

**Financial Advice for a Successful Military  
Career**

*Fiscal fitness for military families*

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## INTRODUCTION

Many military families are already aware that financial problems can often have an impact on a service member's ability to carry out his or her duties. Recent reports have highlighted this issue, including one released in 2003 by the Department of Defense and the Rand Corporation. The study revealed that financial difficulties could have significant mission impact, such as requiring an individual to return from a deployment to resolve a financial emergency.<sup>i</sup>

In the military, financial problems are often the first listed by leaders when asked about personnel problems.<sup>ii</sup> Often, "immaturity, a lack of spending restraint, and naiveté regarding financial matters [are] the most significant drivers of financial problems."<sup>iii</sup> And if a military family does experience financial difficulty, it can be a long path to recovery due to lower than average pay, the near impossibility of service members to get a second job, and difficulties with spouses finding employment due to frequent moves.

But research also shows that this problem can be addressed with comprehensive financial education. The National Council on Economic Education reported that nearly 50 percent of the adult population receives a failing grade on basic economic knowledge. But it also noted that just 10 hours of financial education could improve spending and savings habits.<sup>iv</sup>

This booklet is intended to provide a reference guide to the fundamentals of personal financial management. Specifically, it focuses on how to get military families on a solid financial footing. Stressing both discipline and training, this guide was developed from 20 years of experience working with military families, and is aimed at helping them better understand their finances. The topics presented include:

1. **Everyday spending**—Knowing where the money is going is the first step.
2. **Emergency savings**—How to set aside money for unplanned expenses.
3. **Saving for the future**—Thrift Savings Plans and other long-term savings.
4. **Credit bureau**—Why scores matter and how to protect against identity theft.
5. **The cost of borrowing**—How to discover the true costs and break the debt cycle.
6. **Credit insurance plans**—Managing risks and controlling costs.
7. **Saving habits for children**—Good financial habits start early.
8. **Reading the fine print**—All the fees and costs associated with borrowing.
9. **Deployment issues**—How deployment and PCS can affect finances.

The goal is to provide complete, accurate and usable information so every military family can gain essential knowledge, be good stewards of their finances, and help those that serve focus on their primary mission. And by including the tools and resources to equip military families to act, real change can occur. Because information without execution is meaningless.

## MILITARY FAMILIES AND EVERYDAY SPENDING

*A Sailor and his wife were expecting their first child and he was concerned that if they didn't get their money matters together soon, they wouldn't be able to purchase a house. Using a Certified Credit Report Reviewer, they evaluated their credit report and highlighted several collections items that may have pulled down their credit score. The next step was a plan for paying off those small amounts, sacrificing a little bit now so that they could keep their "eyes on the prize" of a home down the line.*

*The couple elected additional Break the Debt Cycle information to get familiar with the various pitfalls and stumbling blocks that could derail their progress. The couple left with good information and the tools they needed to execute their plan.*

*But the most important thing they brought to the table was the motivation and ambition to see it through.*

The formula for financial success is actually quite simple: Earn more than you spend, create positive cash flow, and then save it whenever possible. While this may seem overly simple, it can be done if you follow some key steps to manage your day-to-day spending.

Before you can start planning how to pay for college tuition, a house, or retirement, it is important to define your current spending patterns. This will create a baseline that allows you to monitor progress and map a course to financial independence. From there you can set short-term, medium-term and long-term goals. You can then create a budget and, by practicing day-to-day fiscal discipline, achieve your goals.

### **Attitudes about budgets**

Budgets are not *only* for people who have lots of money or for those whose money doesn't run out each month. Budgets are for everyone, even those who seem to be committed to spending more than they make. All you have to do is deal with your finances and *take control of your money*, rather than ignoring them and having your money control you.

When you think of your budget, look at it as a tool to help you manage, control, and evaluate your spending and saving habits. There will be trade-offs, but budgets aren't just about sacrifice—they are about information, realizing where your money is going and translating that knowledge into the power to change financial behaviors.

### **Starting a budget**

The process of budgeting includes *tracking* your income and your expenses, and then *planning* on how to increase your income (if possible) and reduce your expenses.

The basic formula you need to keep in mind is: **Income - Expenses = Savings/Debt**

- **Income:** The definition of income is any regular payment you receive. Your income includes your base pay plus any other temporary pay you receive, such as hazardous duty pay, proficiency pay, sea pay, etc. These amounts all show up on the Leave and Earnings Statement (LES).

- **Expenses:** These are any and all bills you pay, including money set aside in a Thrift Savings Plan, child care, cell phone, Internet, and even food and gifts.

Begin your budget by adding up all sources of income each month. Then, add up your total expenses. The difference will tell you if you need to cut spending and/or increase income, or if you have some extra money to set aside for your medium and long term goals. When you are done, the finished product should look something like this:

<b>Income</b>	
Monthly net pay after all deductions	\$ _____
Supplemental Pay (BAH, Jump Pay, etc.; Note if temporary)	\$ _____
Other income (i.e. spouse's income; Note if temporary)	\$ _____
Interest and/or dividends paid in cash	\$ _____
Child support	\$ _____
Alimony	\$ _____
Other income	\$ _____
<i>Total Monthly Income</i>	\$ _____
<b>Expenses</b>	
Emergency Savings Account	\$ _____
Thrift Savings Plan	\$ _____
Mortgage/rent payment	\$ _____
Utilities (gas, electric, water, and sewage)	\$ _____
Home-related payments (e.g., maintenance and upkeep)	\$ _____
Auto loan/lease payment	\$ _____
Groceries and related home expenses	\$ _____
Dining Out Expenses	\$ _____
Entertainment expense related to fun and family	\$ _____
Gifts	\$ _____
Automobile expenses (e.g., gas and tune-up)	\$ _____
Credit card payments*(\$ planned to repay monthly)	\$ _____
Insurance payments (e.g., auto, home, life, and disability)	\$ _____
Travel or holidays	\$ _____
Child Care	\$ _____
Telephone	\$ _____
Clothes and personal items	\$ _____
Other expenses	\$ _____
<i>Total Monthly Expenses</i>	\$ _____
<b>Monthly Balance (Income minus expenses)</b>	\$ _____

There are a few hints to consider when formulating a budget:

- **Start slow**—Begin by focusing on a monthly budget to reach short-term goals. Once you have control you can become more aggressive in planning medium and long-term objectives.
- **Be realistic**—Do not over- or underestimate your income or expenses. It is better to have a little left over than to have your money come up short at the end of the month.
- **Include your entire regular expenses**—Remember to include bills that you pay annually, biannually, or quarterly. For example, if you pay your yearly car insurance in four installments of \$400.00 each, this would amount to \$133.33 per month [ $\$400 \div 3$ ] for your budgeting purposes.
- **Plan ahead**—Save an amount every month to cover annual, biannual and quarterly bills such as car insurance.

### Going from debt to savings

After you make your budget, you may find that you do not have the income needed to match your expenses.

Increasing income is one way to solve an unbalanced budget. But since active-duty service members cannot get a second job, and military spouses actually bring in less than their civilian counterparts, this can be difficult.<sup>v</sup>

The next option is to cut expenses, but you certainly do not want to give up everything you enjoy. If you do, you will not stick to your plan. So how can you make the decisions you must make without giving up everything else in the process?

You can start by following some simple, yet effective, spending strategies to alter your spending patterns

- **Save on groceries**—Save on groceries by planning ahead. If you make a list of everything you need at the store before you go you can save real money. Go through your refrigerator, freezer, cabinets, etc., and write down everything you need. *Then stick to the list!*

Clipping coupons is another great way to save money. If you save \$5 a week you are saving more than \$250 a year. If you don't get the paper, you can go online and print out all the coupons you want for free at [www.smartsource.com](http://www.smartsource.com).

Also, never go food shopping when you are hungry. You may wind up buying items that sound good while you're there, but you may not actually eat when you get home.

- **Build savings with a change jar**—Each day put your change into a jar and periodically visit your financial institution and deposit the money into your savings account. For the more aggressive savers, put one-dollar bills into the same jar and accelerate the saving process.
- **Buy Used**—Did you know that a car loses an average of 20 to 30 percent in value the day you drive it off the lot? A 3-year old car with low mileage can save you

60 percent on the price of the car. For example, a brand new Mustang GT Convertible is over \$28,000; but after three years it could be purchased for less than \$12,000. At only two years old, expect the depreciation to be 25 to 75 percent of the original sticker price.

- **Pay cash, or finance smart**—When buying a car, try to pay cash. However, if you do need financing, be sure it is a short-term installment loan to minimize interest costs.

Some may say that financing a new car is less expensive due to lower interest rates. But if that new Mustang (\$28,000) is financed at four percent, and the used one (\$12,000) is at 14 percent, the monthly cost of the new Mustang is \$842 and the used one \$394. By buying used you save almost \$450 a month, which is money that you can use to pay off debt or put toward savings.

- **Adjust your insurance**—The average person submits a homeowner's or renter's insurance claim only once every 11 years, and an auto insurance claim every four years. Based on the real risk and the premiums you pay, it is a lot cheaper for you to have a higher deductible and a lower premium.

Here is an example of the insurance premiums for the Mustang financed above. With a good driving record, a \$100 deductible will cost about \$175 a month. By raising your deductible to a reasonable \$500, the monthly premium goes down to about \$140. This is a savings of about \$35 a month or \$420 a year.

- **The IRS can be your friend:** The average American family pays 38 percent of its total income for all taxes every year, which is more than they pay for food, shelter, and clothes. So it is important to look for ways to minimize overpaid taxes.

