Chapter 1

The Lowdown on Credit Essentials: Just What You Need to Know

In This Chapter

- Seeing yourself as lenders see you
- Understanding credit reports and credit scores
- Establishing credit for the first time
- Handling mortgage problems
- Living happily ever after

Whatever did people do before there was credit? In the olden days, it was much more difficult for the average person to buy the goods and services that are taken for granted today — things like a car, a home, and a college education, to name a few. Imagine if first-time home-buyers had to save $267,000 (the national average for the cost of a new home in 2008, according to the Federal Housing Finance Board) before taking ownership and stepping over the threshold. If that were the case, they'd likely be using walkers to enter their new abodes.

Credit is a powerful tool. It can be used to move mountains. Unfortunately, it can also bury you beneath one if you use it improperly. Credit doesn't come with an instruction manual or a warning label. The subject generally isn't well-taught in schools or, for that matter, in the family, either. So where do you get an understanding of this genie in a bottle before you make your three wishes? You're holding the answer in your hands.

For nearly two decades I've been helping people just like you recover from the aftereffects of credit gone bad. The best of my experience is contained within the pages of this book. I firmly believe that if you know the rules of the credit game, you stand a much better chance of getting a good score. We all make mistakes, and this applies to credit use as much as anything else. The important thing is to know how to recover from your mistakes without compounding the damage.

I start with the basics so you can better understand the principles and concepts behind credit. Consider this chapter your jumping-off point to this book and to the world of credit. My goal is to make your credit the best it can be and keep it that way. Not just for the sake of having good credit, but so you can live the American dream of having a decent job, a place to call home, and whatever else you desire for yourself and those you love.

Defining Credit: Spending Tomorrow's Money Today

Credit has its origins in the Latin word *credo,* which means, "I believe." The real underlying issues of credit are: Do you do what you promise? Are you believable and trustworthy? Have you worked hard to have a good reputation? Little is more precious to a person than being believed — and that's what credit is all about.

You (and Webster's) can also define credit as:

- Recognition given for some action or quality; a source of pride or honor; trustworthiness; credibility
- Permission for a customer to have goods or services that will be paid for at a later date
- The reputation of a person or firm for paying bills or other financial obligations

The concept of credit is simple: You receive something *now* in return for your promise to pay for it *later.* Credit doesn't increase your income. It allows you to conveniently spend money that you've already saved — or to spend the money today that you know you'll earn tomorrow.

Because businesses make money when you use credit, they encourage you to use it as often as possible. In order for creditors to make as much money as possible, they want you to spend as much as you can, as fast as you can. Helping you to spend your future earnings today is their basic plan. This plan may make them very happy — but it may not do the same for you.

Many types of credit are available to consumers today, which is no surprise to you. I suspect you receive as many offers for various types of credit cards and lines of credit as I do. But despite the endless variations and terms that seem to exist, most credit can be classified as one of two major types:

- **Secured credit:** As the name implies, *security* is involved — that is, the lender has some protection if you default on the loan. Your secured loan is backed by property, not just your word. House mortgages and car loans fall in this category. Generally, the interest rates for secured credit are lower and the *term* (the length of time before you have to pay it all off) may be longer because the risk of loss is lessened by the lender's ability to take whatever you put up for security.
- **Unsecured credit:** This type of credit is usually more expensive, shorter-term, and considered a higher risk by the lender. Because it is backed by your promise to repay it — but not by an asset — lenders are more vulnerable if you default. Credit cards fall into this category.

Chances are, you've always looked at credit from your own perspective — the viewpoint of the *borrower.* From where you're standing, you may be the customer who should be catered to. Consumer spending is two-thirds of the U.S economy, and much of that is generated by using lines of credit or credit cards. Whether you use credit as a convenience or because you need to spread out your payments, you keep the economy humming and people employed. Right? From the lender's perspective, however, you represent a risk. Yes, your business is sought after, but the lender takes a chance by giving you something now for a promise to pay later. If you fail to keep your promise, the lender loses.

