



Personal Finance: Another Perspective

Credit Use:

Understanding Credit Reports,

Scoring and Cards

Updating 2017-02-02



Objectives

- A. Understand the principles of using credit wisely
- B. Know about credit bureaus, credit reports, and your credit score
- C. Understand the correct uses of credit cards and how they can help (or hinder) you attain your financial goals
- D. Know how to manage your credit cards and open credit
- E. Know how credit cards work and the costs involved



Your Personal Financial Plan

- Section VII: Credit Use: Cards, Reports and Scores
 - What type of credit card user are you (credit, convenience, or both)?
 - Include credit card names, rates and fees
 - Get one credit report and one credit score, and give provider, score, and rankings (use the TT01-07 Credit template)
 - Check and ensure your credit report is correct
- Action Plan:
 - What will you do to improve your credit card use?
 - What will you do to improve your credit score?



Opt Out for Credit Card Applications

- Getting too many credit card applications?
 - There is a national credit opt-out number to take your name off the mailing lists of all four major credit reporting agencies either permanently or for five years. This may also help reduce your risk of identity theft. It is easy and (relatively) painless!
 - Call 1-888-567-8688 or 1-888-5 OPT OUT or www.optoutprescreen.com
 - Answer the questions on the phone or online. It only asks your home phone number, your name, address, and your social security number. Then they send a form for you to fill out and mail in.
 - It is worth it (unless you like junk mail).



Opt Out for Telemarketers

- Getting too many telephone calls:
 - The do not call registry can be accessed by signing on to:
 - www.Donotcall.gov
 - From here, you will put in up to 3 phone number(s) and your email address.
 - You will then receive confirming emails. When you receive them, click on the hyperlink to confirm them, and you will be set up on the Do Not Call list



A. Understand Principles of Using Credit Wisely

- What are the Principles of using credit wisely?
 - 1. Know yourself (your VMVS, goals and budget)
 - 2. Know where you are financially (in regards to your budget, assets and liabilities)
 - 3. Keep current on all bills (and pay off all credit cards and other debt monthly)
 - 4. Make only planned purchases (that are in your budget and that are planned for, particularly large purchases)
 - 5. Be wise in your use of credit and debt (and don't go into debt except for a modest home and education)
 - 6. Review your credit score and credit reports annually (to ensure correctness and no identity theft)



B. Understand Credit Bureaus, Credit Reports, and Credit Scores

- Credit Bureaus
 - Private organizations which maintain credit information on individuals which it allows subscribers to access for a fee
- Credit Reports
 - Information collected by credit bureaus from subscribers, creditors, public court records, and the consumer
- Credit Scoring
 - A numerical evaluation of your credit based on specific criteria determined by the credit scoring company



Credit Bureaus, Reports, and Scores (continued)

- Three Major National Credit Reporting Bureaus
 - Equifax Credit Information Services
 - www.equifax.com
 - Experian
 - www.experian.com
 - Trans Union
 - www.transunion.com
 - For your Financial Plan, you will need a credit report from at least one provider



Credit Bureaus, Reports, and Scores (continued)

- Information on your Credit Report
 - Personal demographics
 - Age
 - Social Security #
 - Addresses
 - Employment history
 - Credit history
 - Criminal convictions and judgments
 - Two years of inquiries
- Factors that determine Credit Worthiness
 - Annual income
 - Time at current residence
 - Time at current job
 - Age
 - Employment
 - Number of bank accounts
 - Number of credit cards
 - Credit history



Credit Bureaus, Reports, and Scores (continued)

- Your Rights With the Credit Bureau
 - 70% of Americans have at least one negative remark on their credit report and almost 50% of reports contain incorrect or old information, so:
 - Be proactive: you can change things
 - Review your report and report inaccuracies for investigation
 - If applicable, add a statement to protect yourself—it is worth the time
 - Recent laws have entitled you to get a copy of one credit report each year from each provider



Credit Bureaus, Reports, and Scores (continued)

