



BOBCAT PERSONAL FINANCE

HONORS THESIS

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By

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ABSTRACT

With the cost of living rising each day, one would assume that personal financial education would be a priority for any college student living in America. However, this assumption is often taken for granted by the majority of college students. In a survey conducted at Texas State University in the Fall semester of 2005, we found that:

- 50% of students have 1 to 3 credit cards
- 35% of these students do not know the interest rate on their credit cards
- Only 51% of the students surveyed follow a budget
- Around 75% did not have insurance or a cell phone account in their name
- 45% do not know which tax form they filed last year
- 89% of the students surveyed do not know their credit score

The sad reality for most students is that their financial education begins after being denied a loan or having to “take a semester off” from school due to financial difficulties. However, those students who are not in immediate financial danger are often the most ill-prepared to begin their own lives after college. Parents providing for their child’s education often do not realize that they are handicapping their child’s opportunity to learn about savings, budgeting and becoming a wise consumer.

Of the students surveyed, over half expressed interest in participating in a class on managing personal credit. Personal finance is a key issue involved with becoming independent. Because of the growing importance of credit scores, it is important for students to learn how to manage their credit.

Through this manual and the development of the Bobcat Personal Finance Program, we hope to better inform the Texas State student population about their personal finances and encourage the university to acknowledge the growing financial problems associated with young college students’ lack of financial education today.

The manual we have developed for our thesis contains information regarding various subjects related to personal finance for a college-aged student. We begin with a discussion of Student Loans, including the growing need for student loans in today’s society, options for students considering taking out a student loan. Following these sections, we discuss consolidation of student loans and student loan default, along with the consequences of allowing a loan to go into default status.

The next portion of our thesis discusses budgeting. It provides information on preparing a budget and tips and tricks for personal budgets. Characteristics of a successful budget, money management basics, and some basic information on the time value of money are also covered in this section.

We continue with discussion of consumer credit. The topic is defined, and the factors which make up a personal credit score are analyzed. We also offer tips for improving an individual credit score in this section. Items which are not included in the personal credit

report and the reasoning behind the use of personal credit scores follows. This section concludes with examples of benefits resulting from maintaining a good personal credit score.

Immediately following the discussion of personal credit scores, we discuss the factors involved in choosing a credit card based on individual need. This is followed with some tips for using credit cards effectively in order to follow a budget, avoid excessive debt, and build a positive credit history.

Because of the growing threat of identity theft, the next section of our thesis is dedicated to answering common questions regarding this crime, such as:

- How does identity theft occur?
- How do identity thieves use my information?
- How can I tell if I'm a victim of identity theft?
- How can I remedy the effects of identity theft?

From the discussion of identity theft, we turn to information on tax preparation. In this portion, we discuss the basic principles of federal income tax, the importance of record keeping, and how to determine how much you owe. We then provide guidance on tax credits, focusing on the two major education credits available; the Hope Credit and the Lifetime Learning Credit. We conclude this section with information of the various tax forms and some helpful links for additional tax advice.

The next portion of the manual defines insurance. Information on automobile insurance is presented, including bodily injury coverage and property damage coverage. Advice on how to manage automobile insurance cost is given next. Following the discussion of automobile insurance, health insurance is presented. Common terms in health insurance contracts and types of health insurance coverage are covered in this section. A brief discussion of disability income insurance follows.

The final section of our thesis presents basic information on sample employee benefits for once a student has graduated. Common retirement plans and health care plans are defined. Following this, a brief list of other benefits employees commonly offer is presented.

This manual is designed for a college student to gain insight into their personal finances. It is the hope of the authors that this information will contribute to more responsible financial planning for students of all academic backgrounds.

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With the cost of living rising each day, one would assume that personal financial education would be a priority for any college student living in America. However, this assumption is often taken for granted by the majority of college students because of several different factors:

The typical college student:

- Is completely insured by his or her parents (health, dental and auto)
- Does not pay for over half of his or her living expenses.
- Does not have a budget.
- Has never checked his or her credit score.
- Has no idea what determines his or her credit score.
- Has never filled out a tax return form.
- Has no idea how to effectively manage student (or any) loans/debt.
- Saves less than 5% of their after-tax income.

Students at Texas State University are similar to this demographic. In a survey conducted during the fall semester of 2005, we found at Texas State:

- 50% of students have 1 to 3 credit cards
- 35% of these students do not know the interest rate on their credit cards
- Only 51% of the students surveyed follow a budget
- Around 75% did not have insurance or a cell phone account in their name
- 45% do not know which tax form they filed last year
- 89% of the students surveyed do not know their credit score

The sad reality for most students is that their financial education begins after being denied a loan or having to “take a semester off” from school due to financial difficulties. However, those students who are not in immediate financial danger are often the most ill-prepared to begin their own lives after college. Parents providing for their child’s education often do not realize that they are handicapping their child’s opportunity to learn about savings, budgeting and becoming a wise consumer.

Unfortunately, undergraduate students are not exposed to the necessary amount of financial education to live a comfortable life in the first few years after their graduation, or even during their tenure at Texas State. In order to help remedy this

issue, the University will need to incorporate a personal finance course into every degree plan.

As it stands, the only personal finance course offered at Texas State is Finance 3325, which can be taken as a free elective and is offered only to business majors or minors. The curriculum and terminology is often lost on those without a finance background and business minors find themselves having a more difficult time with general class curriculum. By making a universal personal finance course requirement, students will undergo the necessary finance education to inform them of the personal financial issues they will be facing post-graduation.

Of the students surveyed, over half expressed interest in participating in a class on managing personal credit. Personal finance is a key issue involved with becoming independent. Because of the growing importance of credit scores, it is important for students to learn how to manage their personal credit.

Through this manual and the development of the Bobcat Personal Finance Program, we hope to better inform the Texas State student population about their personal finances and encourage the university to acknowledge the growing financial problems associated with young college students' lack of financial education today.



Student Loans



The Growing Need for Student Loans

The cost of attending college is rising. According to reports from the College Board, national public tuition rates have increased over 7% during each of the past five years. Legislation cutting government funding for higher education has caused students to depend more on loans instead of grants. At Texas State University in the spring semester of 2006, 65% of all financial aid distributed was in the form of loans. For the third year in a row, as total financial aid has increased, loans accounted for more of the growth than grants did. In the U.S., students received about \$129 billion in financial aid last year, 49 percent coming in the form of loans.

With this information in mind, it is essential for college students and their parents to seriously consider options for student loans. **Before taking out a loan for college, you should consider how much money you will need.** The cost of attending Texas State University for both Texas residents and non-residents in the spring semester of 2006 is presented here:

	Hours Enrolled per Semester			
	6	9	12	15
Texas Resident Tuition	\$756.00	\$1,134.00	\$1,512.00	\$1,890.00
Additional Fees	\$485.00	\$596.00	\$673.00	\$736.00
Totals	\$ 1,241.00	\$ 1,730.00	\$ 2185.00	\$ 2626.00
Non Resident Tuition	\$2,412.00	\$3,618.00	\$4,824.00	\$6,030.00
Additional Fees	\$485.00	\$596.00	\$673.00	\$736.00
Totals	\$2,897.00	\$4,214.00	\$5,497.00	\$6,766.00

When calculating the actual cost of attendance, there are factors other than tuition and fees.

- **Books and Supplies-** In general, for each class taken, the cost of books and supplies is around \$150.00. This expense can be reduced through purchasing used textbooks from the bookstores or finding textbooks online.

- **Room and Board** - Room and board is a significant cost for most students.

All unmarried students who are either under the age of 21 as of September 1st of that school year or who have completed fewer than 56 hours are required by the university to live in the dorm unless they are living at home with their parents. The cost of living in a dorm may seem considerable, but it has been found that social experiences gained are well worth the cost. Another benefit of dorm life is that utilities are included, so these additional costs do not need to be considered. Most dorms also include optional meal plans that allow the student to eat on campus and avoid the cost of groceries. The average cost of living in a Texas State dorm for one semester, including various options for meal plans, is summarized in the following table.

Room Charge	Utility Surcharge	Meal Plans	Board Charge	Room & Board
\$1,612.00	\$150.00	100 Block Meal Plan	\$895.00	\$2,657.00
		150 Block Meal Plan	\$927.00	\$2,689.00
		200 Block Meal Plan	\$977.00	\$2,739.00
		250 Block Meal Plan	\$1,043.00	\$2,805.00

If the student's parents live near the college the student will attend, then living at home can greatly reduce the cost of college for the family. Texas State will allow a student to live at a parent or legal guardian's permanent home, as long as it is within a sixty mile radius of San Marcos.

Once a student has either completed 56 hours or reached the age of 21, he (or she) is allowed to move off campus. Now items such as rent, utilities, household supplies, and other incidentals must be considered. Students with roommates save a significant amount each month on rent. Aside from rent, it is important to determine the cost for electricity, water/waste, cable, telephone, and incidental expenses, such as personal products, food, household products, and gasoline.

By setting a realistic estimate of these costs and following a budget, students may find that it is not necessary to take out the full loan amount available. Options other than student loans do exist; personal savings, part time jobs, and scholarship options do exist and should be considered.

A useful tool for determining the right amount to borrow is the Loan Repayment Calculator. Found online at www.collegeboard.com, this tool can calculate future monthly payments based on the average starting salary for the student's chosen profession. The higher the amount borrowed, the more future income will be required to make the monthly payments. Students should keep that in mind whenever considering how much they will borrow. However, when given the decision between student loans and paying for school with a credit card, student loans are the best option. They have lower interest rates and repayment plans tailored for recent college graduates. Careful management of funds and lower balances can make the repayment process much easier upon graduation.