Use amended returns if you discover prior year overpayments. If you owe the IRS, don't send payment until it is due. And if the IRS owes you, file early. The goal is to get your money working for you sooner.

Also, review your LES for accuracy—many people select the wrong number of exemptions or dependents. If you get a big refund in April you should consider giving yourself a monthly pay increase by altering your exemptions.

There are a number of different tax advantages for service members. While you should visit a tax professional familiar with the military to get more information, the Military Family Tax Relief Act of 2003 provides some key provisions:

- **Death benefits**—the \$12,000 survivors benefit (up from \$6,000) is tax-free.
- **Dependent care**—Clarifies that assistance programs for military personnel are excludable.
- **Combat Zone extensions**—Allows filing extensions for tax payments.
- **DoD Homeowners Assistance**—Payments after Nov 11, 2003, are excludable from your income.
- **Deduction for overnight expenses**—Reservists more than 100 miles from home may deduct non-reimbursed travel expenses from their taxes.

- **Military academy attendees**—The 10 percent tax on Coverdell Education Savings no longer applies.
- **Sale of Residence**—Those on extended duty may suspend the 5-year ownership-and-use period for up to 10 years.

The bottom line is that well-organized tax records and efforts to educate yourself about tax strategies could improve your annual savings.

### **Budgeting savings**

Part of any spending plan includes saving money, and the entire concept of saving is to “**pay yourself first.**” This means that you set extra money aside for your future before you go and make a “want” purchase, such as new rims for the car or that latest video game system. Think about the financial implications for every purchase and consider how those same “wants” could be converted into long-term wealth.

If you aren’t already there, once you get to the point at which you have a positive monthly balance, put money into a savings plan. Since military pay is usually below that of the civilian sector, paying bills first and then finding money to save while avoiding “wants,” such as fast food, electronics, or auto accessories, seems virtually impossible for some military families.

The key is to be disciplined and stick to your budget. Many families benefit from the discipline of a budget, especially writing down their income and taking the time to define all their monthly expenses. Many also quickly realize how quickly \$5 and \$10 purchases add up.

#### *Short-term savings*

The first step is to develop an emergency fund for those unexpected expenses that can wreck your budget. Even if you only pay yourself \$20 a month, do so before you spend anything on leisure activities or buy something new. Doing so prevents you from having to use a credit card or other financing when you need car repairs, emergency travel home, or have unplanned bills.

#### *Medium-term savings*

Next, consider any large purchase coming up in the next 5 – 10 years. Will you need a new car? New furniture? A down payment for a home? Start putting money aside in an interest bearing, yet easily accessible account to help offset the cost. You may not be able to set aside enough to cover the entire purchase, but you can get closer by putting a few dollars away now.

#### *Long-term savings*

Last, look at options for long-term savings—preferably a tax-deductible, tax-deferred Thrift Savings Plan offered by the military. What makes this type of plan a good way to save money is the power of compounding interest: When interest earned is added back to the account, rather than paid out to you, the interest itself earns interest. This is the best way to earn money quickly.

While thinking about retirement may seem pointless when you are young, a little money put aside now quickly adds up:

- \$1,000 spent on new rims today could turn into \$17,449 in a 30-year TSP.

- \$6 spent on a weekly six-pack of beer could turn into \$153,043 over 40 years in a TSP.
- Two fast food meals a week could turn into \$91,173 in 30 years in a TSP.
- A \$7,500 reenlistment bonus could turn into \$130,871 in a 30-year TSP.

These numbers not only show the power of compounding interest; they also show that cutting out a little here and there adds up over time if the discipline learned in the military is applied to money management.

Starting a savings program earlier is always better. The following chart shows the power of compound interest when someone puts either \$50 or \$100 per month into an account or investment that offers a 10 percent rate of return:

Start saving at age	Save this amount/month	Amount saved at age 65	TSP Value at age 65
18	50	\$28,800	\$581,395
25		\$24,600	\$295,426
35		\$18,600	\$110,213
18	100	\$57,600	\$1,162,791
25		\$49,200	\$590,854
35		\$37,200	\$220,426

For illustrative purposes only. Figures are based on a 10% rate of return.

The key to any long-term strategy is to start early. While rates of return are important, saving early and often are the most achievable, high payoff behaviors. No matter the rate of return, the longer the money has to earn interest, the more money will be there when it comes time to retire.

Many people neglect to save and wind up with tremendous debt, poor spending habits, and have to work well past retirement age. This is even more troublesome for military families because financial issues can distract a service member from his or her duties. But with a workable plan, the discipline to stick to that plan, and a few changes to your spending and savings habits, you can reach financial independence.

## MILITARY FAMILIES AND EMERGENCY SAVINGS ACCOUNTS

*Several months ago a young military family used a Debt Management Loan to pay off several of their credit cards and started putting money away toward some emergency savings. During a follow-up call with the spouse, she was so thankful for the help. Since they had been putting away \$100 per month in an emergency savings fund, she was able to withdraw the money she needed to fly home to Idaho when her father had a stroke. Instead of having to “beg, borrow, and plead” to get the money, she had the available funds right there, was able to purchase the tickets online that night and fly out two days later.*

One of the most important steps for financial independence is being prepared for unexpected bills. And the best way to do that is to create an Emergency Savings Account (ESA). This is important because it prevents you from having to finance car repairs, a trip home to see family, or other expenses.

### **The need for an ESA**

In a 1999 survey of active duty military personnel, service members were asked if they had any financial difficulties within the last year. Some of those difficulties included:

- Bounced two or more checks
- Fell behind in paying rent or mortgage
- Fell behind in paying a credit card, AAFES, or NEXCOM account
- Pawned or sold valuables to make ends meet
- Borrowed money from friends or relatives to help with a financial difficulty
- Borrowed money via Emergency Loan Assistance Program or a Service Aid Society
- Had utilities shut off
- Had a car, household appliances, or furniture repossessed

More than half of the E1-E4 ranks reported having one or more of these and other difficulties, and 40 percent of E5 and E6 ranks reported the same. But having an ESA could have easily solved the problems listed above.

### **Determine the amount of your ESA**

Deciding how much to set aside is unique to each family—there is no hard and fast rules to determine how much is needed. Some experts have recommended a flat \$1,000, while others have recommended three to six months living expenses. Regardless of what you choose, consider the minimum amount needed to pay all of your family’s bills for at least two months should all sources of income become unavailable.

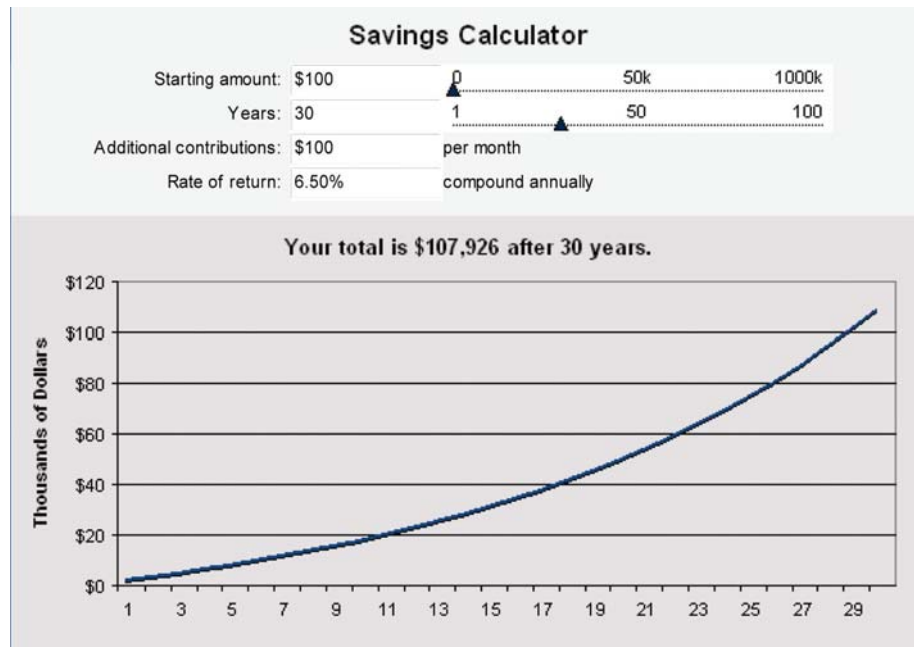
One of the few rules that everyone agrees on is to “pay yourself first.” This means savings comes first, before the bills are paid, before the groceries are bought, before the vacation is planned. But where do you find the money? Where are the hidden savings?

There are a few tips that can save you money almost every day:

- Save on groceries by planning ahead and clipping coupons; it can save you \$250 a year.

- A “change jar” can net \$100 or more each year.
- Pay cash whenever possible to save yourself thousands in interest.
- Increase insurance deductibles and potentially save hundreds each year.
- Eliminating two fast food meals per week could save more than \$500 each year.
- Deposit your reenlistment bonus in your ESA, thus building it quickly.

If you saved \$100 per month, and earned a 6.5 percent rate of return, you could turn that money into more than \$100,000 in 30 years:



These tips are only the beginning—there are many ways to save enough money each month to prepare for your financial future, so think of creative ways to find extra money each month.

### Deciding on the type of account

Since your ESA needs to be readily available, you need to put the money into an easily accessible account. Bear in mind that you should look for an account that pays you interest, has no penalty for early withdrawal, is insured or guaranteed, and is easily accessible for emergencies. This can include passbook savings, money market accounts, money market mutual funds, Treasury bills, or Certificates of Deposit.

No matter what type of account you choose, consider making the deposit via allotment. Doing so makes the deposit automatic and is a key part of the “pay yourself first” philosophy.