- Getting your Credit Report
 - You can get 3 free credit reports each year, one from each of the three major reporting agencies
 - Go to www.annualcreditreport.com
 - Choose your state and credit reporting company
 - Fill out their forms. Make sure the connection is secure (https and the lock at the bottom)
 - Answer their questions—they are very picky!
 - Click on “Save as PDF” or “Print”
 - Print off your credit report from one provider for your PFP



Credit Bureaus, Reports, and Scores (continued)

- Getting your Credit Score
 - Click on Score, and get a free credit score
 - They use Vantage Score 3.0 which is not used as much in the industry (but its free)
 - Print it off for your PFP
 - Review credit factors to improve your score
 - The most used credit score is from FICO
 - Most loans are sorted based on FICO scores, and there are different FICO scores: FICO Score 8 (most widely used), FICO Score 2 (mortgages) and FICO Auto Scores 8 (autos)
 - Other credit score providers include VantageScore, PLUS Score, etc



Credit Bureaus, Reports, and Scores (continued)

- You can go five routes for your credit score:
 - 1. Look on your screen for a credit report button when you are getting your credit report
 - They may offer a free credit score (a VantageScore 3.0 score)
 - 2. Go to Google.com, and search for “Myfico promotional code”
 - They are generally 10-30%
 - Go to www.MyFico.com and order a standard credit report and FICO score for \$15.95 (they are discounting it themselves 20% from the normal \$19.95 cost)



Credit Scores and International Students

- 3. If you like, you can use a free site like CreditKarma.com (with an app) or Creditsesame.com to monitor your score on a monthly basis
 - While not a FICO score, it can help you if you see your trending score
- 4. If you are an international student or have no score, you can get a proxy for your credit score at <http://www.bankrate.com/brm/fico/calc.asp>
 - View and print off your credit report and credit score and put it in your PFP



Credit Scores and International Students

- 5. You may be able to get a copy of your credit score from your bank or credit card provider
 - This is generally free
- You will only hand in the name of the credit report and credit score provider and score for your PFP



Credit Bureaus, Reports, and Scores (continued)

- Why is Credit Scoring important?
 - It may determine whether you get your house or not
 - 75% of all mortgage loans are sorted on credit scores, the most common being FICO
 - The higher your credit score, the lower your interest cost
 - It may help you get the best deal on many types of loans: home, car, and consumer
 - It also may reduce the cost of your insurance products which are based on your credit score
 - Know your score!!!!!!!



Credit Bureaus, Reports, and Scores (continued)

- How does it work?
 - Lenders base your interest rate on your score
 - The higher the score, the lower the rate
 - Research by Fico showed (Fico uses a 0-850 range):
\$300,000 30-year fixed rate mortgage
 - Scores 760+ paid 3.27% Scores 700+ paid 3.49%
 - Scores 680+ paid 3.67% Scores 660+ paid 3.88%
 - Scores 640+ paid 4.31% Scores 620+ paid 4.86%
 - Source: <http://www.myfico.com/HelpCenter/FICOScores>
2013-01-30
 - A mortgage at the bottom versus the top rate paid \$99,275 more in interest over the life of the loan



Credit Bureaus, Reports, and Scores (continued)

- What is a “FICO” Credit Score?
 - Credit scoring method developed by Fair, Isaac and Company of San Rafael, CA (hence FICO)
 - Opened to the public in March 2001
 - Ranges from 300 to 850
 - Can be purchased for a \$19.95 fee (less discount) from www.myfico.com
 - One of three major scoring companies, but generally used the most
 - Used in credit approval and other areas as well, i.e. insurance
 - FICO has multiple credit scores for different users and industries (28)



Credit Bureaus, Reports, and Scores (continued)

- How is your “FICO” score determined?
 - Your Payment Record: 35%
 - Pay your bills on time--Don't get into debt!
 - Total Amount Owed (as % of limit): 30%
 - Keep balances low, particularly on revolving debt as a percent of your available limit
 - Credit History: 15%
 - Keep your oldest accounts
 - Application History: 10%
 - Don't apply for too many new cards!
 - Credit Mix 10%
 - Don't have too many of the same type of accounts!