Student Loan Options

If the decision is made to take out a student loan, there are several options available. As with any financial decision, it is important to compare loans before accepting a particular loan offer. Four key factors should be considered before taking out a loan.

1. **Interest Rate**: As with any type of loan, the lower the interest rate, the less money you will have to repay.
2. **Subsidized or Unsubsidized**: If you qualify for a subsidized loan, this is always the best option. With this type of loan, the government pays the interest that accrues while you are in school. This prepayment of interest will save a substantial amount of money during the repayment process. For an unsubsidized loan, you are responsible for paying back both the full amount of the loan and any interest that accrues during the life of the loan.
3. **Fees**: Many loan contracts have processing and origination fees. These fees may be taken out before you receive any money and can reduce the amount of cash supplied by the loan. Being aware of these fees can prevent overextension of loan money.
4. **Repayment Plans**: There may be several types of repayment plans and incentive plans for actions such as timely payments to choose from. These conditions can prove beneficial to the savvy borrower.

The type of loan with the best terms is the federal need-based loan. Need-based loans are especially attractive because they:

- Feature lower interest rates than other types of loans
- Do not require a credit check
- Do not require repayment while you are in school
- Government pays accrued interest until graduation or exit from school

In order to be eligible for federal student aid, you must meet a certain criteria. The following conditions must be demonstrated:

- Financial need
- GED or high school diploma
- Valid Social Security number
- U.S. citizenship or eligibility by a non-citizen
- Enrollment as a regular student
- Registration with Selective Service (if applicable)
- Satisfactory academic progress
- Updated personal information

If you qualify for this type of loan, there are three main options to consider:

- 1) **Perkins Loans**: These loans are awarded by the school financial aid office to students demonstrating the greatest need. No payment is due until graduation and these loans have very low interest rates.
- 2) **Subsidized Stafford Loans**: When this type of loan is approved, you are asked to choose a lender from a provided list. This lender will continue to loan you money throughout your college career unless a change in lender is requested. Repayment of this type of loan begins once you have graduated and your forbearance period (usually 6 months) has expired.
- 3) **Subsidized Direct Loans**: A direct loan is similar to a Stafford Loan, except the lender in this case is the federal government rather than a private company. As with the Stafford Loan, repayment usually begins 6 months after graduation.

If you don't meet the criteria for a need-based loan, there are still options. One of the factors used to determine need is the **Expected Family Contribution**. This amount is what you and your family are expected to contribute to educational costs. Factors involved include:

- Student dependency status
- Family size
- Income
- Assets
- Expenses
- How many family members are currently enrolled in some type of college

Often families cannot actually make the expected contribution, and a loan becomes necessary. The loan options for a family that does not qualify for need based loans are:

- 1) **Unsubsidized Stafford or Direct Loans**: These federal loan programs are similar to their subsidized counterparts, except for the fact that they are not need based. Because financial need is not involved, you are responsible for the interest payments. These annual payments may be made while you are in school or added to the balance of the loan. **Whenever possible, it is a good idea to pay the interest to prevent more interest accruing, leading to a higher overall balance.**
- 2) **Federal PLUS Loans**: This is an option for parents of college students. A PLUS loan allows your parent to borrow the full cost of attendance minus any other aid received. Once approved, the money is sent to you and repayment begins as soon as the money is paid to the college.

- 3) **Private Loans:** With more students borrowing money for college and the amount of federal aid not matching this demand, private loans have become a popular method for obtaining funds. While these loans are attractive options, there are important aspects to consider before using a private lender.
- Interest begins to accumulate at the time the money is received, so interest is added on for the duration of the time you are in school.
 - Many of the interest rates are competitive with federal loans, but it is essential to read the contract carefully. While rates may be “fixed,” it is possible that they are actually fixed to a fluctuating prime rate and can increase or decrease on a quarterly basis. What this means to you, as the borrower, is that you may have to pay a different amount of interest each 3-month period.
 - There is more flexibility in repayment, but the cap on repayment is 15 years, which is half the cap on federal borrowing. This seemingly small detail can dramatically increase the amount of your monthly payment in the end.
 - Private loans are not forgiven under any circumstances, unlike federal loans, which may be forgiven in the event of disability or death.

When considering a private loan, you should carefully examine the terms of the loan to avoid future problems.

Choosing the right student loan is an important decision for you and your parents. Once all options are considered, responsible financial planning and realistic budgeting can make the borrowing process much easier.



Consolidating Your Student Loans

Loan Consolidation: all student loans are lumped together and paid at the same time with a new, fixed interest rate

With the recent increases in the interest rate charged on student loans, loan consolidation may be an effective tool when it is time to repay student loans. You may benefit from loan consolidation but consider the following:

- 1) **Current Lender Rights:** If one company holds all of your student loans, it is required that you request to consolidate through that organization. Check your lender's website or talk to your loan officer to find out your options. If several institutions hold your loans, you may consolidate through any lender. You should select a consolidation lender based on the ease in application and incentives offered. Remember, some consolidation "lenders" are only marketing agents and not actual lenders. **Always ask for the name of the organization that will actually own your consolidated loan and investigate the company before agreeing to any contracts or giving out personal information.**
- 2) **Borrower Benefits:** Interest rates may be lowered through incentive programs offered by the consolidation provider. Such programs reduce the interest rate if you have your loan payments deducted from a bank account automatically or if payments have been timely throughout the loan's history.
- 3) **Grace Period Effects:** A typical federal loan offers a six month forbearance period before repayment begins. If you choose to consolidate during the grace period, repayment will begin immediately. If you wish to do this, you should weigh the benefit of a slightly lower interest rate locked in with the necessity of beginning repayment immediately. **To avoid this change in repayment, you may apply for consolidation during the grace period and request the lender delay the actual consolidation until the expiration of the grace period.**
- 4) **Monthly Payment vs. Total Interest:** With consolidation, you may extend the repayment term of the loan. This process will lower the amount of the monthly payment. This option may appear attractive; however **remember that by taking longer to pay off the loan, the total amount of interest paid will be significantly higher.**
- 5) **Perkins Loans:** The program that provides Perkins loans offers you many options that don't exist with other loans. Examples of these options include interest-subsidy deferment and loan cancellation programs for borrowers with extenuating circumstances. **Any benefit offered by the Perkins Loan Program can be lost if these loans are transferred to a consolidation lender.**



Student Loan Default

If, after nine months, you do not begin repayment as scheduled the loan may go into default. When a loan goes into default, the lender reports that you have not made the required payments.

There are many negative consequences to default, and it is crucial to avoid default at all costs.

There are many ways to prevent default and lenders are usually accommodating if circumstances arise and you are having trouble repaying a loan. Alternative financing options may be available, and there are procedures that delay and/or lower the monthly payments to prevent default.

The first step in preventing default is to be aware of the loan agreement. There are federal guidelines established to regulate repayment. The guidelines for federal loans are:

1. Payments are expected on a monthly basis
2. Minimum monthly payment is \$50 or the amount of interest owed on the loan if that amount exceeds \$50
3. Unless a shorter term is requested, the lender must give you at least 5 years to repay the loan amount
4. There will be no penalty for paying early, which you can do at any time
5. If you become permanently disabled or die, the loan obligation is cancelled
6. You may be eligible for graduated repayment (lower monthly payments while initially becoming financially stable) or income-sensitive repayment (monthly payment amount adjusted with annual income)
7. If you are a “new borrower,” the amount of time allowed to repay the loan may be extended
8. A forbearance period may allow you to put off payments during the first 6 months after graduation



Remember...

- **Careful consideration of the amount to be borrowed can proactively prevent default. Through avoiding excessive borrowing, you can keep student loans at a reasonable level.**
- **Keeping the lender informed of changes in situation allows the lender to establish a more secure relationship with you.**
- **By making payments on time, you not only establish a positive history with the loan institution, but build your credit rating.**

Consequences of Student Loan Default

If you ignore your obligation and allow your student loan to go into default, there are serious consequences. These consequences may include, but are not limited to:

- Extremely negative impact on your credit rating
- Lawsuit filed for the entire amount of the loan plus legal fees, which can be up to 25% of the loan balance
- Income tax refunds being withheld
- Wages being garnished
- Federal financial aid and benefit programs no longer be available
- Any deferment or forbearance options in the loan contract are discontinued
- Professional licenses may be taken away from some individuals, such as lawyers, doctors, or CFA's.
- The loan will be assigned to a professional collection agency, who will continue to pursue the borrower until payment is received.

Considering these possible consequences of defaulting on your student loans, it is obvious how serious this situation can be. For more information on student loans and preventing default, go to www.fafsa.com

- ✓ **If at any point you become near default status on a loan, it is crucial that you contact your lender and arrange to stop the loan from going into default.**



Budgets



Preparing a Budget

The purpose of a budget is to estimate and track actual expenses in order to minimize the common problems of overusing credit, shorting your savings program and failing to ensure financial security. In essence, a budget is an outline of personal financial goals normally set on a monthly basis. The number of items in your budget will depend on your personal situation and your financial goals.

A simple budget can be kept either by hand or on a computer spreadsheet program. A sample budget is shown below. You can use this sample as a base for your personal budget, and add or take out categories as they fit your life.

