

Credit Wise

Credit: a Useful Tool

Most of us use consumer credit on a daily basis, whether or not we realize it. The most familiar type of credit involves making purchases now and paying for them out of future earnings. Examples of this include purchasing a home or buying items using your credit cards. When we use public utilities or pay the doctor's bill at the end of the month, we are also using a form of credit.

Credit is easy to use, but it's not free; when you use credit, you're in effect "renting" the use of someone else's money. The cost of credit varies depending on the type you choose and the institution that issues it.

Consumer credit is a financial tool that no one can afford to ignore or misuse. It can help you achieve your goals, or if misused, it can lead to a serious financial crisis. The way it will serve you depends on your knowledge of credit and credit practices, and your skill in applying it to the goods and services you choose to buy.

Credit Arrangements

Credit arrangements can be formal or informal. The three most common types of credit used by consumers are described below.

Incidental Credit is an informal credit agreement between you and public utility companies, such as electric, gas, water or telephone, or between you and professionals and/or businesses, such as a doctor or dentist. These companies or businesses charge you for their services after they have been used and usually do not charge a fee for the use of credit. Utility companies will charge you according to the amount of their services you use. They may also require a deposit before providing services and may charge a fee for late payments and returned checks.

Closed-End Credit is a single-purpose loan, such as a consumer or mortgage loan, that involves a one-time, lump-sum advance of credit. Credit is advanced for a specific time period. The amount financed, the finance charge, schedule of payments and regular monthly payment amounts are agreed upon by the lender and the borrower.

Open-End Credit, such as credit cards, lines of credit and cash advance checking accounts, can be used repeatedly up to an approved borrowing limit. Monthly repayment options will vary from paying the complete outstanding balance to paying a minimum amount. Additional charges for these types of credit may include annual fees for the credit cards and maintenance/usage fees for lines of credit.

What Are the Costs of Credit?

When you use credit, you are charged a fee called a finance charge. This charge is determined by the factors involved in the process of granting credit. These include opening, maintaining and collecting accounts; interest charges; insurance protection and miscellaneous expenses. By using credit, you are paying for the convenience and privilege of having it available when you want or need it.

For every closed-end credit transaction, the creditor must tell you two things: the finance charge, which is the cost of credit as a dollar and cents amount, and the annual percentage rate (APR), which is the cost of credit as a yearly amount expressed as a percent of the amount loaned.

The actual cost of open-end credit will vary depending on which type of credit plan you choose to use (credit card or line of credit) and your credit history. How much you pay will depend on when the finance charge begins and how the balance is computed.

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There are three ways of determining the finance charge: adjusted balance, average daily balance and previous balance.

Adjusted Balance.

The finance charge is calculated after payments made during the billing period are subtracted.

Average Daily Balance.

The finance charge is calculated after daily balances are averaged for the billing period.

Previous Balance.

The finance charge is calculated without considering payments made during the billing period. This is the most expensive method. Ask your lender if there is a free ride or grace period provision that allows you a 25–30 day period in which you can pay the total balance without having any finance charge accrue. The beginning of this period is either the:

- closing date on the bill
- date the purchase was made or
- date the purchase was billed to your account

Just What Are Lenders Looking For? Creditworthiness.

Your credit request is evaluated by credit approval officers (loan officers). Their job is to determine if you are willing and able, now and in the future, to repay your potential debt. A credit decision is based on several factors.

Character—Will you repay your debts? Lenders will look at your credit history: how much you owe, how often you borrow, when you pay your bills and whether you live within your means.

Capacity—Are you able to repay the debt? Can you meet your monthly loan payments as well as your other current obligations?

Collateral (when required)—Is the collateral sufficient to secure your loan? Before you decide to borrow, consider all the factors associated with your purchase (the credit approval officers will). For example, if you decide to purchase a new car, have you also considered the added expense of insurance, maintenance, gas and oil? A car note payment of \$250 per month may seem to be within your budget, but add on these additional expenses and your monthly outlay for a car may be more than you can afford.

Budgeting your money can help you determine a safe amount of debt. You begin by developing a workable budget. A budget is an outline of how you plan to distribute your earnings. It is your responsibility to monitor your income and outgo. Make sure all your living expenses (rent, food, utilities, etc.) and savings are taken care of before you take on additional credit expenses.

Also, remember to establish an emergency savings account. Most financial counselors recommend that you have ready cash savings (easily obtainable without notice or penalty) of three month's earnings or even more. The amount you will need in case of an emergency will depend on several factors—your job security, income, the kind and amount of insurance you carry, your borrowing power, assets and debts and the condition of your home, car and major appliances that you depend on.

Establishing Credit

It is important not to wait until you need credit before you attempt to establish it. If you currently find yourself in a situation where you need credit, you may have no choice but to use a lender that charges high interest rates. Without an established credit history, you may be labeled a risk. There are a variety of methods available to establish credit. But remember, it may take time and persistence.

