BALANCE
Financially Empowering You

Credit Matters Podcast

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Nikki:

You're listening to Credit Matters. Hi. I'm Nikki, your host for today's podcast. In today's world credit does matter. In fact, getting and using credit is part of almost every American's financial life. However, because it's so easy to make expensive mistakes that can follow you for a long time, it's a good idea to learn how to handle credit wisely from the beginning.

To help you do this, we're going to discuss five important topics in this podcast. 'What is credit?', 'Getting started', 'Using credit to your advantage', 'Deleting your debt' and 'Consumer rights and responsibilities'.

To begin, we must answer the question 'What is credit?' In the broadest sense, credit means getting something before you actually pay for it. Credit adds flexibility to planning and makes it possible to pay for expensive items over time. Credit also comes in many different forms, so it's important to understand how each type works.

One type of credit is called secured credit. People typically use secured credit to buy large items such as a house, a car or a major appliance. An asset, which in most cases is an item you're purchasing, secures the loan. This is called collateral. If for some reason you don't make your loan payments, the lender can repossess your collateral. In other words, if you stop making your car payment, your car can be repossessed.

There are two types of secured credit. The first is called secured closed-end credit. With this type of credit you put down an initial deposit and the item you purchase is taken as collateral for the loan. You then pay back the loan in equal payments over a specific timeframe. A good example would be a car loan.

The second type of secured credit is called secured open-end credit. This type of credit is usually revolving credit, which means you can access it any time. This credit is secured by collateral that you put down to secure the loan and can be repaid in a single payment, equal payments or unequal payments. A home equity line of credit is an example of secured open-end credit.

There's also something called unsecured credit. This is credit that is extended without collateral or security. Because there's higher risk to lenders, unsecured credit generally carries a higher interest rate than secured credit.

There are two types of unsecured credit. First is unsecured closed-end credit. This is also called a signature loan or a personal loan. A good example is a debt consolidation loan. The second is unsecured open-end credit. The lender sets a credit limit and the borrower may use up to that amount. Bills are issued monthly, and the minimum payment due is based on the balance and terms.

Credit cards are the most common type of unsecured open-end credit. Speaking of credit cards, there are several types available today. For instance, general purpose credit cards can be used virtually anywhere. If you have an excellent credit history and a high income, you may even be offered a premium card, better known as a gold card or platinum card. These come with higher credit limits and other benefits. Some credit cards also offer points, rebates or cash back rewards.

Another type of credit card is a retail card. These are tied to a specific retailer like a department store or a gas station. Small business cards offer special perks to business owners and their employees, while student cards generally offer lower credit limits and special benefits for students.

A charge card is similar to a credit card, but you have to pay the entire balance each month. The credit limit is often very high or even unlimited. Charge cards usually come with higher annual fees than credit cards because no interest is charged. If you can't make a full payment, a high rate of interest is assessed and late fees are charged. Collection action can be swift and severe.

Getting started. If you're just starting out and don't have a credit history, getting credit can be a challenge. Don't worry. You have a few options. An excellent way to start is with a secured credit card, which lets you secure your credit line with money you deposit into a savings account. Your credit is determined by the amount of money you have on deposit. Application and fees for secured cards are usually higher than unsecured credit cards.

Another great way to start is with a retail card. Their standards are often less demanding than larger credit issuers, so it may be easier to qualify, but be sure they report to the major credit reporting agencies. If they don't, you won't be establishing a credit history.

Another option is having someone with a positive credit record co-sign an account for you. This requires a great deal of trust on the part of a co-signer. If you don't pay, they are responsible. You could end up jeopardizing a relationship as well as a credit history.

What do creditors look for in a credit applicant? There are basically three factors they consider before approving a credit application. First is capacity. This is whether or not you have enough income to meet your current and potential credit obligations.

Second is collateral. A creditor will need to know if you have something of value that will be available to them if the loan isn't repaid. Collateral may include a car, home, life insurance or money in a savings account. Third is character. Creditors will look to see if you've made payments on time and for the full amount in the past. This information will normally come from a credit report. Stability in employment and residence may also be considered.

Before applying for a credit card, make sure you understand the different terms by reading the application carefully. For instance, you may know that the annual percentage rate, or APR for short, represents the interest you're charged for outstanding credit. Did you know that there are actually three types of APRs?

A fixed APR doesn't change. The rate stays constant for a set period of time. A variable APR, on the other hand, does change and is based on a number of factors determined by the lender. A tiered APR is a rate that is tied to your outstanding balance. For example, you may be charged nine percent interest on the balance up to $500, but twelve percent for over $500.