Monthly Budget Financial Goals

	Budgeted Amounts		Actual	Variance
	(dollars)	(percent)		
Cash Inflows - \$46000 Annual Salary				
Salary (Less Federal and Social Sec.)	2917	100%	2917	0
Cash Outflows				
Emergency and Savings				
Emergency Fund Savings	150	5%	150	0
Savings for Auto Insurance	35	1%	35	0
401K/Retirement	438	15%	438	0
Savings for investments	100	3%	100	0
Total Savings	723	25%	723	0
Fixed Expenses				
Rent Payment	500	17%	500	0
School Loan Payment	75	3%	75	0
Auto Loan Payment	220	8%	220	0
Cell Phone	50	2%	50	0
Health Insurance	97	3%	97	0
Life Insurance	0	0%	0	0
Renter's Insurance	17	1%	17	0
Dental Insurance	45	2%	45	0
Disability Insurance	16	1%	16	0
Total Fixed Expenses	1020	39%	1135	0
Variable Expenses				
Food	275	9%	247	-28
Utilities	165	6%	170	5
Clothing	60	2%	40	-20
Transportation	250	9%	300	50
Personal and Health Care	100	3%	79	-21
Entertainment	125	4%	130	5
Reading, education	60	2%	40	-20
Gifts, Donations	0	0%	0	0
Misc Expenses	25	1%	40	15
Total Variable Expenses	1060	36%	1046	-14
Total Outflow	2080	100%	2904	-13



Steps for Successful Budgeting

Step 1: Set Financial Goals

Financial goals are plans for future activities that require you to plan your spending, saving and investing. These goals are the main reason you will be following a monthly budget. Common goals for college students include:

- **Short-term goals** such as paying off an auto loan, paying insurance and completing college.
- **Intermediate goals** (2-5 years) may include paying off student loans and attending graduate school.
- **Long-Term Goals** (5+ years) may include providing for a retirement fund, saving for a vacation and buying a home.

Step 2: Estimate Income/Salary

Estimating your income is a straightforward process, and should be calculated in monthly increments. For example, if your starting salary is \$46,000, your monthly income would be \$2,917 after taxes. Furthermore, you must only include income you are **absolutely sure** you will receive. If your earnings are irregular or vary by season, always be conservative with your estimations to help avoid overspending. If you expect a cash shortage, make sure to budget it for the future so you may plan ahead to be prepared for the shortage.

Step 3: Budget an Emergency Fund and Savings

The emergency fund is self-explanatory, but should never be shorted. Ideally, your emergency fund should be able to cover a minimum of three months' expenses in case of troubled times.

Step 4: Budget Fixed Expenses

Fixed expenses are relatively unchanging, definite obligations. For example, life insurance premiums, auto insurance premiums and cell phone bill (barring any overages) can be considered "fixed expenses." It is wise to budget fixed expenses before variable expenses because you are obligated to pay fixed expenses.

Step 5: Budget Variable Expenses

Variable expenses represent the most volatile type of expense due to a variety of factors. Variable expenses tend to fluctuate by time of year and health and economic conditions. Variable expenses include entertainment, food/groceries, transportation (including gas and repairs), utilities (electric, water, gas), and other miscellaneous expenses.

Step 6: Track and Review Spending Amounts

After setting your budget, the most important step is to track your spending amounts. At the end of the budgeted month, record actual amounts spent in each category and compare these values to the desired budget value you set previously. The variance column represents the difference (over or under spending) and can provide a detailed look into what you may or may not need to improve.



Tips and Tricks for Personal Budgets

Managing your expenses during a hectic semester is often a menial task that can be taken for granted. However, creating a budget and following your spending plans will provide a detailed look into how much of your paycheck you spend on unnecessary items. The following list describes some ways to allocate more money to your more important financial goals:

- **Cut down on entertainment and fast-food:**
While it is often difficult to cut back on these two categories, they are the most problematic areas for the average college students' budget. Staying home and cooking a couple nights out of the week and renting a movie instead of paying 15 dollars (ticket and concessions) are two ways to save money.
- **Purchase less expensive brand items:**
Old Navy, Hill Country Fare and other less expensive brand items will help you to save money, rather than paying for more expensive, yet almost identical, brand name items.
- **Use your credit card SPARINGLY:**
As convenient as credit cards are, they can also be a great detriment. College students often find themselves spending their entire month's salary before they receive their paycheck. The constant usage of a credit card will not only spoil your budgeting plans, it will eventually consume all of your finances.

Characteristics of Successful Budgeting

A budget will only work if you are disciplined enough to follow it. Straying from your goals will make your budget irrelevant and may prevent you from accomplishing any of your financial goals in the near future.

A successful budget must be:

Well Planned – Time and effort must be dedicated in order to provide for accuracy and relevance of your budget.

Realistic – As young college students, current and post-graduation income will usually not be anything to brag about. Being realistic about your financial goals is a key component in successfully budgeting for your future.

Flexible – Unexpected changes will require a budget that you can easily revise.

Clearly Communicated – Make sure you are not the only one who knows about your budget. Communicating your financial goals to others will help solidify your budget's relevance and your determination to follow it.



Money Management Basics – Record Keeping

The basis for smart money management hinges upon the organization of the manager. In essence, to manage your money, you will have to be organized. The foundation for personal financial management begins with a system for personal financial records.

Personal financial records consist of but are not limited to:

- Credit card statements
- Invoices
- Insurance Policies
- Tax Forms
- Automobile Titles
- Budgets

All of these records are critical to the objective of properly managing your cash (or credit) inflows and outflows. Furthermore, by developing an organized system of records, you will be able to:

- Effectively pay your bills on time and complete routine financial activities
- Plan and measure financial progress
- Ease the process of filing your taxes
- Determine resources for current and future spending

The process of organizing your records into a file can become quite messy. Normally, financial records are split up into two areas based on the importance of the documents. The following list suggests the most appropriate place for financial records based on their importance:

Home Filing Cabinet/Folders

- Automobile records (registration, repairs, owners manual etc.)
- Warranties
- Credit records (unused credit cards, monthly statements, account numbers)
- Insurance records (original policies, claim reports, premiums)
- Personal and employment records (resume, social security numbers, pay stubs)
- Previous years' tax returns

Safe Deposit Box (fire proof lock box preferable)

- Automobile title
- Birth certificate
- Property deeds

Home Computer

- Budgets
- Summary of bank transactions



Financial Costs and the Time Value of Money

Even though investing is not covered in this manual, it is wise for every person to understand the concept of time value of money. Saving or investing a dollar today results in a future amount greater than a dollar. As a consumer, every time you spend your money, you should consider the opportunity costs (what else you could have done with the money).

Interest calculations represent the opportunity costs or tradeoff involved in purchasing and investing. To calculate one-year interest on savings, the following formula must be used:

$$\text{Amount Saved} * \text{Annual Interest Rate} * \text{Time Period} = \text{Interest}$$

For instance, if you saved \$200 for seven months at a rate of 6% (.06 decimal), you would earn:

For seven months:

$$200 \times .06 \times 7/12 = \$7 \text{ in interest}$$

For one year:

$$200 \times .06 \times 12/12 = \$12 \text{ in interest}$$

For twenty years:

$$\$441.43 \text{ in interest}$$

It is wise to keep the idea of time value of money in mind. Money invested today will always be worth more in the future. In the previous computations, interest is earned on interest. For example, the yearly interest return of \$12 will earn 6% as well. This process is called compounding – which is the basis for the time value of money. The sooner you make deposits, the greater your future value will be. Future value tables and financial calculators (such as the HP10BII) are available for calculations that are more complicated. As a future investor or general consumer, it would be wise to obtain either resource to aid you in determining opportunity costs.

Do You Want to Retire Wealthy?

Invest 10% of your monthly salary (each month) into your company's 401k, an IRA, or a safe mutual fund and watch your money grow. Investing \$4000 per year at a 10% interest rate will earn you \$1,084,097 at the end of 35 years. **Do not withdraw your money!**
The key to compounding is to let your earnings grow.



Consumer Credit



What is Consumer Credit?

Consumer credit is the use of credit for personal wants or needs. The amount of consumer credit granted to you is based on your credit score. Examples of consumer credit are the video game or outfit you charged. The school loan and auto loan you may have taken out represent consumer credit. These two examples represent both types of consumer credit:

- **Open-End Credit (Credit Cards)** - Open-End credit is the most volatile, subjective type of credit. Purchases of fast food, entertainment, necessities, etc. represent open-end credit.
- **Closed-End Credit (Loans)** - Closed-End credit is used for a specific purpose such as an auto, school, or mortgage loan. This type of credit is often the most sought after by young college graduates looking to establish themselves.

Consumer credit is a major force in today's economy because it provides many advantages:

- **Convenience** – As a consumer, you are able to enjoy whatever you want, when you want it. Even when your funds are low, you will always be able to afford items that you desire.
- **Safety** – Carrying around cash is a huge burden. However, with the use of a credit card, no cash carrying is necessary.
- **Lag-Time** – Allows you as the consumer to accumulate funds without having to worry about deductions from your savings account immediately.
- **Incentives** – Department stores and auto manufacturers often provide rebates for purchases on credit cards.
- **Stability** – Repaying your debts in a timely manner shows lenders that you are a responsible person.