Credit Bureaus, Reports, and Scores (continued)

- What Should You Do?
 - We manage our assets weekly--lets manage our liabilities as well
 - Take an active role in managing your credit
 - Review the things that go into your credit score
 - Review your credit report every year (it is free) and purchase your credit score (I recommend a FICO score) every two years, or more often if you are planning to take out a loan for a house



Credit Bureaus, Reports, and Scores (continued)

- What do you do about mistakes on your credit report?
 - 1. Contact the creditor (information is at the end of the credit report)
 - Many of the mistakes can be fixed over the phone
 - If you cannot get the problem solved



Credit Bureaus, Reports, and Scores (continued)

- 2. Contact the credit reporting agency's customer service representative
 - Explain inaccuracies in writing with necessary support documents using the "Investigation Form" from the website
 - If you cannot get the problem solved
- 3. Fill out a dispute form
 - You can put up to 100 words on your credit report explaining a situation and what you have done to try to resolve that situation



Questions

- Any questions on Credit Bureaus, Credit Reports, and Credit Scoring?

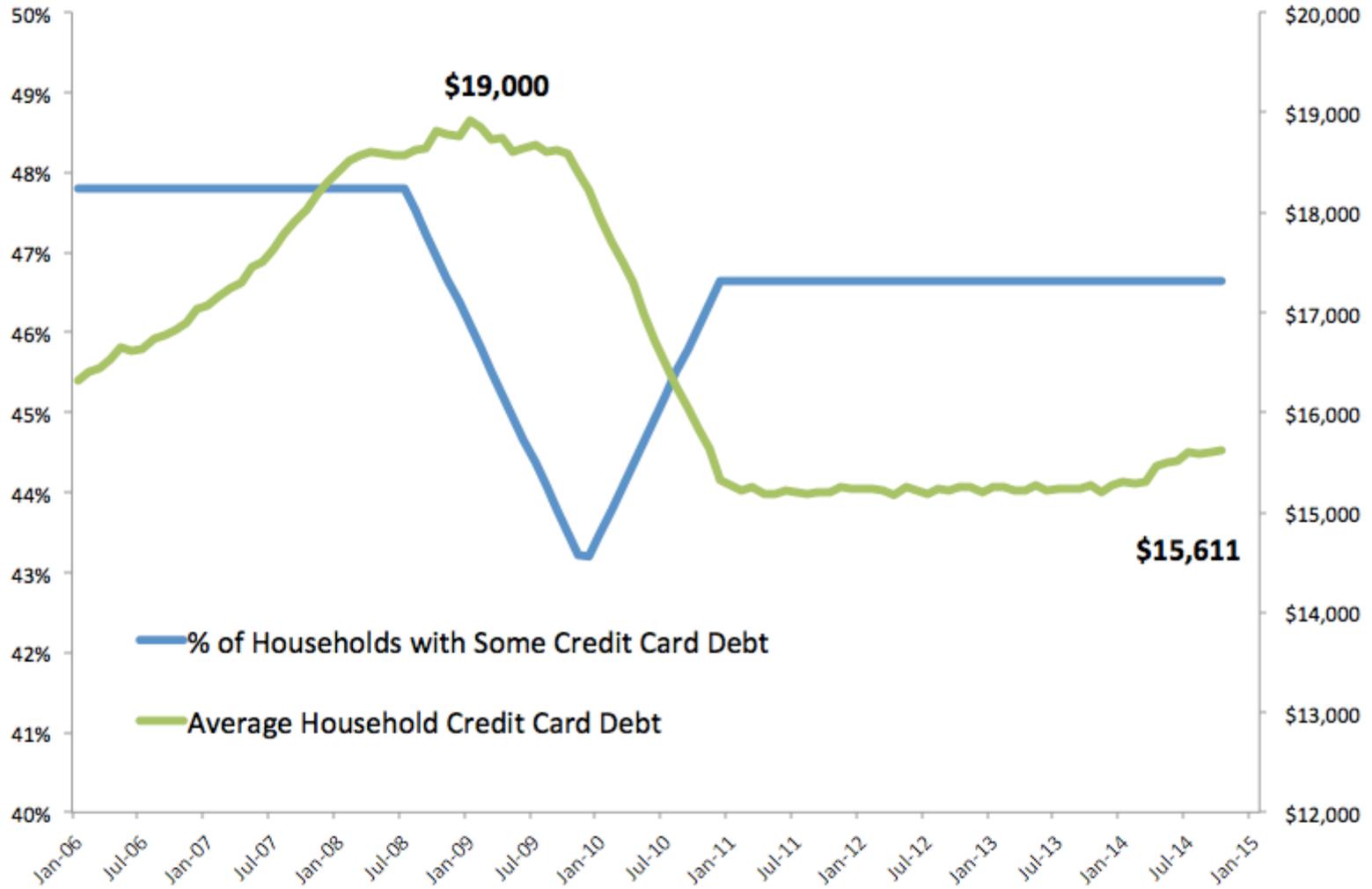


C. Understand Credit Cards and the Correct Uses of those Cards

- What are credit cards?
 - Credit cards are essentially open lines of credit
 - Credit cards can be either:
 - The single most destructive financial instrument in the history of the world, or
 - A tool to help us reach our personal and family goals
 - It depends on us!
 - If we use them to borrow money and get further into debt, they are destructive
 - If we use them to achieve our personal and family goals, they can be helpful



Credit Card Debt, Average US Household



• Source: <http://www.nerdwallet.com/blog/credit-card-data/average-credit-card-debt-household/>



Credit Cards (continued)

- What are the correct uses of credit cards?
 - Guarantee / Emergency Use
 - Hotel rooms, rental cars, emergencies, etc.
 - Convenience
 - Buying things over the internet
 - Float/Timing
 - Buy things before you pay for them
 - Can take advantage of things on sale
 - Free services
 - Extended warranties, travel insurance, airplane miles, gasoline, etc.



Credit Cards (continued)

- Problems with Credit Cards?
 - It is too easy to spend money
 - You don't think of how much you are spending
 - It is too easy to borrow money
 - When you do not pay it off you are borrowing
 - It's easy to lose track of what you spend
 - Its requires discipline to track charges