The degree of doubt between the lender making money and losing money dictates the terms of the credit. But how does a lender gauge the likelihood of your paying on time and as promised? The lender needs to know three things about you to gauge the risk you represent:

- **Your character:** Do you do what you promise? Are you reliable and honest?
- **Your capacity:** How much debt can you handle given your income and other obligations?
- **Your collateral:** What cash or property could be used to repay the debt if your income dries up?

But where can this information be had — especially if the lender doesn't know your sterling attributes firsthand? The answer: your credit report and, increasingly, your credit score. That's why, before you open up that line of credit that allows you to buy the new dining room suite on a 90-day-same-as-cash special, you have to fill out and sign some paperwork and wait a few minutes for your credit to check out.

Sometimes, however, an unscrupulous creditor may try to take advantage of you and charge you more than the market price for the credit you want. Why? Because they like to make money. So, how do *you* know if you're being overcharged? The same way the lenders decide whether to offer you credit and what to charge you for it: by knowing what's in your credit report and your credit score.

Meeting the Cast of Characters in the Credit Story

Before I delve into the saga of credit and all its complicated plot twists, allow me to introduce the characters. In most lending transactions, three players have lead roles: the buyer (that's you), the lender, and the credit reporter.

The buyer: I want that now!

The cycle of credit begins with the buyer — a person who wants something (that's you!). A house, a car, a plasma TV . . . it doesn't matter what it is that you want. The definitive factor is that paying for it upfront is either inconvenient or impossible. Maybe you just don't have the cash with you and you want the item now, perhaps because it's on sale. Or maybe you haven't even earned the money to pay for the purchase, but you know you will and you don't want to pass up the chance.

"Hmm," you calculate as you gaze longingly at the coveted find. "I really want to get this now. If I wait until I have the money, it might be sold or the price might have gone up, so it only makes sense to buy it now." Or, if you're generous (or making excuses), you might say, "My sweetie would love this — and *me* — if I bought this. Who cares that I don't have the money right now? I will someday. I just know it."

Enter creditors, stage right.

The creditors: Heroes to the rescue

The creditor spots your desire a mile away, and it stirs the compassionate capitalist within him. "Hey," says the person with the power to extend you credit, "no need for you to do without. We have financing. We just need to take down a little information, do a quick credit check, and you can walk out the door with this thing you're lusting for."

If businesses can't sell you something or lend you money, they can't make a profit. So believe it or not, they really do want to loan you money. But there's that risk factor: They need to find out how risky a proposition you may be. In order to get the rundown on your credit risk, they call the credit bureau.

Enter credit bureau, stage left.

The credit bureaus: In a supporting role

The merchant most likely contacts one of three major credit-reporting bureaus — Equifax, Experian, or TransUnion — to get the credit lowdown on you. The credit bureaus make the current lending system work by providing fast, reliable, and inexpensive information about you to lenders and others.

The information in your credit report is reported by lenders doing business with one or more bureaus and put into what is the equivalent of your electronic credit history file folder. This file of data is called your *credit report,* and I devote a good portion of this book to credit reports. (See Chapter 2 for the full-blown story.)

Over the years, as more information has built up in credit reports and faster decision-making has been found to result in more sales, lenders have increasingly looked for shortcuts in the underwriting process that still offer protection from bad lending decisions. This need was met by the *credit score,* a shorthand version of all the information in your credit report. The credit score predicts the likelihood of your defaulting on a loan. The lower the score, the more likely you are to default. The higher the score, the better the odds for an on-time payback. By far, the most-used score today is the FICO score, which I cover in detail in Chapter 2. FICO scores range from 300 to 850.