The average person carries six active credit cards. However, with all of its advantages, consumer credit also has many pitfalls:

- **Overspending** – The mere fact that credit cards offer a person the ability to purchase anything, at any time, often leads to overspending and eventual bankruptcy.
- **No Salary** – Oftentimes, the over usage of credit leads to future funds being tied up in personal debt.



How is your Credit Score Derived?

One of the most important measures of personal credit is your credit score. This number is created by a mathematical model which analyzes information in your credit file and estimates the risk incurred by a company considering opening an account with you.

*The most common overall measure of personal credit is the **FICO score**. Your FICO score is the credit score most lenders use to determine your credit risk. You will have three FICO scores, one for each of the three credit bureaus – Experian, TransUnion, and Equifax. Each of these scores is based on information the credit bureau keeps on file about you. As your personal information changes, your credit scores will change also.*

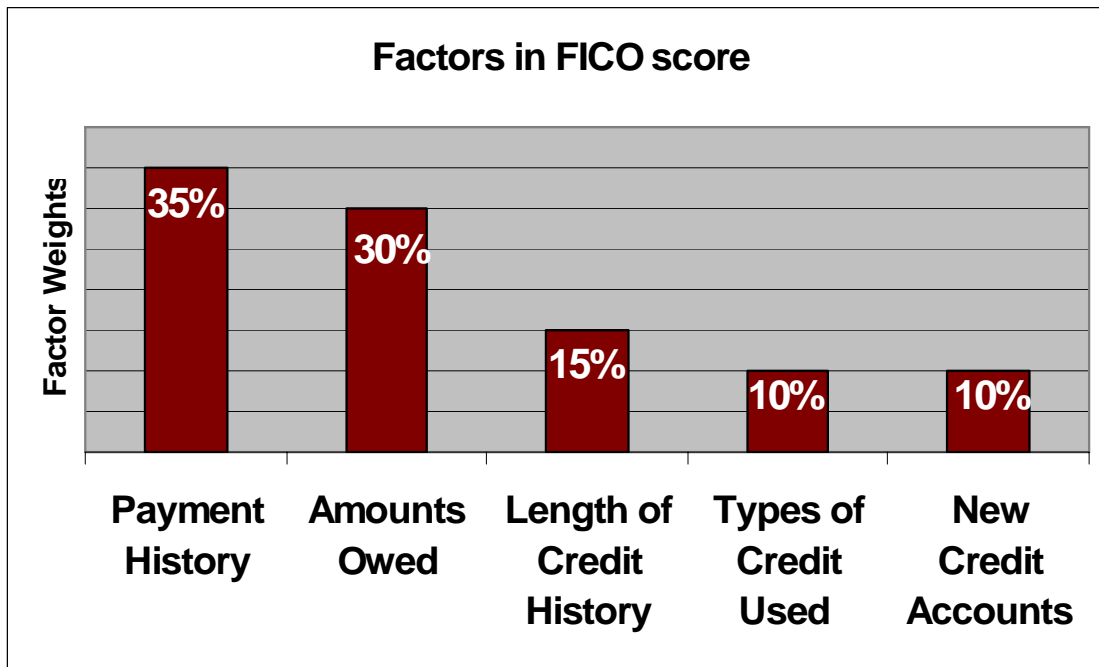
A recent development in credit scoring is the VantageScore, which uses similar criteria to the FICO score, but differs in that the three major credit reporting agencies do not disclose how the different factors of your credit scores are weighted. In other words, the exact weight of each factor is not publicly known, which makes it very difficult to improve your Vantage credit score. It is safe to assume that if you are applying for any type of loan your lender will use your FICO credit score rather than your Vantage score to determine whether you are a good risk.

There are four main categories included in an individual credit report.

- 1) **General Information:** Although companies may have different formats for credit reports, the general information included will be similar. Your identifying information is not used in scoring. **This section will include name, address, social security number, date of birth, and employment history which can be used to identify you.** Updates on this information are provided either by you or by lenders inquiring about you.
- 2) **Trade Lines:** The trade line section of a credit report is a detailed report on current and former credit accounts. **Lenders report the type of account opened, the date of origin on the account, the credit limit and corresponding balance on the account, as well as payment history on the account.** This portion contains the bulk of information used to evaluate and form your credit score.
- 3) **Inquiries:** Each time you apply for any type of loan or credit line, the lender will submit an inquiry from a reporting company. Upon application, the inquiry is authorized. **In the inquiries section, all inquiries within a two-year span are listed.** There are two types of inquiries included in this section:
 - **Voluntary** inquiries are requests that originate directly from you.
 - **Involuntary** inquiries generally relate to pre-approved, mail or promotional type offers. As these inquiries do not originate from you, they may not be considered to impact the credit score shown in the report depending on the nature of the inquiry.

- 4) **Public record and collection items: Information on overdue debt from collection agencies, as well as foreclosures, suits, wage attachments, liens, and judgments appear in this section.** This information is collected from state and county agencies, and is used in the evaluation of your credit risk.

Around 85% of creditors use the individual FICO score. The calculation of this score includes five major categories with varying emphasis placed on each. Depending on the length and number of accounts in your history, the importance of these categories may vary. For the purposes of the general population, the calculation is based on the following data.



Details of each of the five major components of a FICO score are described in the next section and tips for keeping your score high are included. It is important to remember that the factors included vary depending on the personal situation of each creditor.

1. **Payment History**: This section is a detailed history of items regarding how likely you are to make payments in full and on time. In this section, you will find:
 - Account payment information on specific accounts
 - The timeliness of payments
 - Whether the appropriate amounts were paid
 - Any adverse public records appearing on the credit report
 - Accounts that are delinquent, including the severity of the delinquencies, the amount past due, the number of delinquent accounts, and the length of time since the delinquent account occurred
 - Accounts that have been paid as agreed, whether the payment was according to the original contract or part of a settlement

- ✓ **In order to maintain a good score on this part of the report, you should make all of your payments on time. If for some reason you can't, arrangements should be made with the lender. Once you fall behind, as soon as you possibly can, you should get current with the account and stay current. Don't forget, paying off an old account doesn't make it go away. The information will remain on your report even after the account is closed. If you are having a lot of problems, you should find a legitimate credit counselor to work with you to fix the consequences of past mistakes.**

2. **Amounts Owed**: Within this section of the FICO report the amount of outstanding credit you owe is considered. In this section of your report, you will find:
 - The amounts owed overall
 - Amounts owed within specific accounts
 - Number of accounts with balances
 - Proportion of credit lines in use
 - Proportion of loan amounts still owed

These proportions are calculated by comparing the outstanding portion of the credit line or loan with the total amount available or already borrowed. In some cases, a lack of accounts will be a factor of this section.

- ✓ **To manage this part of your credit, keep outstanding balances low. On “revolving” credit, high amounts of debt will only hurt your score. Pay balances down to improve your score on this section of the report. Also, closing unused accounts will not necessarily help. This may actually make your score go down because the amount of credit available to you will be less. Opening a lot of new credit accounts at once is also a bad idea, because your history with these accounts has not been established. Initially when you do this, your score will drop.**

3. **Length of Credit History**: This portion contains the amount of time since accounts were originally opened. The accounts presented may be divided into specific categories, based on the type of account. The amount of time since the most recent account activity is also considered in this portion.
 - ✓ **To maximize your score on this section, don't close unused accounts. These accounts make your history longer and actually help you. And again, if your history is short, don't open too many new accounts in a short period of time.**

4. **Types of Credit Used**: The importance of an account may be based on the type of the account. A home mortgage will be considered more important than a retail credit card, for example. The presence of varying types of accounts is shown in this portion of the FICO report.
 - ✓ **Here it is especially important to shop around before choosing a loan. Whether it's a credit card or mortgage, you will be rewarded for doing your homework. Be wary of opening too many accounts at once, but wisely use credit here to rebuild past mistakes.**

5. **New Credit Accounts**: The final component of the FICO report considers lines of credit recently established. This section includes:
 - The number of recent accounts
 - Proportion of the newly opened accounts currently in use
 - Credit inquiries, including the number of inquiries and time since recent inquiries
 - Any reestablishment of credit after past credit problems occurred
 - ✓ **Often it is tempting to open a new account to make your score appear higher. That can have dire consequences on this part of your score. However, having only necessary outstanding lines of credit and managing them carefully can keep this part of your score high.**

The above factors are based on the general population. A student may or may not have this type of information available, which will be taken considered when the credit score is calculated.



Items Not Included in a Personal Credit Report

Information included in a credit report is extensive. However, there are many aspects of your life that are not included.

- Because of the Consumer Credit Protection Act, it is illegal for an agency to consider **race, religion, color, sex, marital status, or national origin** in a credit rating. It is illegal for a creditor or credit reporting agency to request this type of information because of the possibility of discrimination.
- Although FICO gathers basic employment information as an identifying factor, this information is not used in the determination of credit scores. **Salary, occupation, and title** are not identified in the FICO report. The **age** of the individual may be shown in the report but age is not a factor in the FICO score. Similarly, **geographic area of residence** is not considered in the calculation.
- Outstanding accounts may have varying **interest rates**. The rates are determined by the account lender and will not be shown as a factor of the FICO score. **Rental agreements** are also not included in FICO scores, unless the rental account becomes late or go into default and are turned over to collections. If this happens, the matter becomes one of public record. The information is then considered in calculating the FICO score.
- As discussed earlier, credit inquiries are normally considered in the determination of a FICO score. However, there are certain types of inquiries that are not initiated by the consumer and are often done without consent. These inquiries, known as **promotional inquiries**, usually involve a pre-approved offer that you may or may not be aware of. In this situation, the action is disregarded by the agency. When you make a **consumer-initiated inquiry** to examine your credit report, it is not regarded in credit scoring. The final type of inquiry that is not considered on a credit score is an **administrative inquiry**. These inquiries are normally initiated by employers and do not affect scores.
- Many consumers with bad credit undergo a **consumer credit counseling program**. The actions taken by these programs to repair or build the credit of the client. Most of these actions are possible without the program, and FICO, as well as the other major credit agencies, do not take membership in such a program into consideration. Results of credit repair programs such as these, while possibly indicative of future credit performance, are inconclusive and are excluded from the report.



