Credit Management & Counseling

Credit can be a useful tool that helps you to make major purchases, like a car or a house, by letting you pay for them over time. It's convenient, it can help in emergencies, and it's safer than carrying cash. Credit can also be dangerous if not used in the right way.

It's tempting to buy something using a credit card, even though you don't have the cash to pay it back. If used too much, credit payments can add up quickly, leaving less money for your basic necessities.

An important part of your financial foundation is understanding credit and the possible consequences of using and misusing debt.

Section Overview

Overview and Goals

Every time you pay a bill (or don't) it contributes to your credit history. While you may not give a lot of thought to your credit history in the day-to-day, your everyday actions have long-term effects on your financial security. It's important to fully understand how simple transactions and payments can affect you into the future. This chapter will provide basic information about managing your credit, including what impacts a credit score, warning signs of credit overload, and where individuals can go for assistance.

The goals of this chapter are:

1. To overview the benefits and drawbacks of debt.
2. To provide information about how to order and what to look for in a credit report.
3. To help you understand what's in a credit score and ways to improve it.
4. To provide options for managing debt.

Take-away messages:

1. Always keep an eye on your credit—it affects more than you think
2. Manage an economic hardship with the least damage to your credit record
3. Check your credit score
4. If you run into trouble you may need to repair your credit too
5. Bankruptcy and repayment are options but will not make your financial problems go away

Credit Basics

When you use credit, you borrow money with the promise that you will pay it back over time. You will also have to pay the creditors a fee for using their money. Various fees could include interest, late fees, over-the-limit fees, and annual fees paid once per year to the credit card company just so you can have the card.

When would you want to use credit?

Although it is usually best to plan and save for bigger expenses, there are times when using credit has its advantages. Many financial experts recommend having at least one credit card that can be available for emergencies. Credit cards also offer convenience for online purchases and for making reservations at airlines, hotels, and car rental agencies.

It makes sense to use credit to purchase things that are going up in value, last a long time, or give you a financial pay off. An example of this type of "good debt" would be a house, a college education, or a reliable car for getting to work. On the other hand, "bad debt" is when you borrow for things that don't give you financial benefits and don't usually last as long as the time it takes to pay them off. This includes borrowing for clothing, furniture, eating out, or vacations.

Whether you make a conscious choice not to have a credit card or can't get a credit card, there are other ways to make purchases. Many companies will accept debit cards when taking reservations, for example. Just be aware that if you use your debit card for this purpose, the company will most likely place a hold on your account for a certain period of time for an amount equal to the total cost of your reservation. Even if you end up actually paying cash for your purchase, the temporary hold will still be there and may tie up the cash balance in your checking account.

Another option is to use a pre-paid credit card for these types of transactions. Pre-paid credit cards operate very similarly to pre-paid phone cards in that you "load" the card with a certain dollar amount that you purchase with cash. The card can be used anywhere that accepts major credit cards. The down side to pre-paid cards is that you are charged a fee every time you make a purchase, so you are basically paying to use your own money. This may make sense in certain circumstances, but is not a great idea for a shopping spree where you make multiple small purchases.

Types of credit

Credit is available in different forms, and it's important to know one type from the other to find the right option if you're thinking about using credit. "Closed-end" credit is credit given for a certain period of time for a specific amount of money. Once the loan is paid off, the account is closed. Examples of closed-end credit include car loans and mortgages.

An "open-end" credit account is one under which you can make repeated purchases. You can either pay the balance in full or in installments. You can use the same credit at a later date to buy something different and not have to sign a new contract with the creditor. Examples of open-end credit include credit cards like Master Card and Visa, gas cards, and department store cards.

You might also use "service credit accounts" such as through a doctor or dentist who provides a service and bills you later. Utilities that you use first and pay for later are a form of credit, and some larger utility companies report to Credit Reporting Bureaus which keep track of your credit history.

Secured vs. unsecured credit

When entering into a credit agreement, it's important to know whether the money you're borrowing is unsecured or secured. When a debt is *unsecured,* there is no collateral attached to the money being borrowed. *Secured* credit means there is some kind of collateral attached to the money you're borrowing. *Collateral* is defined as property that a borrower puts up to secure a loan. If the borrower misses or defaults on a payment, the lender may repossess the collateral. In the case of a home loan, the lender may foreclose on a house. The most common forms of secured credit are home mortgages, home equity loans, and car loans.

Some credit cards and debt consolidation loans might also be secured. Approach debt consolidation loans with caution especially if they involve rolling unsecured debt into secured debt. On the other hand, a secured credit card that is linked to a bank account can be used to the borrower's advantage if they're trying to rebuild their credit history.

Credit cautions

Don't enter into a credit agreement without understanding the terms of the loan or if you're not sure you'll be able to pay back the loan. For example, payday lenders charge high fees for advancing you money on your paycheck. The fees can quickly become unmanageable if you can't cover the check and have to roll it over for a longer period of time. *Rent to Own* stores are another high-cost credit option, especially tempting for new homeowners or renters. You can expect to pay many times more than the actual price of an item when you rent it than if you bought it out-right.

Be sure to keep the total cost of credit in mind when you compare credit offers. All too often, people fall into the trap of just asking how much their monthly payment will be, without adding up all of the interest charges and other fees. With some loans, you might even discover you'll be paying back more than double the amount of money you originally borrowed.

Controlling your use of debt

Follow the ***28/36 Rule***: A good credit risk is when mortgage payments are below 28% of gross monthly income, and total debt payments are below 36%.

- **Gross monthly income** = total income on your paycheck before taxes, withholding and benefits reductions
- **Mortgage payment** = Principal and Interest
- **Total debt payments** = mortgage + auto loans + credit cards and any other consumer loans

Note that Home Affordable Modification Program (HAMP) loans follow the 31/55 rule, with the numbers substituting in to the formula above. This type of loan is specifically for people in financial distress or hardship.

What is Credit Management?

Your credit history can affect many areas of your life, which is why it is so important that you do everything you can to keep your history in good standing. Lenders use your credit report as a tool to decide whether to loan you money and what interest rate to charge. Insurance companies, landlords, and employers can also check your credit history for information that will help them determine how responsible you are. If you do not have good credit now, make this one of your top goals. It would be a shame to miss out on that great job or apartment because your credit history was in poor condition. Without good credit, you may not be able to get a mortgage for your home, a low interest loan for your car, or a loan for your education. By showing improvement, you will increase your chances of getting credit when you need it, and at a lower interest rate.

Managing Your Credit

- Every time you pay a bill (or don't) it contributes to your credit history
  - Paying 'slow' or not at all is seen as a warning to other lenders
  - Signs of 'Risky behavior'
  - May result in
    - Higher interest rates and fees
    - More rejections of loans
    - Smaller loan amounts

Credit reports

A *credit report* tells several things: how you've paid your debts, how much debt you have, and whether you've made payments on time. Lenders want to know that they will be repaid. To help determine if you are credit worthy, they use credit records—histories of consumers' credit accounts and bill-paying habits. A credit reporting agency (CRA)—commonly called a credit bureau—collects, stores, and sells these records to creditors.

There are three credit reporting agencies:

Equifax, Inc.	TransUnion	Experian
1-800-997-2493	1-800-888-4213	1-888-397-3742
www.equifax.com	www.transunion.com	www.experian.com

What do credit bureaus do?

Have you ever wondered how a credit bureau gets the information in your credit report? To begin with, you furnish some information when you apply for credit: your name, spouse's name, Social Security number, address, former address, employer, and former employer. Also, credit bureau members—the merchants and other creditors with whom you do business—supply information on how much you owe, if payments are up-to-date, or if a collection agency secured the payments from you. Other information in a credit file comes from public records—divorces, tax liens, bankruptcies, and court judgments.

Although some people mistakenly think so, a credit bureau does not "rate" your credit history or grant credit. Credit bureaus sell the information they gather to potential creditors, landlords, insurers, employers, or other businesses with a "permissible purpose" as defined in the Fair Credit Reporting Act, although employers must get written permission from a prospective or current employee in order to check that employee's credit file.

Getting your FREE credit report

It's always a good idea to look at your credit report a few months before you plan to apply for credit, such as a credit card, car loan, or mortgage. Reviewing your credit report lets you find out if there are any errors or other surprises in your credit history. Consumers are entitled to receive one **free** credit file disclosure every 12 months from each of the nationwide consumer credit reporting companies.