Knowledge is power: Knowing your rights

When it comes to credit, you have rights — a lot of them. Two big laws address your rights pertaining to your credit standing:

- **Fair Credit Reporting Act (FCRA):** The Fair Credit Reporting Act ensures fairness in lending.
- **Fair and Accurate Credit Transactions Act (FACTA, or the FACT Act):** The FACT Act updated some sections of the FCRA (though not all, so both acts still stand on the books). It addresses credit-report accuracy and entitles you to access your data and dispute it. It also addresses the problem of identity theft and gives you leverage to deal with this crime if it happens to you.

I discuss these laws throughout this book, but if you want the nitty-gritty details, you can find copies of these acts on the accompanying CD.

In Chapter 5, I tell you about an additional 20 bureaus that have information about you. They're known as the *national specialty consumer reporting bureaus,* and they contain information on everything from how much you gamble to what medical condition you may have.

Understanding the Consequences of Bad Credit

Over the last 17 years, I've seen the underside of credit up close. During that time, I started a local credit-counseling agency that grew into a regional consumer resource and helped thousands of individuals and couples from all walks of life with credit issues. During the last few years, I've gotten questions from consumers just like you from all over the country — questions about their credit-related problems and opportunities — through my weekly "Debt Advisor" column that appears in newspapers and on the financial megasite Bankrate.com. I've witnessed time and again the devastating effects of credit gone bad.

Aside from the obvious increase in borrowing costs and maybe a hassle getting a credit card, what are the very real costs of bad credit? The extra interest you have to pay is only the tip of the iceberg. The real cost of bad credit is in reduced opportunities, family stress, and having to associate with lenders who, more often than not, see you as a mark to be taken for a ride and dumped before you do it to them. And, believe me, they're better at it than you are. In this section, I fill you in on some of the unpleasant consequences of bad credit.

Paying fees

From your perspective as the borrower in trouble, paying fees makes no sense at all. You're having a short-term problem making ends meet, so what do your creditors do to help you? They add some fat fees onto your balance. Thank you very much.

How do these fees help you? They don't. The fees helps the *creditor* in two ways:

- They focus your attention on *their* bill, instead of someone else's.
- The creditor gets compensated for the extra risk you've just become.

As bad as the fees can be on your credit cards, they can be even worse on your secured loans. If you fall three months behind in your house payment, you can be hit with huge fees to the tune of thousands of dollars.

Secured lenders tend to be low-key. Don't let that calm voice or polite, nonthreatening letter lull you into complacency. They're low-key because they don't *have* to shout — they'll very quietly take your home or other collateral, unlike the credit-card guys, who can be heard from across the street. Pay attention to the quiet guy, and take action.

Late fees, over-limit fees, legal fees, repo fees, penalty fees, deficiency payments, and default rates: When the fees show up, it's time to get serious. Call the creditor and ask to have the fees waived. Explain your plan to get current (make any past-due payments) and let them know that you need their help, not their fees. Chapter 13 of this book helps you put together a budget so you know exactly how much you can afford. If you have difficulty developing a budget, your creditors may accept a debt-management plan, which you work out with the help of a credit-counseling agency (see Chapter 3). Take action early enough in the game while you and your account are still considered valuable assets, and you're more likely to have success getting the fees removed.

Being charged higher interest rates

Consider two home-buyers: one with a credit score of 760, the other with a credit score of 659. The happy new homeowner with the lower score won't be so happy to learn that, because of that lower score, he'll pay more than $90,000 more in interest over the life of the loan. Why? Because the mortgage company offers an interest rate of 5.3 percent to the individual with the 760 score, and an interest rate of 6.6 percent to the borrower with the 659 score.

The concept works basically the same in any lending situation. What impact would these scores have on a new car loan? A 36-month interest rate is more than *50 percent higher* for the person with the 659 score versus the 760 score!

Your credit score is based on your credit actions yesterday, last year, and maybe even ten years ago. If you miss a payment or two, that low-interest-rate credit card on which you're carrying a high balance can take your breath away. Watch the rate climb to the mid- to upper-20s or even 30-something — percent, that is! After all, you made a mistake and might stop paying altogether. So the lender is going to make money on interest while it can.