Why Use Credit Scores?

Credit scores provide lenders with a consistent, fair way to determine the risk associated with a potential borrower. When the lender is aware of the risk of each loan made, they are able to approve more loans. This increased availability of funds allows borrowers with less than perfect credit to easily strengthen and rebuild their credit rating. Most lenders have a variety of credit options, dependent on the credit score of the applicant. **A person with a lower credit score may have to pay a higher interest rate in exchange for the increased risk of the lender.**

With the advancements in communication and technology, credit decisions may be made quickly. The ability of a lender to measure the risk of an applicant makes the process more efficient for all parties involved. Because of the increased efficiency of the process, lenders are able to offer lower interest rates to consumers. The timely transfer of information allows the lender to make a fast decision and saves them the cost of evaluating each applicant.

Possibility of discrimination is minimal. If an applicant is rejected, all parties involved know the decision was based on the objective report generated by the credit agency. As discussed in the above section, information which could be used for discriminatory purposes is not used in determining personal credit scores. This prevents unfair or discriminatory lending practices.

Consumers with poor credit ratings are able to rebuild their scores over time. Whether the situation is due to a lack of knowledge or irresponsible decisions, consumers often find themselves overwhelmed and frustrated by their poor credit rating. As time passes and the steady repayment of existing accounts occurs, the credit score automatically adjusts. Credit scoring evaluates both past and present activity. This enables a consumer to qualify for some loan type accounts while in the process of increasing their credit score.



Benefits of Having a High Credit Score

- ✓ Lower interest rates are charged on money you borrow. Whether it's a car loan, a personal loan or even a credit card, with a high credit score, you will have to pay less interest.
- ✓ You will be approved for credit faster. If your score is high, companies will be more willing to loan you money and the process will be much simpler.
- ✓ Deposits required will be smaller. When you have a higher score, you are viewed as a less risky investment; therefore, utility companies will offer you a lower deposit.
- ✓ Apartments are easier to qualify for. A leasing agent will see your score and assume that you will be timely with your rent. This will allow you to qualify for nicer apartments without having a parent or friend sign as a guarantor.
- ✓ Offers from credit cards and loan companies will be better. Because these offers will stem from their evaluation of your credit, you will be offered better rates and more incentives to borrow than an individual with a low credit score.

An Example of the Benefit of a High Credit Score...

From a calculator available on www.myfico.com, the following table shows just how much impact a good score can have on mortgage payments. The following information displays the monthly payments and overall interest paid on a 30 year fixed rate mortgage on a \$100,000 home.

FICO score	APR	Monthly Payment	Total Interest Paid
720-850	6.188%	\$612	\$120,209
700-719	6.314%	\$620	\$123,159
675-699	6.853%	\$655	\$135,965
620-674	8.008%	\$734	\$164,356
560-619	8.590%	\$775	\$179,108
500-559	9.589%	\$847	\$205,048

As you can see, having a higher FICO score can make a very significant difference. The monthly payment in this example was reduced by \$235, and the total interest paid is \$84,839 less for the individual with a good score!



Credit Cards



Choosing a Credit Card

The number of college students using credit cards is growing. Due to marketing campaigns focused on college campuses, acquiring a credit card has become easy for students. As students face the rising cost of attending college, a growing concern is that 83% of undergraduates in the U.S. have at least one credit card. From the time they arrive on campus until graduation, U.S. college students double their average credit card debt and triple the number of credit cards they own. What some do not realize is by taking on credit card debt and student loan debt at the same time, repayment will be challenging to life after graduation.

Using a credit card can be one of the most beneficial or dangerous credit decisions you can make. When faced with options available for opening a line of credit with a credit card company, it is easy to become overwhelmed. If the card is used wisely, it is a useful tool for building a solid credit history. But, if you do not use your credit card the right way, the effects of the accumulated debt can devastate your personal credit.

To begin the process of understanding credit cards, it is essential to be familiar with the terms and conditions included in credit card offers. Careful evaluation of an offer before acceptance is important in making an informed choice. Some common terms are described below:

- **APR:** The Annual Percentage Rate (APR) is the cost of credit at a yearly rate. The amount of interest due is usually expressed as a percentage of the amount borrowed, and is defined as the cost of borrowing money. There may be several APR's applied to one card, including an APR for purchases, a different APR for cash advances, and another APR for balance transfers. The APR for purchases is usually lower than the rates for other services.
- **Annual Fees:** The annual fees on a credit card are the yearly fees charged by the company for the privilege of using the credit card, which are either billed annually or paid as a portion of your monthly balance. Annual fees are usually expressed in a dollar amount and may vary greatly. These fees may be waived as part of a promotional offer, and if your annual fees are waived for the first year, you should find the amount of fees after the first year is over.
- **Compounding:** This is the collection of interest on both the balance of the amount borrowed and interest accrued on that balance throughout the year. Because of the effects of compounding, it is important to check the compounding periods of a credit card. There are 2 main types of compounding methods. The "average daily balance" is the most common approach taken by companies and is the best choice for students. If a card offers the "two-cycle" method, the amount of interest charged is higher. You should avoid cards using this method.

- **Introductory Rate:** In order to entice students to accept a promotional credit card offer, lenders may offer an introductory rate. This lower rate is only charged for an initial period of time. Once that period expires, the interest rate will increase to the stated interest rate of the card. In some offers the APR is delayed, which means that a different, and usually higher, rate will apply in the future. When a delayed rate is listed on the application, it is important for you to look for the APR that will take effect and become the permanent interest rate. Although the difference in APR's might seem small, the difference in overall cost may be large.
- **Fixed rate:** If a credit card has a fixed rate, the APR rarely changes. When the rate increases, the company must inform you of the change. Another type of rate is a variable rate. On a variable rate credit card, the APR is usually tied to another interest rate in the economy, such as the Treasury bill rate or the prime rate. This means that if this rate changes, the rate charged on the credit card changes also. For a college student on a budget, the fixed rate card offers a more predictable charge to be included in financial planning.
- **Penalty APR:** If you make late payments, a penalty APR may go into effect. This stated rate, which is higher than the APR, goes into effect when a payment is missed. The increase in rate is usually large, and is used as an incentive to keep the account up to date. In addition to interest rate increases, there are often fees involved with late payments. If a payment is received after the due date, a late-payment fee is charged. Credit cards have limits to the amount of credit available, and when the user exceeds the limit, an over-the-credit-limit fee is charged. A college student should carefully read and understand these conditions before choosing a card. It is important to pay your bills on time in order to avoid these additional charges.
- **Balance Transfers:** Some credit cards have an option that allows you to move a balance from one credit card to a different card with a lower interest rate. This process is known as a balance transfer, and is generally done to lower the interest rate paid on the balance. The terms of these transactions may involve a different interest rate or a fee and are included in the credit card offer. If this option is important to you, these terms should be evaluated before choosing a card.
- **Cash Advance:** If you desire the option to borrow cash against your credit card account, the conditions involved in cash advances are important. The cash advance feature makes having actual cash in hand convenient, but can be a dangerous option. There is often a fee involved with cash advances and in many offers, the interest rate applied to the repayment of cash advances is higher than the purchase APR. Monthly payments are often applied to repayment for purchases before cash advances. If this occurs, you will end up paying a higher interest rate over a longer period of time. In addition, if you use this feature often, there is the danger of exceeding the limit on the account and assessing more penalty fees. Access to this type of feature may vary for different offers. **This option should be used in extreme emergencies only.**

- **Incentives:** Incentives and special features encourage you to choose a certain credit card or maintain a good standing with the company. Rebates on purchases are common incentives, as are frequent flier miles. Companies may also offer warranty or insurance coverage to desirable consumers. In exchange for the incentives, a higher interest rate may be applied. If you are interested in incentives, be aware of rate increases.
- **Grace Period:** A credit savvy student will take advantage of the grace period offered. This is the amount of time in which you can pay off balances without incurring interest charges. Typical grace periods are from 20 - 25 days after the purchase. Grace periods are an effective tool in sticking to a budget, as well as a way to save money.

Understanding these terms and options is important for you when choosing a credit card. Depending on your credit situation and needs, you can determine which features are most important and choose a card which will most benefit your situation. Through careful examination of credit card offers, you can also avoid paying unnecessary fees or unreasonably high interest rates.

While many parents are tempted to offer their children access to their line of credit, it is much more effective for the credit card account to be in the student's name. By doing this, the student has an opportunity to build credit history and begin developing healthy spending habits. In order to monitor the student's spending, parents have the option to be co-signors on the account. This will allow them access to the account activity and may offer the student more attractive terms due to the parent's more established credit history.