> **Beware**
>
> Many "imposter" websites and 1-800 numbers will try to sell you a credit report or score or sign you up for costly "credit monitoring.". Do not enter your credit card information! This is totally unnecessary since you can order a credit report for free. And if you've already used up your three free requests for the year, you can always then choose to purchase another copy of your report for a small fee.

The Fair Credit Reporting Act (FCRA) and the 2003 amendment known as the Fair and Accurate Credit Transactions Act (FACT Act or FACTA) give you the rights to:

- learn what your credit record contains
- correct inaccurate or incomplete information
- obtain a free credit report every 12 months from each of the three nationwide consumer credit reporting agencies at: www.annualcreditreport.com or 877-322-8228
- Please note that while this does provide a free credit report, it does not provide a free credit *score*.

In addition to your annual free reports, you are entitled to a free copy of your credit report if you're unemployed, receive public benefits, suspect credit fraud, or if you've been denied credit, insurance or employment within the last 60 days. If your application for credit, insurance, or employment is denied because of information supplied by a credit bureau, the company you applied to must provide you with that credit bureau's name, address, and telephone number.

How to read your credit report

Your credit report will contain the following information: the person requesting report, potentially negative items, accounts in good standing, requests for your credit history, and personal information.

1. Make sure your name, social security number, and current/past addresses are correct.
2. Public Records: Verify any information appearing here from local courthouses regarding defaults and legal judgments
3. Account History: Check that balances make sense, payment history is accurate, and the accounts listed are in fact yours.
4. Look for anything suspicious in the section that lists who has received copies. You're checking to make sure no inquiries have been made about loans or leases you didn't apply for.
5. Mark or highlight items you feel are not accurately reported.
6. If your account contains incorrect information, contact both the creditor and the Credit Bureau. Follow up with a letter. Report the problem quickly and in writing.

What if there's a mistake on my credit report?

You can dispute mistakes or outdated items for free. Ask the credit-reporting agency for a dispute form or submit your dispute in writing, along with any supporting documentation. Do not send any original documents and make copies of all information you mail to the creditor and the credit bureau. You also should tell the creditor or other information provider in writing that you dispute an item. Many providers specify an address for disputes. If the provider then reports the item to any credit bureau, it must include a notice of your dispute. In addition, if you are correct—that is, if the information is inaccurate—the creditor may not use it again or resubmit the information to the credit bureau.

Clearly identify each item in your report that you dispute, explain why you dispute the information, and request a reinvestigation. If the new investigation reveals an error, you may ask that a corrected version of the report be sent to anyone who received your report within the past six months. Job applicants can have corrected reports sent to anyone who received a report for employment purposes during the past two years.

When the reinvestigation is complete, the credit bureau must give you the written results and a free copy of your report if the dispute results in a change. If an item is changed or removed, the credit bureau cannot put the disputed information back in your file unless the information provider verifies its accuracy and completeness, and the credit bureau gives you a written notice that includes the name, address, and phone number of the provider.

If the reinvestigation does not resolve your dispute, have the credit bureau include your version of the dispute in your file and in future reports. Remember, there is no charge for a reinvestigation. If you have problems with a dispute, the Federal Trade Commission (FTC) enforces the Fair Credit Reporting Act and the Fair and Accurate Credit Transactions Act, along with other consumer credit regulations. More information is available on the FTC website at www.ftc.gov or by calling 1-877-FTC-HELP.

Understanding Credit Scores

In general, the longer you have a positive credit history, the better your credit score. In order to have a credit score, your credit report must list at least one account that has been open for six months or more.

> **Your Credit Score**
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> - A credit bureau is a private organization that maintains credit information on individuals, which it allows subscribers to access for a fee.
>   - **Experian, TransUnion, and Equifax are examples.**
> - They compile a credit report on you and assign a credit score.
> - Your credit information not only impacts whether you get a loan, it affects your interest rate.

Determining "creditworthiness"

Your credit information translates into a three digit number – your *credit score* – which measures your creditworthiness. It involves the numerical evaluation or "scoring" of applicants.
Your score reduces the lender's uncertainty, enabling the lender to make credit available to good risk customers at lower interest rates.

How your credit score is computed

A credit score is usually referred to as a ***FICO score*** based on models developed by Fair Isaac Corporation. Each model begins with information on your report, using it to calculate your score. Most scores range from 300-850 and the majority of people fall between 600 and 800. FICO scores vary from one credit bureau to another depending on the credit scoring model they use.

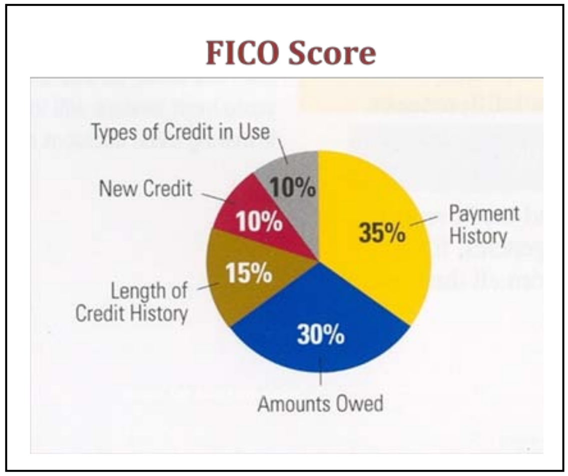
What's a good score?

The national average is between 600-700, and this is often the minimum for receiving credit. A good credit score – around 750 or higher - doesn't just mean that you'll get a loan, it also means you'll pay less for it. A low FICO score may result in a credit card interest rate twice that of a high FICO score.

Impacts of types of credit

Not all creditors report in the same way, or at all, to the credit bureaus. You can and should check your own credit report to see if your payment history is being reported as you expected since only those debts reported to the credit bureau will impact your credit score. Some creditors may not report on-time payments to the credit bureaus, but they will report if you miss a payment. The following is a list of several examples of credit use and how they might be reported to credit bureaus:

Type of credit	Reported?
Credit cards & Revolving credit accounts Very common; due monthly; huge variations in interest rates and terms	**Yes**
Store credit cards Store specific; limited use and amounts	**Yes**
Credit accounts for store or service Payments due only after you use the service; mostly convenience	**Sometimes**
Payday Loans Short-term; high cost loans	**Sometimes**
Rent to Own High-cost loan that's disguised as a rental	**Sometimes**



Factors that determine your score

1. Your payment history = 35%

   To raise your score:
   - Pay all bills on time
     - Pay attention to due dates and due times.
     - A late payment stays on your report for 7 years.
     - A recent 30 days late payment can lower your score more than a paid judgment from 6 years ago
   - If you carry a credit card balance, pay more than the minimum every month. Paying only the minimum can lower your score.
   - Schedule automatic monthly payments if that helps you pay on time.

2. Amount you owe and your available credit = 30%

   To raise your score:
   - Whenever possible, pay off your credit card balances in full every month.
   - Don't use more than half of your available credit limit on credit cards and other revolving loans – even if you pay it off every month. If you use more than half of your total credit limit, it will lower your score.
   - Pay attention to credit card limits – card companies can lower your credit limit triggering over the limit fees.
   - Pay off debt instead of moving it around to different credit cards or lenders.

3. Length of credit history = 15%

   To raise your score:
   - If you're young or don't have a very long credit history, don't open a lot of new accounts too quickly. That can lower your average account age and your credit score.
   - If you pay off a credit card, don't close the account if it is an account you have had for a while. If you only recently opened it, closing the account may not have much effect.
   - Ask a family member with good credit if you could be an authorized user on their credit card – that's if their creditor reports authorized user data to the credit bureaus. You could also ask to be added as a joint account holder. Note there are risks with attaching your credit report to another person.
   - Secured credit cards can help build up a credit history but **only** if the creditor reports to a credit reporting bureau.
   - The better your financial track record, the better you can weather the occasional late payment without greatly impacting your score.

4. Types of credit used = 10%

   To raise your score:
   - It's good to have at least one major credit card in addition to retail store credit cards.
   - Don't open new accounts just to have a better credit mix. That could lower your score more in the short term.

- "Payday" and title loans may not report to Credit Reporting Bureaus unless you miss a payment. Even if these lenders do report regular payments to the Bureaus – be careful using these higher cost forms of debt since other lenders may view them negatively.