You think that getting your interest rate hiked for a minor infraction is unfair? That's not the end of it. Under the policy of *universal default,* if you have an issue with one lender, all your other lenders can hike their rates as well. Yes, even though you're still paying the others on time and as agreed! In fact, some companies even use a deteriorated credit score as reason to escalate your rates to the penalty level. Even though you're paying that loan on time, a change in your credit score (perhaps from too many account inquiries or carrying higher balances) gives the creditor that has a universal default policy full rein to hike up your interest rates. All the more reason to pay all bills on time and keep track of your credit report and credit score on a regular basis.

Losing employment opportunities

Prospective lenders aren't the only ones who judge you based on your credit report and credit score. Potential employers check out your credit report, too. Why is that, you ask? Businesses reason that the way you handle your finances is a reflection of your behavior in other areas of your life. If you're late paying your bills, you may be late for work. If you default on your car loan, you may not follow through with an important assignment.

Even if your credit woes can be explained, bad credit is a distraction from the employer's perspective, and it detracts from worker productivity. Recent research shows that employees with credit problems are significantly less productive on the job than those without.

Increasingly, credit checks are a standard part of the hiring — and even promotion — process at companies large and small throughout the United States. And from the employer's perspective, it's easier to hire someone with good credit than to bother to find out what's going on with someone whose credit is bad.

Increased insurance premiums

The brain trusts at the insurance companies (known as *actuaries*) love their numbers. They sniff out a trend, sometimes even before it happens, and slap a charge on it faster than my cat can catch a mouse — and, let me tell you, she's *fast!* The fact that a strong correlation exists between bad credit and reported claims hasn't escaped the attention of these people. The upshot: Bad credit will cost you a bundle in insurance-premium increases and may result in you being denied insurance.

Some states have gotten very excited about safe drivers and homeowners getting premium increases with no claims being reported. About 50 percent of states have restricted the use of credit-based insurance scores (and to a lesser extent, credit reports) in setting insurance prices. To find out whether scores and to what extent credit reports are used in your state, contact your local state insurance department. The states are still battling with this issue and it's difficult to say whether current laws will be overturned or upheld, or whether more will be added.

I'm not talking about your garden-variety credit score here. Fair Isaac has developed an Insurance Score. This score is calculated by taking information from your credit report, but the formula is different from the one used to figure your typical credit score. Insurance scores range from 500 to 997 with 626 to 775 being average. The Federal Trade Commission recently weighed in on the topic when a study they conducted found that these scores are effective predictors of the claims that consumers will file.

Getting a divorce

Would your better half dump you because of bad credit? Maybe not, but one thing is sure: Half of all marriages end in divorce, and the biggest cause of fighting in marriages is due to financial issues — as in bad credit.

Spouses want to be proud of their mates. And with credit playing a bigger role in so many aspects of modern American life, living with bad credit has to be a real blow to your image and self-esteem. I advise couples who are serious about pursuing a life together to talk about their attitudes on money and credit use. Sweeping this topic under the rug is too easy. Having a credit card refused for payment (often in front of others), worrying about which card still has available credit, or getting collection calls in the sanctuary of your home can be part of the credit nightmare you face as a couple. If you can't seem to find the words to talk about this sensitive topic or agree on a solution, get some professional advice before it becomes too late (see Chapter 3 for more information).

As a former counselor, I've seen too many people ruin otherwise promising marriages over money and credit. I can't help but offer some advice on bad credit and marriage:

- Get a credit report before you marry.
- Discuss money and credit and agree on goals.
- Find out if your honey is a spender or a saver.
- Fix your credit before it fixes you (as in "My cat is going to get fixed").

I cover couples and credit in more detail in Chapter 14.

