THE USAA EDUCATIONAL FOUNDATION®

Good Information for Good Decisions.®

MONEY MANAGEMENT

MANAGING CREDIT AND DEBT

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OUR MISSION

The mission of The USAA Educational Foundation is to help consumers make informed decisions by providing information on financial management, safety concerns and significant life events.



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November 2009

2 THE IMPORTANCE OF DEBT MANAGEMENT

Credit is the ability to borrow money to buy something now with a promise to pay for it later, with an added interest charge. Every time you use credit, you incur debt.

Debt is a double-edged sword. Responsible borrowers can use debt to pay for a vehicle, home or college education over time rather than all at once. Those who are careless with debt, however, will see an increasing portion of their income consumed by debt payments, jeopardizing their financial futures.

USE CREDIT FOR	DO NOT USE CREDIT FOR
• Items that appreciate in value (a home or home improvements).* • Items that generate future income (a college education).* • Items that have value longer than it takes to pay them off (a vehicle or furniture).	• Depreciating goods and services (vacations, dining out, clothing or holiday gifts). **Exception:** When you can afford to pay these charges in full upon receiving your statement.

**The loan interest charges you pay for most mortgage loans and some student loans may be tax deductible for federal income tax purposes.*

Debt Categories

Sound debt management begins with understanding your financing options. There are two major categories of debt — secured and unsecured. Secured debts are those that require you to pledge collateral to back up your promise to pay. Collateral is something of value which lenders can re-possess if you fail to make payments on their terms. Unsecured debts have no collateral, only the promise you give them to repay the loan in full.

Typically, the property being purchased with the loan serves as collateral, such as a vehicle or home. Because secured debt exposes the lender to less risk, it usually has lower interest rates than unsecured debt.

Used properly, credit helps you achieve major financial goals.

Mortgages

One of the smartest uses of credit is for a home purchase. A mortgage is a secured debt that facilitates the purchase of a home. While there are different types of mortgages, the type of mortgage loan that is best for you depends on your specific situation. Some of the more common mortgages available are Fixed Rate, FHA, VA, Interest-only and Adjustable Rate (ARM).

You should analyze your budget early in the home buying process, before you start talking with a mortgage lender. See the "Budget Work Sheet" on pages 14–15 to help you determine how much you can afford to spend each month. Be realistic and avoid buying a home that exceeds your budget limits. You may also want to consider obtaining pre-approval for a home mortgage. This will enable you to find out exactly how much a lender is willing to loan you.

Also remember that the mortgage interest and property taxes may be deductible for federal income tax purposes up to certain limits and the home may increase in value — factors that offset some of the interest charges you must pay.

Home Equity Loans

Home equity is the difference between the market value of your home and the amount of your mortgage debt. There are two ways to borrow against the equity value of your home. With a home equity loan, you borrow a fixed amount in one lump sum and repay it in monthly installments over a set time period, such as 10 years. With a home equity line of credit, a fixed amount of credit is made available to you and you access the credit as needed in amounts up to the limit. You pay interest and principal on the balance due, just as you would with a credit card.

Home equity loans and lines of credit are appealing because the interest on them is generally deductible for federal income tax purposes and the interest rates are usually lower than those offered with credit cards and other unsecured debt. The downside of a home equity loan is that you are using the equity in your home as collateral, which could put your home at risk if you fall behind on your payment. You could lose your home through foreclosure, where the lender takes ownership of your property and sells it in an attempt to recover the money loaned to you. Also, when you attempt to sell your home you may find that you owe more than your home is worth. This can easily happen if real estate values fall.

Vehicle Loans

These loans are used to facilitate the purchase of vehicles. Like mortgages, they can have fixed or variable interest rates with payment periods ranging from 3 to 6 years. As you select the length of your loan, remember that the longer the loan, the greater the likelihood that you will find yourself "upside down" — owing more money than the vehicle is worth.

Credit Cards

There are two categories of credit cards. Revolving credit cards, the most common, allow you to charge up to a predetermined limit and either pay the balance in full each month or make payments over time with interest. Pay-as-you-go cards generally assess higher annual fees and require the balance to be paid in full each month.

When selecting a credit card, compare the annual percentage rate of interest and all fees associated with each card. Choose a card that allows at least 25 days after the monthly closing date (grace period) before imposing finance charges on purchases. With these cards, you avoid all interest charges on purchases if you pay your balance in full by the payment due date.

