



*How to*  
Establish, Use  
& Protect  
Credit



**C**redit is a valuable commodity. Having the ability to borrow funds enables us to obtain things we would otherwise have to save years to afford: homes, cars, a college education. Credit is an important financial tool, but it can also lead people into debt far beyond their ability to repay. That is why learning how to use credit wisely is one of the most valuable financial skills anyone can learn.

## **WHAT LENDERS LOOK FOR**

Before creditors lend money, they need to be assured that the funds will be repaid — in other words, is the prospective borrower creditworthy? To find out, they ask for various types of information:\*

### *Income & Expenses*

Lenders will look at what you earn and your regular expenses, such as rent, utilities, food, and other ongoing items. The amount left tells them whether you can afford to take on additional debt.

### *Assets*

Do you have assets that can serve as collateral? Lenders will look for things like bank accounts and valuable items such as a house, if you own one.

### *Credit History*

How do you manage debt? If you have credit cards or have borrowed money before, you have a history that indicates to prospective lenders whether you are

creditworthy by revealing details about the amount of debt you already have, how many credit cards you have, and whether you make payments on time.

It's easy to qualify for credit if you have a good history, but what if you have never used credit before? This is a common problem for people who have just started working, people who always pay in cash, or people who have not had assets or accounts in their own names. For people in these categories, the first step is to establish a credit history.

*\*Creditors obtain much of this information from your credit report, a computerized profile of your borrowing, charging, and repayment activities. For further information on credit reports, see Understanding & Improving Your Credit Score, a brochure published by the Federal Reserve Bank of Philadelphia.*

## **HOW TO ESTABLISH CREDIT**

You can apply for a bank loan secured by the funds you have on deposit or by items you own, such as a car. You can ask a friend or relative who has good credit to cosign a loan, which means that he or she shares the liability for the loan with you. You can also apply for department store and gasoline credit cards, which generally are easier to obtain than regular credit cards.

Before you apply for any credit, however, make sure you understand the

terms. For example, how long is the grace period — the time you have to pay the current balance in full before finance charges are incurred? Is there an annual fee, or other fees, associated with the credit? If you believe that you will carry a balance, you need to know how finance charges are calculated.

Patience is important. It takes time to establish credit, to build a record of consistency in making payments that demonstrates your creditworthiness. And it is much better to go slowly and assemble a strong credit record than to apply for too many credit cards or a loan that is larger than you can handle.

Start slow, be cautious, keep track of your overall debt, and pay on time. Most important, remember that credit represents real money and has to be repaid with interest. These are the keys to establishing good credit.

## **PROTECTING CREDIT**

Once you have obtained credit, it is essential to protect it. This means safeguarding your credit, debit, and ATM cards, as well as your account and personal identification numbers (PIN).

Carry only the cards you expect to use and keep the others in a safe place. Maintain a list of account and telephone numbers of the companies that issued your cards. Then, if your cards are lost or stolen, you can notify the companies

quickly. If your notification is received before the cards are used by someone fraudulently, you have no liability. If it is received after a credit card has been used, your liability cannot exceed \$50 for each card. Your liability for ATM or debit cards depends on how quickly you report the loss.

If you dispute an item on a bill, you are responsible for notifying the creditor in writing within 60 days of receiving the bill. You should include your name, account number, the item you believe is in error, and the reasons why.

## **COMMON REASONS FOR DENYING CREDIT**

Among the most common reasons people are turned down when they apply for credit are:

- too little time in current job or at current residence
- too much outstanding debt
- unreasonable purpose for requesting credit
- limited credit experience
- foreclosure or repossession
- delinquent past or present credit obligations

In general, creditworthiness must be determined on the basis of criteria that relate to your ability and willingness to repay debt. You cannot be denied credit based on your sex, marital status, race, color, religion, national origin, age, reli-

ance on income from a public assistance program, or exercise of rights under the Consumer Credit Protection Act.

If you are denied credit, the creditor must provide to you in writing a statement of the action and your rights, as well as the reason for denial, or how to request the reason. For information on the laws applying to credit, see *Do You Know Your Credit Rights?*, a brochure published by the Federal Reserve Bank of Philadelphia.

For information on rectifying credit report errors, see *What Your Credit Report Says About You*, a brochure published by the Federal Reserve Bank of Philadelphia.