5. New credit = 10%

   To raise your score:
   - Think twice about store offers to open a new credit card to receive an instant discount on your purchase. The new account could lower your credit score and cost you more in interest and insurance rates than you will have saved with a 10% discount on your purchase. Plus you should take time to review the details of the offer—hard to do in the checkout line.
   - When you apply for new credit, a "hard inquiry" shows up on your credit report and can affect your credit score for 12 months. Too many hard inquiries can send the message to creditors that you are desperate for new credit.

"**Soft inquiries"** appear on your credit report every time you get your own credit report or creditors send you pre-approved offers. Soft inquiries don't affect your credit score, so don't worry about ordering your free annual credit reports or a free report if you've been turned down for credit.

If you don't want to receive pre-approved offers, call 1-888-5-OPT-OUT (1-888-567-8688).

How can these five factors affect a credit score?

Each of the factors has different effects on lower credit scores than they do on higher ones. There are several different credit score models being used by the three credit reporting bureaus and FICO scores that may weigh these various credit events differently. Below is one example of credit scoring:

Credit Karma Credit Simulator Score Chart

Credit Event	Jane	Change	Points	John	Change	Points
Add a New Credit Card with a Credit Limit of $15,000	793	791	**-2**	576	557	**-19**
Increase Credit Limit of Credit Cards by $10,000	793	793	0	576	612	***+36***
Closing Oldest Account	793	793	0	576	558	**-18**
Increase Credit Card Debt by $10,000	793	769	**-24**	576	556	**-20**
Paying Off All Credit Card Debt	793	793	0	576	615	***+39***
Allow 1 Monthly Account to Become 30 Days Past Due	793	759	**-34**	576	558	**-18**
Have On Time Credit History for 24 Months	793	793	0	576	595	***+19***

Source: CreditKarma.com Credit Simulator, Retrieved June 2009

Getting your credit score

Credit bureaus are required by law to share your credit score with you upon request – except unlike a credit report – they can charge you for your credit score. If a mortgage lender pulls a copy of your score, however, they are required to share information about your credit score with you for free. Also, the score that the credit bureau sells to you may not even be the same score they provide to your creditors.

When you purchase your credit score, the bureaus are required to give you the top four factors that most affected your score. Knowing the factors that had the biggest impact on your score is key to figuring out what you can do in the future to improve your score.

There are a few different ways to get your credit score:

- *To purchase your credit score*: **www.myfico.com**
- To estimate your FICO score: **www.bankrate.com** – under "calculators"
- To sign up for a free credit score service:
    - **www.creditkarma.com**
    - **www.credit.com**
    - **www.quizzle.com**

Dealing with Debt Overload

Sometimes a household's income drops suddenly because of a job layoff, an illness or death, or a divorce and you're not able to keep up with monthly bills. Or sometimes we fall victim to our own overspending and live beyond our means without even realizing it. And maybe you set some money aside in savings, but when an emergency happens, there's just not enough savings to go around.

Credit Danger Signs

- Paying only the minimum monthly payment on credit accounts
- Being charged fees for late payments, partial payments or over the limit
- Inability to make all monthly credit payments
- Using savings to cover everyday items
- Using credit on items you formerly paid cash

Whatever the cause of a financial shortfall, the sooner you adjust your household budget and contact your creditors, the better off you'll be in the long run. There are many options and agencies offering help with debt repayment or debt management. Getting help from a credit counseling agency can be a good idea for some consumers, but it can be very hard to sort out the good agencies from the bad. And even good credit counseling agencies won't be much help if you have too little income and a lot of debt.

Credit repair agencies

You see the advertisements in newspapers, on TV, and on the Internet. You hear them on the radio. You get fliers in the mail. You may even get calls from telemarketers offering credit repair services. They often make too good to be true claims like:

- "Credit problems? No problem!"
- "We can erase your bad credit-100% guaranteed."
- "We can remove bankruptcies, judgments, liens, and bad loans from your credit file forever!"

To locate a credit counselor near you, go to: www.debtadvice.org or call the National Foundation for Credit Counseling 1-800-388-2227.

For more information, contact the Federal Trade Commission toll-free at 1-877-FTC-HELP (877-382-4357), TTY 1-866-653-4261 or the Department of Financial Institutions, Wisconsin Consumer Credit Act Section at 1-800-452-3328. For a list of credit counseling (adjustment service) companies that are licensed to do business in Wisconsin, see the Department of Financial Institutions web site at http://www.wdfi.org/fi/lfs/licensee_lists. A copy of the state regulations that govern adjustment service companies can be found at http://tinyurl.com/p9xw9c.

Scam agencies promise to clean up your credit report for a fee so you can get a car loan, a home mortgage, insurance, or even a job. The truth is, they can't deliver. After you pay them hundreds or thousands of dollars in up-front fees, these companies do nothing to improve your credit report. Many simply vanish with your money. Others use illegal methods that will make things worse for you. Be wary especially of agencies that tell you they'll create a new credit identity for you. This is fraud, and is a criminal offense.

It takes time, planning, and effort to follow through, but you can improve your credit report. It's usually better to handle your own credit problems because you can do for yourself anything these agencies would charge you a fee to do.

Credit repair and the law

By law, credit repair organizations must give you a copy of the "Consumer Credit File Rights under State and Federal Law" before you sign a contract. They also must give you a written contract that spells out your rights and obligations. Read these documents before signing the contract.

The law contains specific protections for you. For example, a credit repair company cannot charge you until they have completed the promised services. Your contract must also specify items such as payment terms for services, including total costs, and more.

The first steps to repair your credit

Stop creating debt.

In order to decrease debt, you need to stop creating new debt as soon as possible. To increase your awareness about your spending habits, track your spending and come up with a monthly spending plan. Starting to save for emergencies and large future expenses is the best defense against creating more debt in the future.

How do I stop creating debt?

- Look at ways to increase income and decrease spending so you have more money for regular and unexpected expenses.
- Come up with a plan to lower monthly spending and the use of credit cards. Some ideas include:
    - Remove your credit cards from your purse or wallet.
    - Give yourself a 24-hour “cooling off” period before making a purchase with a credit card.
    - Check in with your spouse or a friend before making a credit purchase.
    - Create a written plan to repay the debt before making the purchase.
- Finally, consider closing all but one or two credit card accounts. To minimize impact on your credit score, close those credit cards that you opened most recently and leave your oldest accounts open.

Figure out how much money you have each month to start paying down your debt.

Your spending plan will help determine the amount you have for debt repayment. Subtract the amount needed for monthly expenses and the amount needed for your savings goals from your total monthly income. The remaining amount is available for debt repayment. Example: Total Monthly Income $1200.00 - Total Monthly Expenses $1000.00 = $200 for Monthly Debt Repayment.

Create a list of your debt.

Gather information on each of your debts including balance, interest rate, and minimum payments due. The balance listed on your credit report may not be up to date, so either use your most recent bill from the creditor or contact the creditor for the balance. If the amount of debt starts to feel overwhelming, focus on your most recent debts first as a place to start.

There are computer programs that can help you to organize and come up with a repayment plan that fits your budget. Power Pay is one free debt management tool found at: www.powerpay.org.

Credit repair options

Once you have a good idea of your monthly spending plan and current debts, you can start to explore options to deal with your debt and find the best solution for your specific situation. While doing nothing is always an option, it is your responsibility to understand the consequences of not acting to repair your credit. If you find yourself burdened by debt, however, and you want to get back on track towards healthy credit, you have several options to address the situation:

1. ***Communicate with your lender.*** As a consumer, you always have the option to contact your creditors and negotiate with them directly. Depending on your financial situation, you could request a lower monthly payment amount, a reduction in interest rate or late fees, or the option to skip a few months of payments without being reported as late to the credit bureaus. Not all creditors will be willing to work with you, but if you've been a good customer and call before you fall behind on payments, you'll be in a better position to bargain.

Pitfalls and Traps

- **Talk to the right person**: When you call your creditor about your bill, you usually speak with a customer service representative who may be more interested in getting your monthly payment than in problem-solving with you. Ask to speak with supervisor or "loss mitigation" specialist who has the authority to adjust your account.
- **Get it in writing**: Before you send in your new agreed upon payment amount, ask your creditor to send you the agreement in writing. You'll then have a written record in case there's any question about the arrangement in the future.
- **Don't give up**: It could take an hour or longer on hold and you might get "no's" from several creditors before you find one who's willing to work with you. But if you don't even ask, the answer is already "no."