Signature Loans

A signature loan is an unsecured debt. The loan gets its name from the fact that the only security the lender has is the promise of the borrower as evidenced by a signature.

Used improperly, credit can lead to financial trouble. It is easy to lose track of how much you are spending when credit is used for vacations, dining out, clothing or gifts. Try to use credit only if you can pay your account balance in full each month.

Your Credit Reputation

It is important to establish healthy credit habits.

- Set a monthly limit for charges and stick to it.
- Pay bills on time and in full to avoid monthly charges.
- Do not skip a payment.
- Limit the number of credit cards you own.
- Know the terms and conditions of your credit card(s) and loan(s). If you have questions, ask the company for an explanation.
- Keep credit card and loan information in a safe, secure place.
- Keep copies of sales slips and compare charges when your billing statements arrive. Call your company immediately if you find a discrepancy.

By practicing healthy credit habits, you can build a good credit reputation which will result in the following.

- You have a better chance of being approved for credit when you need a credit card, vehicle loan or mortgage loan.
- You are more likely to receive higher loan amounts at lower interest rates.
- You are more likely to acquire insurance coverage, secure an apartment and get a desirable job. Insurance companies, landlords, employers and other businesses review your credit history during the application process.

Establishing Credit For The First Time

If you have not yet had the opportunity to establish a credit history, there are a number of steps you can take to position yourself favorably in the eyes of lenders.

- Maintain active checking and savings accounts with no checks returned for insufficient funds. This demonstrates that you can manage money well and have the discipline to save.
- Apply for a small, secured loan or credit card from your financial institution, backed by your savings account. Use it carefully and make payments promptly. Paying small credit transactions responsibly establishes your creditworthiness.
- Secure a credit account from a local store if you cannot qualify for a bank card. Use it in moderation until you have established a good payment record. Then apply for a bank card and stop using the store credit account by formally closing the account with the merchant.

6 SHOPPING FOR CREDIT

When you have a need to take on debt, it is important to find the most attractive terms you can. You do not want to pay higher interest than necessary or pay fees that could have been avoided by shopping around.

Comparing Credit Cards

Credit cards offer a variety of interest rates, terms and features. Two cards, both with the same name, may offer very different features. Each financial institution that offers credit cards establishes its own terms. Be cautious of credit cards that start charging interest on items you buy the day each transaction is posted to your account. You pay interest on all purchases with this type of card.

Compare credit card options carefully and consider the following.

- Annual percentage rate (APR), or the rate of interest (expressed as a percentage) charged for a loan over a year's time. The APR includes interest, transaction fees and service fees.
- Fees charged by the card issuer, such as over-limit fees, annual fees or cash advance fees.
- Grace period, or the amount of time you have to pay before interest is charged.
- Other benefits, such as frequent flyer miles or access to an automated teller machine (ATM).
- Penalty APRs that increase your interest rate if you are late on a payment.

Comparing Loans

Like credit cards, loans vary depending on the institutions offering them. When shopping for a loan, compare the following.

- Annual percentage rate (APR), or the rate of interest (expressed as a percentage) charged for a loan over a year's time. The APR includes, interest, transaction fees and service fees.
- Length of the loan, which affects the total amount of interest you will pay.
- Service reputation of the lender.

When deciding on a loan, it is easy to commit to a large long-term debt when a low monthly payment looks advantageous. Before you do, compare the total amount of interest over the entire life of the loan. Remember, you pay more total interest when you select a longer-term loan. Be sure to ask questions and read the contract carefully before you sign.

The table below illustrates how total costs can vary among loans in which there is only a modest variation in the APR and the length of the loan.

COMPARISON SHOPPING FOR LOANS

	AMOUNT OF LOAN	APR	LENGTH OF LOAN	MONTHLY PAYMENT	TOTAL INTEREST	TOTAL COST
Loan A	$12,000	7.5%	3 years	$373	$1,438	$13,438
Loan B	$12,000	8.5%	3 years	$379	$1,637	$13,637
Loan C	$12,000	7.5%	4 years	$290	$1,927	$13,927
Loan D	$12,000	8.5%	4 years	$296	$2,197	$14,197

How would you evaluate these loan options?