 - Interest costs are very high
 - They are double to triple other sources
 - You are obligating future income
 - Debt limits future flexibility



Credit Cards (continued)

- Keys to Effective Credit Card Use:
 - 1. Know yourself and your goals
 - 2. Spend only on things planned for and in your budget
 - 3. Don't go into debt
 - 4. Use wisdom in your expenditures
- Note:
 - If you cannot control your spending and cannot pay your credit cards off at the end of each month (i.e., you are borrowing money from the credit card company), then the use of credit cards is a bad idea and should not be used. "I am building my credit" is not an excuse to go into debt



Credit Cards (continued)

- Debit Cards
 - What are debit cards?
 - Debit cards are like a check in that money is taken from your checking account, and like a credit card in that you use it instead of cash.
 - Unless you have overdraft protection, it cannot be used for more than is in your account so you cannot spend borrowed money



Credit Cards (continued)

- Smart Cards
 - What are smart cards?
 - These are similar to debit cards except that these cards magnetically store a certain amount of money
 - When this money is gone, the card is worthless until more funds are magnetically transferred in
 - These cards are convenient and reduce the need to carry cash



Credit Cards (continued)

- Secured Credit Cards
 - What are secured credit cards?
 - Secured credit cards are similar to credit cards except that these cards are generally tied to a checking or savings account
 - When this money is gone, the card is worthless until more funds are added
 - These cards are convenient, especially to build credit, as credit scoring agencies cannot tell the difference between a secured and unsecured card



C. Know How to Manage Credit Cards and Open Credit

- Four key areas:
 - 1. Reduce your balance
 - 2. Protect against fraud
 - 3. Be aware of trouble signs in credit card spending
 - 4. Control your spending



1. Reduce your Balance

- Set up your budget and stick to it
 - Commit to reducing your balance each month by a specific dollar amount (i.e., \$150)
 - Do not go into any new debt
 - Develop your budget and have the discipline to stick to it



2. Protect Against Fraud

- Use wisdom in what you do
 - Save your credit card receipts to ensure against fraud
 - Compare receipts to your credit card statement
 - Once checked, destroy your old receipts.
 - Use caution when giving out your credit card number
 - Be aware of where your cards are at all times
 - Never leave a store without your card