1. Open a savings and/or checking account at a financial institution that offers credit cards. Set up a systematic savings program—if you can only save

\$10 a month, start there. After you have maintained a checking or savings account for six months or longer, apply for a credit card from the same financial institution. When making a credit decision, most will look at how you have managed your accounts with them.

2. Take out a small loan. If you can't get a signature loan, ask for a savings-secured loan. These are available at financial institutions. The institution simply freezes the money in your savings account—where it continues to earn dividends—while you are borrowing their money, usually at the lowest interest rate available. You will make monthly payments just like a regular installment loan. This tells the financial institution that you are responsible for a monthly payment and that you are a good saver as well. This type of loan needs to be for six months or longer to show the lending institution (and the credit bureau to whom it will be reported) that you are able to make payments over a period of time.
3. Apply for a department store card. When applying for this type of credit card, try two or three stores, because each sets its own criteria for creditworthiness. But remember, each time you apply for credit, it is reported to the credit bureau (credit reporting agency) as an inquiry—too many inquiries about your credit record in a short amount of time will make potential lenders cautious.
4. Apply for a secured loan using a completely paid-for possession (car, motorcycle, boat or house) for collateral.
5. Ask a relative or friend to cosign a loan with you if you cannot get credit on your own—but be sure you can repay the loan before you do that.

Credit Protection Laws

To be a knowledgeable consumer in today's marketplace, you must be aware of the credit protection laws and let them work for you.

The Equal Credit Opportunity Act prohibits the denial of credit because of your sex, race, color, marital status, religion, national origin, age or because you receive public assistance.

The Fair Credit Reporting Act gives you the right to learn what information is being distributed about you by credit bureaus.

The Truth-in-Lending Act requires lenders to give you written disclosures of the cost of credit and the terms of repayment before you enter into a credit transaction.

The Fair Credit Billing Act establishes procedures for resolving errors on your credit card accounts.

The Fair Debt Collection Practices Act prohibits debt collectors from using unfair or deceptive practices to collect overdue bills that your creditor has forwarded for collection.

Your Credit Bureau Record

One of the most difficult barriers to overcome when obtaining credit is establishing a credit history, and the importance of establishing a solid credit background cannot be overstated. Before grantors make a credit decision, they frequently use the services of a credit bureau to gain an accurate and current credit profile on a potential borrower. You are also assigned a credit score, based on the information the credit bureau keeps on file about you. Most lenders use the scores to determine your credit risk, which in turn may affect both how much and what loan terms you will receive.

Credit bureaus do not make recommendations or decisions as to whether or not credit should be granted. Prospective creditors—retailers, financial institutions, and landlords, among others—do that.

There are five types of information that appear on your credit bureau record.

1. Personal information consisting of your name, birth date, Social Security number, your current and previous addresses and employers.
2. A record of your repayment habits as provided by your creditors. It details the type of account; whether it's joint, individual or authorized user; how long you have had it; whether it has been paid as agreed; and the amount of the monthly payments.
3. Information from public records concerning judgments, tax liens, foreclosures, litigation and bankruptcies.
4. A record is kept for 6 to 24 months of all creditors making inquiries (seeking information) into your credit history. Multiple credit inquiries may be a tip-off to creditors that you are getting in over your head with credit.
5. Your credit score—this is provided separately by the credit bureaus for a small fee.

In some states, additional information is included in a credit bureau record, such as student loan payments, federally insured mortgage loan payments and child support payments.

You are entitled to one free credit report per year from each credit bureau. If you stagger your requests over the course of the year, you can check your report once every four months at no cost.

Reports can be requested online at annualcreditreport.com or by calling toll-free 1-877-322-8228. Regular reviews make you mindful of how your credit profile looks to others and alert you to mistakes on your record and to identity theft. If you have been denied credit because of information

contained in your record, the lender must provide you with the name and address of the credit agency that supplied the credit information. You can receive a free copy of the report provided by the agency if you contact them within 60 days (longer in some states) of denial. You can also request a free copy of your credit bureau report if you feel you are a victim of fraud.

Personal Bankruptcy

Feeling buried by bills? Although you may think that filing for bankruptcy will give you instant relief from financial pressures, it is not a good solution.

A bankruptcy report delivers a severe, damaging blow to your credit record. It affects your ability to get credit for long into the future and may prevent you from getting a job, because many prospective employers review credit bureau reports as a condition of employment. A bankruptcy filing will remain on your credit bureau report for as long as 10 years.

Keep in mind, too, that even if you file for bankruptcy, some of your debts may not be forgiven and some of your belongings may be repossessed or sold to pay off existing debt.

Instead of filing, consider other, more positive solutions to your financial problems. Your first telephone call should be to your creditors, asking for their assistance, rather than an attorney. Navy Federal members can use our free personal financial counseling services.