- Loan A offers the lowest total interest.
- Loan C charges the same interest rate as Loan A, but paying over 4 years rather than 3 years adds $489 in total interest.
- Loan C charges a lower interest rate than Loan B, but Loan C's longer term still results in a higher total cost.
- Loan D's 8.5 percent interest rate results in $270 more in interest paid than with Loan C, even though there is only a small difference in monthly payments.

If you can afford the monthly payments, choosing Loan A over Loan D would save you $759 in total interest paid over the life of the loan.

8 YOUR CREDIT REPORT AND SCORE

As you establish credit, you build a credit rating resulting in a record of creditors' experience with you as a borrower. It is this credit report that future lenders, employers, landlords and other businesses review to make their own decisions about your creditworthiness.

Your credit report is a month-by-month record of your payment history with financial institutions or credit card issuers (companies that grant credit). It shows how much credit you are using, how well you pay your debt, who is inquiring about your credit, and information on bankruptcies or federal income tax liens. Failure to pay your creditors on time can lead to a bad credit rating. Bankruptcy remains on your credit record for 7 to 10 years, depending on the type of bankruptcy that is filed. Good credit information can remain on your report indefinitely.

The Annual Credit Report Request Service is a centralized contact for requesting your annual credit report. It was created by the three nationwide consumer reporting agencies: Equifax, Experian and TransUnion. Visit the Web site at www.annualcreditreport.com to request a free annual credit report.

Order A Free Credit Report

You may request and receive a free credit report annually from any or all of the three consumer reporting agencies. One strategy would be to order your free credit report every 4 months from one of the three agencies. These agencies also sell various financial products and services, which you are not required to purchase. You are entitled to a free credit report anytime if you have been denied credit, are a victim of identity theft, receive welfare benefits or are unemployed but expect to apply for employment in the next 60 days.

A poor credit rating could mean you will be denied a loan or credit card or incur higher interest rates. You could also be turned down for insurance, an apartment or even a job. Review your credit report at least once each year to ensure it is accurate and that you are not the victim of identity theft. It is also important to check your credit report before you apply for a mortgage or other major loan.

Your Credit Score

In addition to your credit report, creditors will also look at your credit score. Your credit score is a three-digit numerical summary of your credit report.

Credit scores range from approximately 300 to 850. The higher your score, the better. Most lenders consider scores above 700 a good indicator of low credit risk, while scores below 620 may indicate credit problems. A low score may cause you to be denied credit. With a slightly higher score, you could get credit but at a higher interest rate. If your score is high enough, you may qualify for the best rate on a loan or credit card account.

No single factor determines your score. But one or more of the factors may affect the final score more than others, depending on the overall information in your credit report. Your score can change as new information is received by consumer reporting agencies and credit scores will vary by agency depending on which agency your creditors report to. Your score today could be different from your score 3 months from now.

FACTORS DETERMINING CREDIT SCORES

- Payment history.
- Length of credit history.
- Types of credit used.
- Amounts owed.
- New credit.

Your Credit Rights

Under the Fair Credit Reporting Act and the Fair and Accurate Credit Transactions (FACT) Act of 2003, you have the right to require a consumer reporting agency to do the following to ensure that your credit rating is accurate.

A consumer reporting agency must:

- Provide you with a complete credit report. Anyone may request a free credit report annually. You may request a free credit report anytime if you have been denied credit, are a victim of identity theft, receive welfare benefits or are unemployed but expect to apply for employment in the next 60 days.
- Investigate, at your request, erroneous or missing information in your report. The consumer reporting agency must provide you with a written report of the investigation, as well as a revised copy of your credit report if the investigation resulted in changes.
- Keep your credit report information from anyone other than legitimate users of the consumer reporting agency.
- Remove detrimental credit information from your file after 7 years. Bankruptcy information can be removed after 7 to 10 years.

Your Credit Responsibilities

When you receive your credit report, you have the responsibility to review it and act on any errors you find.