3. Know the Trouble Signs

A “Yes” below means you may have a problem:

- ✓ Do you only make the minimum payment each month?
- ✓ Have you reached your credit limit on any of your cards?
- ✓ When with friends, do you pay the entire bill and have them reimburse you with cash?
- ✓ Do you wait for your monthly bill to determine how much you have charged?
- ✓ Do you get cash advances because you do not have enough in your checking account?
- ✓ Have you been turned down for credit or had a card cancelled?
- ✓ Have you used some savings to pay off credit card bills?
- ✓ Do you know how much of your credit card bill is for interest?



4. Control Your Spending

- Commit to always live on less than you earn
 - If you have problems with credit, cut up your credit cards
 - If all else fails, use the “envelope method” of budgeting
 - Put money for each budget category in an envelope. When it is gone, you have nothing more to spend.



What to Do if Your Credit Cards are Lost or Stolen?

- 1. Call your credit card company **IMMEDIATELY** (or sooner)!
 - Copy all your cards, front and back, and keep the 800 numbers handy to report any loss or theft.
 - Put this information in a safe place in case of theft.
- 2. File a police report **IMMEDIATELY** in the jurisdiction of the loss
 - This shows the credit card company that you are diligent and trying to find it.



Lost Credit Cards (continued)

- 3. Call the 3 national credit reporting organizations and the Social Security Administration to place a fraud alert on your name and social security number:

Equifax: 800-525-6285

Experian 888-397-3742

Trans Union: 800-680-7289

Social Security Administration

(fraud line): 800-269-0271



One-off Ways of Reducing Debt

- 1. Call the credit card company and request a lower interest rate
- 2. Move your balances to another card that has a lower interest rate (and with low transfer fees)
- 3. Use savings or sales of other assets to pay off debt
- 4. Exchange consumer debt for mortgage debt, assuming you have some equity in your home and you have changed your spending habits
- 5. Have a yard sale and sell those things you probably should not have bought in the first place to reduce debt



Questions

- Do you know how to manage your credit cards and open credit?



E. How Credit Cards

Work and the Costs Involved

- Why do companies like to issue credit cards?
 - ✓ Large annual fees (\$10-\$300)
 - ✓ High interest rates (up to 23% +)
 - ✓ Large balance transfer fees (3%+)
 - ✓ Wonderful cash advance fees (4.0%+)
 - ✓ High penalty rates (25%+) plus late fee
 - ✓ All of this on top of a 1.5%-5% charge to merchants. **What a Business!!!**
 - ✓ In 2003, 4.0 billion credit solicitations were mailed, or 25 for every adult in the US



How Credit Cards Work (continued)

- What type of credit card user are you? This will tell you what type of card to look for:
 - Credit user
 - You carry a balance, so look for a low interest rate
 - Convenience user
 - You pay it off each month, so look for a low annual fee, interest-free grace period, and free benefits
 - Convenience and credit user
 - You generally pay it off, but sometimes carry a balance, so balance the interest rate and annual fee
- Have the card that matches your needs!



How Credit Cards Work (continued)

- What determines the Costs of Open Credit?
 - The balance owed
 - Interest rates
 - Balance calculation method
 - Cash advance costs
 - The grace period
 - The annual fee
 - Additional or penalty fees



How Credit Cards Work (continued)

- Interest Rates
 - Credit Card rates are stated in terms of an Annual percentage rate (APR)
 - ✓ The APR is the true simple interest rate paid over the life of the loan. It does not take into account the time value of money!
 - ✓ The APR assumes no interest compounding while Credit Card companies compound daily!
 - Teaser rates
 - ✓ These are introductory interest rates used to attract new customers, some as low as 2.9%. But they increase soon after. Don't be fooled!



