Lesson 17

Unmask the Credit Monster

You may agree with me that today's marketplace makes it very easy to spend money. As a matter of fact, I could spend my entire monthly allocation in just a few minutes sitting right where I am. Online shopping has added a completely new meaning to the expression "shop till you drop". But think of all of that money I'm saving on gas by shopping online...right. The varied and multifaceted opportunities to spend, coupled with very aggressive credit card issuers create the perfect storm for the consumer. So, let's take a look at the credit business in general and credit cards in particular to see if we can master some techniques which will prevent us from becoming victims of the credit system.

The credit reporting system is a very complicated and confusing one. You are constantly seeing pitches attempting to take even more of your money by selling various credit services to you that should be provided for you (and usually are) for nothing. For example, every consumer is entitled to a free annual credit report from each of the three Credit Reporting Agencies.

Go to www.annualcreditreport.com to take advantage of this free service.

Your credit score is not provided on the free report, but often, your bank or insurance company will provide a free credit score periodically. It would be easier if we could just ignore the credit score, but unfortunately, we all need to make an effort to maintain a good one. Even if you don't plan on buying anything on credit, the credit score is now used to evaluate insurance premium rates, housing rental applications and job applications, to mention a few.

The FICO© score (formerly Fair, Isaac and Company) is one of the most popular monitored credit scores. You can go to *www.myfico.com* to find out more than you probably want to know, but here is a quick summary. Your credit score will fall in the range from 300 to 850.

The higher, the better. Generally, a score above 700 is good; above 800 is excellent.

There are numerous factors that affect your credit score, and it has been my experience that no one can predict exactly the impact of one particular action on your credit score. Based on my experience, two factors have a major influence on your score.

First, the amount and length of your credit history. That means you want several different types of creditors reporting good information for a long period of time. This information of yours is reported to 3 major Credit Reporting Agencies, also called Credit Bureaus: Experian©, Equifax© and TransUnion©. The second major influence is the debt to available credit ratio for your accounts. For example, if you have an account with a $10,000 credit limit and you have a $5,000 balance, the debt to available credit ratio is 50%. You want to maintain the debt to available credit ratio near or below 20% to improve your credit score. High ratios negatively affected your score because it appears you are pressing your credit limit and not managing responsibly.

Bottom line: if you have a good payment history on several accounts for the last two years and your debt to available credit ratios are kept low, your credit score should be well above average unless there is some previous history dragging you down.

Credit problems such as late payments, creditor initiated closed accounts, written off accounts, and other negative information generally remain on your credit report for seven years. As a consumer, you have certain rights under the Fair Debt Collection Practices Act. Information regarding those rights and others can be found at the Federal Trade Commission's website, www.ftc.gov.

I am often asked about the impact on one's credit score if they seek help paying off their debts with not for profit credit counseling organizations that offer consumer debt relief. The point to remember is that the Credit Bureaus do not influence your score. They only compile and report what creditors report to them. So, your credit score is totally dependent upon the information the creditor reports to the Credit Bureaus. Consequently, a debt payoff plan through a non-profit agency may negatively affect your credit – it just depends on how the creditor reports the payment history. Monitor your credit report on a regular basis. If you find errors, the credit bureaus have processes in place for you to use to correct errors. **I strongly encourage you to communicate with your individual creditors if problems are on the horizon.** It is much easier to deal with a creditor before a delinquency occurs rather than after – be very proactive. That's why every creditor provides a toll free number – use it.

We can't talk about credit without discussing most every American's favorite form of credit – the credit card. I will go ahead and state what should be the obvious: if you are in the red on the Financial Condition and Stress Meter, your use of credit cards should cease immediately, at least until the meter moves considerably to the left. And, for some people, the credit card should be off limits, period. The most recent federal data indicates the average household credit card debt in the US has increased to over $16,000! I'm hoping you're not helping raise the average. If you are, use the tools we discussed in Weeks 3 and 4 to attack the debt aggressively. On the other hand, for those who have a balanced budget in place and have been operating on it successfully for at least six months, a credit card can be a useful tool.

The key to remember about the credit card is that we want it working for us, not the creditor.

