record
- Inquiries from creditors/potential employers
What is on a Credit Report?

Consumer Information:

<table>
<thead>
<tr>
<th>Name</th>
<th>Jane Doe</th>
</tr>
</thead>
<tbody>
<tr>
<td>Social Security Number</td>
<td>123-45-6789</td>
</tr>
<tr>
<td>Birthdate</td>
<td>4/15/1965</td>
</tr>
<tr>
<td>Address</td>
<td>123 Apple Lane</td>
</tr>
<tr>
<td></td>
<td>Anywhere, OH 12345</td>
</tr>
<tr>
<td></td>
<td>456 Dove Street</td>
</tr>
<tr>
<td></td>
<td>Flying High, CA 55443</td>
</tr>
<tr>
<td>Current employer</td>
<td>Pretend Manufacturing</td>
</tr>
<tr>
<td>Previous employer</td>
<td>Nice Time Employer</td>
</tr>
</tbody>
</table>
What is on a Credit Report?

Credit Summary:

<table>
<thead>
<tr>
<th>Revolving Accounts</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Count</td>
<td>4</td>
</tr>
<tr>
<td>Balance</td>
<td>5678</td>
</tr>
<tr>
<td>Current</td>
<td>3</td>
</tr>
<tr>
<td>Delinquent</td>
<td>1</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total Accounts</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Count</td>
<td>6</td>
</tr>
<tr>
<td>Balance</td>
<td>127,428</td>
</tr>
<tr>
<td>Current</td>
<td>5</td>
</tr>
<tr>
<td>Delinquent</td>
<td>1</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Account Summary</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Open</td>
<td>6</td>
</tr>
<tr>
<td>Closed</td>
<td>0</td>
</tr>
<tr>
<td>Public Records</td>
<td>0</td>
</tr>
<tr>
<td>Inquiries (Prev 2 years)</td>
<td>4</td>
</tr>
</tbody>
</table>
What is on a Credit Report?

Account History:

<table>
<thead>
<tr>
<th>Creditor Name - (i.e. XYZ Bank)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Account Number</td>
<td>1234-XXXX-XXXX-XXXX</td>
</tr>
<tr>
<td>Account Type</td>
<td>Revolving</td>
</tr>
<tr>
<td>Responsibility</td>
<td>Individual</td>
</tr>
<tr>
<td>Monthly Payment</td>
<td>$55</td>
</tr>
<tr>
<td>Date Opened</td>
<td>9/1998</td>
</tr>
<tr>
<td>Date Reported</td>
<td>5/2012</td>
</tr>
<tr>
<td>Balance</td>
<td>$2750</td>
</tr>
<tr>
<td>Credit Limit</td>
<td>$5000</td>
</tr>
<tr>
<td>High Balance</td>
<td>$3500</td>
</tr>
<tr>
<td>Past Due</td>
<td>$0</td>
</tr>
<tr>
<td>Remarks</td>
<td>Current, was 90 days past due</td>
</tr>
</tbody>
</table>

Payment History

<table>
<thead>
<tr>
<th>Year One</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012&gt;</td>
</tr>
<tr>
<td>2011&gt;</td>
</tr>
<tr>
<td>5        4</td>
</tr>
<tr>
<td>OK</td>
</tr>
</tbody>
</table>
### Public Record Information:

<table>
<thead>
<tr>
<th>Bankruptcy</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Type</strong></td>
</tr>
<tr>
<td><strong>Status</strong></td>
</tr>
<tr>
<td><strong>Date Filed</strong></td>
</tr>
<tr>
<td><strong>Reference Number</strong></td>
</tr>
<tr>
<td><strong>Closing Date</strong></td>
</tr>
<tr>
<td><strong>Court</strong></td>
</tr>
<tr>
<td><strong>Liability</strong></td>
</tr>
<tr>
<td><strong>Exempt amount</strong></td>
</tr>
<tr>
<td><strong>Asset amount</strong></td>
</tr>
<tr>
<td><strong>Remarks</strong></td>
</tr>
</tbody>
</table>
Credit Inquiries:

<table>
<thead>
<tr>
<th>Creditor Name</th>
<th>Date of Inquiry</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank of USA</td>
<td>9/7/2009</td>
</tr>
<tr>
<td>Orange Mortgage Company</td>
<td>10/1/2011</td>
</tr>
</tbody>
</table>
Information you provide in an application for credit, housing, or insurance is reported to credit reporting companies.
How long is information kept on a report?