2. ***Transferring balances.*** Transferring balances from one credit card to a lower interest credit card can save money on interest or lower the monthly minimum payment due, but be careful.

Pitfalls and Traps

- **Recycling debt.** When people who are having trouble managing their money consolidate their debt, they often recycle their debt by continuing to create new debt. That's because they haven't changed any spending behaviors. People may intend to change, but once the pressure and stress of the debt is reduced through the consolidation, the motivation to change is gone.
- **Increase risk or cost of credit.** Often people want to use equity on their home to repay debt. They do this because they have no other collateral for a consolidation loan. They have increased their risk of losing their home by converting unsecured debt (credit card debt not secured by any property) into a secured debt. They also have increased the amount of interest they will be paying and perhaps the length of time it will take to pay off their debt.

3. ***Consolidation loans.*** These loans take several debts and consolidate them into one loan. Ideally, a consolidation loan offers a lower interest rate, but this isn't always the case. An acceptable loan can lower your monthly payment and often reduce the overall amount of interest you are paying. A consolidation loan can be a good idea for people who already can pay their monthly bills and just want to be more efficient with debt repayment. However, you need to have good credit and collateral in order to get a consolidation loan without paying excessive interest.

Pitfalls and Traps

- **Cost to transfer debt:** Some creditors are charging balance transfers at the same rate high rate as cash advances.
- **Read the fine print:** Read the contract. It often is the case that if you slip up, such as being one day late on a payment, the interest rate goes way up and you're back where you started.
- **Fees:** Be aware of the cost of extra charges on "low interest" credit cards: late fees, over limit fees, cash advance fees, yearly fees.
- **More interest:** If you switch balances, you may be stretching out the time it will take to pay off your debt and end up paying more in interest in the long run.

4. ***Refinancing your home*.** People refinance their homes to take advantage of lower interest rates or to decrease their monthly payment. Sometimes it is done to create extra money for purchases (like a car) or for debt repayment. This type of "cash-out refinance" adds to the total debt and increases the time and cost of repaying the loan. And if your credit score is low, lenders will consider you a higher credit risk and charge you a higher interest rate.

Pitfalls and Traps

- **Costly:** Refinancing fees can be very costly and will add to the amount of debt you have overall.
- **Financing unsecured debt:** Even when your refinanced home loan is at a lower interest rate than your car loan or credit card debt, you may end up paying more in the long run if you consolidate these debts. Do you really want to be paying for your used car or a dinner out for the next 30 years?
- **Affect on retirement:**
  Consider the age of the person thinking of refinancing and the impact this may have on paying off their home before retirement.

5. ***Use a credit counselor to negotiate debt.*** A non-profit consumer credit counseling agency may be able to negotiate a debt management plan **(DMP)** with your creditors. **DMP**s are voluntary agreements between borrower and lenders that are designed to help organize debts. This often includes reduced interest rates, lower monthly payments, and consolidates them into one monthly payment. Costs are usually based on your ability to pay. For more information on DMPs:
   - *Knee Deep in Debt:* http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre19.shtm
   - *For People on Debt Management Plans - A Must-do List*: http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre38.shtm

Pitfalls and Traps

- **Type of Debt:** While DMPs might be a good fit for some consumers, this type of plan may or may not be right for you. A DMP is most helpful if your debt is unsecured and you have money to put towards debt repayment every month.
- **Timeline:** If a repayment plan cannot be accomplished in three to five years, usually this is not an option.
- **Credit Report:** Debt repayment plans that decrease interest or monthly payments will show up on credit reports as late or reduced payments.
- **Total Cost:** It can be expensive, especially if you have several creditors and the fee is based on the number of accounts in your debt management plan.
- **Check out the agency:** There are dishonest companies claiming to do credit counseling, so choose carefully. They could overcharge for their services. Others may take your money and not pay your creditors, or they may not even have called your creditors. Many states, including Wisconsin, require licensure of credit counseling agencies that do business in the state.

6. ***Discharge debt (file bankruptcy).*** Bankruptcy is a specialized branch of the law. It is not your responsibility to understand bankruptcy and all the laws that apply to it. It is your responsibility to become an informed consumer and know the consequences of filing bankruptcy and the long-term effect it will have on your credit.

Pitfalls and Traps

- **Consequences of filing bankruptcy:** It can be difficult to rent or obtain employment if a credit check is required. It can be difficult to borrow money from a financial institution. Loans that are approved will have a higher rate of interest.
- **Recycling:** Behavior must change or debt will reoccur. Sometimes people file bankruptcy and then turn around and start to incur more debt.
- **Determining if it's the best option:** A bankruptcy attorney will almost always recommend bankruptcy if a person is eligible without determining if this is the best option for a client. They also don't address spending issues that might put them at risk after the debt is discharged.
- **Embarrassment:** Often people who file bankruptcy feel ashamed and it is kept a secret. This can be a heavy burden to carry.

Credit repair options to approach with caution

1. ***Debt Settlement***: Debt settlement agencies are different than debt management plans. Usually debt settlement agencies collect your payments for many months instead of paying off creditors each month. When the agency has saved up a sizeable amount from your payments, then they will attempt to negotiate a lump sum settlement with your creditor for less than the full amount owed.

Pitfalls and Traps

- ❖ **No legal protection:** Debt settlement agencies typically take a percentage of what you save for their fee. While the agency saves up your monthly payments, your creditors can continue to come after you for payments and could pursue legal action.
- ❖ **Scams:** Any debt elimination or debt termination company that claims to be able to wipe out all your debt is most likely a scam. Some companies use fraudulent documents that claim your debt is invalid or challenge your creditors to arbitration over legitimate debt.

2. ***Selling Assets:*** You might consider selling something you own to help come up with some cash to put toward your debts. While selling items online or at a rummage sale can be a good one-time source of cash to pay down debt, it doesn't add to your monthly income to cover future debt payments.

Pitfalls and Traps

- ❖ **Lose Money**: When selling, you typically won't get as much money as you paid for an item. If you plan to replace the item when you get back on solid financial ground, this option could cost you more money in the long run.
- ❖ **Willing to sell**: You might own some family heirlooms or items with sentimental value that would be too hard to part with.
- ❖ **Do you own it:** You might not be able to sell an item that is being used as collateral for a loan. Sometimes the creditor will give you permission to sell the item, such as an auto, in order to use the money to pay off the loan.

3. ***Withdrawing Retirement Savings***: The Internal Revenue Service allows "hardship withdrawals" from certain retirement plans under circumstances which present an immediate and heavy financial need, including preventing foreclosure or eviction. Your withdrawal is limited to the amount of money you paid in and does not include any employer match or interest income. A withdrawal is not considered necessary if you still have other options available to you, such as securing a bank loan or selling assets.

   A hardship withdrawal is different from taking a loan out of your retirement account. Unless you're purchasing a home, a loan must be repaid within 5 years with payments beginning immediately. On the other hand, a hardship withdrawal doesn't need to be paid back. If you take out a loan and then leave the company before the loan is paid back, you must repay the loan right away or else pay taxes and penalties.

Pitfalls and Traps

- **Taxes:** Withdrawals are taxed as income, plus there's a 10% penalty added on, so you need to figure this amount into how much savings you plan to withdraw. It's extremely important to check with a tax professional about penalties and taxes due if you are considering cashing in a retirement policy. Find out more on the IRS website at: www.irs.gov.
- **Exceptions:** A retirement plan is not required to offer hardship withdrawals. Your options for withdrawing savings also depend on the type of plan you have, such as a 401(k), 403(b), 457(b) or IRA.
- **Long-term impact**: A hardship withdrawal permanently lowers your retirement savings since the money can't be paid back once it's taken out. Also, you won't be able to contribute to any retirement account for at least 6 months following a withdrawal.
- **Bankruptcy:** Retirement savings is exempt from seizure by your creditors during a bankruptcy. Once you've spent the hardship withdrawal from your retirement savings, what other options do you have for keeping up with your bills? Borrowing from retirement savings may not be the best option if you end up filing for bankruptcy a few months later.

Bankruptcy

If you owe a large amount of money and your creditors will not accept reduced payments, you may have to consider your option of last resort - ***bankruptcy***.

A bankruptcy stays on your credit report for 10 years, making it hard to get credit, buy a home, get life insurance, or sometimes get a job. However, it is a legal procedure that can offer a fresh start for people who can't pay all their debts. Filing for bankruptcy could cost between $1500-$2000.