With adequate emergency savings, you can focus on how to best meet your family's needs, rather than worrying about finding the money to handle difficult financial situations. Once an ESA is established, your family can apply those same savings habits toward longer-term investments or Thrift Savings Plans, and start down the road to financial success.

## **MILITARY FAMILIES AND THRIFT SAVINGS PLANS**

*No matter the rank, some individuals still need financial education. A Gunnery Sergeant and his wife traveled 3.5 hours to a trusted financial advisor for lending help and participated in Break the Debt Cycle (BDC) training. The Gunnery Sergeant and his wife had just received a nice tax refund, and decided that paying cash versus a loan would be better for them. The reason was clear: the Gunny hoped to retire in a few years and he never started a Thrift Savings Plan. The BDC training was so helpful the family drove back to base and set up his Thrift Savings Plan to the max of 10 percent.*

There are many ways to have income after retirement: Social Security, interest from investments, and a Thrift Savings Plan (TSP) or 401(k) plan are just a few. While many experts say that you'll need 60 to 80 percent of your pre-retirement income in your retirement years, the truth is that your spending could equal or exceed pre-retirement levels depending on debt, mortgages, medical or insurance costs, and quality of life objectives.

Many military families leave the military with no retirement pay or benefits. They re-enter the civilian world much earlier than planned and less financially independent than they had hoped. For those that do retire with pay, they sometimes have to find other work to pay off debt and live the way they want. And even then they must remember that Congress can change military retirement pay and benefits.

As long as the family has defined what they want to do after retirement, and can minimize and maintain a reasonable level of debt, they can set out a solid savings plan. These planning efforts are essential to have a firm grasp on what is needed to retire in comfort.

### **Military retirement pay**

It used to be simple for military families to calculate retirement pay—with 20 years of service you received 50 percent of your base pay immediately upon retirement. If you put in more than 20 years, then you received 2.5 percent more for each year of active duty past that point, up to 75 percent of your active-duty pay. But now it is a little more difficult due to the “High-36” or “High-3” rule.

For example, a service member who entered the military after September 8, 1980, and served 22 years, would receive 55 percent (50 percent plus 2.5 percent for each years past 20) of the *36-month average* of his highest base pay (which would usually be the last three years).

That formula may seem a bit confusing, but the point is that retirement income would only be 55 percent of what it was before. It also would not include other active duty pay, such as housing, food allowance, family separation allowance, bonus payments, and other such income. Because of these factors, it is vital to have other sources of income.

### **TSP Basics**

The TSP is a federally-sponsored retirement savings and investment plan that allows military families to set aside money pre-tax, which is similar to a 401(k) plan in the civilian sector. As a “defined contribution” plan, the retirement income received from a

TSP account will depend on how much you contribute and the earnings on those contributions.

#### *Putting money in*

While you can technically contribute from one to 100 percent of any pay (except housing, food, etc.) into your TSP, the IRS does have dollar limits on how much can be contributed each year. Also if you receive tax-exempt pay (i.e., pay that is subject to the combat zone tax exclusion), contributions from that pay will also be tax-exempt, even when withdrawn.<sup>vi</sup>

Contributions are made by allotment and, since they are taken out before taxes are deducted, can actually reduce the total amount of tax you pay.

#### *Taking money out*

There are many ways to get money out of a TSP account, and the tax laws regarding such withdrawals can be quite complex. But there are three common ways to take money out before retirement, and each one has its own financial consequences.

- **Transfer**—When you leave military service, you can simply transfer the money to a civilian employer’s qualified retirement plan, into an Individual Retirement Account (IRA), or leave it in the TSP (as long as you start withdrawing the money by age 70 1/2).
- **Loan**—You can get a loan by borrowing the money out of your TSP account. You will have to pay interest on the loan, as well as a \$50 fee. It’s also important to remember that the money borrowed will no longer be in the account, meaning that it is not earning interest and contributing to retirement.

Taking out a loan against a TSP account is relatively easy to do, but there are some guidelines. In general, as long as you have at least \$1,000 in individual contributions and interest, are still in the military, are “in pay” status, and have not finished paying another TSP loan within 60 days, then you can get a loan.

- **Withdrawals**—You can withdraw money from an account before retirement, but there are a number of factors to consider.

First, the money withdrawn is taxed immediately, thus eliminating the tax-free savings. Secondly, there is a 10 percent penalty for taking the money early. Both of these can have a dramatic impact on the amount of money received when making an early withdrawal.

You must also remember that *the money cannot be replaced*. The TSP Web site states, “When you make an in-service withdrawal, you are removing money from your account forever. It **cannot** be put back or repaid to your account.” The site also points out that if “you make a financial hardship in-service withdrawal, the overall impact can be even greater because you cannot contribute to the TSP for 6 months following your withdrawal.”

#### **Start early, save often**

While it’s almost never too late to start a retirement or savings plan, the earlier the better. The reason for this is the power of “compound interest.” Compound interest is

when the interest earned in an investment is put back into that investment. This way, the interest is itself earning interest and increasing your savings quickly.

For an example of the power of compounding interest, take the following chart. It shows the difference in starting a retirement plan at various ages, the amount set aside each month, the total contributed over the course of the account, and the total value of the account by age 65. The rate of return is 10 percent, which is the average annual increase in the stock market.

<b>Age</b>	<b>Monthly allotment</b>	<b>Total saved</b>	<b>TSP value</b>
35	\$50	\$18,600	\$110,213
25	\$50	\$24,600	\$295,426
18	\$50	\$28,800	\$581,395

As you can see, starting even a few years earlier can make a dramatic difference in how much you will have in retirement. The difference is even more dramatic if the amount is increased to \$100 per month:

<b>Age</b>	<b>Monthly allotment</b>	<b>Total saved</b>	<b>TSP value</b>
35	\$100	\$37,200	\$220,426
25	\$100	\$49,200	\$590,854
18	\$100	\$57,600	\$1,100,000

As the figures show, compounding interest can grow relatively quickly. And just a few years can mean all the difference between retiring somewhat secure, or retiring as a millionaire—the earlier in life someone saves, the less they can invest and the more they can get due to compounding interest.

### **How to enroll**

The Defense Finance and Accounting Web site has a section where service members can sign up and select TSP contribution amounts. For more information visit [www.dod.mil/dfas](http://www.dod.mil/dfas) and [ww.tsp.gov](http://ww.tsp.gov). You can also test TSP planning with many financial calculators on the Internet, including [www.pioneerservices.com](http://www.pioneerservices.com).

Also, remember that all of the services have formal programs to help families successfully transition from military service to the civilian sector. These programs are available at every installation, are staffed with experienced career counselors, and have resources to help plan the transition from active-duty to retired status. Every retiring service member can benefit from these services.

## **MILITARY FAMILIES AND THEIR CREDIT BUREAU**

*A Soldier was turned down for a car loan request, but wanted to learn more about his credit report. He found several charged off and collection accounts and one loan that was not his.*

*His first action was to contact the prior creditors and work toward a payoff or settlement. Then he worked with the credit bureau to remove the debt that was not his. Soon he and his wife both deployed to Iraq, but continued to pay on the old accounts, eventually paying them in full.*

*Returning from Iraq, the family was surprised to learn that none of those debts had been updated by the credit bureau; they sent proof to the bureau and submitted dispute letters—including a customer statement reflecting their side of the dispute. All this effort resulted in great news: the military family was approved for a \$260,000 home—their long-term dream! And all because they kept up with their credit report.*

Today's global economy and information highway create and retain huge amounts of information about you. Because of this, your credit report is now an essential part of your livelihood. This information is currently warehoused by three major credit bureaus—Trans Union, Experian and Equifax—and their reports create your credit “reputation,” so to speak.

### **Credit score basics**

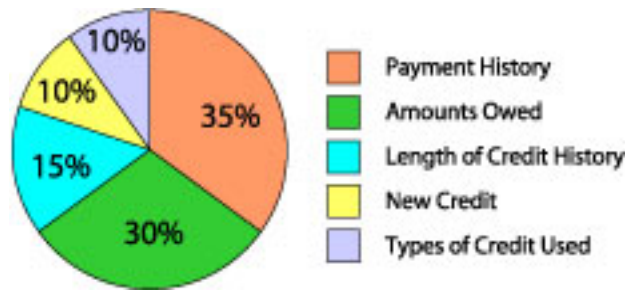
A credit score is a method of determining the likelihood that credit users will pay their bills. Fair Isaac & Company (FICO<sup>®</sup>) developed this method in the late 1950s and, since then, scoring has become widely accepted by lenders as a reliable means of credit evaluation.

A credit score attempts to condense a borrower's credit history into a single number. The credit bureaus do not, however, reveal how these scores are computed, and the Federal Trade Commission has ruled this to be acceptable.

Developing these models involves studying how millions of people have used credit. Through this process they have developed a scoring system that indicates future credit performance. At one time, a consumer could have had three different scores (one from each bureau), but now each bureau combines their score with the scores from the other bureaus to provide a simplified and consolidated number.

### **How scores are determined**

While the specific calculations are unknown, some of the research suggests that payment history, the amount of debt, and the type of debt you owe primarily determine FICO scores.



The score also considers other factors, such as:

- Late payments
- The amount of time credit has been established
- The amount of credit used versus the amount of credit available
- Length of time at present residence
- Employment history
- Negative credit information such as bankruptcies, charge-offs, collections, etc.

The end result of the model is a single number or score, which typically determines the interest rates an individual can obtain.

With a typical age of less than 25, multiple addresses in a short period of time and limited income, one can see how a military family might be at a disadvantage—since these all negatively affect a score, service members and their families often have artificially low scores.