Credit cards can work for us in the form of convenience, rebates and security. However, **studies have shown that you or I will spend more if we regularly use a credit card than if we use cash.** Why is that? Think about this scenario: you or I walk into the big box store and see a flat screen that we really like for $1000. If we walk to the register and slide or insert the credit card very little wrist motion is required, and the transaction is almost invisible. But, if we had to count out fifty $20 bills, by the time we counted to number 25, we might start having second thoughts about how nice that flat screen looked. Let's admit it, that credit card makes it all too easy to spend money.

So, how do we make them work for us? First of all, we should shop for the best deal on a credit card just like we shop for the best deal on anything else. I have two minimum requirements for a credit card. 1) There is no annual fee. 2) The card pays me a rebate in cash. Some people like airline points and other types of benefits. For me, the cash rebate is king, because I can use the cash for anything, unlike some of the other types of rebate. **Various web sites are listed in the appendix to help you compare credit card offers.**

Next, it is imperative that the monthly balance on the credit card is paid in full by the payment due date each month. If the balance is not paid in full or if the payment is late there is no "grace period" on the interest rate. You will then pay the stated interest on the previous balance and interest on your next purchase from the instant you make the purchase. Also, a late payment usually results in the interest rate jumping to the highest rate allowed stated on your credit card agreement. During counseling sessions, I've had people complain to me about what the credit card company had just done to them (raising rates, closing accounts, etc.). Please hear this. The credit card company did not do anything that the credit card holder did not authorize them to do when the user signed the credit card agreement. We are often guilty of not reading what we sign. If there is any doubt that you will not pay your credit card bill in full and on time, make certain you know the consequences that you have agreed to in writing.

Make the pledge today, that if you don't pay the balance in full, you will stop using the account until you do.

Other credit related topics that I am often asked about are balance transfers, zero percent offers and loan consolidations. If you receive a balance transfer offer and can transfer a credit card balance which is costing you interest each month to one which doesn't, obviously the zero rate is preferable. But, it is not quite that simple. There is almost always a transfer fee, typically around 3%. If you transfer $10,000, your transfer fee would be $300 at a 3% rate; $500 at 5%, etc. Compare that to the remaining amount of interest you would pay on the original account; if the savings are considerable, then the transfer might be to your advantage. Realize also, each time a creditor makes an inquiry into your credit history, that inquiry reduces your credit score slightly. Several inquiries over a short period of time can significantly reduce your score.

What about the home improvement store's offer of making a major purchase with 0% interest rate for six or twelve months – often called "same as cash"? I will place a big **IF** on this one. **IF** the purchase is a planned purchase within your budget, and **IF** you have your monthly spending under control and you are absolutely certain the funds to pay the bill in full will be available on the due date, then feel free to use the company's money instead of yours for those months. The best technique is to pay yourself the equivalent monthly payment each month to make certain the full amount is available to pay the bill on the due date. Because, if you don't pay in full when the bill is due, interest accrued from the original purchase date will be due.

Let's deal with the ugliest one last – loan consolidation. This is what I typically see when someone attempts to consolidate a lot of credit card or other debt into a single, larger loan at a lower interest rate: Spending habits don't change, and the next thing the person realizes is that the credit card debt is right back where it was. At that point, they have the consolidation loan and more credit card debt and there is no option for future consolidation. The end result is that they are in much worse shape than they were before the consolidation. The same condition applies to this situation as the 0% offer above. **Only use loan consolidation if you are absolutely certain spending is under control.**

Here are the keys to all of the credit related issues above. If you will put your spending plan in place; if you will successfully operate on it for several months; if you will reach Milestone 6, then you will be in a position where all of the credit techniques can start working for you instead of against you. You will see that your credit score will increase, your bank account will increase because of rebates and smarter shopping, and your stress level will decrease.

REFLECTION: For the credit system to work for you instead of against you requires much discipline. Are you certain you have the discipline necessary? Are you willing to totally stop using credit, if necessary? If you are not already in a position to make the credit system work for you, how can you accelerate your financial progress to get to that point? How is easy access to credit adversely affecting your monthly spending? Identify and prepare to discuss with your group the statement or concept that was most meaningful to you in this lesson. **Record your thoughts:**

ACTION STEP: If you have not checked your credit report within the last year, go the website mentioned in the lesson and order one. One technique is to order one from each of the 3 credit bureaus every four months. This process will result in your receiving three free reports per year. If you are not yet to Milestone 4 (page A-10), focus your efforts and stop any credit card balance increase. Continue tracking your daily expenses using the spending areas listed on page A-4.