Personal Finance Management

If you believe you need help with your personal finances, contact Navy Federal about its personal financial counseling service. It can help you reach your financial goals, avoid monetary pitfalls before they are upon you or deal with a financial crisis that has already occurred. There is no charge for this service, and assistance ranges from answering specific questions to developing a detailed budget or even to the establishment of a debt management program.

Personal financial counseling is confidential, and your credit rating will not be harmed. Call toll-free 1-888-503-7106, and ask to speak with a personal financial counselor.

Credit Card Tips

Do...

- Open your billing statements promptly and compare them with receipts you have saved.
- Read and understand all information in a credit agreement, and make sure all of the blanks are filled in before you sign it.
- Draw a line through blank spaces on charge slips above the total so the amount cannot be changed.
- Write promptly to the card issuer if any questionable charges appear on your statement. A phone call will not protect your billing rights.
- Sign new or renewed credit cards in ink as soon as you receive them.

Don't...

- Sign a blank receipt.
- Lend your card to anyone who is not a joint owner or authorized user.
- Leave your card or receipts lying around. Destroy all carbons and incorrect receipts; people can steal your account number off them.
- Put your card number on the outside of any correspondence where it can be read, such as on a postcard or envelope.
- Give your card number over the phone unless you are certain the company or organization is highly reputable, especially if you did not initiate the call.

Ask for information about the offer to be sent to you before you decide to purchase. If the company stalls or refuses to send information, terminate the conversation.

- Acquire more than a couple of major credit cards. The low minimum monthly payment on each of many large outstanding balances can get you over your head in debt in a hurry.

Questions and Answers

Q. My buddy asked me to cosign a loan for him. Should I?

A. The first thing you need to ask yourself is "Can I afford this debt if my friend can't or won't pay it?" By cosigning any type of credit agreement (consumer loans, credit cards, etc.) for a friend or family member, you are saying to the lender that you will be completely responsible for the entire debt if the other person fails to repay the loan. In some states, once an account becomes delinquent, creditors can demand repayment from the cosigner first, before they even contact the borrower for a repayment.

Q. I was in a car accident last year which resulted in loss of my income for several months. I am now late with all my creditors. I have also incurred medical bills. How can I let my creditors know my financial problems are due to an accident and not negligence?

A. There are two things you can do. First, write to all of your creditors and explain your situation—do not avoid your creditors. Ask for their help in setting up reduced repayment plans. Second, file a statement in your credit bureau record. You may include a written statement of no more than 100 words of your version of the situation. This statement will become part of your credit report and must be shown to all lenders who request your file. This will at least give you the opportunity to tell your side of the story.

Q. What is secured collateral?

A. A new car on which the lender has a lien is an example of secured collateral. If you fail to repay the loan, the financial institution will claim ownership, repossess the car, and sell it to pay off the loan balance; you pay any remaining balance. The key is whether an item has sufficient resale value to the financial institution. Items of little value are furniture, appliances, electronic systems, etc.

Q. I plan to buy a home in a few months, and the realtor advised me to get a copy of my credit bureau report before I start shopping around. Why?

A. It is a good idea to review your credit bureau report and learn your credit score every year to make certain there are no inaccuracies or omissions. It is especially important to know what is in your credit record before making a major purchase, such as a home or a car. An advance check on the accuracy of your credit file could speed the credit-granting process. If you do find information that is inaccurate, you should write the credit bureau and ask them to investigate and remove any items that cannot be checked. Contact the credit bureaus at annualcreditreport.com.

Q. I don't understand why financial institutions all charge different annual percentage rates (APRs) for their credit cards. What is the difference?

A. Each financial institution makes the decision as to what interest rate to charge for its credit cards. As you shop around for the best credit card bargain, consider your charging needs first. If you normally pay off your charge balance at the end of each and every month, look for a card that

offers no annual fee, or at least a low annual fee; plus a fully interest-free grace period. The interest rate won't matter to you because you pay your card off in full. On the other hand, if you don't pay the balance off completely each month, look for a card with a low APR.

Q. I saw an ad in the newspaper which said that for \$350 I could get my bad credit history erased. This sounds too good to be true. Is it?

A. Yes, because a poor credit history that is accurate cannot be changed. There is nothing that you or any person or any business, such as a credit repair clinic—a company that guarantees to get negative information removed from your credit bureau report and obtain credit cards for you for a fee—can do to require a credit bureau to remove accurate information from your record until the reporting period has expired. Any negative information can remain in your file up to seven years, after which it must be removed. Bankruptcy reports are filed for ten years.

Remember

Once you have established credit, the first and most important factor to controlling credit is to limit its use to amounts you can pay safely out of current and future income. Treat consumer credit as a privilege—which it is—and it can help you have more and enjoy more. But if you misuse credit or take it for granted, it may become a trap. You have a choice. Either you can control credit, or credit can control you.



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