



## **Surviving the Financial Maze**

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Money can change one's life in a good way or bad way. Everyone wants to have money but not everyone knows how to use it responsibly. Many people use money and may do things to fit in or may succumb to pressure from others which results in financial disaster. However, if you are empowered with knowledge about how to effectively manage your money, you see things differently than everyone else. You are able to make the right decisions and understand that every decision you make today affects your future.

### **Abstract**

Being in debt provides insight into how you manage problems, deal with struggle and shows your true character. Francois Rabelais stated "Debt and lies are generally mixed together". Being in debt means you lied to yourself about what you could afford and the lie catches up to you when you receive your monthly credit card or loan statement. Many adults find it difficult to manage their money and use credit wisely due to lack of personal finance education and the easy lure to use credit cards. Educating yourself about personal finance is the best solution to managing your money. Personal finance education provides the tools and resources needed to prevent victimization by the credit card industry and minimizes the chances of having a financial crisis.

### **Problem**

The recession highlighted the impacts of the lack of individual financial education and the results of risky financial behavior. This type of behavior endangers individuals as well as the entire country. Consumers awareness of the consequences of their financial decisions will have an impact on their lives, future generations and substantially determine the future health of our economy.

Due to the presence of internet shopping, it is much easier to make purchases which can result in overspending and lead to filing for bankruptcy, foreclosure, repossession, judgments or liens. The fastest growing group filing for personal bankruptcy is adults aged 18 to 25. Over 1 million adults file bankruptcy every year and many due to medical debt. Over 1.5 million have filed for foreclosure this year. These statistics address the critical need for financial literacy and financial education. According to a University of Michigan report 1 out of every 5 families owes more on student loans, credit cards, medical bills, and other unsecured debt than they have in savings. According to the EBRI's 2012 Retirement Confidence Survey 60% of employees state the value of their investments and savings is less than \$25,000. According to Nerdwallet.com as of September 2012 credit card debt is the 3<sup>rd</sup> largest source of household debt.

The National Center on Economic Education (NCEE) performed a survey that examined adult understanding with basic economic principles, knowledge about the economy, and knowledge of some key economic terms. Of the 1,010 adults surveyed, adults received an average grade of 57% for their knowledge of basic economics. The study showed that education and an interest in economics translates into higher scores.

It is critical for adults to understand their options to solve their debt problems, and understand how their financial choices impact their future. If they are not properly educated about finances consumers will continue to experience personal financial crises and the country will continue to remain financially unstable.

Consumers who are in debt: are less likely to have access to credit, have lower credit scores, and are unable to obtain favorable terms when applying for credit. These consumers are also at an increased risk of victimization by predatory companies and scams.

This white paper addresses the financial options that are available to adults in debt, giving them the information they need to make informed decisions about their financial future.

### **Solution**

Financial success is not achieved by many adults because financial education concentrates on specific subjects and usually does not include basic money management skills. Former Treasury Secretary Paul H. O'Neill testified before the Senate Committee on Banking, Housing and Urban Affairs in February 2002 that "financial education can be compared to a road map to the American Dream. We need to teach all Americans the necessary skills to read that map, so that they can reach the dream".

Financial literacy encompasses many areas of personal finance including: budgeting, taxes, credit, retirement, saving and investing. Adults must be taught about personal finance including warning them of the financial pitfalls associated with obtaining financial products and services such as high fees and predatory lending that are a severe problem especially for vulnerable groups such as minorities and the elderly.

The following key factors can be used to assist consumers in debt:

- Supporting adults who have defaulted on student loans, other loans and credit cards and provide better legal protection.
- Provide relief for adults burdened with student loan and credit card debt.
- Provide free financial counseling services for adults to help them make better financial decisions and avoid going into debt in the future which will be available by phone, online and face to face. In addition, provide websites and help lines available to adults across the country.
- Provide a dedicated helpline to offer support and advice by licensed healthcare workers to help adults experiencing debt-related depression, stress and anxiety, or thoughts of suicide.
- Provide traditional and non-traditional medical services to help adults experiencing mental health problems, depression, stress and anxiety related to debt.
- Request congressional support to provide enforcement action against scams and companies that exploit adults in debt.

### **Payment Methods**

Once adults have received financial literacy education they must choose a method to pay their debt. The following is a list of six effective options that can be used to pay debt.

1. **Pay Debt** – Paying down debt is the best way to increase your credit score. The first step is stop using credit cards. Next, you should pay off all secured debt such as a car loan. Then pay as much as possible on the debt that has the highest interest rate and get current on any collection accounts. Stay current on all open accounts by making the minimum monthly payment. When the first debt is paid in full, use the same "snowball" strategy to pay the next debt with the highest interest rate. Another option to pay debt is to pay the smallest debts first then pay off the largest debts. Creating a budget in conjunction with creating a debt payoff plan identifies areas where spending can be reduced and helps to prioritize paying debt.
2. **Negotiate** – Negotiate with creditors to pay debt. If you cannot make the minimum monthly payments call your creditors and ask for a temporary financial hardship. Some creditors may setup a payment plan but are not required to do so. Creditors may require documentation to support your financial hardship request, and you may not be able to use the account after it is paid in full. Other options for repayment are to: pay the debt in full or settle the account for less than the full amount owed.