The Ultimate in Secured Credit: Mortgages

Over the last few years, the mortgage market has been turned on its head. Credit has gone from amazingly loose to amazingly tight. People who took out mortgages with rates and payments that reset with market conditions have been stunned by the rapid increase in interest rates as a result. Many mortgages were oversold to people who relied on increasing property values to allow them to continue to refinance periodically and avoid high-interest-rate resets. Others have been unable to keep up with payments because of an unrelated financial problem. Either way, millions of homeowners have found themselves unable to refinance due to falling real estate prices and are trying to keep their heads above the financial waters that are rising higher and higher.

This section looks at what help is available and some pointers you need to remember. Check out Chapter 9 for more detail on mortgage issues and how a foreclosure can affect your credit score.

Knowing the type of mortgage you have

Today's market has a wide number of types of mortgages. So what kind of mortgage do you have? Will your payments increase or stay the same? How long? Knowing this information is important so you can make plans or take action ahead of time. If you have any doubt, start by contacting your loan servicer and asking. Following are some common types:

- **ARMs (Adjustable Rate Mortgages):** Mortgages that have adjustable rates from the start, which means your payments change over time based on preset interest rates usually up to certain preset caps.
- **Hybrid ARMs:** These mortgage payments stay the same for a few years, and then turn into adjustable loans. Common varieties are called 2/28 or 3/27 hybrid ARMs: The first number is the number of years the loan has a fixed rate and the second number is the number of years for which the loan has an adjustable rate. Some others are 5/1 or 3/1 hybrid ARMs: The first number again refers to the number of years the loan has a fixed rate, but the second number indicates how often the rate changes. In a 3/1 hybrid ARM, for example, the interest rate and payment are fixed for three years, then adjust every year thereafter.
- **Fixed rate mortgages:** Also called *traditional mortgages,* the rate is fixed for the life of the loan, often 15, 20, or 30 years. Usually payments don't vary unless you include taxes and/or insurance in your payment to your servicer.

Coping if you can't make your payments

If you're having trouble keeping up with your mortgage payments, you're probably worried sick about potentially losing your home. Rather than sitting helplessly, you can take some action. Consider doing the following if you're having a difficult time making your payments:

- **Find out whether you can refinance to a fixed-rate loan with a lower payment.** Check your mortgage documents first for prepayment penalties. Prepayment penalties may require large payments to the original loan holder if you pay off the loan early. After you know this info, contact your loan servicer and find out your options. The earlier you call the better. More programs are available to you if you begin before you default (miss a payment or pay less than is due) rather than waiting.

- **Contact a HUD-certified counseling agency.** Make sure you have all your options clearly explained to you. Furthermore, an agency can give you referrals to any programs for which you may be eligible.

  Don't go through the foreclosure prevention process alone. A counselor with a housing counseling agency can help you to assess your situation, provide answers to your questions, give you options from which to choose, and help you know what to ask for from your lender. Very often, credit counseling agencies also provide housing counseling under a grant from HUD at no cost to you. Be sure you are dealing with a HUD-certified office. See Chapter 3 for more details on what to look for. Or consider contacting the NeighborWorks Center for Foreclosure Solutions at 888-995-HOPE or `www.nw.org`.

Avoiding default and foreclosure

Foreclosure can be a shattering experience. Beyond the financial loss, your pride and self-esteem can take a major hit. Moreover, foreclosures can really put a major dent in your credit history.

REMEMBER

Being 90 days past due is a critical number in the transition from mortgage delinquency to the beginning of the foreclosure process. Most mortgages have a 14-day grace period, so your mortgage payment is due on the 15th of each month rather than the first. However, after you're delinquent (make a payment after the grace period has ended or only make a partial payment), the grace period goes away, so your next payment is now due the first of the next month with no grace period, period! Many homeowners are surprised when they think their payment won't be seriously past due for another two weeks, and they receive a foreclosure notice instead.

