Credit Management

Module Description

A sixty- to ninety-minute interactive program suitable for all audiences, designed to develop knowledge and skills that will enable participants to establish and maintain a good credit rating, avoid excessive debt, and make wise use of credit as a consumer.

Materials

Debt-to-Income Ratio

Shopping for Credit Worksheet

Credit Reports and Shopping for Credit

Power Payment Plan (optional)

Note

Due to the complexity of the subject matter and a requirement for the presenter to possess sufficient background knowledge to field questions, this module provides for more detail than can normally be presented in a sixty- to ninety-minute program. The instructor should obtain as much information as possible about the level of financial knowledge and experience of the anticipated audience. Instructors should select appropriate program content that will fit the allotted time period and participant level of knowledge. **The instructor should be prepared to provide local phone numbers for the appropriate sources of help and should provide information on relevant state consumer credit protection laws.**

Instructor References

SECNAVINST 1754.1, Family Service Center Program

OPNAV Instruction 1740.5A (Draft), Personal Financial Management Education, Training and Counseling Program

Command Financial Specialist Training Manual, NAVPERS 1560.8C (or later)

Bamford, Janet et. al., The Consumer Reports Money Book, Mt. Vernon, NY, Consumers Union, 1992, Chapter 8.

"Consumer Handbook to Consumer Protection Laws", Board of Governors of the Federal Reserve System, 1995.

"Credit Wise– Coming to Terms"-American Express (video)

Detweiler, Gerri, The Ultimate Credit Handbook, Penguin Books USA, New York, NY, 1992.

"Exchanges Moving to Credit Program", Navy Times, August 9, 1999, P. 12, Karen Jowers

Garman/Fogue, Personal Finance, Boston, MA Houghton Mifflin Company, 1994, Chapters 6 and 7.

National Consumer Law Center, Surviving Debt: Counseling Families in Financial Trouble, National Consumer Law Center, Inc., Boston, MA, 1992.

"Out of Hock", Dalstrom & Company, Hollingston, MA, 1997.

Relevant Websites

www. AAFES.com

www.lifelines4qol.org

Objectives

At the conclusion of this program participants will be able to:

- List two appropriate and two non-appropriate uses of credit.
- Identify three factors affecting the cost of credit.
- Calculate their debt-to-income ratio.
- State three warning signs of too much debt.
- Identify three sources of help in answering questions about credit and managing personal indebtedness.
- State one Consumer Credit Protection Law

1 *Introduction*

1. Introduce Self: Financial education background and affiliation with the Navy.

2 **2. Motivational Statistics:**

- VISA International has determined that just placing a credit card in someone's hand will cause an increase in spending of 32%.

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- The average American family has 9 credit cards *(1996 American Express survey)*. Three or four of those are used regularly; the average total balance on those cards is $3,900, at an interest rate of 18%.

- Nearly half of all credit card holders—43%—make only the minimum required monthly payments at least part of the time. (This number has been on the rise in recent years. Incidentally, the percentage of smart consumers who pay their credit card bills in full each month has also increased, from 29% in 1990 to 36% in 1996.)

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- For example, on a $5000 charge at 18%, if you make the 2% minimum monthly payment, it will take you 40 years to pay of this charge, and you will have paid $13,397 in interest!

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- Over nineteen percent of Americans' monthly income is now eaten up by debt payments.

Purpose and Agenda

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The purpose of this program is to provide some basic information on credit: how to establish and maintain a good credit rating, when and how to borrow money, how to get the best deal on a loan, and how to manage your debts properly. It will provide the information necessary to enable you to establish and maintain a good credit rating, avoid excessive debt, and make wise use of credit as a consumer. Specifically, we will cover:

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- An introduction to credit
- Establishing a credit history and qualifying for credit
- Shopping for credit
- Choosing and using credit cards
- Warning signs of too much credit
- Credit reporting agencies and understanding your credit record
- Consumer Credit Protection Laws
- Dealing with creditors
- Debt recovery programs
- Sources of Help

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Introduction to Credit

1. Introduction:

NOTE:
At this point, instructor can engage smaller audiences in brief discussion as to why credit is needed.

But is credit really necessary? Why do we have to have it?