- Understand the entries on the credit report. Each consumer reporting agency's credit report contains information such as how long an account has been tracked, the highest amount charged, the account balance at the time of the report and the type of account. Other entries identify creditors that have viewed your credit history. Codes indicate debtors' arrangements, repossessions and bad debts, if applicable.
- Ensure the credit report is accurate. Common errors include incorrect personal information, missing information and failing to correct damaging information after problems are resolved.
- Take action to correct errors. Document your actions and follow up until the problem is resolved.
- Inform creditors of errors. The credit reporting agency must investigate the items in question — usually within 30 days — unless they determine that the dispute clearly lacks merit.
- Retain your written account of errors or discrepancies in your file. If an investigation does not resolve the dispute to your satisfaction, you have a right to add a statement to your credit report file contesting the accuracy or completeness of the disputed information.

Manage Debt

Once you have credit cards in your wallet, you need to manage debt responsibly to build and protect your credit record and score.

THE DO'S AND DON'TS OF DEBT MANAGEMENT

DO

- Seek credit cards and loans with the lowest interest rates.
- Stay within your credit limit.
- Track your charges online.
- Pay charge accounts in full monthly, if possible.
- Use Web-based automatic bill-pay programs to ensure payments are on time.
- Save your receipts and compare them to the charges listed on your statement.

DON'T

- Use credit to buy things you cannot afford.
- Let the total monthly debt payments (less mortgage or rent) exceed 20 percent of your net income.
- Apply for too many credit cards. Remember: three lines of credit are enough.
- Give in to impulse buying.

Stop Adding New Debt

When debt is a problem, the first step toward a solution is to stop adding to your existing balances. It may be helpful to remove your credit cards from your wallet and place them in a secure but less convenient location so you will be less likely to use them.

Review your most recent credit card statements to identify any recurring monthly charges on your cards. Cancel those purchases that are not essential, such as subscriptions to entertainment services.

DEBT DANGER SIGNALS

Warning signs of overindebtedness appear long before creditors start sending collection notices. Answer the following questions to help determine if you are managing debt appropriately.

	YES	NO
1. Are you borrowing to pay for items you once paid for with cash?	❑	❑
2. Is an increasing percentage of your income going to pay debts?	❑	❑
3. Are you paying bills with money reserved for something else?	❑	❑
4. Are you taking money from savings to pay current expenses?	❑	❑
5. Is your emergency fund (which should equal 3–6 months of basic living expenses) inadequate or nonexistent?	❑	❑
6. Do you pay only minimums on your revolving charge accounts?	❑	❑
7. Are you making payments in 60–90 days that you once made in 30?	❑	❑
8. Are you near or at the limit on your credit cards and other sources of borrowing?	❑	❑
9. Do you take out a new loan before the old one is paid in full or take out a new loan to pay an existing loan?	❑	❑
10. Do you take out payday loans before you receive your scheduled pay?	❑	❑
11. Are you unsure about how much you owe?	❑	❑
12. Are you chronically late in paying your expenses?	❑	❑
13. Are you threatened with repossession of your vehicle, cancellation of your credit card(s) or other legal action?	❑	❑

IF YOU ANSWERED:	YOU ARE:	YOU SHOULD:
"No" to all questions	Managing debt well.	Continue practicing good money management.
"Yes" to any question 1–5	Getting out of control.	Stop using credit until current debt balances are paid.
"Yes" to any question 6–11	On the verge of trouble.	Stop using credit. Develop a budget and debt payment plan.
"Yes" to question 12 or 13	Probably overextended.	Consult a financial planning professional now, before your financial goals become impossible to achieve.

Develop And Follow A Monthly Budget

Before attempting to pay your debt in full, it is critical that you know how much money you receive and where every dollar goes each month. Use the Budget Work Sheet on pages 14–15 to take that important step. It will help you identify opportunities to trim expenses, saving money that can be used to pay down your balances. The easiest expenses to eliminate are flexible expenses like dining out, clothing, gifts and entertainment.

As you examine your monthly income and spending, you should also consider opportunities to increase your income — especially if you find your expenses exceed your income. Even if it is only temporary, additional income will quicken your return to financial health.

A budget or a spending plan, is a tool for establishing financial control and direction. It helps you:

- Track how you use money each month and year.
- Avoid unnecessary spending.
- Prepare for unexpected expenses.
- Save for short-term goals and invest for long-term goals.

Several financial software programs are available to help you accomplish this task. Utilizing this information will help you more wisely manage your income and expenses to meet your financial goals.

Creating A Budget

Total every dollar you spend for a month and keep track of what you buy. You may be surprised how much you spend and on what things.