### **Knowing your credit score**

The basic thing to remember about your score is the higher the better. While scores originally went from 350 to 850, all three bureaus have announced a program called VantageScore. To simplify the process and help consumers better understand their score, the new scores will be grouped based on the familiar academic scale:

- A - 901-990
- B - 801-900
- C - 701-800
- D - 601-700
- F - 501-600

Borrowers with “A” credit will be eligible for the lowest interest rates, while those with an “F” will pay high rates, or might not even be able to get credit at all. It can be very confusing, but scoring models will remain as a cornerstone for evaluating credit worthiness.

### **Credit scores and risk-based pricing**

As noted, credit scores are used as a way to gauge risk, with the lower score being the higher lending risk and the higher score being the lower risk.

The simplest way to understand this prime, non-prime, and sub-prime model is to compare car insurance premiums to interest rates.

<b>Higher Risk Insurance</b>	<b>Higher Risk Loans</b>
First time driver	Inexperienced Borrower
Speeding ticket	Late payments
Minor accident	Charge off loan
DWI	Bankruptcy

At age 16, auto insurance is very expensive (sub-prime) due to the extreme risk. If the driver avoids problems (tickets, accidents, etc.) he can expect to be rewarded with lower insurance costs after age 25 (non-prime). If he further avoids problems, and as he gets older, the costs drop even lower (prime).

The defined risk for the insurer is directly attributed to lack of experience and the probability of a claim for the inexperienced or bad driver. Similarly, the type of interest rate you earn is attributable to your credit history—if you have paid your bills late or not at all, or eventually went bankrupt, then your ability to obtain a lower interest rate (or obtain credit at all) is negatively impacted.

### **Analyzing your credit report**

Knowing what is in your credit report is the first step toward building and maintaining good credit. Doing so allows you to avoid some of the problems that can arise.

#### *Incorrect information*

The three bureaus do not always contain the same information, so one may have an incorrect account, another may not reflect an accurate payment history, and another may have the wrong address. Each of these can negatively affect your credit score, so it's important to review each of the three reports at least once a year.

Incorrect information can be disputed and the credit bureau is required to investigate the matter within 30 days, remove any incorrect information, and notify any institution that has made a recent inquiry. In some cases you are allowed to have the bureau post a 100-word statement in your report explaining the nature of your dispute.

Correcting this information is vital because your credit information can stay with you for up to ten years. Items from collection agencies, missed payments, and court records (such as bankruptcy, liens and judgments) all stay on your credit history for seven years. In other words, businesses will view the credit choices you make today for years to come, even after your military career. This means good credit decisions and correct information are very important.

#### *Prevent identity theft*

The latest threat to your credit comes from theft. Identity theft occurs when someone obtains enough of your personal information to acquire credit in your name. And unless you check your report at least once a year, you may never even know it has happened until you get a call from a bill collector.

You can avoid identity theft by guarding your personal information and routinely auditing your credit bureau for accounts you did not open. If you find any, immediately

notify the credit bureau and the creditor to begin an investigation into the fraudulent account.

With over 41 million credit and identity theft victims and counting, military families are encouraged to verify the accuracy of their credit bureau and make sure it only contains their information. Working with certified professionals—the front line of defense in the fight against credit and identity theft—military families can repair their credit bureau information and thereby improve their FICO scores.

Remember that ensuring your payment history is reported correctly is *your* responsibility, so make sure to check it at least once a year. You can obtain a free copy each year by visiting [www.annualcreditreport.com](http://www.annualcreditreport.com). Also, the Federal Trade Commission has excellent information about identity theft at <http://www.consumer.gov/idtheft/>.

### **Credit scores and the military market**

There are a number of factors that can negatively affect a military family's credit and lead to an incorrectly low score. Frequent moves, deployments or TDY can result in shorter durations at a single location and lead to multiple credit relationships in many cities. Relocation can also lead to poor credit histories, as bills get lost in the shuffle of the move. In addition, many retailers and small loan companies in military communities do not report to a credit bureau, so a very positive history is never contained in the FICO score.

The truth is, no matter what models or scores are used, the military families with the best money management habits will have a better chance of getting credit and at a lower cost. The following are some suggestions that can improve your score:

- **Eliminate delinquent payments**—Pay bills on time and as agreed, and avoid bankruptcy.
- **Avoid frequent credit applications**—Inquiries themselves can lower your score.
- **Reduce credit-card balances**—Scores are lowered if you've borrowed the maximum amount, so pay more than the minimum to pay them off faster.
- **Choose the right company**—Avoid borrowing from companies that do not report your history to credit bureaus, and consider using specialty financial services companies that do not have FICO limits or rank restrictions.
- **Review your credit reports annually**—Keep close tabs and correct all errors.
- **Simplify bill paying**—Use electronic payment systems when available to avoid unnecessary delinquency due to unexpected deployment or extended training.

The key thing to remember about your credit score is that it is used for many different purposes—the price for credit, getting a job, security clearances, and even auto insurance can all be based upon your score. As long as you keep close tabs, minimize negative information, and take control of your finances, you and your family will have an easier journey toward financial independence.

## **MILITARY FAMILIES GUIDE TO BORROWING MONEY**

*A Sergeant brought four separate revolving credit cards to the table with true interest rates ranging from more than 19 percent to 27 percent. The Sergeant was making minimum monthly payments on all four debts. When he learned how to calculate the long-term cost of staying the current course, the service member realized that his current balances of \$5,186 would end up costing over \$46,289 to fully repay, and would have taken over thirty years to do so.*

*With that powerful and eye-opening educational experience, he was ready to take action. By paying off those revolving credit cards with a single and responsible installment loan, the Sergeant could repay the debts in just 30 months. The total payback of \$8,080, including all interest and disclosed fees, saved him more than \$38,208.*

When expenses exceed your income, the negative cash flow either reduces savings or creates debt. But before taking on any type of debt, make sure it is necessary and, if so, only get what you actually need.

One rule of thumb is that debt should not exceed 20 percent of your take home pay. Another way to handle debt is to set a threshold—for example, no more than 40 percent total debt ratio (all debts divided by take home pay). The key is to know how much debt is reasonable and set a plan to give yourself a better chance of paying it.

Without debt management experience or proper debt planning, a family can soon find themselves in a spiral of debt. Whether it's making minimum payments on your credit cards, having to take out a payday loan, or taking your valuables to a pawnshop, being stuck in the debt cycle can cause damage for years to come.

### **Avoid the debt cycle**

To determine if your family is in the debt cycle, ask yourself a few questions:

1. Am I depleting my savings or emergency cash fund?
2. Am I making minimum payments on my credit cards, versus paying in full?
3. Am I using payday loans to get cash for my regular monthly bills?
4. Am I being charged overdraft fees on my bank account?
5. Am I being charged late payment fees on any loan?

If you answer “Yes” to any of these questions, there is a good chance your family is currently in the debt cycle. In order to get out of it, there are several key things you should know about borrowing money.

### *The true cost of borrowing*

Using credit or debt to pay for purchases is a fact of life in today's economy. Before you're caught in a financial crisis, however, it's worthwhile for you to learn how to accurately evaluate various lending options. Why? Because all loan options are not the same. In the haste of the moment, when you're desperate for cash, you may not be paying enough attention to what a loan is *really* costing you.

One way to compare different types of borrowing is comparing interest rates or annual percentage rates (APR). The problem with doing so is that the *term*, or length, of the loan is just as important in figuring out the actual *cost*.

For example, a 90-day \$300 loan at 34.95% is often seen as a bad decision, while borrowing \$300 at a cost of \$17.34 is a much better deal. The problem is that these numbers represent the same loan.

So what happens when you need that \$300 right away and there are no friends or family members to lend you the money? Do you use a credit card cash advance? A signature loan from a bank, credit union or finance company? A cash loan from an instant check-cashing store or payday loan operation? How do you know which option is best?

The answers are not so simple, because there are many factors that play a part in the decision: availability, likelihood of approval, convenience, confidentiality, disclosure of proposed loan terms, and of course, whether the loan is fairly priced. For example, borrowing \$300 for two weeks at a cost of \$20 may be a good deal if done once, but a horrible decision if renewed every other week for 12 months.

An analysis of mortgage interest rates is a good example of how the length of the loan determines its true cost. If you had two choices for a mortgage with different rates, you may be tempted to go with the one with the lower rate. But if you only planned on being in the home for three years, the higher interest loan (8.5%) plus points (one point is equal to 1% of the principal loan amount) is actually “cheaper” than the lower interest loan (8.00%).

<b>Rate</b>	<b>Points</b>	<b>APR at:</b>	<b>3 yrs.</b>	<b>5 yrs.</b>	<b>7 yrs.</b>	<b>10 yrs.</b>	<b>15 yrs.</b>	<b>30 yrs.</b>
8.50%	1.5		9.53%	9.15%	8.98%	8.85%	8.75%	8.66%
8.00%	3.5		10.44%	9.52%	9.12%	8.82%	8.59%	8.38%

The point is, you cannot just focus on rates and fees alone when determining the real cost to you, especially when borrowing over a short period. The term of the loan must also be considered.

### **Know the disclosures**

There are several laws designed to help you better understand the fees and other costs associated with obtaining credit.

- The Truth in Lending Act and Regulation Z (TILA)—Passed by Congress in 1968, TILA provides a uniform manner of calculating and presenting the terms of consumer loans. It mandates specific disclosures that enable you to compare costs in order to help you make informed credit choices.
- The Consumer Credit Act of 1974—This law developed APR calculations in order to provide a standardized formula for determining loan costs. Today, APR disclosures must comply with the Truth in Lending Act and Regulation Z, which means the total cost of a loan must reflect interest charges, loan fees and points.
- The Fair Credit and Charge Card Disclosure Act—This was passed in 1988 to further ensure uniform disclosure of rates and costs.