Credit has been with us since the moneylenders of ancient times, and was originally used by farmers and later by businesses wishing to grow. Credit for the average consumer only became widespread in the last 25 years. Why is so much available? The reason is there is money to be made from it; interest on consumer purchases brings over 100 billion into the economy every year. Using credit means taking out a loan or using a credit card to make a purchase. There are ways to use it to your advantage.

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2. Wise uses of credit:

The best use of credit is to purchase assets—things that will grow or increase in value over time, like your own business or buying a home or a rental property. Credit is also useful for convenience—avoiding having to carry large sums of cash or as a management tool. Wise use of credit virtually always falls into one of these two categories—assets or convenience. Sometimes use of credit for major consumer goods (so-called "big ticket" items) cannot be avoided; few of us can purchase our first car without a loan. This too, is an acceptable use of credit.

NOTE:
This section should be given greater emphasis with younger audiences, who may be particularly prone to the following pitfalls.

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3. Unwise uses of credit:

Credit becomes more dangerous when used to purchase consumables. Furniture, clothing, sporting equipment, meals out, and vacations, lose much or all of their value immediately after purchase. Credit is often used for non-financial reasons.

a. 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 at a mall on impulse tend to pay about 1/3 more than they would if they first compared prices at discount outlets or other locations where the same item might be on sale.

b. 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 great 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. It is wise to remember that who you are and what you have done says far more about you than what you own or the charge cards you have in your wallet or purse.

c. 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. When this happens, even couples where each partner has a high income job can easily find themselves in difficulty.

d. 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.

e. <u>Everyday Living Expenses.</u> Meeting everyday living expenses is perhaps the most dangerous use of credit. If you don't have the money to pay for it today, what makes you think that you will be able to pay for it next month?

f. <u>Possible Negative Effects.</u> If you are unable to keep up with your monthly payments creditors can take legal measures to get the money you owe them, and/or take back the items. Creditors will normally start by sending you letters requesting payment. They can also send a Letter of Indebtedness to you command notifying them of your failure to pay and asking them to get involved. Further action such as garnishment, repossession and foreclosure are common legal remedies. Most contracts also say that you must continue to pay even though you no longer have the item! The law does limit the amount that can be taken/garnished from your paycheck to 25% of your disposable income per pay period. However, money you owe the Government and court-ordered family support is not limited.

NOTE:
Instructor ask class to respond to the following statements; keep responses to themselves, no show of hands necessary.

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4. Is this you?

How you respond to these statements is an indication of how you handle credit. None of these are the best way to use credit.

- I have 7-9 credit cards
- I rarely pay off my balance every month
- I have no idea where all of my cards are right now
- I have not seen my credit record in 5 years

Establishing a Credit History / Qualifying for Credit

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1. Establishing a credit history

Now that we have established some guidelines for using credit wisely, let's explore how we go about getting a loan. Normally a consumer has to have some kind of established credit history. You achieve that in several steps.

- Properly maintaining a checking and savings account at a financial institution. Creditors will look on this as evidence of responsibility.

- Paying existing bills (such as rent and utilities) on time.

- Virtually anyone can get a loan at a military affiliated credit union by making what is called a "share secured loan". As an example, say you want a $600 stereo. Instead of buying it outright, you take out a loan and pledge to pay back $50 per month, with $600 of savings as collateral. The credit union will "freeze" that amount in your savings account until you start making payments; the more you pay off, the more access to your savings you get back. Since the credit union knows it will get the money, the rate on the loan is normally very low, usually only slightly more than the interest rate they are giving you on your savings. Admittedly, you are paying to borrow your own money, but only a small amount and for a short time. In return, after a year, you have four benefits:

  (1) You own the stereo, free and clear.

  (2) You have $600 in savings free to use as you wish (perhaps as an emergency fund!).

(3) You have a habit of paying $50 per month that you can now use to continue to build up more savings, start an investment program, or other worthwhile purpose.

(4) You have a successfully repaid loan as part of your credit history. Be certain that the information will be reported to the credit reporting agency.

- A so-called signature loan (unsecured) is normally difficult to get for someone with a limited credit history. Another option may be to have a relative co-sign a loan 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 of your own. 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. However, there are over 6,000 different banks issuing these cards. So 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 so-called "premium" cards (often called gold or platinum) targeted at consumers with the best credit ratings.