All individuals filing for bankruptcy must meet with a Department of Justice approved provider for financial counseling before filing, and again for debtor education after filing. You can find a list of approved providers at: http://www.usdoj.gov/ust/eo/bapcpa/ccde/index.htm

Bankruptcy

Common forms of bankruptcy:

- **Chapter 7** Straight bankruptcy
- **Chapter 11** For businesses or those exceeding debt limitations or lack regular income.
- **Chapter 12** Available to family farmers.
- **Chapter 13** The wage earner plan

**Personal bankruptcy doesn't wipe out all obligations.

There are assets that are exempt from bankruptcy, such as your home, as long as you agree to continue making your mortgage payments. You are allowed to keep one vehicle that you already own and some personal property, although the value of these items is determined at a state and federal level. Each state has its own guidelines. Also, certain debts cannot be discharged in a bankruptcy; for example, you must continue to pay alimony, student loans, child support, and back taxes.

While it is possible to file a bankruptcy case *pro se*, that is, without the assistance of an attorney, hiring an attorney is recommended. Contact the Wisconsin Bar Association Lawyer Referrals: (608) 257-4666 or 1-800-362-9082. Also, look online or in the phone book for "Bankruptcy" listed as a specialty branch of Wisconsin law.

Questions for selecting a bankruptcy attorney

1. How long have you been handling bankruptcy cases?
2. About what percent of your business is bankruptcy?
3. What will be the total cost of this bankruptcy?
4. Will I have extra charges later on that are not included in the original fee?

Bankruptcy is a specialized law practice; use a qualified attorney.

Types of bankruptcy

Chapter 7: straight bankruptcy

Chapter 7 bankruptcy allows individuals who don't have any chance of repaying debts to eliminate them and begin again. While you will not lose everything, courts confiscate and sell most assets to pay off debts. Some debts remain your responsibility, including child support, alimony, student loans, and taxes.

Chapter 13: the wage earner plan

To file for Chapter 13, you must have regular income and both secured and unsecured debts below certain limits set by the courts (visit www.uscourts.gov/bankruptcycourts.html for more information). The repayment schedule is designed to cover your normal expenses while meeting repayment obligations. For creditors, it means controlled repayment with court supervision.

Chapter 128 Receivership: a bankruptcy alternative
A so-called "Chapter 128" receivership is based on Wisconsin legal statutes which offer an alternative to bankruptcy for individuals or businesses in a difficult financial situation. This plan will help consumers catch up on unsecured debt payments for up to three years. Unlike a bankruptcy, the consumer can choose which debts to include in the plan. While a bankruptcy will eliminate the debt (and stay on your credit history for ten years), a receivership will simply stop additional interest from being added. It will only remain on your credit report for seven years.

Chapter 128 Receivership is reserved for individuals with regular monthly income who will be able to keep up with payments. More information about Chapter 128 Receivership in Wisconsin is available at: http://www.legis.state.wi.us/statutes/Stat0128.pdf

Rebuilding and improving your credit following bankruptcy

One important task you will have following a bankruptcy will be to begin rebuilding positive credit history. It is true that your bankruptcy will remain on your credit report for many years (7 years for Chapter 13, and 10 years for Chapter 7); however, there are things that you can do to improve your score in a year or two:

Rebuilding Your Credit after a Bankruptcy

- ***Pay your bills on time***
  35% of your credit score is based on how you pay your bills. Use your fresh financial start as a way to keep up with any remaining or reaffirmed debt.

- ***Pay off re-affirmed loans and credit cards with high interest rates***
  The interest you pay on these accounts could be used for more important expenses or savings for future emergencies.

- ***Re-establish credit by opening a secured credit card.***
  A secured credit card is a bank credit card backed by money you deposit in a bank account. If you don't pay your credit card bill, the money in your account will be used to cover the debt. Shop around to find a good deal on a secured card. You can compare current information about secured cards at www.bankrate.com on the internet. Before you apply, make sure the card issuer will send the information on your credit account to a credit reporting bureau. Get in the habit of paying off the balance on time.

  Look for a secured card with:
  - A low annual fee
  - No up-front application, processing or membership fees
  - An interest-bearing account for your deposit

Supplemental Materials

This chapter contains a number of supplemental worksheets, handouts, activities, and other resources to help you or someone else best understand this material. The options are outlined below. Feel free to photocopy or print these supplemental materials and use them as you see fit.

Definitions

Activity: Match the Credit Terms

- Use this activity to challenge basic knowledge about debt, credit, and credit management.
- Answers on following page.

Creditworthiness

Handout: Summary of Consumer Credit Laws

- Overview of a select group of laws that seek to protect consumers.

Handout: Credit Scores

- A helpful set of information that quickly and simply explains credit scores.
- Offers examples as to why improving a person's credit score is desirable.

Handout: How Much Debt Do You Have?

- Allows a person to look at how much debt they have compared to their income.

Bill payment

Handout: What Can Happen If You Don't Pay Bills?

- Sometimes, a person may not realize the consequences of being late or delinquent on their bills.
- Highlights the hidden costs of not paying utilities, mortgages, creditors, and government debts.

Handout: Where Do You Start If You Can't Pay Bills?

- This list details the steps a person should take if they simply cannot afford to pay their bills in a given month.

Handout: Deciding Which Bills to Pay First

- A suggested list of payment priorities for use when the bills start piling up.
- Offers insight into several different types of government debt.

Credit management or counseling

WORKSHEET: LIST YOUR CREDITORS

- A worksheet that requires an individual to track down some relevant information about their creditors.
- May be difficult to fill out on the spot if a person does not have paperwork with them.

HANDOUT: CONSUMER CREDIT COUNSELING

Describes the credit counseling process, its advantages and disadvantages, and offers suggestions for individuals who may be considering this option.

HANDOUT: SAMPLE LETTER TO YOUR CREDITORS

- A template of a letter to a creditor or a company that can be altered to fit an individual's needs.

WORKSHEET: HOUSEHOLD ASSETS

- Challenges a person to assess value to their assets, calculate their debts, and determine what they're willing to sell.
- May be difficult to assess the value of some assets.

WORKSHEET: CHECKLIST FOR COMPARING CREDIT CARDS

- Use this handout to examine the pros and cons of several different credit cards. Often times, looking at multiple cards in this way will clearly show which offers the best deal.

Match the Credit Terms

activity

Match each credit term with its definition.

A. Finance Charge	1. ____	A loan or mortgage in which the interest rate is determined at the beginning of the loan & stays constant throughout the loan
B. Credit Score	2. ____	Failure to pay an obligation when due
C. Fixed Rate Loan	3. ____	The total cost of obtaining credit
D. Delinquency	4. ____	A card for which the financial institution requires a collateral deposit to be kept to cover purchases made with the card
E. Secured Credit Card	5. ____	The cost of credit; usually a percentage of the total loan which is charged for the benefit of using the borrowed funds
F. Variable Rate	6. ____	An agreement to borrow money for a specific period of time, at a stated interest rate & repaid according to a specified plan
G. APR	7. ____	A system that creditors use, based on various factors, to help determine whether to give you credit & how much to charge you for it
H. Revolving Credit/ Open-end Credit	8. ____	An interest rate that may change from time to time; if the rate can change, this must be disclosed to you in writing
I. Interest	9. ____	An account to which additional purchases may be made to which finance charges are assessed on outstanding balances & which may be paid in full at any time
J. Loan	10. ____	Annual percentage rate (the cost of credit over a year)

Developed in August 2009 by RN Schriefer, Family Living Agent, UW-Extension Iowa County. Adapted from DFI Understanding Credit, 2009

Answers to "Match the Credit Terms"

The answers to the activity on the previous page are:

1. C
2. D
3. A
4. E
5. I
6. J
7. B
8. F
9. H
10. G

Summary of Consumer Credit Laws handout

The Fair Credit Reporting Act (FCRA) requires creditors to furnish complete information regarding your credit history and for credit bureaus to maintain your credit report accurately. Among other things, this act also provides you with the right to a free credit report and other rights following denial of credit, insurance, and employment.

The Equal Credit Opportunity Act (ECOA) prohibits credit discrimination on the basis of sex, marital status, race, color, national origin, religion, or age. Also, a creditor may not discriminate against you because your income is from a public assistance source or because you exercise your rights under federal consumer credit laws. Under this act, you have the right to know if a credit application has been accepted or denied within 30 days of applying, and the specific reasons if your application is denied.