The last law required all issuers of credit (including banks, credit card companies, and loan companies) to provide consumers with disclosures that must be provided with applications and pre-approved solicitations:

- The APR charged for purchases made on credit, cash advances or balance transfers.
- How the APR is determined and whether or not it is variable.
- The method the issuer uses to compute the balance for purchases where a finance charge is imposed (calculating an average daily balance or using the outstanding balance at the beginning of the billing cycle are examples of such methods).
- The amount of any type of annual fee.
- The amount of any minimum or fixed finance charge that could be imposed.
- Any transaction fee, whether a specific dollar amount or percentage, for purchases.
- Transaction fees for cash advances, and fees for paying late or exceeding the credit limit.
- The amount of any fee imposed to transfer an outstanding balance.
- Whether there is a grace period, and if so, its length.

While these disclosures are helpful, they still may not reflect the true cost of credit. Consider a \$100 loan for 14 days, with a \$25 fee. The disclosed annual percentage rate is 651 percent. This may seem like an excessively high interest rate, but the reality is simply the \$25 cost. A bank might charge you the same \$25 if you “bounced” a check. This bank fee does not require a TILA disclosure, but if you calculated the APR, it would exceed 3,000 percent.

Make sure you read all the disclosures and know what fees you may be charged in the future so you are not hit with any surprise costs.

### **The truth about credit cards**

Comparing the true cost of a credit card can be conflicting and confusing, and much has been written to better educate consumers about the true nature of credit card debt.

Beyond interest rates, fees, grace periods, and balance calculations, a recent concern has been minimum payment amounts and the length of time for full repayment. Elected leaders, non-profit organizations and businesses have recently begun education efforts to help consumers better understand costs associated with long-term credit card debt.

To highlight some truth about credit cards, take three examples:

- If you had \$1,000 of credit card debt at 12 percent interest, and only made the minimum payment of four percent of the balance, it would take you 74 payments—more than six years—to pay off. During that time, you will have paid nearly \$300 in interest.

But if you had a fixed rate loan for the same amount—even at 30 percent interest for 12 months—you would have only paid \$169.85 in interest.<sup>vii</sup>

- If you had \$2,500 of credit card debt at 17 percent APR, and only made the minimum payment, it would take you 119 months (nearly 10 years) and cost you nearly \$1,300 in interest.
- And if you owed \$5,000 at 17 percent interest, you would make payments totaling \$7,665 over 145 months (12 years) if you only made the minimum monthly payment.<sup>viii</sup>

You can find out how many years you will pay on your credit card debt by using the online calculators at [cardweb.com](http://cardweb.com) and [bankrate.com](http://bankrate.com).

Another way to look at credit cards is to analyze where your payment actually goes. If you had \$5,030 of credit card debt and just made the minimum payment (\$100 per month) your payments wouldn't actually be going to pay off your purchases:

Category Applied To	\$100 Payment	What's Left
Late charges	\$15	\$85
Unpaid finance charge	\$28	\$57
Fees (over limit fee, returned checks etc.)	\$10	\$47
Outstanding balances previously billed (ex: \$1,000)	\$47	\$0.0
Current cash advances and purchases.	\$0.0	N/A

In this example, a \$100 payment didn't even touch the cash advance and purchase balance. Late fees, over the limit fees and other finance charges ate into the payment so much there was little to nothing left. This is the reason a consumer who only makes minimum payments can spend years paying off credit cards.

These types of “hidden costs” are also why political leaders have begun looking at options to place more controls on lending practices. Some of the legislative proposals would require a credit card issuer to provide cardholders information about the length of time it will take, at various payment rates, to pay off the balance.

### **The truth about payday lending**

According to the Center for Responsible Lending (CRL), 91 percent of all payday loans are made to borrowers with five or more payday loans per year—on average, they receive 8 to 13 payday loans from a single payday lender—while only one percent of all payday loans are made to one-time emergency borrowers. And most payday borrowers go to more than one lender, dramatically increasing the number. A 2004 CRL study noted that one in five (20 percent) military families used a payday loan service.

A typical payday loan—\$300 to \$500—is due in full on the following payday. A military family that borrows \$300, yet is not able to pay it off at the end of two weeks,

will find themselves paying another \$45 to \$60 each time they roll it over. According to CRL, the average \$325 payday loan results in total payback of \$800.

The fact is, when one looks at the true costs, payday loans are simply not a financially sound way to borrow money.

THE TRUE COST OF BORROWING: PAYDAY LOAN vs. INSTALLMENT LOAN		
TYPE OF DEBT	PAYDAY LOAN	INSTALLMENT LOAN
Initial Amount	\$500	
APR	730%	24%
Monthly Payment	\$650 due in two weeks	\$89.26 per month
Total Interest/ FEES Paid	\$150	\$35.56
Total Amount Paid	\$650	\$535.56
Time to Pay OFF	Two (2) weeks, but is "rolled over" into another loan if not paid off in two weeks.	Six (6) months with no rollover allowed

This chart is for illustrative purposes only. The actual payments, interest rates, and dollar amounts you may owe on similar debt may be different than the numbers listed here. The laws regarding payday lending vary from state to state, so the amount you owe may vary depending on where you live.

One of the main issues with this type of lending is “rolling over” or “flipping” because of an inability to repay. This can start you and your family on a financially dangerous cycle of debt.

Most cash-strapped borrowers who get payday loans are not able to repay the whole loan within two weeks, and end up rolling over their loan and paying renewal fees multiple times. Trapped on this “debt treadmill,” military families typically pay much more in fees than the amount they originally borrowed.

The key question that every military family in a financial emergency should ask: “If I don’t have the \$500 today, what are the chances I’ll have the money in two weeks?” If the answer is “slim to none,” the rollover cycle is bound to begin.

**Protect yourself from predatory practices**

In the past few years, the subject of predatory lending has become more visible than ever and usually refers to easy-to-get loans that are intentionally structured to be deceptive and hurtful to borrowers. Predatory lending practices often involve high interest rates, allow for unrestricted rollovers and lack any consideration of the borrower's ability to repay. Customers who fall victim to such practices quickly find themselves in a seemingly endless cycle of debt.<sup>ix</sup>

One thing to note is that predatory lending is a “practice,” not a characterization of a particular type of financial institution or where the institution is located. A common belief is that predatory lending to military personnel is an “outside the gate” issue created by small or unscrupulous lenders. That belief is, in fact, false. These practices can also occur in big banks and credit unions, including some that operate on military installations. Location is irrelevant.

But according to Community Financial Services of America, the trade group that supports the payday lending industry, the subject of predatory lending isn’t so simple as to say that payday loans are predatory and other forms of credit are not. Fees on services from many institutions can be higher, and therefore considered “predatory,” but are often overlooked. Consider the APR comparisons in the following chart:<sup>x</sup>

<b>Transaction</b>	<b>APR*</b>
\$100 payday advance with \$15 fee	391%
\$26 late fee on a \$100 credit card balance	678%
\$48 Non-sufficient Fund/Merchant fee on a \$100 bounced check	1,251%
\$50 late/reconnect fees on a \$100 utility bill	1,304%

\*Calculated on a 2-week term

Using this data, it is easy to see that predatory lending isn’t simply a practice that is associated with a particular institution or where that institution is located. If a service member pays his utility bill late, or has his services disconnected for late payments, the fees (when calculated as an APR over a two week period like a payday loan) are astronomical—and this is from a utility company, not a so-called payday or predatory lender.

The Center for Responsible Lending has a similar treatment of the data, but depicts the term for one-month versus a two-week period.<sup>xi</sup>

<b>Transaction</b>	<b>Fees/Month</b>	<b>APR</b>
\$255 payday loan	\$90	391%
\$255 bounced check	\$43	202%
Late fee on \$255 credit card bill	\$30	141%
Late fee on \$800 mortgage	\$32	48%
Late fee on \$600 rent payment	\$30	60%
Late fee on \$300 car payment	\$15	60%

No matter which set of data you rely upon, the simple fact is that many financial practices can be painted with the so-called “predatory practices” brush. A financial institution on a military installation charges late fees and overdraft fees just like those not

on the installation. Again, predatory lending isn't a result of the type of institution or its location, it is the "practice" that determines its characterization as "predatory."

In recent years the number of industries and institutions involved with predatory products or practices has increased. For example, in May 2004, the Federal Reserve ordered a unit of Citigroup to pay \$70 million for abuses in personal and mortgage loans to low-income and high-risk borrowers. The Federal Reserve said that the company engaged in "unsafe and unsound" practices by converting personal loans into home equity loans without adequately assessing their borrowers' ability to repay.<sup>xii</sup>

More recently, the Federal Reserve has approved amendments to regulations for bank and credit union programs that are sometimes called "bounce protection," "courtesy protection" or "overdraft privilege," and are promoted as ways to cover a bad check for a certain amount of time. Consumer advocates view these fees of \$20 and more as disguised loans because banks are charging triple digit interest rates.

While called "protection" or "privilege," one could argue that these overdraft privileges are identical to a payday loan advance, but are presented as a benefit, rather than a true loan. They are also easily obtained using an ATM card, credit card or automatically when your account is overdrawn.

Many states are examining optional regulatory solutions, most related to either full disclosure or APR limits for certain transactions. It is clear that their focus is on predatory lending practices while not curtailing sub-prime borrowing opportunities to those who might not otherwise qualify for loans.