3. **Credit Counseling Agencies** - Credit counseling agencies maintain prearranged agreements with credit card companies to lower interest rates on existing debt and usually enroll customers in a debt management plan (DMP). The agencies collect a monthly fee and revenue from the credit card companies. The DMP may slightly reduce monthly payments and interest rates. Harassment from creditors is terminated upon enrollment in a DMP. Participating in a DMP may affect future approval for credit.
4. **Debt Settlement** – Debt settlement companies work on the clients' behalf to lower balances on existing debts. The company negotiates with creditors while the consumer saves money for the settlement through a monthly payment program. Companies charge a fee typically a percentage of the total debt owed or a percentage of the debt reduced. Monthly payments are usually less than the monthly minimum payments. Companies can only charge fees associated with debts that they actually settle. Creditors or debt collectors can take legal action for unpaid accounts during the settlement period. Debt settlement can lower your credit score.
5. **Debt Consolidation** – Debt consolidation combines multiple debts into one large loan. Debt consolidation services usually require making one monthly payment, which the consolidator then uses to pay creditors. One hundred percent of the debt is paid plus interest. Consolidation may provide a lower interest rate and usually requires collateral such as a car, home or other assets. Fees may be higher when using consolidation, may impact your credit score and may affect future approval for credit.
6. **Bankruptcy** – Bankruptcy should be a last resort. Bankruptcy requires financial counseling and requires a filing fee. Chapter 7 bankruptcy can eliminate most consumer debt except private student loans. Chapter 7 bankruptcy affects your credit score for up to 10 years. Chapter 13 bankruptcy develops a debt payment program over a period of 5 years, may reduce the total amount of debt owed and affects your credit score for up to 7 years.

Figure 1 compares the various debt payment methods.

	<b>Credit Counseling</b>	<b>Debt Settlement</b>	<b>Debt Consolidation</b>	<b>Chapter 7 Bankruptcy</b>	<b>Chapter 13 Bankruptcy</b>
<b>Monthly Payment</b>	\$300-\$1,500, \$0 if nonprofit	\$300-\$600 plus possible fees	monthly loan payment	N/A	N/A
<b>Annual Fees</b>	12-14%	Fee only if negotiation is successful	N/A	N/A	N/A
<b>Average Program Length</b>	3-5 years	2-4 years	varies depending on length of loan	6 months for approval	6 months for approval
<b>Total Cost</b>	Requires specific amount of debt owed	Requires specific amount of debt owed	Varies depending on loan fees and interest rate	\$2,000+ with lawyer, cheaper to self-file	\$1,500+ with lawyer, cheaper to self-file
<b>Risks</b>	Creditors may not agree to terms Credit score lowered, viewed negatively by creditors	Credit score lowered, creditors calls may continue, payments not made until initial fees paid and sufficient savings in account balance	Approval may be difficult, collateral used for approval	Credit score drastically lowered	Harder to file, credit score drastically lowered

Figure 1 - Comparison of various debt payment methods - Source: Freedom Debt Relief White Paper, 2010



Adults need adequate time to make payment arrangements for paying their debt without being harassed by creditors for payment. They can benefit from professional assistance in assessing their financial situation and communicating with their creditors.

This translates into more productive employees that develop innovative ideas and use leading edge technology to help advance the country and remain competitive in the global market. They can also serve as role models for future generations and provide knowledge that will help them avoid mistakes and reach their goals quicker than previous generations.

### **Summary**

The internet and social media make it easy to communicate and advertisers take advantage of this by flooding users with advertisements for every type of product or service. A lack of adequate financial education results in being in unnecessary debt. Owing debt increases problems and provides additional stress for college students and adults who may already be experiencing stress due to other issues.

Most adults wanting to learn financial literacy basics have to find the information on their own. Adults' knowledge of financial concepts and the tools they need to make decisions are extremely beneficial to their economic prosperity. Financial education involves learning basic financial concepts about managing money, and provides adults with practical information they need to make sound financial decisions. Financial literacy and education also helps to minimize our nation's rate of financial illiteracy.

According to Lenhart, 75% of adults aged 18-24 use social network sites such as Facebook, Twitter, and Flickr. Personal finance-related information can now be shared through social media.

According to Lusardi and Tufano, adults with low financial literacy are more likely to have problems with debt. According to Stango and Zinman, adults with low financial literacy are less likely to accumulate wealth and manage wealth effectively. According to Lusardi and Mitchell, adults with low financial literacy are less likely to plan for retirement. According to van Rooij, Lusardi, and Alessie, adults with low financial literacy are less likely to participate in the stock market.

The objective of providing financial literacy and education should include the following:

- Promote a better understanding of financial literacy.
- Increase knowledge of financial literacy topics.

- Recognize the warnings signs of a financial crisis.
- Learning how to survive a financial crisis.
- Learning how to plan for your future.
- Learning about lifestyles that can lead to financial prosperity.

NCEE states that ten hours of financial education can have a positive impact on adults. In the past decade more complex financial products have been developed. Some require more in-depth knowledge of financial literacy and economics to ensure they choose the right products and services for their financial needs.

The major benefits of providing financial literacy and education are:

- Adults will be able to make good sound financial decision when graduating from college.
- Employers will have higher productivity rates.
- Colleges will have more active alumni.
- Alumni will be able to make monetary donations to colleges.

Financially literate adults are able to make smart decisions for achieving their financial goals, whether that means financing a college education, starting their own business, buying a computer, obtaining credit, purchasing a home or planning for retirement. If adults are not properly educated about finances, they will continue to make poor financial decisions and experience personal financial crises which will have a negative impact on our society.

#### **About the Author**

Harrine Freeman is owner of H.E. Freeman Enterprises, a personal finance consulting company. Freeman has appeared in various publications such as Forbes, Wall Street Journal, Black Enterprise, Ebony, Woman's Day and Essence Magazines and NPR. She is the author of *How to Get Out of Debt: Get an "A" Credit Rating for Free*. Freeman is a freelance writer and has written several articles for various publications.