Grace period is another term that's important to understand. This is the number of days you have to pay before you're charged interest on a purchase. In other words, if you use your credit card to buy something and then pay it off before the grace period ends, you won't be charged any interest on that purchase.

There are three types of grace periods. The first is full grace period. This is when interest is charged on the carried over balance but not new purchases. The second is typical grace period where interest is charged on new purchases unless the balance is paid in full the previous month. Third is the two-cycle method. This is when interest is charged from the statement cycle date, not the payment due date. Essentially, you'll be charged interest before you even receive the bill.

Other terms to watch include fees to use credit. Here are some examples. Annual fee. If you're new to credit, you may only be eligible for credit cards with a high annual fee. However, once you build a positive credit history, request that it be reduced or eliminated or shop for a card that doesn't charge an annual fee.

Late fee. Virtually every credit issuer will charge a late fee if you don't pay on time. These fees typically range from $25 to $45. Over-limit fee. These are charged if you go over your credit limit and are usually the same cost as late fees.

Application or activation fee. Some credit issuers actually charge a fee just to activate the card. Unless you have bad credit, you shouldn't have to pay such a fee. In addition to all the fees I mentioned, there are many other fees you may encounter when applying for credit, but just remember the better your credit history is, the less you have to accept such expensive terms.

Use credit to your advantage. Although using credit has many advantages, there are some downsides. Interest rates and fees can increase the cost of a purchase, and large credit lines make overspending easy, but when used wisely credit can be a great tool and help you build a positive credit history. The key is understanding the difference between wise use and misuse.

When should you use a credit card? Well, sometimes using a credit card is the only way to get what you need, such as booking hotel rooms, buying concert tickets, making online purchases and renting a car. Using a credit card is also helpful if you're trying to track your spending by reviewing your monthly account statements. Other times it's just more convenient to use a credit card.

The trouble begins when credit cards are misused. Never confuse a credit line as extra cash. It's not a bonus for vacations or money for emergencies. That is what savings is for. Most importantly, it's not additional income to get you through a shortfall until the next month. Using credit that way may help temporarily, but it'll make the next month more stressful when the same cash flow problems arise but with more debt to pay.

Here are a few tips for using credit wisely. Only charge the amount you can afford to repay when the bill comes due. Always pay on time. Have just the right amount of available credit for your needs. Have and use different types of credit, such as credit cards, loans and charge cards. Only apply for the credit you need. If you have debt now, repay it as quickly as possible. Last, avoid expensive high-penalty loans that can work against you.

Not all credit offers are created equal. There are some loans out there that can cause serious financial problems. These include payday loans. With average annual interest rates ranging from 390 to 871 percent, payday loans are no bargain.

Car title loans. Though most loans are for $1,000 or less, the finance charges quickly rack up and it is possible to lose your vehicle if you can't meet the payments. High cost credit cards. Inflated fees and a whole host of other charges can result in you owing hundreds of dollars regardless of how much you charge. Avoid these types of credit whenever possible.

Deleting your debt. Okay, let's talk about getting rid of your debt. If you owe money on credit cards, it's smart to figure out a way to pay them off as quickly as possible. Finance charges make holding on to balances extremely expensive. Fortunately, there are several ways to delete your debt.

Where do you begin? Try these ideas. Pay more than the minimum. A $2,000 debt at 18 percent interest will take about thirty years to pay off if you only pay the typical minimum payment. Determine a realistic and fixed amount you can pay each month.

Don't charge more than what you can repay when the bill comes in. It doesn't make sense to add to the balance when your goal is to pay off your debt. Ask your credit card company for a rate reduction. Transfer your balances to cards with lower rates. Pay off your most expensive credit cards first.

After you have built up emergency savings, use extra cash to pay off debt. If you get a raise or a bonus, apply at least some of it to your debt. Close open lines of credit if they're too tempting. If you're a homeowner, using the equity in your home to pay off unsecured debt can be a smart move. This is called a second mortgage. Low rates, tax-deductible interest and a single monthly payment make this a very popular way to consolidate debt.

Second mortgages come in two basic forms. The first is a home equity loan. This is a lump sum loan, and you can usually borrow up to the amount of equity you have in your home. The repayment term is usually a fixed period, typically from five to 20 years.