If you're running late on making payments, don't assume a foreclosure is inevitable. The sooner you look for help, the more options there will be that fit your situation. Even late in a delinquency, help can still be had, but you have to ask for it. Here are some alternatives you can pursue:

- **Forbearance:** This may be an option if your income is reduced temporarily, for example, your overtime is cut but you expect it to resume in the near future. Your mortgage payments may be reduced or even suspended for a period of time. Both you and the servicer need to agree on the time. Forbearance won't help if your financial situation has changed permanently and you can't afford your regular payments.
- **Repayment plan:** This may be an option if you've only missed a payment or two due to a temporary problem that is now resolved, and you can afford your payment but not the arrearage in one lump sum. Ask the loan servicer for a set amount of time to repay the amount you are behind by adding part of what you owe to your regular payment.

- **Loan modification:** If you can't afford your current payment, either because it has gone up or your income has gone down, this option may be for you. It entails a permanent change to one or more of the terms of the mortgage to make your payments affordable. Modifications may include reducing your interest rate, extending the term of your loan, or adding missed payments to the end of the loan or the loan balance. Before you ask for forbearance or a loan modification, be prepared to show that you are making a good-faith effort to pay your mortgage. For example, if you can show that you've reduced other expenses, your loan servicer may be more likely to negotiate with you. A HUD counselor can help you prepare for this.
- **Selling your home:** Depending on the real estate market in your area, selling your home may be an option. If your home's value is less than the amount owed, you can ask for a short sale or deed-in-lieu of foreclosure in which your lender takes back the property title and cancels the remainder of your debt. These may result in credit damage and perhaps a tax liability, but they are better for both you and the lender than long-term delinquency followed by a foreclosure.
- **Bankruptcy:** If other debts are making it impossible to make your mortgage payments and you have little or no equity, a personal bankruptcy may be worth looking into. A Chapter 7 bankruptcy is usually a last resort because it stays on your credit report for 10 years and can make it more expensive or difficult to get credit, qualify to buy another home, get life insurance, or even get a job. A Chapter 13 bankruptcy may be a less damaging alternative. In Chapter 13, the court approves a repayment plan that allows you to use your future income toward payment of your debts during a three-to-five-year period rather than surrender the property. To find out more about filing bankruptcy, flip to Chapter 11.

Dealing with a Thin Credit File

Are you new to credit? Is your credit history file a tad thin? (No, your credit history hasn't been on a diet.) A *thin file* means that you don't have enough information in your credit file on which to base a credit score or make an underwriting decision. Typically people who have just graduated from school, who are recently divorced or widowed, or who are new to this country have a thin file. The good news is this group of newbies is so large and potentially profitable in today's comparatively saturated credit market that they've been given their own name — the *underbanked.* Basically the underbanked are individuals who don't have access to the basics of the banking system such as checking and savings accounts and credit services.

WARNING!

Don't confuse underbanked with subprime. The folks in the underbanked group don't have blemished credit histories. They simply don't have much, if any, credit history. A better term may be *pre-prime!*

This section takes a closer look at some of the subgroups among the under-banked who have thin credit files and discusses some important points. Check out Chapter 4 for more in-depth coverage.

When you're new to the country

Those individuals new to the United States may bring old attitudes about banks with them. But the reality is that not only does the Statue of Liberty welcome you, so do many banks and lenders. Furthermore, many immigrants have to overcome misconceptions and understand that in this country banks are safe, insured for deposits, currency doesn't become worthless overnight, and the government is unlikely to nationalize the banks!

Social classes don't carry much weight in American banking. Anyone who walks into a bank or credit union gets treated with respect, regardless of what they do for a living. In fact, in many states with large enough concentrations of immigrants, banking services are being offered in different languages and in informal community settings, not just traditional banking offices.

Credit is essential to making a full and comfortable life in the United States. Lending, employment, insurance, and more are tied into establishing a positive credit history. The American dream, if you will, is intimately related to the credit system. So where to start? Here are some things to consider:

- You don't need a social security number to open a bank account if you are a foreign national. A consular ID or taxpayer identification number is sufficient with many banks.
- Credit bureaus don't require a social security number to establish a credit history for you. Name, address, and date of birth all come before social security number when it comes to linking credit histories with individuals.
- Credit doesn't consider race, national origin, gender, or any of those discriminatory categories.
- Building a relationship with a mainstream lender can help you avoid overpaying for credit products.