2. Credit Scoring

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NOTE:
This overhead and the information on credit scoring are included primarily for presenter background information; it is anticipated this section would be normally be included in the an advanced presentation or based on participant level of interest.

Lenders today use one of two ways to evaluate credit applications. Some lenders will look at each application individually, using guidelines that may take into account the applicant's income, credit history, and other individual circumstances, i.e., they use their own judgment for each application. More commonly, particularly when it comes to credit cards, evaluation is based on credit scoring. Lenders identify a number of factors that relate to credit-worthiness and assign point values to each factor. Factors may include employment (skilled, unskilled, clerical, managerial, etc.); length of time at current job, homeowner or renter status, number of credit cards and other loans, and payment history. Credit scoring can be fairly simple or very complex. In a highly automated system, a data-entry person will enter information from an application and credit file into the computer; sometimes information is fed directly from the credit bureau into the computer via a modem. Credit scores are determined by computer and, if the applicant does not qualify, the computer generates a denial letter. The whole process is automatic and the score is usually not passed on to the applicant.

3. Three C's of credit:

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What lenders are really looking for is the answer to these questions:

(1) **Character:** Do you have a history of repaying loans on time? Credit references that appear on credit reports are used. These include bankcards (the single best reference), travel and entertainment cards, department store cards, mortgages, and auto loans. Stability (length of time on the job and in a location), age, and checking and savings account records are also taken into account.

(2) **Capacity:** How likely is it you can repay the loan on time? Income, how much potential credit you hold (number of cards, number or inquiries), and total debt levels are considered.

(3) **Collateral:** What if any additional security is there to ensure the loan will be repaid? Collateral is normally required for any large loan, such as for a home or a car. This is also known as capital.

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Shopping for Credit

1. Comparison shopping: Since most states have no laws regulating the amount you can be charged for a loan, it is important to shop carefully. Comparison shopping for the money you borrow is every bit as important as comparison shopping for your purchase. Most types of credit are installment loans, in which the loan is paid in equal payments, usually paid monthly. Some loans are secured loans. A secured loan is backed-up by collateral which can be taken in case you fail to pay. A car loan is a secured loan. These loans are easier to get because the lender is confident about getting their money. A loan made solely on your signature and promise to pay is an unsecured loan.

Use the standard decision making process when preparing to take out a loan, just as you would for any other major decision in life:

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- Define the need to make a decision
- Search for alternatives
- Obtain information
- Compare the alternatives
- Make the choice
- Review and evaluate the decision

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2. Debt-to-income ratio: First determine whether you need to borrow at all, and if so, how much? Are you going into debt to purchase an asset, or really just spending on consumables?

Handout: Debt-to-Income ratio

Calculating your consumer debt-to-income ratio: This is an important step in evaluating your personal financial situation. Any lender will want to know this figure before they decide whether or not to give you a loan. We have a handout that will help you determine your debt-to-income ratio.

1. Determine your net monthly income. This is not just your take-home pay times two. It is everything you make in one month minus only what is being withheld for taxes.
2. List each of your consumer debt payments: car payments, credit cards, and any other installment loans. Do not include rent or mortgage. That would give a different debt-to-income ratio—much higher—that is useful when considering or qualifying for a home mortgage.
3. Total all monthly payments and divide by net monthly income. The result is your debt-to-income ratio.

Example: Income=$2000
Credit payments=$500
Debt-to-Income Ratio= 25%

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If your debt-to-income ratio is below 15%, congratulations! Your financial situation is above average, and you can probably assume additional debt safely. Use caution; you may want to figure out what your ratio will be with the new/higher payment. As you approach 20%, you are fully extended, and should probably not take on additional credit. Over 20% means you are over-extended; over 30%, seek help immediately!

Notes

Handout: Shopping for Credit Worksheet

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3. Shopping for credit: Once you have decided to get a loan, the time has come to do some real comparison shopping. 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. Turn over the debt-to-income ratio handout and you will see a sheet you can use later for comparing loans. The cost of credit is determined by a number of factors, such as:

- Who you borrow from
- How much you borrow
- How long you take to repay
- How is the interest calculated
- Your credit worthiness

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Where to borrow: Where you borrow will definitely affect your cost.

1. Credit Unions - Owned by members, loans to members only, normally offer the most attractive rates.
2. Commercial Banks – Offer a wide variety of products, average rates, for lower risk people
3. Savings & Loan Associations – Focus on mortgages, often offer other services, similar to banks
4. Consumer Finance Companies – Accept higher credit risks, rates often high
5. 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.