The second is a home equity line of credit. This is a form of revolving credit. Once approved, you'll be able to borrow up to a set amount. The interest is usually variable, and the repayment term is usually fixed. Before you decide on a second mortgage, determine if you really need one. If you

spend more than you make, using the equity in your home to pay off debt is a short term solution that can put your home in jeopardy of foreclosure.

Many people get into trouble by using their home equity to pay off unsecured debts then running up the credit cards again. This leads to a very difficult situation. No home equity, high debt and no way to meet your financial commitments.

Another way to help pay off debt is to refinance your mortgage with a lower interest rate. The reduced interest rate decreases your monthly mortgage payment and frees up cash for other expenses, including debt repayment. Every percentage point makes a difference. For example, if you refinanced a $200,000 home and lowered your interest rate from seven percent to six percent, you'd have about $130 more in your pocket each month.

To determine if refinancing will work in your favor, weigh the savings and interest against any associated fees. These costs can be high, and some lenders require at least a portion of them be paid at the time of application. Most importantly, make sure you're in a secure financial position before refinancing a mortgage. You never want to put your principal residence and greatest asset in jeopardy.

Another possibility you may have is consolidating all or some of your debt into a new loan. The advantage is that you can bundle your payments, making it easier and more convenient to pay, and if your credit standing is good you may be able to get an interest rate that is less than what you currently have. However, if it isn't, be prepared to pay more.

If you have money saved in a retirement plan, you may withdraw funds to pay down debt, though it will result in an expensive tax consequence and costly penalties. A better option could be borrowing from your retirement fund.

Most plans offer loans against contributions of up to half of your vested balance with a $50,000 limit. Interest rates are usually much lower than those for the average credit card. Be aware though, if you leave your job, the remaining loan balance will be due immediately. If you're unable to repay the loan the IRS will consider this as an early withdrawal.

You can also consider a debt management plan or DMP for short. A DMP is arranged by a credit counseling agency during a thorough financial counseling session. It's an arrangement where

you make one payment to the agency and they distribute the money to your creditors. During the repayment period of between three to five years, you are required to suspend use of all your credit lines.

DMPs are beneficial because many creditors reduce or even eliminate interest rates and fees, so less money goes towards finance charges and more goes to the principal. To know if the DMP is right for you, a counselor will examine your assets, income, spending habits and debt. If there's enough money left over after paying your essential expenses to pay your debt on the DMP, then it's one of your options.

Consumer rights and responsibilities. Finally, we're going to talk about consumer rights and responsibilities. When you use credit you enter into a contract. A financial institution lends you money with specific terms, and you agree to repay it under those terms. Therefore, as a borrower, you have both rights and responsibilities.

For example, the Federal Trade Commission, also called the FTC, enforces federal laws regarding consumers. Any violation should be reported to the FTC at www.ftc.gov or by calling 202-326-2222.

Another example is the Truth in Lending Act, which requires credit issuers to disclose the following. The monthly finance charge, annual interest rate and any late or penalty fees that may be imposed. Also, they must disclose a written itemization of the amount borrowed and the total amount of the loan, including interest in fees and the number amount and due dates of all payments necessary to repay the loan.

The Fair Credit Billing Act, FCBA, offers the following protections under the law. Liability for lost or stolen credit cards. This is limited to $50 if you notify the card issuer within 30 days. Also, if you purchase a defective item or substandard service by credit card, the payment can be withheld if the seller refuses to replace, repair or otherwise correct the problem.

If there has been an error in a credit card bill the lender must correct it or explain why the amount is believed correct within 90 days after being notified.

Fair Debt Collections Practices Act regulates collection agencies' conduct and specifically prohibits such actions as calling before 8 a.m. or after 9 p.m. or at any other inconvenient time, calling you at work if you have informed the collector that the calls are jeopardizing your job, discussing your

debt with a third party other than your spouse without your permission except to leave a message that he is trying to contact you, using profanity, misrepresenting himself. For example, he cannot say he's an attorney if he's not.

Collectors cannot make false threats. If a collector says he's going to take a specific action against you to enforce the debt, he has to do it. It's important to understand that a creditor or collector for a credit card or personal loan cannot take any wages, money or property without first suing you in court, winning and then obtaining a judgment. Also, be aware that in most cases you can't go to jail for non-payment of unsecured debt, even if you have lost a lawsuit.

You may also have additional rights under your state's law, so check with your state's office of the Attorney General for more information. To locate your attorney general, contact the National Association of Attorneys General at www.naag.org. [Music] That's all for today's podcast. I want to thank you for listening. This is Nikki saying goodbye.

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