The Fair Credit Billing Act gives you the right to challenge billing mistakes *and* the right to withhold payment, in some circumstances, for inferior goods and services purchased by credit card. The act protects your credit record while you dispute billing mistakes or try to work out a complaint for defective merchandise.

The Fair Debt Collection Practices Act protects consumers from harassment by third party debt collectors, such as a lawyer or outside collection agency. Creditors do not have to comply with this act if they are trying to collect their own debts. Under this act, you may write a collection agency and telling it to stop contacting you for a debt. The agency must then stop collection practices, but can choose to take you to court to recover the debt. Also, debt collectors:

- May contact you in person, by mail, telephone, or fax, but cannot contact you at inconvenient places or times, such as before 8 a.m. or after 9 p.m.
- Cannot share information about your debt with others, such as an employer or neighbor, but they can contact other people to find out where you live and how to reach you.
- Cannot make illegal threats, threaten to arrest you, or pretend to be a lawyer.

The Truth In Lending Act requires credit advertisements, applications, and contracts to contain certain disclosures and provides you with certain rights if the disclosures are not provided. Different types of credit require different disclosures. Some parts of the act include:

- If your credit cards are lost or stolen your maximum liability is limited to $50 per card. If you notify the issuer promptly, you may have no liability.
- You have the right to cancel any contract that uses your home as security, such as with a home equity loan, within three business days of signing it (the right of rescission), unless you are initially purchasing the home.
- There is no right of rescission for a home mortgage.
- The home you are about to purchase cannot be used as collateral.

The Electronic Funds Transfer Act limits your liability if your ATM or debit card is lost or stolen. The act also protects you in disputes arising from direct deposits or telephone transfer transactions with your bank. You must contact the bank within two days of losing your ARM card to limit your liability to $50. Your failure to make a timely notification could increase your liability to $500 or even your entire balance, depending on the circumstances. If you let a friend or relative use your card, however, the bank may not be liable for any losses.

Credit Card Accountability, Responsibility, and Disclosure (CARD) Act of 2009 includes reforms on rate increases, plain language disclosures, accountability, prohibits universal default, and provides protections for individuals under 21 years of age. Takes effect in 2009 and 2010.

Credit Scores handout

Range is 300-850:

- *850 - 780* - Low Risk
- *780 - 740* - Medium - Low Risk
- *740 - 690* - Medium Risk
- *690 - 620* - Medium - High Risk
- *Below 620* - High Risk (sub-prime)

These are general guidelines since there's no one "score cutoff" used by all lenders. Be aware that in the last few years most lenders have RAISED their minimum score. Also know that your score can change from month to month and can be different at each of the credit bureaus.

How do poor credit scores hurt?

Typical rates for a 3-year loan on a $20,000 vehicle:

FICO score	APR	Monthly payment
850-720	6.000%	$608
719-690	7.554%	$623
689-660	9.000%	$636
659-620	11.475%	$659
619-590	15.305%	$696
589 and below	People with these scores aren't usually accepted for a loan through a financial institution.	

Compare:

Highest score	**Lowest score:**
FICO score 850-720 = 6.000%	FICO score 619-590 = 15.305%
$608/month X 12 months = $7,296	$696/month X 12 months = $8,352
$9,144 X 3 years = **$21,888 total paid**	$8,352 X 3 years = **$25,056 total paid**

Difference = $3,168

A person with a high score saves $3,168 in interest payments alone. Plus, higher credit score can save you thousands of dollars on interest in home loans

How much debt do you have? handout

Sometimes people ask: "How much debt is too much? Financial experts and lending institutions provide some guidelines on how much debt a person could reasonably handle compared to their income. Most people will probably not want to have more than 20% of their monthly paycheck going towards debt payments. Also, lenders will base their lending decisions on these limits and may not want to give more credit to people who already have a lot of debt. In addition, lenders may charge borrowers a higher interest rate for any new credit.

To figure out how much debt you have compared to your income (debt-to-income ratio), add up your monthly debt payments and fill in the spaces below.

A. **Total Monthly Debt Payments** $____________________
   (Include credit cards, loans, car payments, etc. Do <u>not</u> include a home mortgage)

B. **Household Total Monthly <u>Take Home</u> (Net) Pay** $____________________

C. Divide **A)** by **B)** X 100 = ____________________%

For example, if your total monthly debt payments equal $400 and you take home $1800 in your paycheck every month, divide $400 by $1800 = .22. To get the percent, multiply .22 x 100 = 22%. If you look in the box below, you can see that a consumer with a 22% debt limit might be feeling overextended or worried about making their payments.

Percent of Consumer Debt Compared to Net Income

Percent	Level of debt is:
10 or less	Probably a safe limit; borrower may feel little debt pressure.
11 to 15	Probably a safe limit; borrower may feel some pressure.
16 to 20	Fully extended; borrower may hope that no emergencies come up.
21 to 25	Overextended; borrower may worry about debts and making payments.
26 or more	Could be disastrous; borrower may feel desperate.

If you have a home mortgage, the percent of debt limit is different since a home is considered to be an investment, not just an expense. Use the formula below to include a mortgage:

A. **Total Monthly Mortgage Payments** (without tax & insurance) $_____________
B. **Total Monthly Debt Payments** (not including mortgage) $_____________
C. Add **a) + b) = Total Monthly Debt/Mortgage Payments** $_____________
D. Total Monthly **<u>Gross</u>** Pay (before taxes are taken out) $_____________
E. Divide **c)** by **d)** x 100 = _____________%

Financial experts usually recommend that total debt *including your home mortgage* should <u>not</u> be more than <u>35% of your gross pay</u> or more than <u>50% of your take home (net) pay</u>.

Developed in 2007 by Peggy Olive, Family Living Agent, UW-Extension Richland County, 2007. Adapted from UW-Extension Family Living Education, Consumer Credit.

What Can Happen If You Don't Pay Bills? handout

If you have emergency expenses or a sudden drop in income, you may be tempted to ignore bills or credit charges. Here is what may happen if you put off paying bills:

Utilities

- Utility service may be shut off. Services such as electric, gas, or your cell phone may be turned off if you don't pay bills. Also, you may not qualify for energy assistance if you owe money to the utility company.
- A large reconnect charge may be difficult to pay later.
- Interest and fees may be charged on overdue amounts.

Mortgage

- *Default* - If you miss a mortgage payment, you will receive notice from your lender that foreclosure will begin if you do not pay by a certain date.
- *Late fees* will be added to the amount you owe.
- *Cosigner will be asked to pay* - If a relative or friend cosigned the mortgage, the lender will expect them to make the payments if you do not. Your missed payments could create serious problems for your cosigner as well.
- *Foreclosure* - If you continue to not make payments, the lender will ask the courts to auction your home so the lender can regain the money owed. If this happens, you could lose your home, all of your money invested in it, and still owe more money to your lender. You may want to consider selling your house before court action begins.

Other Creditors

- If you miss a payment, you will receive a letter reminding you that you missed a payment and asking you to pay promptly. After that, you may receive a more direct letter or get a phone call demanding payment.
- Bills will probably be turned over to an independent collection agency. At that point, you will no longer be able to negotiate with the person or company you owe money to. Collection agencies can be aggressive, but you do have certain rights. Collection agencies can't use abusive language or threaten you with violence. They can't call you at unusual hours or threaten criminal prosecution. And they can't discuss your financial situation with others.
- Creditors can take several kinds of legal action against you. These actions are often written into the sales contract you signed. If you fail to make payments, you will receive letters from a creditor's attorney warning you of the action the creditor plans to take. These actions may include:
  - *Acceleration* – the entire debt is payable at once if you miss a payment. The courts can force you to pay by seizing your property and selling it.
  - *Repossession* – the creditor can seize the item you bought or the property you used as collateral. If the sale of the property brings less than the amount you owe, you still must pay the difference.
  - *Wage garnishment* – a court order or judgment that requires your employer to withhold part of your wages and pay your creditor. The creditor can also garnish your checking or savings account if you have more than $1000 in your account.

Government Debts

- Debts like property taxes or child support are handled differently than a loan or credit card payment.