Tips for Using Credit Cards Effectively

Use a debit card or secured card, rather than a credit card. By having a set balance available, you can avoid overspending. When a debit card is used, money is automatically deducted from an existing account. This helps to keep spending in perspective and monitor the balance in the account. A secured credit card requires an initial bank deposit when the account is opened. The credit limit on the card is related to the amount of the bank deposit. If the bill isn't paid, the bank is able to take money from the deposit. This decreases the risk to the lender and makes this an attractive offer for a student with a low credit score or short credit history.

Evaluate offers carefully. Reading the fine print on every credit card offer is essential in choosing a credit card. Often companies target college campuses in marketing campaigns. These campaigns may offer free gifts to unwitting students. Any time you begin searching credit card offers, you may be flooded with many promotional offers. Thorough consideration in decision-making will ensure you receive the most beneficial terms.

Don't overextend available credit. The optimal amount of credit cards for you to carry is three, including two with small limits and one with a larger limit for emergency use only. Regardless of the number of cards you choose to carry, it is ideal to never let the balance of the account to exceed 50% of the credit limit. When you "max out" your credit card, it reflects poorly on your credit report. There may also be additional fees or higher charges on balances that remain high over a long period of time.

Use credit cards to repair a damaged credit rating. To build credit in the fastest way, it is recommended to never carry an overall balance (interest charges included) of more than 50% of the limit. Also, you should not pay the full balance each month, but not carry the balance for more than 6 months. If you revolve 1 month of purchases and pays the next month in full in a steady cycle, a good credit rating will be established in 18 months. Timely payments are essential when building credit. If you reach a point where you cannot pay the balance of an account in two months, you should not use the card until the balance is paid down to a manageable level. If credit is denied, the issuing company is responsible by law to inform you of the reason. Request a credit report at the time of denial and make sure it is accurate.

Keep track of purchases and monitor your credit report. With the ever-growing threat of identity theft, monitoring your credit report is essential. Through regularly checking your credit report, if this crime occurs its effects can be contained and fixed more efficiently. A credit report is very important for future desired purchases, such as a home or an automobile. The contents of a credit report reflect your credit history. It is extremely important for you to check the accounts on your credit report on a regular basis



Identity Theft

Whether you write a check, charge items on your credit card, rent a car, mail your tax returns, change service providers for your cell phone, or apply for a credit card, in each transaction you reveal bits of personal information. Your bank and credit card account numbers; your income; your Social Security number or your name, address, and phone numbers are goldmines of information for identity thieves. Once a thief has your information, it can be used without your knowledge to commit fraud or theft.

Identity theft is a serious crime. People whose identities have been stolen spend an average of one year clearing their good names. They may lose out on job opportunities, and loans for education, housing, or cars. They may even get arrested for crimes they didn't commit.

How Does Identity Theft Occur?

Skilled identity thieves can use a variety of ways to gain access to your personal information. The following list describes only some of the ways that an identity thief can obtain your personal information:

- Steal your wallet or purse.
- Steal your social security card.
- Steal your personal information through email or the phone by saying they're from a legitimate company and claiming that you have a problem with your account.
- Steal your credit or debit card numbers by capturing the information in a data storage device in a practice known as "skimming." They may swipe your card for an actual purchase, or attach a device to an ATM machine where they may enter or swipe your card.
- Obtain your credit reports by abusing the authorized access that was granted to their employer, or by posing as a landlord, employer, or someone else who may have a legal right to your report.
- Rummage through your trash, the trash of businesses, or public trash dumps in a practice known as "dumpster diving."
- Steal personal information they find in your home.
- Steal your mail, including bank and credit card statements, credit card offers, new checks, and tax information.
- Complete a "change of address form" to divert your mail to another location.

How Identity Thieves can use your Information

Once identity thieves have your personal information, they may use it to commit fraud or theft. For example, identity thieves can:

- Call your credit card issuer to change the billing address on your account, and then run up charges in your name.
- Open new credit card accounts in your name. Delinquent accounts are reported on your credit report and will damage your ability to receive loans.
- Establish phone or wireless service in your name.
- Open a bank account in your name and write bad checks on the account.
- Counterfeit checks or credit or debit cards, or authorize electronic transfers in your name, and drain your bank account.
- Buy a car by taking out an auto loan in your name.
- Get identification such as a driver's license issued with their picture, in your name.
- Get a job or file fraudulent tax returns in your name.
- Give your name to the police during an arrest. If they don't show up for the court date, a warrant for arrest is issued in your name.

How You Can Tell if You're a Victim of Identity Theft

The most effective and often the most overlooked prevention method for identity theft is the monitoring of your financial accounts. Most of the telltale signs of identity theft can be found by keeping a keen eye on your bank account, credit report and other financial accounts and documents. The signs of identity theft are listed below:

- Opening new credit accounts in your name, these accounts are likely to show up on your credit report. You can find out by ordering a copy of your credit report from the three nationwide consumer reporting companies at www.equifax.com, www.experian.com and www.transunion.com
- Monitor the balances of your financial accounts. Look for unexplained charges or withdrawals.
- Failing to receive bills or other mail. This could mean an identity thief has submitted a change of address.
- Receiving credit cards for which you did not apply.
- Denial of credit for no apparent reason.
- Receiving calls from debt collectors or companies about merchandise or services you didn't buy.

You are allowed one free credit report per 12 months in the United States. To order your free report, go to www.annualcreditreport.com. You are also entitled to a free credit report if a company takes adverse action (denying you credit, insurance, employment) against you based on your credit score. You must request your report within 60 days to receive a free report.

Managing your Personal Information

A responsible consumer will always monitor his or her financial accounts and any other potential risks involved with their finances. The most effective way to manage your personal information is to be proactive in monitoring all financial risks involved with your personal information. This prevention method has many nuances, which are listed below:

Steps You Can Take Today to Prevent Identity Theft

- Always place passwords on your credit card, bank, and phone accounts. Avoid using easily available information like your mother's maiden name, your birth date, the last four digits of your SSN or your phone number, or a series of consecutive numbers.
- Secure personal information in your home, especially if you have roommates.
- Ask about information security procedures in your workplace or at businesses, doctors' offices, or other institutions that collect your personal identification and ask about the disposal procedures for those records.

Long-Term Prevention

- Don't give out personal information on the phone, through the mail, or on the Internet unless you've initiated the contact or are sure you know who you're dealing with.
- Before you share any personal information, confirm that you're dealing with a legitimate organization. Check an organization's website by typing its URL in the address line, rather than cutting and pasting it in.
- Treat your mail and trash carefully. Promptly remove mail from your mailbox and deposit your outgoing mail in post office collection boxes or at your local post office, rather than in an unsecured mailbox.
- Shred all personal information documents before trashing them.
- Don't carry your SSN card in your wallet; store it in a secure place.
- Only give out your social security number when necessary. Outside of your workplace, always question businesses or people who ask for your social security number to identify that they are legit.
- Be cautious when responding to promotions.
- Keep your purse, wallet, and all personal documents in a safe place at work.
- When ordering new checks, pick them up from the bank instead of having them mailed to your home.
- Always have an available antivirus program for your computer; do not open emails or files from strangers. Try not to store any personal information on your computer.

Remedying Identity Theft

The first and most effective step in remedying identity theft is to request a 90 day fraud alert on your social security number and credit report. Initial fraud alerts can be filed at any of the three credit bureaus previously listed. Normally, you will have to call the bureau to activate the initial fraud alert. However, once filed, the credit card bureau will forward your fraud alert to the other two respective bureaus.

Essentially, this measure will “stop the bleeding,” by requiring the thief to obtain approval and provide identification before applying for credit or further damaging your credit score. While the fraud alert is active, you are able to obtain free credit reports to monitor any more illegal activity in your name.

Other measures to take when you feel that you are a victim of identity theft are listed below:

- **Financial accounts** - Close accounts, like credit card and bank accounts, immediately. When you open new accounts, place passwords on them. Also, dispute all fraudulent charges and notify your bank or credit card companies (in writing) of potential or current identity theft.
- **Social Security number** - Call the toll-free fraud number of any of the three nationwide consumer reporting companies and place an initial fraud alert on your credit reports. An alert can help stop someone from opening new credit accounts in your name.
- **Driver's license/other government-issued identification** - Contact the agency that issued the license or other identification document. Follow its procedures to cancel the document and to get it replaced. Ask the agency to flag your file so that no one else can get a license or any other identification document in your name.
- **File a police report** - Filing a police report will help reinforce the validity of your identity theft claims and assist you in recovering any fraudulent charges and possibly stopping the identity thief altogether.
- **File a complaint with the Federal Trade Commission** –The FTC can refer victims' complaints to other government agencies and companies for further action, as well as investigate companies for violations of laws the agency enforces. You can file a complaint online at www.consumer.gov/idtheft

Once you have taken these precautions, watch for signs that your information is being misused, and that your identity has been stolen.

- **Equifax:** 1-800-525-6285; www.equifax.com; P.O. Box 740241, Atlanta, GA 30374-0241
- **Experian:** 1-888-EXPERIAN (397-3742); www.experian.com; P.O. Box 9532, Allen, TX 75013
- **TransUnion:** 1-800-680-7289; www.transunion.com; Fraud Victim Assistance Division, P.O. Box 6790, Fullerton, CA 92834-6790



Taxes for the Independent College Student



The Basic Principles of Federal Income Tax

- Every citizen or resident of the United States is required to file a federal income tax return if his or her gross income is above \$8,200, as reported for 2005 income tax returns.
- There are five filing status categories: Single, Married-Joint, Married-Separate, Head of Household, and Widow or Widower. Normally, college students will be filing under the Single status category.
- Every taxpayer receives at least the **standard deduction**, which is an automatic subtraction (savings) from adjusted gross income. Many taxpayers also complete **itemized deductions**, which are specific expenditures allowed to reduce your taxable income. However, if you claim the standard deduction, you may not claim any itemized deductions, and vice versa.