How Credit Cards Work (continued)

- Balance Calculation Methods
 - The cost depends on how the credit card company calculates their fees
 - Average daily balance--most common
 - Sum the daily balances, divide by the number of days in the month, times the stated interest rate
 - Previous balance—the most expensive method
 - Multiply the previous monthly balance times the interest rate
 - Adjusted balance—this is the least expensive
 - Subtract payments from previous balance times the interest rate



How Credit Cards Work (continued)

- Cash Advance Costs
 - This is an extremely expensive way to borrow
 - Interest begins immediately and may be at a higher rate than for purchases
 - Usually there is a “cash advance fee” of 2% to 4% of the amount advanced
 - Some cards require payment of the purchase balance before payment of the cash advance balance so they can keep earning the higher fees



How Credit Cards Work (continued)

- The Grace Period
 - Normally 20 to 25 days, excluding cash advances
 - Doesn't apply if you carry a balance
 - With no balance, you could avoid paying for a purchase for nearly 2 months
 - Not all credit cards offer a grace period



Questions

- Do you understand how credit cards work and the costs involved?



Addendum: Getting Copies of Your Records

- There are many specialty consumer reports
 - They are records compiled by various institutions that may be of interest to you. Sadly, there is no one-stop shop for these. A few are:
 - Check Writing History
 - Chexsystems at 800-428-9623
 - Shared Check Authorization at 800-262-7771
 - TeleCheck at 800-366-2425
 - Tenant History Report
 - ChoicePoint at 877-448-5732
 - SafeRent at 888-333-2413



Other Records (continued)

- Insurance claims history
 - ChoicePoint at 866-312-8076
 - A-Plus Reports at 800-709-8842
- Medical history report
 - Medical Info. Bureau at 866-692-6901
- Prescription history report
 - MedPoint at 888-206-0335
 - IntelliScript at 877-211-4816
- Employment background screening
 - ChoicePoint at 866-312-8075



Review of Objectives

- A. Do you know the principles of effective credit use?
- B. Do you know about credit evaluation, credit reports, and your FICO credit score?
- C. Do you understand the correct uses of credit cards and how they can help (or hinder) you attain your financial goals?
- D. Do you know how to manage your credit cards and open credit?
- E. Do you know how credit cards work and the costs involved?



Case Study #1

- Data
 - Adrian Tanner graduated from college and got her first job. Based on her salary of \$70,000, the bank pre-qualified her for a home loan and she found the perfect house. However, when she went in to finalize the loan, she was told that she didn't qualify for the loan due to her low credit scores.
- Application
 - A. What didn't she do?
 - B. What should she have done? and
 - C. What can she do to remedy the situation?



Data: Adrian Tanner, salary of \$70,000, bank pre-qualified them for a home loan. When she went in to finalize the loan, she was told that she didn't qualify for the loan due to her low credit score. Recommendations: A. What didn't she do? B. What should she have done? and c. What can she do to remedy the situation?



Case Study #1 Answers

- Recommendations:
 - A. What she didn't do was determine her credit score before going and getting a loan. Know your credit score before you go. Knowledge is power!
 - B. She should have reviewed her credit report and score, and tried to resolve any problem areas of her credit before getting the loan. She also should have gotten her credit score to see how she was looked upon by the financial community.
 - C. She can get her free annual credit report from each of the three agencies each year, and then pay to get her credit score, then work to improve that score.



Case Study #2

- Data:
 - Steve carried an average daily balance of \$600 this month. His balance last month was \$1,000 and he made a \$900 payment on the 15th of this month.
- Calculations
 - Calculate the monthly interest charges for his credit card accounts charging 10%, 16%, 18%, and 24% interest. Fill in the following chart:

	<u>10%</u>	<u>16%</u>	<u>18%</u>	<u>24%</u>
Average Daily Balance	\$5.00			

Application

- What does this chart say about the need to get a low interest rate?



Data: Steve carried an average daily balance of \$600 this month. His balance last month was \$1,000 and he made a \$900 payment on the 15th of this month. Calculate the monthly interest charges for credit card accounts charging 10%, 16%, 18%, and 24% interest. Fill in the following chart: Average Daily Balance 10% = \$5.00, 16% = ?, 18% = ?, 24% = ?. What does this say about the need to get a low interest rate?