Where Do You Start If You Can't Pay Bills? handout

1. **Take action right away!**
2. Contact creditors BEFORE you miss a payment. You can reduce your chances of being harassed by creditors or collection agencies by working out solutions early.
3. At the first sign that you will not be able to make a payment, do the following:
4. Work out your new income and expenses. Use a monthly spending plan worksheet to compare your income to current expenses. This will give you a picture of your current spending and possibly places to cut back on your day to day expenses.
5. Prioritize your bills. Credit card collection agencies can be rude and persistent if you miss a credit card payment, but missing a mortgage payment could mean losing your house. Figure out what other bills are priorities to you, for example, the car payment or groceries. See "Deciding which debts to pay." After you set aside enough money for priorities, then divide the rest of your income among the other creditors and bills.
6. Contact your creditors before they contact you. When you contact creditors, you'll need to work with someone—a supervisor, accounts manager, or "loss mitigation" specialist—who can negotiate with you. When you call, this may mean getting busy signals or spending some time on hold since many others in similar situations may be calling too. If the creditor is local, make an appointment to meet with them in person.
7. Make specific and realistic offers to creditors. A creditor does not have to accept a lower payment from you, but it never hurts to ask and explain your situation. Agreements may include lower payments over a longer period (with more interest added) or payment on interest alone for a set time period. Don't make promises you can't keep.
8. Follow up with a letter detailing the arrangements you agreed to with each creditor. In the letter, write down the terms of your agreement including amount and due date, the name of the person you talked to, and the date. Keep a copy of the letter for your records. Get agreements in writing and signed by the creditor before you send in payments.
9. Contact a credit counseling agency if you need help working with your creditors. Be aware that these agencies charge a fee to help you and a debt repayment program may affect your credit rating.
10. Consider seeking legal advice. You have rights under the Consumer Protection Act. If a creditor has filed a judgment against you to garnish your wages or repossess collateral, you may want to speak with an attorney before the court date.
11. Don't take on new debt. You may be tempted to use credit cards, take out a home equity loan, or borrow money to pay bills. Unless your situation turns around quickly, more debt only creates bigger problems.

WHAT ABOUT YOUR CREDIT RATING? *Nonpayment of bills is reported on your credit record, which can damage your ability to get credit or increase the cost of credit. A prospective employer may ask to see your credit record. If you contact all creditors immediately and pay something on each debt as agreed, creditors are less likely to report problems to credit bureaus.*

Deciding Which Bills to Pay First handout

When you are between jobs, the paychecks may stop coming, but the bills don't. You're legally obligated to pay all debt, but when you don't have enough money to cover your monthly expenses and pay your creditors the minimum amount due, you face some tough decisions. There is no magic list of the order in which debts should be paid since everyone's situation is different. Here are some general rules about how to set priorities:

1. First, pay housing-related bills. Keep up rent or mortgage payments if at all possible. Failure to pay these debts can lead to loss of your home.

2. Pay basic living expenses next. This includes groceries and medical insurance if you can afford the premiums.

3. Pay the minimum required to keep essential utility service. Full and immediate payment of the entire amount of the bill may not be required, but you should make the minimum payment necessary to avoid disconnection if at all possible.

4. Pay car loans or leases next if you need to keep your car. If a car is needed to get to work, you will usually make the car payment the next priority after housing, food, and utilities. Your creditor can repossess your car without going through the courts first. If you keep the car, stay current on insurance payments as well to avoid additional fees, legal problems, or an overwhelming expense from an accident.

5. Make tax debts a high priority. You must pay any income taxes owed that are not automatically deducted from your wages and any property taxes if they are not included in your monthly mortgage payment. You must file your federal income tax return, even if you cannot afford to pay any balance due. The government has many collection rights that other creditors do not have. Also pay child support; these debts are court-required and will not go away. Nonpayment can result in very serious problems, including prison for nonpayment.

6. Make student loans a medium priority. In general, pay them ahead of low priority debts but after top priority debts. Since most student loans are backed by the government they are subject to special collection remedies, such as wage garnishments, seizure of tax refunds, and denial of new student loans and grants.

7. Make loans without collateral a low priority. These include credit card debts, doctor or hospital bills, other debts to professionals and similar obligations. Since you have not pledged collateral for these loans, there is rarely anything these creditors can do to hurt you in the short term.

8. Make loans with only household goods as collateral a low priority. Creditors rarely seize the goods due to their low market value and the difficulty in retrieval without involving the courts. If the creditors do start actions to repossess household items, you will be notified by letter.

9. Treat cosigned debts like any others. For example, if you put up your home or the car as collateral, that is a high-priority debt for you if other cosigners are not keeping the debt current. If you have put up no collateral, make the debts a low priority. If others have cosigned for you, you should let them know about your financial problems so that they can decide what to do about the debt.

10. Don't pay when you have a good legal reason to not pay. Examples include defective merchandise or the creditor is asking for money that it is not entitled to. If you believe you have a legal defense, contact a lawyer.

11. Don't move up a debt's priority based on threats to ruin your credit report. In most cases, the creditor has

already reported the delinquency to a credit bureau.

12. Don't move up a debt's priority because of debt collection efforts or threat of a lawsuit. Be polite to a collector, but make your own choices about which debts to pay based on what's best for you. Many threats are not carried out, and the procedure itself is long and complicated for the creditors. On the other hand, nonpayment of rent, mortgage, and car debts may result in immediate loss of your home or car.

13. Do move up court judgments in priority if the creditor has already sued. After a court judgment, that debt should move up in priority because the creditor can enforce that judgment by asking the court to seize your property, wages, and bank accounts.

14. Be cautious about consolidating debts or refinancing your home. Depending on your situation, this may or may not be the right option for you. It can be expensive and give creditors more opportunities to seize your important assets. A short-term fix can lead to long-term problems.

Government Debt

Income Taxes: If you cannot pay the total amount due, contact the Wisconsin Department of Revenue and the IRS right away. Ask for information on repayment plans and find out whether your reduced income makes you eligible for tax credits. Contact the Wisconsin DOR at (608) 266-7879 or www.dor.state.wi.us. There's a $20 fee to make an installment agreement. Contact the IRS at (800) 829-1040 and ask to be transferred to "advanced accounts."

Property Taxes: Contact your county treasurer and explain your situation right away if you're not able to pay property taxes.

Child Support Orders: If your income has dropped sharply, contact your family court to find out about lowering your support order as soon as possible. This cannot be done retroactively.

Student Loans: If you are having trouble making your federal student loan payments, contact your loan servicer immediately. You may be able to have payments deferred – or postponed – during periods of unemployment or financial hardship. But you cannot qualify for a deferment once your student loan is in default.

Consumer Credit Counseling handout

If you are in financial trouble and are not able to work out a repayment plan with your creditors on your own, a credit counseling service may be able to help. The most common of these services are members of the National Foundation for Credit Counseling (NFCC) with offices known as Consumer Credit Counseling Services (CCCS). There are dozens of credit counseling services (or “adjustment services companies” as they are technically called) licensed to offer services in Wisconsin. This includes agencies with local offices as well as phone and Internet-based services.

What they offer

Credit counseling services provide individual budget counseling and assistance in arranging a payment plan with creditors, usually called a debt management plan (DMP). This is a monthly program that often reduces your bills and consolidates them into one monthly payment. Most people can get out of debt in three to five years on one of these plans (not including secured debts such as a mortgage.)

When you sign up for the debt management plan, you deposit money each month with the credit counseling service and they pay your creditors according to a payment schedule developed by the counselor. A successful repayment plan requires you to make regular, timely payments, and could take 4 years or longer to complete. As part of the repayment plan, most credit counselors will ask you to surrender or cut up your credit cards. You might also have to agree not to apply for or use any additional credit while you're participating in the program.

Cost

The costs are often based on a sliding scale, based on your ability to pay. Typical fees include a start-up fee plus a monthly fee for each month you are in the debt management plan. Wisconsin laws limit the initial budget setup fee to $50, or $25 for clients that sign up for a debt management plan. Monthly fees vary, however, so you need to understand costs before signing any agreement. Some companies charge a flat monthly fee; others base their monthly fee on the number of accounts in your repayment plan. In Wisconsin, the maximum monthly fee cannot exceed 10% of the money sent to creditors or $120, whichever is less.

Most credit counseling services are funded, in part, by contributions from creditors, particularly credit card companies. The credit card companies agree to pay a fee to the counseling service equal to a percentage of the payments sent them each month. In the industry, this kickback is known as “Fair Share Contribution” and is limited to 15 percent in Wisconsin.