How much to borrow: How much you borrow has a big impact on total cost. A down payment can often result in substantial savings. 21

How long to borrow: Borrowing for a longer period lowers your monthly payment but results in higher cost. Note the difference between these otherwise identical one and three year loans; the latter costs three times as much in interest. 22

Monthly payment: Beware making only minimum payments. Base your payment on what you can afford, but always try to pay as much as possible. 23

NOTE:
Go over minimum payment trap, each item on the overhead. Use a solid sheet to cover the lower sections when using a transparency with an overhead projector, vice power point; let the time to pay and total cost figures sink in to the audience.

Credit worthiness: Your credit worthiness determines how much you will pay for a loan. If you are a high credit risk, you may still be granted credit, but at a less favorable interest rate. Also, you may find you have to borrow from alternative financial resources, such as finance companies, which typically charge higher rates because they are willing to accept riskier customers.

4. Calculating loan interest: Interest on loans can be calculated in a number of different ways: 24

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!

Notes

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. The Rule of 78's is particularly unattractive; this is a form of add-on interest where a greater portion of the interest is collected in the early months, before any of the principal. Prepayment of these loans will penalize the consumer. 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 and Using Credit Cards

1. Choosing credit cards: Things to consider include:

- 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.

See Handout:
Debt-to-Income Ratio

- 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?

2. Money saving tips:

- Often 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.

3. Methods of calculating credit card interest:

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NOTE:
The following section and overhead #31 can be omitted with junior audiences or when time is limited.

The method used can make a big difference in the cost of credit. There are four different methods commonly used for calculating credit card interest:

1. **Average daily balance, excluding new purchases:** Determined by adding the outstanding balance, excluding new purchases, and deducting payments and credits, for each day in the billing cycle, and then dividing the number of days in the cycle. This is the most advantageous and cheapest to the customer.

2. **<u>Two cycle average daily balance, excluding new purchases:</u>** The average of the sum of the average daily balances for two billing cycles, the current one and the preceding one.
3. **<u>Average daily balance, including new purchases</u>:** Calculated by adding the outstanding balance, including new purchases, and deducting payments and credits, for each day in the billing cycle, and then dividing by the number of days in the billing cycle.
4. **<u>Two cycle average daily balance, including new purchases</u>:** Figured in the same way as (b) except new purchases are included. This is the most expensive to you but best for the credit card company.

27 **4. Using credit cards:** Credit cards can be a big benefit, due to their convenience. They can even save money; the best use of a credit card may be to offer not to use it! As merchants must pay a small percentage to the credit card company (often 3%) when you use your card, some merchants will give a slight additional discount on a purchase if you offer to pay cash rather than use a credit card. Try asking for a 3% discount for cash! A credit card can be very valuable in an emergency. However, credit cards can become a problem. Normally the worst use of a credit card is for a cash advance. Not only can this be a symptom of bigger problems, but remember that the interest rate clock starts ticking the moment the cash comes out of the ATM and the rate charged on cash advances is very high, higher then you normal APR. There are virtually no cards that offer any grace period on cash advances. Also avoid the use of the convenience checks sent to you. They often carry a higher percentage rate. As soon as you notice a missing card, call to report it, and follow-up in writing. This will limit your exposure to fraudulent charges. Many companies will even waive the $50 limit as long as you report the unauthorized charges immediately.

5. Deferred Payment Plans: Servicemembers can apply for and receive a NEXCARD or DPP credit card that can be utilized at all military exchanges. This type of card allows you to make purchases and defer payment over time. However, the application process and screening is similar to other credit cards and finance charges will be assessed on most items if the bill is not paid in full each month. 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. 28

Warning Signs of Too Much Credit 29

1. Warning signs: Warning signs of too much credit include:

- 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.

2. Other indicators: Other general indicators of difficulties that can be caused by or lead to credit problems include: 30

- 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 the time comes for PCS orders?

- Debt-to-income ratio of over 20%.
- At or near credit limits on credit cards most of the time.

31 **3. Critical point:** 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.
- Relying on a debt consolidation loan to reduce payments enough to meet monthly living expenses.