- **Assess your income and subtract your expenses.** Gather pay stubs and other income statements, check registers, bank statements, credit card statements or bills and receipts. Divide your annual net income by 12 to determine monthly net income.
- **Copy the Budget Work Sheet.** Use it to record the amounts you plan to spend for the month. Financial planning professionals generally recommend targeting at least 10 percent to 15 percent of monthly net income for savings.
- **Monitor your spending.** Keep written records of your purchases and payments. Record the amounts you actually spent for the month.
- **Review your plan.** Compare what you actually spent to the amounts you planned to spend. How well did you do for the month? Did you have extra money (net cash flow), or did you borrow money by using a credit card? Look for areas that require special attention and reduce or eliminate expenses as needed. Review your spending plan at least once each month.
- **Adjust your plan.** Adjust expenses to reach your financial goals.

BUDGET WORK SHEET

Income For The Month Of:	AMOUNT	
Monthly gross income	$	
Other income (spouse, interest, etc.)		
Total Monthly Gross Income	=$	
Deductions		
FITW — Federal Income Tax Withholding (if applicable)	$	
SITW — State Income Tax Withholding (if applicable)		
FICA — Social Security		
FICA — Medicare		
Other deductions		
Total Deductions	=$	
Monthly Net Income (total gross income minus total deductions)	**=$**	
EXPENSES	**AMOUNT PLANNED**	**ACTUAL EXPENSES**
Charitable Giving		
Place of worship	$	$
Other		
Savings/Investments (generally target at least 10%–15% of monthly net income)		
Emergency fund	$	$
Retirement accounts (IRA, 401(k), etc.)		
Other		
Home/Utilities		
Food	$	$
Rent/Mortgage payment		
Utilities		
Home maintenance		
Property taxes (1/12 of total annual expense)		
Furniture		
Phone/Cell phone		
Internet service		
Debt		
Credit card(s) payment	$	$
Loan(s) payment		

EXPENSES *(CONTINUED)*	AMOUNT PLANNED	ACTUAL EXPENSES
Insurance		
Auto insurance	$	$
Renters/Homeowners insurance		
Health insurance		
Disability insurance		
Life insurance		
Education		
Tuition	$	$
Room/Board/Travel		
Books/School supplies/Uniforms		
Transportation		
Vehicle payment	$	$
Gasoline/Parking/Tolls		
Vehicle maintenance		
Registration/License fees (1/12 of total annual expense)		
Public transportation		
Personal		
Clothing	$	$
Laundry/Dry cleaning		
Grooming (hair care, toiletries, etc.)		
Child-care expenses (babysitters, child-care center)		
Recreation/Entertainment		
Vacation(s) (1/12 of total annual expense)	$	$
Entertainment/Dining out		
Hobbies (for example, golf or tennis equipment and fees)		
Club fees/Organization dues		
Cable/Satellite television		
Total Monthly Expenses	**=$**	**=$**
CALCULATE MONTHLY CASH FLOW		
Monthly Net Income	**$**	**$**
Less Total Monthly Expenses	**–$**	**–$**
Net Cash Flow (Deficit)*	**=$**	**=$**

**If your net cash flow is positive, you can save more for emergencies or other financial goals. If negative, you should consider decreasing expenses or increase income (by taking a second job, for example) to reduce or eliminate debt.*

Contact Creditors

If paying bills on time becomes a problem, do not wait for your accounts to become delinquent. Contact your creditors immediately and explain your situation. Emphasize that you want to pay your debts and suggest a repayment plan. Your creditors may allow you to arrange new terms, such as deferring or reducing payments or making interest-only payments for several months.

Being late on vehicle loans is especially risky because most financing agreements allow lenders to repossess your vehicle at any time you are in default. If your vehicle is repossessed, you may also become responsible for the cost of the repossession. In addition, repossession will hurt your ability to obtain credit in the future. Because of this, it is better to sell the vehicle yourself to pay the loan if you cannot work out an agreement with your creditor.

Reduce your interest rates. If you can, move higher interest rate balances to lower interest rate cards or loans. You may be able to take advantage of a low introductory interest rate on a new credit card. Before doing so, be sure you understand what will happen to the interest rate at the end of the introductory period.