Advantages

Because of their contacts with the credit industry, credit counselors are generally able to negotiate better repayment terms with creditors than you could do on your own. Once you are following a repayment plan, you’ll only make one monthly payment to the counseling service.

Once creditors accept your debt management proposal and receive your monthly payments on time, they are often willing to lower interest rates, waive past late fees and even “re-age” your past due accounts to reflect a current “paid-as-agreed” status. However, some creditors may report to the credit bureaus that your account is being repaid through credit counseling, or that you are late, since technically, you are not making your originally agreed-upon payments. Ask the credit counselor for specific information about how each of your individual accounts will be reported to the credit bureaus.

While a debt repayment plan can eliminate much of the stress that comes from dealing with creditors and overdue bills, it does not mean you can forget about your debts. You are still responsible for paying any creditors whose debts are not included in the plan. You also need to review the monthly statements from your creditors to make sure your payments have been received. If your repayment plan depends on your creditors agreeing to lower or eliminate interest and finance charges, or waive late fees, you are responsible for making sure these arrangements are reflected on your statements.

Disadvantages

Since credit card companies largely finance these services, the debt repayment plans usually cover only unsecured debt. Secured debt—like your auto and home loans—may not be included. You must continue to make payments to these creditors directly.

In many cases, a person who has debt problems has gotten into that situation involuntarily due to a job loss, high medical expenses, or other circumstances beyond their control. Often their debt load exceeds their monthly income. The advice for a person with debt problems is different in each case.

Also, in these difficult situations, first priority must be given to the necessities of life—shelter, food, and transportation. Therefore, it is usually essential to insure that payments required to maintain these necessities—housing and vehicle payments—are made on time and in full. That may mean that some creditors, like credit card companies, are not paid for several months.

Impact of credit history

A debt management repayment plan does not erase your credit history. Under the Fair Credit Reporting Act, accurate information about your accounts can stay on your credit report for up to seven years. In addition, your creditors will continue to report information about accounts that are handled through a debt repayment plan. For example, creditors may report that an account is in financial counseling, that payments may have been late or missed altogether, or that there are charge-offs or other concessions. However, a demonstrated pattern of timely payments may help you obtain credit in the future.

Choosing a counseling service

With an explosion in the number of credit and debt counseling agencies today, it's not surprising that consumers are sometimes confused about their options. It can be difficult to distinguish between organizations providing a high level of service and education, and those that operate more like collection agencies for creditors by pushing consumers into repayment plans. The services that counseling agencies provide vary widely. Some are much better than others, so choose carefully. Don't work with a counseling agency if you feel pressured or uncomfortable. You want a counseling agency that will help you successfully conquer your bills—not get you deeper in debt.

Any reputable credit counseling agency should provide you with free information about itself and the services it provides without requiring you to provide any details or your situation. If not, consider that a red flag and go elsewhere for help.

Here are some questions to ask

Services and Fees

- What services do you offer?
- Do you have educational materials? If so, will you send them to me? Are they free? Can I access them on the Internet?
- In addition to helping me solve my immediate problem, will you help me develop a plan for avoiding problems in the future?
- What are your fees? Do I have to pay anything before you can help me? Are there monthly fees?
- What is the source of your funding?
- Will I have a written contract with you?
- Who regulates, oversees and/or licenses your agency? Is your agency audited?
- Will I work with one counselor or several?
- What are the qualifications of your counselors? Are they accredited or certified? If not, how are they trained?
- What information do I need to have for my first appointment (such as a list of monthly income, expenses, and most recent bill statements).
- What information about me (including my address and phone number) will be kept confidential and what information will be shared with creditors?

Repayment Plan

- How much do I have to owe to use your services?
- How do you determine the amount of my payment? What happens if this is more than I can afford?
- Can you get my creditors to lower or eliminate interest and finance charges or waive late fees?
- How does your debt repayment plan work? Is a debt repayment plan my only option?
- What debts will be excluded from the debt repayment plan? Will you help me plan for payment of these debts?
- How will I know my creditors have received their payments? Is client money put in a separate account from operating funds?
- How often can I get status reports on my accounts? Can I get access to my accounts online or by phone?
- Who will help me if I have problems with my accounts or creditors?
- What if I can't maintain the agreed-upon plan?
- What do you report to credit bureaus?

List Your Creditors

worksheet

List as much information as you can about each of your creditors. Don't rely on the current balance as listed in your credit report since this information may not be up to date. Instead, use your most recent bill or contact your creditor.

Name of Creditor	Minimum Payment Due	Current Balance	Date Of Last Payment	Interest Rate %	Default Interest Rate %	Annual Fee	Late Fees
Total	$	$					

Sample Letter to Your Creditors

handout

Use the template below as a guide when writing to or talking with creditors. Replace the blanks with your own information.

(Creditor/Company name)
(Company Address)
(City, State, Zip)

Attention: Account Representative
Date: ___________________________
Name(s) on account: _______________________________
Account number: __________________________________
Date loan/account opened: __________________________
Total amount due: _________________________________
Monthly payment amount: ___________________________

This letter is to let you know that I'm currently having some financial difficulties. I'm not able to pay the complete monthly payment on my account because _____________________.
(List your personal reason here – job loss, illness, etc.)

Looking at my financial situation, I have set up a budget for my basic living expenses and have come up with a debt repayment plan based on my reduced income. I'm contacting all of my creditors to explain my situation and to ask for a reduced payment until my situation improves.

I would like to offer a reduced payment of $_______________ per month. This is the most that I can pay regularly at this time. You can expect this amount as soon as possible until the debt is totally repaid.

I hope you find this repayment amount acceptable. I look forward to your letter of acknowledgement. Thank you.

Sincerely,

(Sign your name)
(Your address)
(City, State, Zip)

Household Assets worksheet

What do I own? What am I willing to sell?

Cash/investment assets	Current Value	Cost of fees/penalties/taxes	Am I willing or able to sell?
Cash on Hand Over $100	$		
Checking Account	$		
Savings Account	$		
Anticipated Tax Refunds	$		
Money Market Funds	$	$	
Stocks/Bonds/CDs/ Annuities/etc.	$	$	
IRA /Keogh Accounts	$	$	

Household Assets	Price Paid	Amount Owed	How much could you sell it for?	Am I willing or able to sell?
Automobile #1	$	$	$	
Automobile #2	$	$	$	
Automobile #3	$	$	$	
Computer/TV/Electronics	$	$	$	
Furniture	$	$	$	
Jewelry	$	$	$	
Boats / Jet Skis	$	$	$	
RV/ Recreational Homes	$	$	$	
Motorcycles / Snowmobile	$	$	$	
Farm Equipment	$	$	$	
Trailers	$	$	$	
Other Property	$	$	$	
Other:	$	$	$	
Total	$	$	$	

Checklist for Comparing Credit Cards worksheet

Think about how you will use your credit card. Do you expect to:

- Pay your monthly bill in full?
- Carry over a balance from month to month?
- Get cash advances?

Once you have decided how you will use your credit card, you can use this checklist to compare cards. Information about most of the features is given in the disclosure box that must appear in all printed credit card solicitations and applications. For more information about the disclosure box, visit www.federalreserve.gov/pubs/shop/default.htm#boxpurchase.

Feature	**Card A**	**Card B**	**Card C**
What are the APRs?			
For purchases?	________	________	________
For cash advances?	________	________	________
For balance transfers?	________	________	________
If you pay late?	________	________	________
What type of interest does the card have?			
Fixed or variable? Tiered?	________	________	________
How long is the grace period?			
If you carry over a balance?	________	________	________
If you pay off the balance each month?	________	________	________
For cash advances?	________	________	________
How is the finance charge calculated?			
One cycle or two?	________	________	________
Including or excluding new purchases?	________	________	________
Average or adjusted?	________	________	________
Minimum finance charge?	________	________	________
What are the fees?			
Annual	________	________	________
Late-payment	________	________	________
Over-the-credit-limit	________	________	________
Set-up	________	________	________
What are the cash advance features?			
Transaction fees	________	________	________
Limits	________	________	________
How much is the credit limit?	________	________	________
What kind of card is it?			
Secured? Regular? Premium?	________	________	________
Does the card offer other features?			
Rebates, Frequent Flyer Miles, Other	________	________	________

Adapted from the Federal Reserve Board “Choosing a Credit Card”, March 2007