Handout: *Credit Reports and Shopping for Credit*

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Credit Reporting Agencies and Your Credit Record

1. Credit bureaus: A credit reporting agency is a company that collects, packages, and sells information about consumers' financial affairs. They do not grant or deny credit; each individual lender does that based on information they receive. The industry is dominated by three credit bureaus: Equifax, Experian (formerly TRW) and Trans Union. These three companies 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, so they 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. Your credit report is a summary of your history of payments and the current status of open accounts. It is important to review your credit report periodically (every 2-3 years) to verify that the information is correct and complete. Mistakes are not uncommon, and if undetected, could ruin your chances of getting a loan. The major credit bureaus have toll-free numbers where consumers can request a copy of their credit report. Information on how to do this is included in your first handout.

2. **Credit records:** Contents of a credit file come in four sections: 33

- personal and employment information
- credit history (so-called trade lines)
- public records
- inquiries

Information remains on a credit report for 7 years. Judgments and Chapter 7 and Chapter 13 bankruptcies stay on for 10 years. History and inquiries stay on for 2 years.

Every individual has their own credit file; there is no such thing as a joint credit report, although information on any joint accounts will normally appear on the credit reports of each of the joint account holders. A current or potential business relationship is required to access the report. Consumers who find information they disagree with have several avenues to correct an error. According to the Fair Credit Reporting Act, when a consumer disputes an entry, the credit bureau must first request confirmation from the business that originally made the entry; if unable to get confirmation, the information is supposed to be removed, since the consumer has the benefit of doubt. If the information is confirmed, however, it becomes very difficult to remove; there are no quick "fixes" available for a bad credit record. The consumer also has a right to enter a statement explaining the entry, up to 100 words. All three credit bureaus now charge for a copy of a credit report, unless you have been turned down within 30 days. A business normally is not permitted, by terms of their 34 contract with the credit bureaus, to show you a copy of your credit report, but they must tell you which bureau they work with. At that point you have the right to request a free copy from that credit reporting agency.

Even though you may owe no money,(a zero balance), having too many open accounts is a strike against you. Credit lenders view any open account as a potential for debt that will then impact your ability to repay their loan. Be sure to close all old accounts and cards you no longer use. Write the creditor and ask them to close the account and report it to the credit bureau. You must make requests in writing and ask them to note that it was closed by customer request. Then, beware of future in-store promotional cards that come with discounts off today's purchase or a free gift.

NOTE:

This section contains a highlight of the federal consumer credit protection laws. It is recommended that the instructor visit the websites to become more familiar with each of these laws. You may choose to omit some information depending on the audience.

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Consumer Credit Protection Laws

1. Truth-In-Lending: The Truth In Lending Act of 1968 and its early amendments still provide the foundation for regulating consumer credit. It ensures that customer are given information about the cost of the credit for which they are applying.

Disclosure: One of its most important provisions requires that lenders disclose the cost of any loan expressed both as the annual percentage rate of interest and as the total finance charge in dollars. It applies to single purchases made on credit as well as purchases by credit cards.

Three-day cancellation: You have three business days in which to cancel a transaction that used your home as security or that took place at your residence (door-to-door sales). You must do this in writing. This does not apply to all purchases, for example, there is no cooling off period on car purchases.

Lost or Stolen Credit Cards: You will be held liable for charges made up to a limit of $50 per account, if you notify the issuing company. Contact them immediately and follow up in writing.

2. Fair Credit Billing Act: This act protects consumers from billing errors and allows you to dispute charges. You must dispute charges in writing within 60 days. You may also withhold payment for items purchased on your credit card which do not meet the quality standards the seller promised. But this act does not allow you to withhold payment because you no longer want something. You must first try in good faith to remedy disputes with the seller. This act does apply to credit card purchases made overseas. It is a good idea to review you statement each month to be sure you recognize all charges billed. 36

3. Fair Credit Reporting Act: This act provides for your right to know what is on your credit record and provides for the dispute and deletion of inaccurate information. This act allows you a free credit report if denied credit and limits the time information stays on your credit file.

4. Fair Debt Collection Practices Act: This act determines the means by which debt collectors can contact you. You are protected from unfair practices from third party debt collectors. They cannot be abusive, harass you, tell anyone else about your debt, or threaten you. You can write to debt collectors and tell them to stop contacting you. You can also sue them for breaking this law.