Case Study #2 Answers

- Calculations:

- Average daily balance (ADB) \$600
- | | <u>10%</u> | <u>16%</u> | <u>18%</u> | <u>24%</u> |
|-----------------------|------------|------------|------------|------------|
| Average Daily Balance | \$5 | \$8 | \$9 | \$12 |

$$\text{ADB} * \text{Interest Rate} / 12$$

Recommendations: If you use credit cards to finance spending (which is not recommended), it is important that you get a low interest rate on your card.



Case Study #3

Data:

- Bill, a BYU student, was reading about the importance of keeping a high credit score, and got his FICO score of 690. He heard a rumor that to improve his FICO score, he needed to reduce the number of cards in his name. Bill cancelled three of his five credit/bank cards which he had not used in a long time. Instead of helping, the next time he purchased his FICO score it had dropped by 40 points.

Analysis:

- A. List three possible reasons why his score may have dropped?
- B. What should he have done to make sure the cancelled cards helped, and not hurt, his score?
- C. What things might he do to improve his score?



Case Study #3 Answers

- A. Three possible reasons his score may have dropped:
 - 1. History. One of the cards cancelled was his card with the longest history. His score may have dropped as his time with credit was lessened.
 - 2. Available credit. Each of the cancelled cards had a large amount of available credit. When these were cancelled, they decreased his total available credit, and increased his percentage usage each month, resulting in a lower score.
 - 3. Mix. Perhaps the cards cancelled resulted in a mix of credit that was biased toward one type of card. This may have lowered his score.



Case Study #3 Answers

B. What should he have done to make sure his score did not drop:

1. History. Make sure the cards cancelled did not have his longest credit history. He should keep the card with the longest credit history.
2. Limits. Before dropping the cards, he should go to his existing credit/bank card companies and request an increase in credit limit, at least to match the amount he had previously. If they will not increase the limit, keep the old cards.
3. Mix. Even though the cards may not be used, if they give a better mix, it may be wise to keep them. Avoid too many of the same types of cards.



Case Study #3 Answers

- C. What other things might he do to improve his credit score (above what has been talked about)?
1. Payment Record. Tighten his budget and save 20%. Pay bills on time and don't miss!
 2. Amount Owed. Use that 20% and any additional money to pay down debt (after he has started his Emergency fund). This will reduce his amount owed and his usage of available balances.
 3. Limits. Call his credit card companies and request an increase in credit limits. This will help his use of available balances.



Case Study #3 Answers

4. Credit History. If he can convince his parents (I am not sure I would do this), have him included on one of his parent's credit cards. This will increase his credit history (this is called piggybacking and it works only for families, not individuals).
5. Application History. Do not apply for new cards. Generally, I recommend between 2-4 cards for most individuals. Do not get new cards (just for the store credit)
6. Credit Mix. Do not apply for too many of the same type of cards.



Case Study #4

Data:

- Bethany, a BYU student, was reading about the importance of having a high credit score. She went to www.annualcreditreport.com but found she has no credit history. She pays her bills on time, has a checking account and a debit card

Questions:

- A. Why might she not have a credit report?
- B. What can she do to improve her credit history?
- C. Does a debit card help build credit?
- D. If banks will not allow her to get a credit card, what could she do?
- E. How could she get a secured credit card?



Case Study #4 Answers

- A. She may not have credit history because she has not had much credit. Even though she pays her bill on time, the bills may be in other student's names. She may also be an international student without a social security number.
- B. She could try to get a credit card. This would be helpful to her in improving her credit history.
- C. A debit card does not help build credit.



Case Study #4 Answers

- D. If she cannot get a credit card, she should (carefully) look into a secured credit card. If she can find one with low fees, she will put money into the card and can charge up to the amount of money on the card. Credit reporting agencies cannot tell the difference between a credit card and a secure credit card
- E. She should check with her bank or www.bankrate.com for a card that does not charge an application or insurance fee and that has a low annual fee



Suggestions from Students

- Discover offers your credit score for free, you can check it often as it is updated monthly.
<https://www.discover.com/free-credit-score/>
- Other banks and credit card companies may also offer you access to your FICO score on a monthly basis
 - These services show what you are doing well and what tools may improve your credit. (OB '17)
- Creditkarma.com and Creditsesame.com offer free credit scores
 - Their mobile apps may help you monitor your credit score