Fundamentals of Money Management

The World of Credit

December 16, 2013 by Guest Commentary

OPINION – I must emphasis one important thing: Your Credit Score is as important as your Birth Certificate, your Social Security Number, your Driver's License and your Passport. Protect your Credit score as if your life depended upon it. An identify thief, will give you a financial nightmare and you will spend many years trying to clean up your good name: https://www.identitytheft.gov/

What exactly is credit?

Credit is a person's ability to borrow money or to obtain goods or services for LATER repayment based on the person's ability to pay it back.

A Little History

Credit has been around since the early 1800's, however it became popular in 1966 when Bank of America issued the BankAmericard (your current day VISA Card), followed by many department stores cards (Sears, Montgomery Wards, JC Penney's etc.). Soon afterwards, American Express, MasterCard, Diners Club and Discover Card entered the plastic card industry. By the late 1970's, credit became a tool used by nearly every consumer establishment. Credit is now considered an essential part of our way of life.

Why do we need credit?

We use credit to live beyond your cash flow needs.

How does it work?

It is a simple process of getting an approval by applying for a card/account. Once you receive approval, the issuer will provide you with a plastic card that has your name, credit number and an expiration date on the front and special number on the back for security purposes.

Here is where it gets dicey because most people do not read the small print on the back of the application where various rates are quoted. This small print becomes a part of your signed credit card application/contract.

The Price of Credit

There is a costs to use your credit card. The Annual Percentage Rate (APR's) can run anywhere from 8% to 29.99% in interest for using the card. Other APR's vary depending on how the card is used (Balance Transfers (14.24% to 24.24%): moving all of the charges from one credit card to another; Cash Advances (24.24% and up); Late Payments (14.24% to 27.99%); Overdraft Advance (13.99% and up).

The grace period (from the time you get your bill until the time you pay it) can run from 10 days to 20 days before a late payment is added to your bill. **Special Note:** All interest continues to accrue until the payment is received. This is why it is important for you to pay your bill as soon as you get it. Other charges can be percentages or cash charges that vary from card to card. You must take the time to read the fine print on the back of the application.

How Does Your Credit Score Effect You?

Credit is defined by your FICO Score: http://www.myfico.com. A FICO or Credit Score is a statistical means of assessing the credit risk that lenders use in the financial services industry.

Fair Isaac Co. started in 1960 and sparked a revolution in credit risk scoring which improved business performance and expanded consumers' access to credit. The score is based on data from the following credit reporting agencies.
– Equifax: http://equifax.com/
– Experian: http://www.experian.com/
– TransUnion: http://www.transunion.com/
About 90% of the American Corporations use the Fair Isaac credit scoring system.
Go to the internet for more information about FICO Scores at: http://www.myfico.com.

What is a Credit Score and What Does It Mean?

Credit Score Ranges are from 850-350. 850 is the best credit score possible and 350 is the lowest credit score possible.

Credit & Expectation Theory

Let's treat credit scores like school grades. Remember how teachers treated the "A" Students and how they treated the "F" Students?
– A Student: Respect, Credibility & Expectation to Succeed.
– F Student: Disrespect, No Credibility, Expectation of Failure
We can look at credit scores the same way:
• 800 – 850 Exceptional (A Student - Credit: Easy to obtain)
• 740 – 799 Very Good (B Student Credit: fairly easy to obtain)
• 670 – 739 Good (C Student Credit: Higher Interest rates)
• 580 – 699 Fair (D Student Credit: Hard Money Loan/High Interest Rates)
• 300 – 579 Very Poor (F Student Credit: Very Difficult to obtain)
Your Credit Score = Theory of Expectation
– Payment History – Public Records & Collection Items
– Outstanding Debt – # of open accounts
– Credit History – Age of Trade Lines & Number of Trades
– New Credit – # of Inquiries & Time Since The Last Inquiry
–Types of Credit – Real Estate, Installment & Revolving
– Delinquent Accounts, Accounts to high, Too many opened accounts and too few accounts currently paid as agreed is a bad thing

Resource reading

The Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit CARD Act of 2009). This law is designed to protect the uninformed on what credit card companies can and cannot do including rules for those 18 years and under.

Credit: A good or a bad thing?

Credit is good if managed in concert with a clear financial plan. When not use properly, credit can lead to all kinds of bad things including loss of employment (yes, they do check your credit score for job applications), not getting into graduate school, home and automobile purchase. My advice is to use credit only when needed and avoid credit trouble by creating a Plan for Financial Success. Our next article will be on Debt Management – Credit Cards.

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