5. Equal Credit Opportunity Act: This act provides for granting of credit regardless of race, gender, marital status, age, religion, color, or national origin.

Notes

6. **Fair Credit and Charge Card Disclosure Act:** This act requires that credit cards solicitations inform you of their total cost. This includes; APR, grace period, annual fee, finance charge, other fees, and the method for calculating the balance.

NOTE:
The instructor must research the laws of their particular area and provide that information here. This information is crucial to all audiences.

7. **State Protection:** It is important to note that Federal laws do not regulate the amount of interest lenders may charge you! Some states may provide for additional consumer protection in credit matters; However, many states, for the most part, have few additional laws or regulations protecting the consumer in credit matters. In particular, in some state there is **no** effective cap on interest rates.

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Dealing With Creditors

1. **Things to do:** Positive steps include:

- 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.
- Approach them with a plan. Be careful of promising more than you can deliver.
- Change your behavior. If you find that you have dug yourself into a hole, what is the first thing you must do? *Answer: Drop the shovel and stop digging!*

2. Things not to do: Things to avoid are:

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NOTE:
Instructor, provide legal rates for your area.

<u>Credit clinics:</u> Many of these 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. Charging up front fees for debt counseling is illegal in a number of other states.

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<u>Debt consolidation loans:</u> These are at best a temporary fix. Debt consolidation loans are not always bad. However, they will not work without a change in behavior. A 1996 study by American Express indicated that 78% 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.

Bankruptcy: Declaring bankruptcy does not allow you to walk away from all past problems. This is a last resort option that may have lasting consequences. It may severely impact on your ability to get credit in the future, in addition to the potentially negative career implications. There are two kinds of personal bankruptcy:

- <u>Chapter 7:</u> Straight bankruptcy is used when there is little chance of repaying debts. Your assets are sold and partial repayment made, then many debts are erased, but not all!
- <u>Chapter 13:</u> This is a regular income plan in which some income is available to pay debts, but not all owed. You keep your assets and the remainder is discharged after 3 years of scheduled reduced debt payments. Again, not all debts are forgiven. This is called the 'wage-earner plan'.

NOTE:
Instructor should refer class paticipants to the Developing Your Spending Plan module for futher information on developing a budget.

Debt Recovery

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NOTE:
If desired, use optional handout: Power Payment Plan

1. A workable budget: your first step to recovery if to construct a budget and a spending plan. You need to 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.

Notes

2. Use a power payment plan: Next, construct 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. Usually that debt is paid off fairly quickly. At that point, you no longer have to make the minimum payment on that bill; add the money left over to your positive cash flow and apply the new, higher amount to whichever loan has the second smallest balance. Often, all but the one or two largest loans can be paid off in a few months. This is like getting a mini-bill consolidation loan, without any extra fees. The psychological effect can be very motivating—a case of success reinforcing success.

If necessary, explore other alternatives with your creditors, such as prorating or temporarily deferring a payment.

3. Seek help: if these steps prove unsuccessful, seek help from a professional financial counselor.

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Sources of Help

NOTE:
Provide phone numbers and names (if possible) for each of these resources.

1. Your Command Financial Specialist: *provide name(s) if this is a GMT at a command.*

2. Navy Family Service Centers. Your local NFSC will have a Financial Educator and/or a CFS on staff to provide personal financial information and counseling. They normally work closely with the CFS at the local commands.

3. Navy Legal Services can provide assistance in a dispute over a bill or contract. They strongly encourage service members to come in with a copy of the contract before signing it when making any major purchase.

4. 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.

5. Consumer Credit Counseling Services (CCCS) provides low or no cost financial counseling and debt management.

Summary

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1. A valuable tool: Credit is something we will use throughout our lifetime, and can be a valuable tool. However, it can also be a source of long lasting difficulty; the availability and over-extension of credit has contributed significantly to the rise in personal bankruptcy rates in the past twenty years.

2. Questions to ask yourself before using credit:

- Will your budget be able to handle the increased payment months or years down the road?
- What will the extra payment do to your debt-to-income ratio?
- Have you shopped carefully for credit; are you getting the best rate?
- What will you have to show for all that money after the loan is repaid?

Wise use of credit can be a key element in achieving financial independence; misuse can be a ticket to financial ruin. It is your decision.