Proposals are also being made to specifically protect military borrowers, with a proposed Anti-Predatory Lending amendment to the Service Members Civil Relief Act of 2004.

Robert Litan, vice president and director of economic studies at the Brookings Institution, in his report to the American Bankers Association, suggested several ways for policy makers to address problems posed by predatory practices.

- Require all lenders (even payday lenders) to disclose the extent and nature of their lending, as well as the interest rates of their loans.
- Provide education and counseling that enables consumers to make proper use of financial information.
- Enact laws that prohibit excessive loan terms and conditions.
- Encourage other lenders to offer programs that give borrowers with questionable credit more choices when seeking credit.

All of these solutions can help curtail the ever-growing predatory practices facing you and your family.

### **What to ask when borrowing money**

When you have to borrow money, you should ask all of the right questions, insist on full disclosure, and know the true costs and terms to ensure that you are making an informed decision. Without complete information, what looks like a good deal may in fact be a bad one.

- **Are you getting full disclosure?** A quality lender will tell you up-front about the interest rate and APR, as well as any fees associated with your loan. A predatory lender most often will not.
- **Does the company calculate your debt ratio?** If they don't, they are not checking to see if you can truly re-pay the loan.
- **Does the company review your credit report with you?** This will ensure its accuracy and identify all past and current debt obligations.
- **Does the company report your payments?** Your best chance to improve your credit score is to prove you can pay your obligation on time and in full. If the company doesn't report positive payment information to a credit bureau, it could be predatory.
- **Does the company offer financial education?** Make sure the company you are working with has a goal of having better-educated, long-term customers who can successfully manage their finances.
- **Does the company always say "Yes" to every loan request?** Make sure the company you are working with does not approve all applications. Ask the company what approval rates they have for first term enlisted families.

These questions can help ensure that you are fully informed and are making the best choice for you and your family. And if military families structure their debt and the repayment plans in a disciplined manner, they can limit borrowing cost and avoid a debt cycle.

## MILITARY FAMILIES GUIDE TO CREDIT INSURANCE

*A petty officer second class was losing vision and was being medically discharged. He had a loan and had purchased Accident and Health credit insurance. He filed an A&H claim and the insurance company is now making his payments. This product helped this family deal with this stressful time in their lives.*

There are two schools of thought when it comes to credit insurance. The first includes consumer advocate and talk show host Clark Howard who, in 2005, said that consumers should not “buy into these credit insurance plans” because “they benefit the company, not you.” The other, backed by the Consumer Federation of America<sup>xiii</sup> and the U.S. Public Interest Research Group<sup>xiv</sup>, says that consumer credit insurance is a good product in the correct situation.

In reality, credit insurance itself is neither good nor bad—it is the way in which it is sold, and to whom it is sold, that makes all the difference. For the right person, it can be a way to avoid debt after the loss of a loved one, or a lost job, or becoming disabled. For the wrong person it can be a poor financial decision.

You need to know the different types of credit insurance coverage, the limitations of such coverage, and some tips to use when shopping for any type of insurance. Having this knowledge is part of a sound financial strategy, and can help ensure that you are focused on the job at hand instead of your family’s finances.

### **Credit insurance basics**

Credit insurance is often sold with a credit transaction, such as a loan or credit card, and is intended to serve as a safety net. Typically added to your monthly payment, the policy will make monthly loan payments if you or your spouse is temporarily disabled or unemployed, or will pay off the entire loan balance if one of you dies.

There are four basic types of credit insurance coverage:

1. **Credit Life**—Pays off the debt if the borrower dies.
2. **Credit Disability**—Pays all or part of a borrower’s monthly loan payment should the borrower become disabled.
3. **Involuntary Unemployment Insurance**—Pays all or a part of a borrower's monthly loan payment in the event the borrower loses income as a result of involuntary unemployment.
4. **Credit Property Insurance**—This type of coverage applies to the item(s) offered as collateral while obtaining a loan or other credit product, or that you purchased using credit. This insurance usually does not cover mobile homes or real estate.

### **Determining need**

Whether or not you need credit insurance depends on a number of different factors. If you do not have other insurance coverage or alternate sources of income or savings, you may find credit insurance products useful. The California Department of Insurance notes that it will depend on the current level of insurance coverage, the flexibility of that

coverage, and future income potential as to whether or not credit insurance is a good financial decision.

The key is to assess your family's financial situation and insurance coverage before making a decision. Service members have insurance provided through Servicemember's Group Life Insurance (SGLI). While this coverage is often enough, you should ensure that it would cover current debts since your bills would not go away because of death or disability. You may also want to consider what will happen once you leave the military and whether or not coverage will still be adequate.

### **Always optional**

Credit life, disability, and involuntary unemployment insurance is optional coverage. A lender cannot require enrollment as a condition for receiving credit. The one exception may be items used for collateral—depending on state laws; some lenders may require insurance on the item. This does not mean that you must purchase the lender's product. Alternatively, you may provide proof of insurance that lasts throughout the term of the credit transaction.

The Truth and Lending Act of 1968 requires the creditor to provide a written disclosure of the cost and notification that the purchase is voluntary and not a factor in the decision to extend credit.

Just remember that credit life, disability and involuntary unemployment insurance is all completely optional. So if you feel pressured into purchasing any type of insurance, if the seller is not answering your questions to your satisfaction, or if you have any doubts, do not buy it.

### **Military issues**

It is important that any policy you buy has no "acts of war" exclusions. Many policies will not pay out if you die or are disabled because of an act of war, so read the fine print to make sure you are purchasing appropriate coverage.

Moving around often can also affect how much you initially pay and the limitations offered by credit insurance coverage. This is because each state has different rules and maximum allowable rates. Some rates can even vary according to the type of lender.

If you buy a policy over the Internet, the laws of the state in which the company operates will dictate the terms of the contract. Make sure to investigate the company and know in which state they do business—the difference between companies can mean the difference of hundreds of dollars for the same amount of coverage.

### **Consumer attitudes**

According to the April 2002 Federal Reserve Bulletin, in 2001, more than 90 percent of installment credit users with credit insurance indicated a favorable attitude toward the insurance.<sup>xv</sup> Furthermore, about nineteen in twenty purchasers of credit insurance said that they would purchase it again. The favorable perception focused on the security or sense of security it provided. Those with an unfavorable perception focused on the cost and absence of any need for more insurance.

Assurant Solutions companies are leading providers of credit insurance and administrators of debt protection programs. In July 2005, the company commissioned Opinion Research Corp., to conduct a survey to determine what consumers want in debt

protection and the primary drivers behind purchases of credit insurance and other debt protection programs.

“Our research found that anxiety – concern over events that could affect one’s ability to make monthly payments – was the main catalyst for interest in debt protection programs,” said Gary Bursevich, senior vice president for Assurant. “The top causes of consumer anxiety are unemployment, followed by death, disability and hospitalization.”

### **Helpful tips**

Before buying credit insurance, you should consider a number of different factors:

- **Know the cost**—Since credit insurance can be included in the price of a credit transaction (i.e. added into a personal loan or mortgage), make sure that all fees and costs of the insurance are disclosed in any paperwork.
- **Know the limitations**—When buying disability coverage, check for any waiting periods or pre-existing condition requirements.
- **Compare**—There can be differences in the flexibility and cost of the benefits between credit insurance and traditional life and disability insurance. Know what each type of policy offers in order to make an informed purchasing decision.
- **Review exclusions**—Make sure that the policy will pay out if you die or are disabled because of an act of war.
- **Ask questions**—If there is anything about the coverage that you don’t understand, keep asking until you completely understand what you are purchasing. If you do not get the answers you want or understand, ask someone else or do not buy the coverage.
- **Find a reputable provider**—Always investigate the company offering the insurance. Find out how long they’ve been in business, if they are a member of the Better Business Bureau, and their levels of customer satisfaction.
- **It’s always optional**—Remember that lenders cannot condition a consumer loan on whether or not you purchase credit life, disability, or unemployment insurance. It should always be listed as an optional item.

“If you live paycheck to paycheck, can’t qualify for traditional insurance and have no savings, credit insurance can provide an important safety net,” Bursevich said. “For young families with limited assets, this coverage can provide valuable protection with few limitations.”

## TEACHING MILITARY CHILDREN ABOUT MONEY MANAGEMENT

So when should you teach kids about money? According to the Institute of Consumer Financial Education, as soon as your child can count. Research shows that the sooner a child learns how to budget and save, the more likely that child will retain those habits well into adulthood.

But understanding the concept of money doesn't come naturally to a child. To help children grasp the idea of spending and saving, give your child an allowance, set clear expectations, and offer guidance.

### **Allowances**

If you give your child an allowance, she will have to make choices regarding money. Deciding how much and how often your child receives an allowance will depend on the age of your child and how much you are willing to spend.

Younger children have shorter attention spans and usually have more spontaneous purchases such as candy or small toys. However, an older child might prefer the flexibility offered by a larger sum less often in order to buy bigger items or to save for future events. Weekly, biweekly and monthly are all options.

It is recommended that the allowance amount is not so low as to be unreasonable but not so high that your child doesn't have to make choices about how to spend his money. If a child gets too much and is not exposed to making tough decisions about purchases or the need to save for weeks or months to make a special purchase, no financial training is taking place.

Remember, an allowance is a tool to teach children about money management, not about chores. The theory is that at some point the youngster may refuse the chore if the money is not immediately needed. Therefore, it should not be payment for chores done around the house like mowing the lawn or washing dirty dishes. If you choose to pay your child for doing tasks outside of what is normally expected, then consider the task as a way to earn extra funds.