After one of life's many transitions

People who have just graduated or who just went through a divorce also often have thin credit files. If you fall into this category, you're probably looking for ways to build your credit history. In order to begin your journey, I suggest you set some long-term and interim goals as your destinations. Financial goals, like traveling goals, make sense, if only to keep you from wandering aimlessly. A car, a better apartment, a home, a vacation are all good goals and reasons to save your money and use credit wisely. (Check out the section, "Setting your financial goals" later in this chapter for more info.)

TIP

You can also do the following to help you begin to build credit:

- **Establish credit easily by using a secured credit card.** You make a deposit into an insured bank account and are given a credit card with a limit up to the amount of your deposit. This guarantees payment and allows you to have positive credit reported in your name. Soon, you'll qualify for an unsecured card and larger credit lines.
- **Open a passbook loan.** With a passbook loan, you make a deposit into a savings account and take out a small loan, using the account as security. There is no credit card, just a lump sum payment to you. But you can build a credit history when you make your payments on time, over time. Plus, the secured nature of the loan keeps costs very low. Credit unions, in particular, like these little starter loans.

Identity Theft: The Crime That Turns Good Credit Bad

Companies and schools seem to be losing the war on hackers and laptop thieves who are reported to be compromising databases with alarming frequency. Identity theft can devastate your credit and your ability to get loans, employment, insurance, and some security clearances and licenses without your ever having done anything to deserve it. An identity theft can also put you on the defensive, burdening you with the responsibility of proving that you are not the person collectors are after. Chapter 15 specifically addresses these issues, but for an overview, read on.

Protecting your identity from theft

TIP

To avoid the havoc wreaked by identity theft, your best bet is to avoid being a victim of identity theft altogether. Consider these tips:

- **Protect your financial information at home.** Don't leave credit-card numbers and statements, Social Security information, bank-account information, and other financial data unprotected. Most identity theft is low-tech (that is, paper-based). And most is carried out by people you know: friends, relatives (I've always worried about some of my aunts), acquaintances, co-workers, and people you invite into your home for a variety of reasons.

Shred statements before putting them in the trash and lock your sensitive information away. Using your computer more (as long as you use it properly and password-protect information) is an even better way to avoid theft.

- **Watch the mail.** Most people think that no one is watching their unprotected mailboxes. And most are right, but that leaves the rest of you with sensitive account numbers and documents containing your Social Security number sitting all day in an unlocked mailbox outside your home or apartment. By comparison, electronic bill paying is much safer.

Taking action if you're victimized

TIP

If you're a victim of identity theft, you may first discover that fact through a collection call on an account you never opened, or unusual activity on a credit card or credit report. When you suspect your identity has been compromised, respond immediately. Here are some tips:

- **Write down everything.** This process may not be quick or simple, but it is critical.
- **Call any creditors affected and close your accounts.** Don't forget ATM and debit cards — you have higher limits of liability for these than you do credit cards, so they're particularly important.
- **Freeze your credit report.** (You can unfreeze it later.)
- **Call the police and make out a report.** Some creditors and collectors require this to take action. Be sure to get a copy of the report.

Taking Charge of Your Credit

Now that you have a better understanding of the uses, perils, and pitfalls of credit, you *can* take charge of your credit! By following some very basic actions — some of which have an element of fun and inspiration — you can harness the power of credit to your advantage:

- Borrowing when it suits your needs without paying outrageous interest rates
- Taking advantage of lucrative lending offers such as "same-as-cash" and "no-money-down" offers typically available only to those with stellar credit histories
- Achieving your life dreams, whether owning that vine-covered cottage or sending your offspring to an Ivy League university

It all begins with the simple steps I cover in the following sections.