<table>
<thead>
<tr>
<th>Information Type</th>
<th>Retention Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Open accounts in good standing</td>
<td>Indefinitely</td>
</tr>
<tr>
<td>Closed accounts in good standing</td>
<td>10 years</td>
</tr>
<tr>
<td>Late or missed payments</td>
<td>7 years</td>
</tr>
<tr>
<td>Collection accounts</td>
<td>7 years</td>
</tr>
<tr>
<td>Civil judgments</td>
<td>7 years</td>
</tr>
<tr>
<td>Chapter 7 bankruptcy</td>
<td>10 years</td>
</tr>
<tr>
<td>Chapter 13 bankruptcy</td>
<td>7 years</td>
</tr>
<tr>
<td>Unpaid tax liens</td>
<td>10 years</td>
</tr>
<tr>
<td>Paid tax liens</td>
<td>10 years</td>
</tr>
<tr>
<td>Credit inquiries</td>
<td>2 years</td>
</tr>
</tbody>
</table>
Credit Reporting Rights

- Fair Credit Billing Act
- Fair Credit Reporting Act
- Fair Debt Collection Practices Act
- Equal Credit Opportunity
- Truth in Lending Act
- Bankruptcy Abuse Prevention & Consumer Protection Act
- Credit Card Act of 2009
Credit Card Accountability, Responsibility and Disclosure Act

An issuer cannot raise a customer’s rate on an existing balance unless the consumer is more than 60 days behind on a payment.
Prohibits applying interest rate charges to two full cycles of card balance.
Requires mailing bills 21 days before the due date.
Prohibits charging over-the-limit-fees unless the cardholder first opts-in to the charges. Fees must be reasonable.
Requires promotional rates to last at least six months and
Prohibits increasing rates on new transactions in the first year the card account is opened.
Common myths about credit reporting

When paid, the bad debt will go away

The credit reporting company denied me credit

I’m not responsible for those charges on our account

A divorce decree separates joint accounts

Consumers must give their permission for a report to be issued (employment is the exception)

Requesting your own report and preapproved offers harms your credit history

There is only one credit score and it is on every report
Credit Score Myths

Which of these are true:

• Some items stay on your credit for 10 years

• Closing accounts always helps your score

• Checking your FICO score can hurt your credit

• Applying for a retail card hurts your score

• A divorce decree automatically severs joint accounts

• I don’t need to check my credit report if I pay my bills on time
Credit Score ➔ Screening Tool

• lenders
  – new accounts
  – change credit lines
• insurance (auto; homeowners; life)
• apartment rentals
• cell phone service providers
• utilities (electric, gas, water, cable)
• employers
• change credit lines
How do I Dispute My Report?

Fair Credit Reporting Act

• The Dispute Process is free
  • Send certified letter to CRA and creditor in question
  • CRAs must investigate within 30 days
• Must delete what they can’t verify
• Must correct inaccuracies
• Must report back to you
• Must share the updated information with the other credit reporting agencies
• Once report is updated, you are entitled to new report
You can’t have information removed if it is accurate.

- Negative account information will be reported for 7 years from the date of first delinquency
- Chapter 7 bankruptcy - 10 years
- Chapter 13 bankruptcy - 7 years
- Defaulted student loans, judgments on loans, and lawsuits can be listed longer per individual state statute
- Foreclosures – 7 years from the filing date
- Hard Inquiries – 2 years
Initiating a dispute

- Must get report directly from Credit Reporting Agency
  - Toll-free number on report gives you access to customer service
  - Report number identifies you and your record
  - You and customer service representative will be looking at the same information in the same order
- Can dispute online, by telephone or by mail
- Dispute must be specific
Processing a dispute

• Credit reporting company verifies with the source of the information (creditor or court)
• Must allow up to 45 days for processing
• Source verifies, corrects or updates
• Secure, encrypted electronic system is used
• Creditors required to report corrections to all databases
• Consumer can add statement of dispute if issue is not resolved with source
Credit Scores

What are they?

• A number developed from a calculation using the information from your credit report.

• Most widely used is the Fico Score
  • Scores range from 300-850

• Other scoring models that use the 300 – 850 scoring range
  • Beacon - Equifax
  • Empirica – TransUnion
  • Plus - Experian

• New Score being introduced called Vantage Score
  • Scores range from 300-850

• The higher the score, the better risk you are determined to be and the better rate you will be eligible for.
What Makes Up My Score?

The 5 areas a FICO score considers

- **Amount of Debt**: 30%
- **Payment History**: 35%
- **Types of Credit Used**: 10%
- **New Credit**: 10%
- **Length of Credit History**: 15%
Payment History (35%)

Key Factors

• Recency
• Severity
• Frequency
Key Factors

- Credit card debt
- Installment debt
Amount of Debt (30%)

Credit Utilization Ratio

Total credit limit of 5 cards $25,000

Total of balances $7,500

30% Credit Utilization

Total credit limit of 4 cards $15,000

Total of balances $7,500

50% Credit Utilization

Close one zero balance card with $10,000 credit limit
Length of Credit History (15%)

Key Factors

- How long have accounts been established?
- New accounts
New Credit (10%)

Key Factors

- Inquiries
- New accounts
Types of Credit Used (10%)

Key Factors

- Revolving credit
- Installment credit
- Mortgage credit
# How Mistakes Affect FICO Scores

<table>
<thead>
<tr>
<th>Credit mistake</th>
<th>If your score is 680</th>
<th>If your score is 780</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maxed-out card</td>
<td>Down 10 to 30 pts.</td>
<td>Down 25 to 45 pts.</td>
</tr>
<tr>
<td>30-day late payment</td>
<td>Down 60 to 80 pts.</td>
<td>Down 90 to 110 pts.</td>
</tr>
<tr>
<td>Debt settlement</td>
<td>Down 45 to 65 pts.</td>
<td>Down 105 to 125 pts.</td>
</tr>
<tr>
<td>Foreclosure</td>
<td>Down 85 to 105 pts.</td>
<td>Down 140 to 160 pts.</td>
</tr>
<tr>
<td>Bankruptcy</td>
<td>Down 130 to 150 pts.</td>
<td>Down 220 to 240 pts.</td>
</tr>
</tbody>
</table>