One suggestion to combat this problem is creating a “base allowance” similar to military base pay. This is given without condition in order to teach spending, budget and saving. If the child wants to “earn” more money then the parents can create work lists or chores that the child can perform to earn more money—much like specialty pay. Like specialty pay, the child should know in advance the amount of compensation and a complete list of the work to be done. Beyond teaching work habits, this is a great opportunity to expose the family to real life experiences.

As the children mature, an effective allowance program can even build other life skills:

- Savings will encourage long term planning—even if it is for a pair of expensive jeans. Suggest a minimum of 10 percent of your child’s allowance for emergencies and another 30 percent for future plans like travel, education or even charity.

- Comparison shopping defers emotional purchases and allows children to begin making more choices on their own.
- Annual allowance reviews continue the teaching process and can create negotiating skills. She may be asking for a raise, and you can then negotiate what new expenditures will be covered and what amount of the raise will go to savings.
- Ownership breeds more responsibility—buying a video game increases the likelihood that he will take better care of it. And if it gets lost, he will have to spend his money for a replacement.
- Open a bank account or savings account and visit monthly about how to balance the register(s). You might even consider a separate account for holiday savings.
- Young teenagers might be ready for debit cards if they have proven an ability to budget and monitor spending patterns. Debit cards should not be linked to their savings accounts.
- Credit cards should be reserved *only* for those that who may need emergency access to money. This might be a great time to teach features and pitfalls of credit cards or you could consider a pre-paid debit card for emergencies.
- By the time your child reaches driving age, you should have discussed an insurance program, as well as other expenses related to driving, such as gasoline, oil change, and even tickets and accidents.

The most important lesson at this phase is teaching your children to budget for items they need and planning for items they want. If they spend all their money before the next “payday” it is essential not to help them by giving them a loan. Remaining consistent is essential to teaching children about delayed gratification and how to avoid the “gotta have it now” mentality. Teach them to live within their means.

### **Expectations**

Financial management is successful when there is a balance between living for today and saving for the future. In order to guide your child in their choices, encourage them to save for big-ticket items.

Have your child put 10 percent of each dollar into a glass jar each week. On the jar, write "Bike" or "Trip." Your child will enjoy watching the money accumulate while she saves for the future purchase.

Even though young children may be interested in only purchasing candy bars and bubble gum, the freedom to make those decisions will benefit them as they grow up. They can then assume more responsibility for budgeting for needs like clothes, books, school lunches, etc. The result of this type of financial education is that by the time they are sixteen, they have been trained to put together a budget and are fully self-sufficient in the management of their finances.

### **Guidance**

Make sure you educate your child on the different forms money can take. Look inside your wallet and you'll find a variety of options: coins, dollars, debit cards, credit cards,

and checks. Eventually, your child will ask about these, so be prepared to tell him how these forms of payment work.

Through all of these steps—an allowance, explaining expectations, and providing guidance—remember to let your child learn on his own time, concentrating on guiding and not on pushing. Also, remember to have fun. You'll have the most success if you maintain a fun atmosphere that encourages your child to learn.

## MILITARY FAMILIES AND READING THE FINE PRINT

While a checking account, debit card, ATM card or credit card are often seen as harmless financial service products, they may be more expensive than you think—the ad may say “free checking” or “low interest,” but there are often hidden costs that you didn’t notice.

Military families are encouraged to ask more questions when obtaining any type of financial service or product, remembering that if it seems to be too good to be true, it probably is. You have to look for things like:

- Minimum balance requirements
- All of the fees they may charge
- Overdraft charges
- Unplanned rate increases
- Rate increases due to late payments with another creditor.

All of these surprises can be eliminated if you read the fine print and adjust how you will use these financial products.

### Checking Accounts

Since military families relocate frequently, it is common for them to have a checking account from their hometowns, or where they enlisted. However, selecting the best checking account requires knowing your checking account habits. Selecting the wrong account or institution can result in unexpected costs.

- **Minimum Fees**—The first question you should ask is whether or not the bank or credit union has rules about minimum balances. While free checking is advertised, it is often related to a minimum balance. It is not uncommon to find a minimum amount to open the account and an average balance requirement to avoid monthly fees.
- **Bounced Checks/Insufficient Funds**—The next question is the cost of “bouncing” a check and insufficient funds fees. Insufficient funds fees can average more than \$25 per returned check, which doesn’t include the additional costs imposed by the retailer or merchant cashing the check. Then there are excessive transactions fees, stop payment fees, etc., associated with such a mistake.
- **Overdraft Protection**—You also have to ask unique questions for accounts with overdraft protection. A recent example involved a service member who went to his ATM and requested \$20. Despite the fact that he only had \$10 in the account, the ATM gave him the money. The account was then charged \$17.50 for that overdraft protection. So make sure that you know the cost of such a transaction.
- **ATM Fees**—ATM fees are another consideration. Some institutions charge fees at their ATM’s, and when you withdraw from an ATM not owned by them, you can expect a “foreign ATM fee.” These surcharges can average nearly \$1.50 and can be as high at \$4 per transaction.

## Credit Cards

Credit card solicitations appear in your mailbox, and the offers look tempting. But then you find that you are charged unexpected fees, or discover that your interest rate isn't what you anticipated.

First is the legal reality. When you signed up for the credit card you were warned in advance. While the font may have been small or the details hidden in pages of disclosures, they did technically inform you that they could raise interest rates, shorten grace periods or unilaterally change the relationship for their benefit.

Here are some of the details you might want to investigate before getting a credit card:

- **Variable Rate or APR**—The initial rate offered may increase after an introductory period or when they increase their “base rate.”
- **Grace periods**—The original disclosure, or periodic updated disclosure, defines the number of days before interest is charged on a new purchase. If the grace period for making payments is 28 days on the initial offer, then you know when to pay your bill to avoid extra interest and fees.
- **Late Payments**—Beyond basic fees like \$25 for late or returned payments, the credit card issuer could automatically raise your interest rate if you miss two payments or are late twice. This can even happen on another card you own, but were not late in paying—this is called “universal default,” where a late payment on one account can raise the interest rate from another company.
- **Over Credit Limit**—You are charged this fee if your balance exceeds the approved credit limit. So if you had a \$2,000 credit limit and, during a PCS, charged enough to make the total \$2,020, you could expect a fee. This fee could be \$10 to \$20 in addition to the other costs related to the card and purchases.

Checking accounts are useful, and in the world of the Internet, both credit cards and debit cards are almost necessary. Selecting the right account and the right organization, however, is vital to paying only what you should. And to do that, you have to read the fine print and avoid all excess—and in some cases predatory—fees.

## MILITARY FAMILIES AND DEPLOYMENT OR PCS

Since military life can be hectic due to deployments and frequent moves, it is vital that you prepare yourself to handle such stress. It is also important that you prepare your finances for the wide range of issues that will inevitably arise.

### Deployment

Before you are deployed, it is important that your family's financial and personal affairs in order. The following represents a "to do" list for service members who receive deployment orders.

#### *Administrative*

You should start by getting some administrative tasks out of the way:

- **Defense Enrollment Eligibility Reporting System (DEERS)**—It is your responsibility to verify DEERS enrollment for your family prior to deployment. This will ensure that your family can receive medical care while you are deployed. To confirm enrollment contact DEERS at 1-800-538-9552.
- **ID Cards**—Check the expiration date of all ID cards prior to deployment. If the cards expire prior to the end of the deployment, contact the appropriate personnel office to initiate the paperwork.
- **Service Record**—Check the pages of your service record to ensure that the contact information is correct. An incorrect phone number can delay a response in the case of an emergency.
- **Contact List**—This is actually composed of two parts. The first is to compile a precise list of agencies, businesses, and units that can assist your family. Also, make sure your family knows how to get in touch with you in case of an emergency. The second is for you to take items that make it easier to contact family and friends back home. This could include a voice recorder (tape or digital), stationery, stamps, an address book, and e-mail addresses.
- **Red Cross Notifications**—If your spouse needs to contact you in case of an emergency while you are deployed, the Red Cross is often the most efficient and rapid way to do so.
- **Spouse Relocation**—If your family is going to relocate during deployment (perhaps to a hometown or closer to family), it is imperative that command is notified with new contact numbers and addresses. In addition, if you live on post, you will need to notify the housing authorities in advance of your move.

#### *Legal*

There are a few key legal documents that make deployment much easier on your family.

- **Power of Attorney**—There are several different types of Powers of Attorney:
  - *General Durable Power of Attorney*—This is a general grant of authority that authorizes your spouse to act on your behalf in financial affairs. It can be revoked at any time and usually takes effect immediately unless otherwise stated in the document.

- *Health Care Power of Attorney*—This document takes effect if you or your spouse becomes incapacitated and is unable to make medical decisions on your own, as determined by one or more physicians.
- *Limited Power of Attorney*—This document is intended to grant you a limited amount of authority with regard to one or more matters. For example, you may give your spouse the authority to make withdrawals from a specific bank account in order to pay bills, but receive no other form of authority.
- **Wills**—The military will assist you with a General Will and Testament. However, you might consider creating a Living Will and Ethical Will.
  - In a Living Will, both you and your spouse can state wishes regarding future health care in case one or both of you become incapacitated and are unable to share your wishes. This includes whether or not you want a feeding tube inserted or removed, or if you do not want doctors to use “extraordinary” measures to keep you or your spouse alive.
  - An Ethical Will is a letter that expresses feelings on common themes such as personal and spiritual beliefs, values, life's lessons, forgiving or asking for forgiveness, and love. This information is then shared with family and friends in case of death.
- **Servicemembers' Group Life Insurance (SGLI)**—Each active duty service member is eligible for life insurance, which is available in increments of \$10,000, up to a maximum of \$400,000. Before deployment, verify beneficiaries and make changes as necessary.