## **IMPROVING POOR CREDIT**

If you have fallen behind in your payments, the only alternative is to begin immediately to repair your credit record. Here's how:

- *Face up to the problem.* Recognize that you are overextended and contact your creditors to see if they will set up a new payment schedule that you can maintain. Contact creditors to try to work out a payment plan that you can live with. In any case, never ignore bills.
- *Immediately stop purchasing with credit.* Take your credit cards out of your wallet. Store them in a place that is inconvenient to reach, or

even cut them up.

- *Consider consolidating debts.* You may find it easier to make a single payment rather than several, and you might obtain a lower interest rate that will make it easier to keep up with the payments. Remember that debt consolidation is not a cure-all: You also have to learn to control your spending to avoid future debt.
- *Contact a credit counseling organization.* You can obtain referrals for organizations in your area through the National Foundation for Credit Counseling's member agency locator, 800-388-2227.
- *Don't expect miracles.* Don't believe companies that promise to fix a poor credit rating quickly and painlessly for a fee. As long as it is accurate and timely, negative information cannot be removed from your credit record. The only way to improve a credit record is to let time pass and establish a record of on-time payment.

## **DIVORCE AND CREDIT**

The dissolution of a marriage does not erase the debts you and your former spouse took on as a couple. Even if your former spouse is ordered by the court to pay debts from the marriage, you can become liable if the payments are not made. Here are a few suggestions to protect your financial standing:

- Decide how to divide or dispose of property. If necessary, you can retain a mediator to work through this with your former spouse.
- Close or separate joint accounts. Decide with your former spouse who will be responsible for paying bills and notify your creditors of your divorce.
- Establish independent credit, if you do not already have it.
- Make sure bills are paid.

### **PAYING OFF A LOAN EARLY**

If you are applying for a loan and you think you may want to pay it off before it has run its full term, you should be aware that lenders have several methods of calculating interest. The method they use affects the amount you may owe if you decide to pay it off early, and since lenders are not required to disclose which method they use, you may have to ask. Here is a brief description of the most common interest-calculation methods.

- *Rule of 78s*  
This formula, which originated when most loans were made for 12 months, is derived from the sum of the numbers from one to 12. Its use may be mandated by state law. The rule of 78s may not be used to calculate interest rebates for loan transactions made after September 30, 1993, and with a term exceeding 61 months.

- *Actuarial Method*  
This method is most often used for mortgages and other loans in which a periodic rate is applied to a declining balance. It does not take into consideration whether a payment is made before or after the due date.
- *Daily Simple Interest*  
In this method, a daily periodic rate is applied to an outstanding balance. Therefore, borrowers benefit by reducing the outstanding balance through early payments or lump-sum payments, both of which reduce the balance and the interest due. Under a simple interest system, late payers will end up owing more.

## **FOR MORE INFORMATION**

The Federal Reserve Bank of Philadelphia has other brochures on credit topics.

To obtain copies of these brochures, or for additional copies of this one, please contact:

### **Federal Reserve Bank of Philadelphia Public Affairs – Publications**

P.O. Box 66

Philadelphia, PA 19105-0066

215-574-6113

[www.philadelphiafed.org](http://www.philadelphiafed.org)

Questions and concerns about credit bureaus can be directed to:

### **Federal Trade Commission Consumer Response Center**

600 Pennsylvania Avenue, NW

Washington, DC 20580

877-FTC-HELP (382-4357)

[www.ftc.gov/credit](http://www.ftc.gov/credit)

For information on credit counseling in the Philadelphia area, please contact:

**Clarifi**

1608 Walnut Street, 10th Floor  
Philadelphia, PA 19103  
215-563-5665 or 800-989-2227  
[www.clarifi.org](http://www.clarifi.org)

For credit counseling in other areas, please contact:

**National Foundation for Credit Counseling**

2000 M Street, NW, #505  
Washington, DC 20036  
202-677-4300  
Member Agency Locator  
800-388-2227  
[www.nfcc.org](http://www.nfcc.org)



To view this and other consumer publications produced by the Federal Reserve Bank of Philadelphia, scan this code with your smartphone.



FEDERAL RESERVE BANK OF PHILADELPHIA

---

Ten Independence Mall, Philadelphia, PA 19106

8/2015