Consolidate your debt. You may be able to consolidate several debts into one obligation with an interest rate that is lower than the interest rate you were paying on the consolidated debts. Debt consolidation is not the answer for everyone. It works only if you are disciplined enough to avoid taking on any new debts.

Review your insurance deductibles. You may be able to improve your cash flow by increasing your insurance deductibles which will generally decrease your insurance premiums. The deductible is the amount you pay before the insurance company pays for a loss. By asking your insurance company to raise your deductible, you agree to assume more for each loss. Remember to set aside the increased deductible amount in your emergency fund which should equal 3 to 6 months of basic living expenses.

Pay high interest debt first. Focus your repayment efforts on the debt with the highest interest rate. When you have identified your highest interest rate debt, continue making the minimum required payments on your other loans but apply available excess cash to paying down your highest interest rate obligation first. Once you have paid it in full, take the payment and extra principal you were paying on that loan and apply it as additional principal payments on the remaining loan that has the highest interest rate. As each debt is paid in full, you will have an increasing amount of cash to use toward paying in full the next one.

Sell assets. Consider selling possessions that are no longer wanted or needed and using the cash to pay your debt. Spare appliances, an extra vehicle or rarely-used exercise equipment may all be items that could be sold and the proceeds applied to debt reduction.

If your debts are well above recommended levels, consider redeeming investments or using your savings to pay debt. Generally, you should only do this if the expected return on your investments or savings is lower than the interest rate you are paying on the debt. Because selling investments may have federal income tax consequences, you should consult a financial planning professional.

Downsize. For many consumers, house and vehicle payments make up the majority of their debt obligations. If your debt is above the recommended thresholds, consider downsizing to a less expensive home or vehicle. In addition to reducing your debts, you may find additional savings resulting from lower insurance premiums and maintenance costs.

Consumer Credit Counseling Service (CCCS) counselors will develop your budget with you to determine how much is available to repay debt. Then they will negotiate on your behalf with creditors to develop a debt repayment schedule.

Under a CCCS debt management plan, you send a monthly check to CCCS for the amount you have calculated as available for debt repayment. CCCS distributes payments to creditors according to the proportion of debt owed to each.

Depending on the circumstances, some creditors may suspend finance and late payment fees for individuals participating in CCCS debt management programs. Some major national creditors have agreed to consider successful completion of a CCCS program as an acceptable credit history, so that if you qualify for credit on other grounds, your previous history may not prevent you from being approved.

Be sure any counseling service you use is affiliated with or recommended by the National Foundation for Consumer Credit (NFCC). Avoid firms advertising that they can resolve debt problems by removing negative information from your credit report.

WHERE TO GET HELP

The nonprofit Consumer Credit Counseling Service (CCCS) offers budget planning and debt repayment plan administration.

To locate the office nearest you, contact the National Foundation for Consumer Credit (NFCC) at (800) 388-2227 or visit www.nfcc.org.

Personal Bankruptcy

There are two forms of personal bankruptcy.

- Chapter 13 reorganization
- Chapter 7 liquidation

Both forms of personal bankruptcy should be avoided if at all possible.

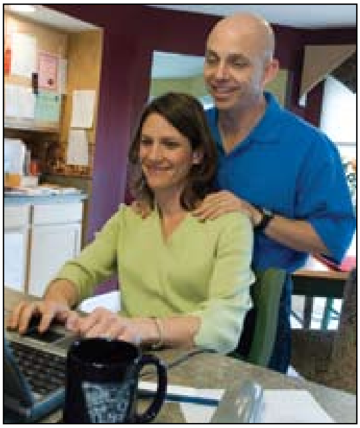
Under **Chapter 13**, you are protected from collection efforts. A bankruptcy judge will make the final determination about how much you can afford to repay. Finance charges cease as you make court-approved payments to creditors over 3 to 5 years.

Under **Chapter 7**, you are released from the obligation to repay your debts, usually after a court-ordered sale of your non-exempt assets to pay as much as possible on your outstanding balances.

Some individuals mistakenly believe they will emerge from bankruptcy with a “clean slate.” Once you have filed bankruptcy you will find it more difficult to qualify for credit or to obtain it on favorable terms. Remember, bankruptcy should only be used as a last resort. Consult your legal adviser for more information.

20 NOTES

RESOURCES



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