Setting your financial goals

Your financial goals serve as a powerful incentive to you and keep you on course. You've heard the saying, "If you don't know where you're going, any road will take you there." Well, if you don't have clear objectives when it comes to how you want to spend and save your money, you risk veering off on that rocky and perilous path to bad credit. Your goals — whether as grand as starting your own business or as modest as buying a new refrigerator — help you keep your eye on what's important to you and guide you to your destination. Chapter 13 helps you put together a list of your goals for both the near and far-off future.

Creating a budget

Call it a spending plan, if you like, but however you refer to it, be sure to see it as a positive *enabler,* rather than a restriction or a barrier. The purpose of the budget is to get you to arrive at your goal. If, for example, your goal is to take a beach vacation next year, putting money aside each paycheck and limiting spending on restaurants and clothing are as important in getting you there as filling the gas tank before you leave for the shore.

Start with an understanding of how much income you have to work with, and then allocate it as necessary for living expenses. If you have debt, set aside part of your income to retire that debt just as quickly as you can.

Then, just as important as your expenses and debt commitment, be sure you contribute to your own savings plans: one toward an emergency fund (in case of job loss or illness, for example); the others, for your goals (your kids, your honey, your retirement). Make saving as automatic as possible (an IRA or 401[k] for retirement, for example); the money can come right out of your paycheck. Use payroll deduction as an easy way to do this — and try to put at least half of your future raises in savings. You can spend the other half. In Chapter 13, I walk you through creating your own personal budget.

Obtaining and maintaining your credit reports and credit score

Like your annual medical exam, checking your credit reports serves as your routine credit checkup — only you're wise to schedule this exam every four months. Get it more often if you have a need — a big purchase on the horizon or a job change, for example. Pay for it, if you have to. It won't kill you. For information about ordering your credit reports and score, read Chapter 5.

Read your credit reports — every word. Errors do happen and when you're dealing with billions of pieces of data a month, they can happen a lot. Do you count your change when you check out at the supermarket or a restaurant? Your credit report is no small change. Dispute the errors, outdated information, and negative stuff that belongs to someone else's report.

Check for signs of identity theft and take immediate action if you discover evidence that someone else is using your good name. Chapter 15 of this book addresses identity theft in detail.

Being a good credit citizen

You're already so many other good things: a good person, a mother or father, a boyfriend or girlfriend, a spouse, a sibling, a worker. Do you really need someone telling you to be a good borrower, too? The answer: Yes.

I bet you knew I was going to say that, didn't you? The reason is not about you, but about the environment you're in. Taking the credit that is offered, using the credit that is offered, even not using credit at all can put you at a disadvantage. So how do you know what's "good"? You weren't born with the credit gene that enabled you to understand the correct path to follow like so many migrating birds.

Being a good credit citizen means being responsible as a borrower, responsible to yourself and those who share your life. This starts with goals, a future vision of your life, and knowing which financial tools to use, in what measure, and when.

Here are my top ten good-citizen credit practices:

- Set goals.
- Know what's in your credit report and dispute out-of-date, inaccurate, or just plain wrong information.
- Know what your credit score is, what it means, and what you can do to make it better or keep it great.
- Have a spending plan or budget.
- Use long-term credit for long-term uses. Don't use a home-equity line to buy sneakers or eat out (see Chapter 12 for more on home-equity lines).
- Use short-term credit for short-term uses. Pay off your credit-card balances as quickly as you can.
- Save money for future goals and needs.
- Pay your bills on time.

- Pay at least the amount due. Always set a time by which you will pay off a debt; don't let the creditor set the time for you, because it may be forever.
- Watch out for the seven warning signs of bad credit and get help as soon as you think you may need it — not as a last resort:
  - Using credit cards for daily expenses and not paying the balance every month
  - Not knowing how much you owe
  - Using cash advances to pay credit-card bills or for daily expenses
  - Only paying the minimum due on credit cards, or paying less than the minimum
  - Getting calls from your creditors
  - Spending more than 20 percent of your take-home pay on credit payments, excluding your mortgage
  - Arguing about money at home