In order to properly file your taxes:

- The first thing you will have to determine is if you are a dependent. This means that your parents/spouse/guardian can/will claim you on their taxes.
- The requirements to be claimed as a dependent on your parent's taxes is if you are a full time student under the age of 24 and your parents furnish over half of your living expenses.

For relevancy, only independent filers will be addressed in this section. The reason is that dependents have almost no deductions or credits available aside from the standard deduction.

The Importance of Record Keeping

It is imperative as a taxpayer to keep evidence of tax deductions, credits and income. Generally, you should keep records for three years from the date you file your return. However, the IRS may require you to provide documentation up to six years old.

Tax Forms and Filing Information (Forever)

- Social Security Number
- Copies of federal tax returns from previous years
- Current tax forms and instruction booklets

Income Records (3-6 Years)

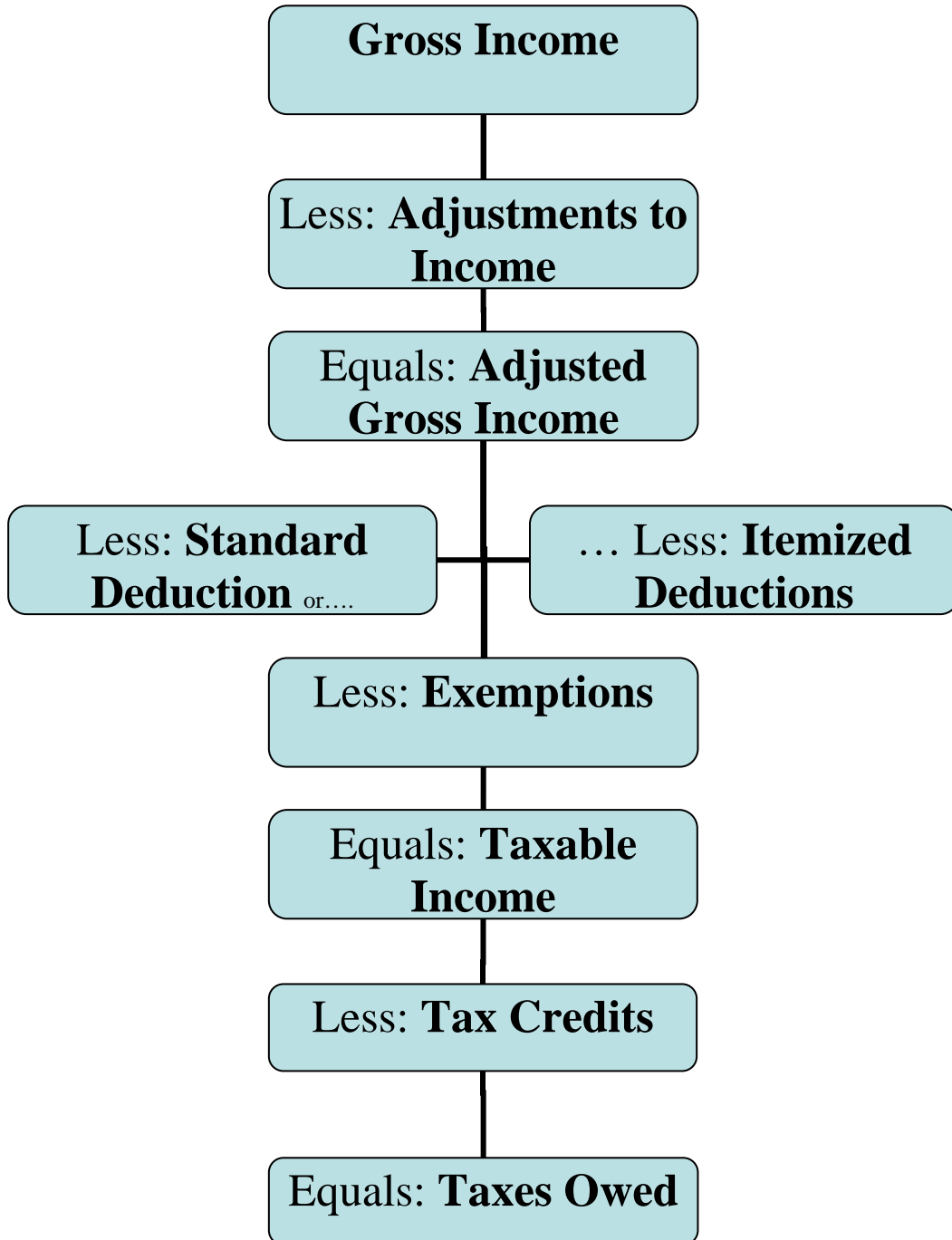
- W-2 Forms reporting salaries and wages

Expense Records (3-6 Years)

- Receipts for medical, dependent care, charitable donations and job-related expenses.

Determining Your Taxes Owed

The following diagram represents the process of determining your taxes owed:



1) Gross Income

The first step in filing your taxes is determining your gross income. For the typical college student, gross income will consist of wages and tips. Gross Income includes working income, and investment income. For our purposes, we will be focusing on hourly wages, the typical filing income for a normal, working college student.

- Working Income consists of hourly wages, salary, commissions, tips and bonuses.
- Investment income is dividends received, interest or income from investments.
- Grants and Scholarships are not taxed and therefore do not have to be reported.
- 401k contributions are subtracted from gross wages prior to federal tax being calculated and reported.

It should also be noted that other types of income such as awards, lottery winnings and prizes are all subject to federal income taxes and must be reported in Gross Income.

Adjusted Gross Income (AGI):

The initial goal is to arrive at Adjusted Gross Income (AGI). For most students, this is the easiest part of tax preparation. Adjustments to gross income must be subtracted from the gross income figure calculated in the previous step.

Adjustments to Gross Income consist of:

- Contributions to an IRA.
- Penalties for early withdrawal of savings must be accounted for.

For our purposes, adjustments to income will be ignored because most of you will not have any adjustments.

2) Computing Taxable Income

A **tax deduction** is a specific amount subtracted from adjusted gross income to arrive at taxable income. Every taxpayer receives at least the standard deduction, which is an automatic reduction from AGI. Some people may qualify for more than just the standard deduction, in which case they would complete the itemized deductions on form 1040, schedule A.

The only viable deduction for college students is the tuition and fees deduction on form 1040. For our purposes, itemized deductions will be ignored. This is because most college students do not have any itemized deductions available to them when they are in school. In addition, the Lifetime Learning and Hope credits are not available to students who choose to take the tuition and fees deduction.

The standard deduction (or total itemized deductions) is subtracted from Adjusted Gross Income to arrive at Taxable Income.

3) Calculating Taxes Owed

Tax Schedule found at: <http://www.irs.gov/pub/irs-pdf/i1040tt.pdf>

Schedule X — Single

If taxable income is over--	But not over--	The tax is:
\$0	\$7,300	10% of the amount over \$0
\$7,300	\$29,700	\$730 plus 15% of the amount over 7,300
\$29,700	\$71,950	\$4,090.00 plus 25% of the amount over 29,700
\$71,950	\$150,150	\$14,652.50 plus 28% of the amount over 71,950
\$150,150	\$326,450	\$36,548.50 plus 33% of the amount over 150,150
\$326,450	no limit	\$94,727.50 plus 35% of the amount over 326,450

2005 Tax Schedule

Your taxable income in the previous step will serve as the foundation to compute the amount of taxes you owe.

For example, if your taxable income is \$11,800, you would owe \$1405 in taxes. This number can be found by the following arithmetic:

11,800-7300	=	4500
4500 * 15% (0.15)	=	675
675 + 730	=	\$1,405



Tax Credits

When filing your taxes, the most beneficial asset you can possibly obtain is a **tax credit**. The difference between credits and deductions is credits are subtracted directly from taxes due, whereas deductions are subtracted from Adjusted Gross Income. For example, if you have a credit of \$1000 and your tax owed is \$1405 (as in the example above), then your tax obligation would be \$405. It is imperative as a student to understand to take advantage of the tax credits available to you. The two major tax credits for independent filing students are listed below.

Education Credits

There are two basic education credits. They are the Hope Credit and the Lifetime Learning Credit. Each is calculated as a percentage of your qualified education expenses. You can only **claim one of these credits!**

Refer to IRS Publication 970: Tax Benefits for Education found on the IRS website:
<http://www.irs.gov/publications/p970/index.html>.

Requirements and Characteristics of both the Hope and Lifetime Learning Credits:

- You can only claim **one** of these credits!
- You cannot claim a credit if your adjusted gross income is over \$53,000.
- You must pay for your own tuition. You will not be eligible if your parents paid for your tuition.
- The Hope Credit is only available during freshman and sophomore years.
- The Lifetime Learning Credit is available to you every year.
- You cannot take both an education credit and the tuition and fees deduction on form 1040, line 34.
- You must use form **8863** when filing your education credits. This form can be found at: <http://www.irs.gov/pub/irs-pdf/f8863.pdf>
- Qualified Education Expenses generally refer to tuition. Room and board, books (unless you have to purchase them directly from the school as a condition of enrollment - very rare) and supplies, transportation to and from school, medical expenses, and insurance do not count toward figuring this credit.
- You **must** file as an independent to take advantage of these credits.