### *Financial*

Once administrative and legal issues are under control, you can then start focusing on financial issues your family will face during deployment.

- **Policies and Benefits**—Spend a couple of hours going over insurance, investments, and benefits, as well as the location of the policy documents. Be very clear about your wishes, take time to explain the details, and make sure you write down your desires for future reference.
- **Tax-Free and Hazardous-Duty Pay**—Your spouse may start receiving \$400 to \$500 more each month due to hazardous-duty pay. This is a good opportunity to build up savings or pay off outstanding debt. Decide what you want to do with these funds before deployment. Then create a plan and follow through with it.
- **Financial Obligations**—Review your monthly budget, and contact creditors to ask about paying bills by allotment or Electronic Funds Transfer (EFT). It may also be easier to pay bills online, rather than by mail.
- **Direct Deposit**—Direct deposit is the fastest and most convenient way to receive pay while your spouse is deployed. By utilizing direct deposit his pay will be automatically credited to a checking or savings account. For more information check with your bank or credit union.

- **Bills**—Before deploying, make sure all bills are ready to be paid. Depending on how you do your family finances, a power of attorney may be necessary so that your or another family member can make payments. Also, be sure to inform your creditors, banks and any investment representatives of your spouse's deployment.
- **Income Tax**—If your spouse is deployed when taxes are due, decide in advance how income taxes will be filed. You may wish to file for an extension through the Internal Revenue Service by filing *Form 2350: Application for Extension of Time to File U.S. Income Tax Return*, available at [http://deploymentlink.osd.mil/pdfs/tax\\_ext.pdf](http://deploymentlink.osd.mil/pdfs/tax_ext.pdf).

More information about how to prepare your family for deployment, visit <http://deploymentlink.osd.mil>.

### **Permanent Change of Station.**

When Permanent Change of Station (PCS) orders are received, your family is confronted with many significant changes. But proper planning will help avoid expensive out of pocket expenses.

#### *Before the move*

Thirty days in advance is a good time to start preparing your house, family and furnishings for the movers. Make sure if you have any changes in your orders that you contact the local transportation office.

While the carrier is responsible for packing and preparing your property—they must mark each box with a brief description of content, and provide you an accurate and legible inventory of your household goods—it's also a good idea to do an inventory of your valuable items. Start a spreadsheet that has all your electronics, CDs and DVDs, computer equipment, jewelry, etc., listed by manufacturer, model number, and estimated purchase date and cost. You can even capture it all in video or pictures, just so long as everything is easily identifiable.

If you have recently purchased anything, keep the receipt. This could save you leg work if it is lost or damaged. Carry them along with small valuable items, such as jewelry, and necessities like medical and dental records, pictures, etc.

Prior to the movers arriving, you should also do the following:

- Unplug all appliances
- Have original boxes near the item if available
- Dismantle all outdoor equipment
- Drain water from fridge, washers and other large appliances.
- Drain all fluids from lawn equipment
- Detach any brackets, curtain rods or storage equipment
- Take down pictures
- Remove personal property from the attic, crawl space, etc.
- Remove satellite dish
- Unplug all electronics
- Secure the items that are not being moved to another room and mark it as such.
- Keep an eye on all the packing that goes on to ensure nothing is forgotten

### *Watch your weight*

The military will use an estimated weight of all your possessions (excluding “professional” materials such as books, papers and equipment for work) to determine its cost. From a fiscal fitness perspective, moving “weight” that exceeds the authorized allowance can cost you out of pocket money. These charges could range from several hundred to several thousand dollars. In addition, the charges could come due months after your move.

If you receive an overweight notification check to make sure those items were credited to your total weight allowance. This should be listed as “PBP&E.”

### *Keep what you can*

Check with your local transportation office, but in many cases you can save a little money by watching what you throw out. While aerosol cans and liquids cannot be moved, spices and canned goods can, which can save you upwards of \$100. So if weight is not an issue, you may want to move these to your new home and save some money. And for things that cannot be moved, give them to a friend, or donate them to someone in need.

### *Entitlement programs*

Planning for your move also includes a thorough knowledge of the many entitlements that your family may be able to receive. There are several separate relocation entitlements for which you may qualify. Some entitlements are applicable only for moves within the U.S., some are for moves outside of the country, and some are for either. While the following can give you an idea of what is available, you should also ask your local finance office for more information.

- **PCS Per Diem Allowance**—Paid to reimburse your family for meals and lodging en route to the new duty station, this amount is the sum total paid per day. There are certain amounts for each family member depending on age, and can be advanced up to 80 percent of the estimated cost and is claimed on the travel voucher.
- **Dislocation Allowance (DLA)**—This is intended to help with all of those miscellaneous costs of moving, such as connecting utilities, paying deposits, and the like. DLA is not normally paid when you initially move. Instead it is paid when the travel voucher is filed after the move, although you can request an advance.

DLA is only paid once per fiscal year, even if your family moves multiple times. It is also not usually paid on a local move, nor if you are assigned to government quarters at the new duty station and are not accompanied by family members.

- **Monetary Allowance in Lieu of Transportation (MALT)**—This is also known as “mileage” and is intended to offset costs related to driving your vehicle to the new duty station. Paid by travel voucher, MALT may include up to two vehicles, and per mile rates will vary.
- **Mobile Home Transportation**—This applies when a commercial transporter moves a mobile home. Reimbursement includes carrier charges, road fares and tolls, permits and charges for the pilot car. If towed by a private transporter,

reimbursement is for actual costs. And for self-propelled mobile homes, reimbursement is at the regular mileage rate.

- **Temporary Lodging Expense (TLE)**—Only paid for moves within the U.S. and is intended to help pay the cost of lodging and meals while your family is staying in temporary housing. The ten day TLE limit can be divided between your last duty station and your new one.
- **Temporary Lodging Allowance (TLA)**—TLA is only paid for moves outside of the U.S., and covers up to 60 days for temporary lodging and meal expenses after arriving at a new overseas location.
- **Move-In Housing Allowance (MIHA)**—Only for moves outside of the U.S., MIHA is intended to pay for one-time rent related expenses, modification of homes for security reasons, and the initial cost of making a home habitable. MIHA is only available at certain locations.
- **Advance Basic Allowance for Housing (BAH)**—Receiving an advance on BAH requires commander approval, and is generally limited to three months within the U.S. and 12 months overseas. Remember that this is *not extra money; it is an advance* on the normal BAH and will be deducted from your monthly pay.
- **Dislocation Allowance (DLA)**—DLA can partially reimburse relocation expenses not otherwise reimbursed under other regulations.
- **Advance Pay**—If you absolutely need the money, you can get an interest free loan for up to 3 months base pay to help with moving. Typically paid back over 12 months, this should only be used in extraordinary circumstances.

It is also very important to keep all paperwork pertaining to your move; you may not be eligible for any reimbursements without the proper documentation.

To obtain more PCS information, visit [www.defenselink.mil/mapsite/relocate.html](http://www.defenselink.mil/mapsite/relocate.html).

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<sup>i</sup> Sgt. 1<sup>st</sup> Class Doug Sample, *DoD Campaign to Improve Financial Readiness*, American Forces Press Service, June 3, 2003.

<sup>ii</sup> Peter Tiemeyer, Casey Wardynski, and Richard Buddin, "Financial Management Problems Among Enlisted Personnel," 1999, RAND National Defense Research Institute, pg. 4

<sup>iii</sup> Ibid, pg. 16

<sup>iv</sup> "NCEE Standards in Economics: Survey of Students and the Public," Louis Harris and Associates, Inc., 1999, <http://www.ncee.net/cel/results.php?print=1>

<sup>v</sup> Margaret C. Harrell, Nelson Lim, Laura Werber Castaneda, and Daniela Golinelli, "Working Around the Military: Challenges to Military Spouse Employment and Education," Rand Corporation, 2004, [http://www.rand.org/pubs/monographs/2004/RAND\\_MG196.pdf](http://www.rand.org/pubs/monographs/2004/RAND_MG196.pdf)

<sup>vi</sup> <http://www.tsp.gov/uniserv/features/chapter13.html#sub10>

<sup>vii</sup> *Credit Card Calculator*, <http://www.cardweb.com/cardtrak/calc/payment.amp> and *The true cost of paying the minimum*, <http://www.bankrate.com/brm/calc/minpayment.asp>

<sup>viii</sup> Ibid.

<sup>ix</sup> *Anti Predatory Lending*, <http://www.freddiemac.com/corporate/initiatives/protection/predlend.html>

<sup>x</sup> *Comparison of payday advances to other forms of credit over the same two week term*, Community Financial Services of America, <http://www.cfsa.net/genfo/igeninf.html>

<sup>xi</sup> *Alternatives to payday lending*, Center for Responsible Lending, <http://www.predatorylending.org/payday/alternatives.cfm>

<sup>xii</sup> *Matter of CitiGroup, Inc. and CitiFinancial Credit, May 27, 2004*, U.S. Board of Governors of the Federal Reserve System, <http://www.federalreserve.gov/boarddocs/press/enforcement/2004/20040527/attachment.pdf>

<sup>xiii</sup> <http://www.consumerfed.org/pdfs/ltdbrochure.pdf>

<sup>xiv</sup> <http://www.uspirg.org/>

<sup>xv</sup> [http://www.findarticles.com/p/articles/mi\\_m4126/is\\_4\\_88/ai\\_85177358](http://www.findarticles.com/p/articles/mi_m4126/is_4_88/ai_85177358)