*Source: FICO*
Nationwide Range of Credit Scores

National Distribution of FICO Scores

FICO Score Range

% of Population

<table>
<thead>
<tr>
<th>Range</th>
<th>% of Population</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to 499</td>
<td></td>
</tr>
<tr>
<td>500-549</td>
<td></td>
</tr>
<tr>
<td>550-599</td>
<td></td>
</tr>
<tr>
<td>600-649</td>
<td></td>
</tr>
<tr>
<td>650-699</td>
<td></td>
</tr>
<tr>
<td>700-749</td>
<td></td>
</tr>
<tr>
<td>750-799</td>
<td></td>
</tr>
<tr>
<td>800+</td>
<td></td>
</tr>
</tbody>
</table>
The FICO Score Indicates Risk

Chance of 90 days past due or worse over 2 years.

Source: FICO
Improving Your Credit Score

These steps will improve your credit score:

• Pay bills on time

• Reduce debt

• Keep balances low relative to your credit limits

• Apply for and open new lines only when you need them

• Check your credit report for accuracy and clear errors as soon as possible
Establishing Credit

- Secured Credit Card
- Bank Card
- Retail Card
- Secured Loan
  - CD Loan
- Co-signer

Check with your financial institution. Many have credit building products.
Opting Out

• Credit Card Solicitations
  • Call 1-888-5-OPT-OUT (567-8688)
  • Website: www.optoutprescreen.com
  • Stops credit bureaus from selling your name
  • You can choose to be off lists for 5 years or permanently

• Do Not Call Registry
  • Stops telemarketing solicitations
  • Register at www.donotcall.gov or 1-888-382-1222
Scenario:
What do you think?

The Sweeney family

• 2 children in college (freshman, junior)
• Both students have summer jobs & work study jobs
• Past tuition payments were covered by savings and mutual funds that parents set up years ago from their earnings
• Father recently became disable due to car accident & is temporarily out of work
• Some of college savings were used to pay medical bills
• Parents are considering a loan to pay part of fall tuition
Ten rules for managing credit

1. Establish a credit report
2. Always pay as agreed
3. Get a credit card
4. Use caution in closing accounts
5. Apply for credit judiciously
6. Time is key
7. Demonstrate stability
8. Have a plan
9. Put credit to work for you
10. Share your knowledge
PENNY A DAY DOUBLED

Day 1: $.01
Day 2: $.02
Day 3: $.04
Day 4: $.08
Day 5: $.16
Day 6: $.32
Day 7: $.64
Day 8: $1.28
Day 9: $2.56
Day 10: $5.12
Day 11: $10.24
Day 12: $20.48
Day 13: $40.96
Day 14: $81.92
Day 15: $163.84
Day 16: $327.68
Day 17: $655.36
Day 18: $1,310.72
Day 19: $2,621.44
Day 20: $5,242.88
Day 21: $10,485.76
Day 22: $20,971.52
Day 23: $41,943.04
Day 24: $83,386.08
Day 25: $167,772.16
Day 26: $335,544.32
Day 27: $671,088.64
Day 28: $1,342,177.28
Day 29: $2,684,354.56
Day 30: $5,368,709.12
Day 31: $10,737,418.24
Reflection

• Reflect on lessons have you learned the hard way about managing credit and debt and what you wish you had known as a youth.
  – As a tween, teen, or young adult, what do you wish you had known about managing finances then that you know now?
  – What is a personal finance lesson you have learned from a mistake?
  – How can you help your students develop skills to make informed credit decisions?
More Resources

These organizations can help:

Apprisen
1-800-355-2227
www.apprisen.com

Federal Trade Commission
www.ftc.gov

Consumer website for credit scores
www.myfico.com
www.scoreinfo.org

Free Credit Reports
www.annualcreditreport.com

Activity Ideas:

• http://www.themint.org/teachers/buy-now-and-pay-later.html
• http://www.thirteen.org/finance/educators/lesson3.html
• http://www.pbs.org/wgbh/pages/frontline/teach/credit/
• http://learning.blogs.nytimes.com/?s=credit
• http://www.igrad.com/games/credit-card-simulator.aspx
Education Resources – On the Web

- **Free annual FACT Act credit report**
  - [www.annualcreditreport.com](http://www.annualcreditreport.com)
    - Access to free report from each of the three credit reporting companies

- **Experian**
  - [www.experian.com/crediteducation](http://www.experian.com/crediteducation)
    - Ask Experian advice column, sample consumer report, frequently asked questions
  - [www.livecreditsmart.com](http://www.livecreditsmart.com)
    - Credit trends and information to inspire consumers to use credit wisely
    - Electronic versions of our published materials, sample credit report, videos, PowerPoint presentations with talk notes and more