Note: Each credit has its own specific requirements that are listed below in their respective sections.

You will need form 1098T from your school in order to do anything with education credits. In either box 1 or box 2, you will see the amount you paid or were billed for tuition. Your university can elect to use either of these boxes when displaying your tuition amount. This is the amount you will use to figure out your education credit.

The Hope Credit

The Hope Credit allows a maximum credit of \$1,500. Remember, you may only take education credits from qualified education expenses – mainly tuition. Also, **only students in their first 2 years of college can claim the Hope Credit.**

Additional Requirements for the Hope Credit

You have to:

- Be pursuing a degree at a recognized institution of higher learning
- Be enrolled at least half time
- Have no felony or drug convictions on your record.

The amount of credit you can apply is presented by following these 2 steps:

1. 100% of the first \$1,000 of qualified education expenses you paid for college
2. 50% of the next \$1,000 of qualified education expenses you paid for college.

This gives a total credit benefit of \$1500 for up to \$2000 in qualified expenses.

The Lifetime Learning Credit

The Lifetime Learning Credit and the Hope Credit are similar in most aspects, but their differences are important:

Lifetime Learning Credit Differences

- The total amount of the allowable credit is \$2,000 for the Lifetime Learning Credit and \$1,500 for the Hope Credit.
- This credit is available for almost anyone pursuing postsecondary education (college and beyond).
- You may claim this credit for an infinite amount of years.
- You do not have to be pursuing a degree, and you can be taking as little as one course to be eligible.
- Felony convictions are excluded.

The other requirements are exactly the same as the Hope Credit: you have to have paid for your own tuition, the phase-out range is the same (\$43k-\$53k), and the qualified education expenses are the same.

Finding the Lifetime Learning Credit Amount:

On Form 8863 (same form used for the Hope), you can claim a credit of 20% of the first \$10,000 of qualified education expenses you paid. So if you paid \$10,000, then you get the maximum credit. If you paid \$5,000 in education expenses, you only get a \$1,000 credit. These credits are below the line, so they get deducted from your taxes owed.

Remember: These credits are deducted from your taxes owed and you may only claim **ONE CREDIT** at a time.

Do Student Loans Count?

Some people might wonder if they have to actually pay cash for tuition to be eligible for these credits, or if having a student loan counts too. The answer is yes; student loans that are used to pay for tuition for the year are allowed to be used in figuring out the amount of tuition that is eligible as a qualified education expense. The general rule of thumb is that if you have to repay the loan (like a federal subsidized direct loan), then you're eligible. A **grant** or **scholarship** is not considered part of the qualified education expense.

In either of the above scenarios (hope and lifetime credits), our example shows that we owe NO federal income taxes (\$1405 federal tax - \$1500/\$2000 credit = 0 Federal taxes), meaning that we would get back 100% of any previously withheld taxes.

Tax Forms

The government offers three different tax forms that are modeled for different tax situations:

Form 1040 – Required to use if income is over \$50,000 or if you can be claimed as a dependent on your parents' return and you had interest or dividend income from investments. This is the tax form that the typical college student with loans will use.

Form 1040A – This form is used if your income is under \$50,000 in taxable income from wages, tips, unemployment, interest, dividends and you take the standard deduction.

Form 1040EZ – For the dependent college student, Form 1040EZ is the form you'll be using. Your income must be less than \$50,000, and you must only take the standard deduction.

Helpful Links to Overcome Tax Confusion:

- E-file: <http://www.irs.gov/efile/article/0,,id=118508,00.html>
With E-file, an individual can practice filling out his or her tax form. Also, e-filing will assist you further if any clarification is needed in the process of filing taxes.
- Tax Requirements: <http://www.irs.gov/individuals/index.html>
A helpful link to help keep up with requirements changes and determine if you need to file can be found at IRS.gov: <http://www.irs.gov/individuals/index.html>





What is Insurance?

As college students, thoughts about obtaining insurance on anything not legally obligated are few and far between. However, many types of insurance are available to you today. Whether it is health, disability, auto, renter's, homeowner's or dental, every person should realize that the purpose of insurance is to **reduce the risk of possible loss**. Having a safeguard now will provide you with peace of mind prevent future loss.

Insurance provides protection for various types of risks:

- The chance of a loss or injury
- Anything that may possibly *cause* a loss
- Anything that increases the likelihood of loss
- Failure to prevent a loss

Insurance companies are businesses that share personal risk with the policyholder (insured person) for a fee or premium and provide a given amount of coverage based on these premiums.

Types of Insurance Costs

- **Premiums** – Monthly payments made to your insurer for coverage of the insurance policy.
- **Deductibles** - A set amount the policyholder must pay per loss or accident. Your insurance company will only pay the amount the deductible does not cover.

An important note regarding insurance is that you may only be insured for personal risks, property risks and liability risks, also known as “accidental risks.” Insurance companies do not cover pre-meditative or “speculative” risks such as investing in the stock market.

Due to the universality of insurance, it is possible for you to obtain protection on almost any property loss, illness, or liability. However, for a risk adverse person, it is possible to overload on insurance. When developing your insurance program, make sure to cover only what is relevant to your current situation. The following example is a list of insurance policies that are relevant to college students:

Insurance Useful to College Students

- **Health Insurance** – Reduces the cost of medical related risks.
- **Renter's Insurance** – Protects against property loss (inexpensive premiums).
- **Disability Insurance** – Provides regular income when you're unable to work.
- **Automobile Insurance** – Protects against potential property loss and repairs.

Automobile and health insurance have many options available and are suitable for most personal situations. Factors that affect the cost of coverage and deductibles on different types of insurance are addressed in their respective sections.



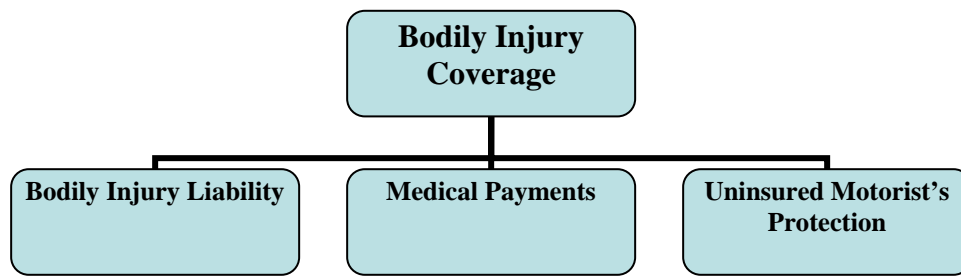
Automobile Insurance

Traffic accidents can be the cause of current and future physical and financial problems in the form of lost wages, medical bills, and pain and suffering. Billions of dollars are lost each year because of these factors, and while insurance cannot eliminate these accidents, it can reduce the financial burden an accident may have on your life.

Coverage for automobile falls into two main categories:

Bodily Injury Coverage

Bodily Injury Coverage includes three main types of coverage: Bodily Injury Liability, Medical Payments and Uninsured Motorist's Protection.



Bodily Injury Liability

Bodily injury liability covers physical injuries caused by accidents which you are responsible for. This coverage is usually expressed by three numbers such as 110/300/50, representing the thousands of dollars of coverage for each respective category listed below:

- The first number (110,000) represents the maximum amount the insurance company will pay for injury to one person.
- The second number (300,000) represents the maximum amount the insurance company will pay for two or more injured people.
- The third number represents the maximum amount the insurance company will pay for **property** damage to the responsible part.

Medical Payments

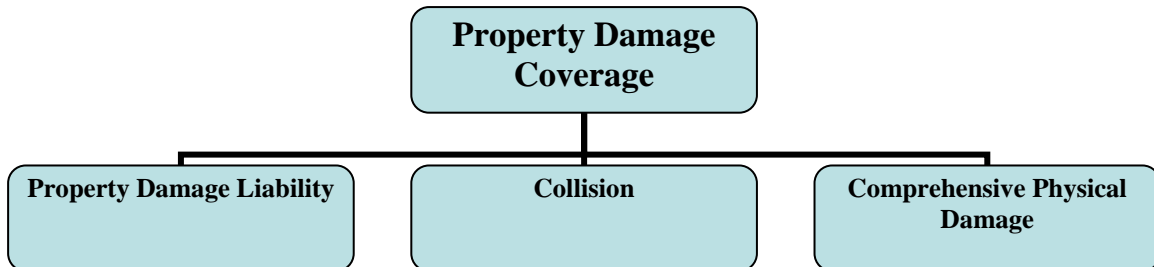
Medical payments coverage is insurance that is used for the medical expenses of any person that is injured in your automobile, including yourself.

Uninsured Motorist's Protection

Due to high costs, many people in the United States are without insurance. Uninsured motorist's protection guards against those without insurance and protects you and your family if you're a victim of a hit-and-run accident. Also, uninsured motorist's protection guards you and your family in the event that the other party in an accident has insufficient insurance coverage to pay for your repairs or medical bills.

Property Damage Coverage

Property Damage coverage includes Property Damage Liability, Collision, and Comprehensive Physical Damage. This coverage is used for damage to your vehicle, or another person's vehicle in an accident.



Property Damage Liability

Property damage liability is automobile insurance that applies when you damage the property of others. Property Damage Liability includes coverage on and for damage to:

- Driving another person's car with the owner's permission
- Buildings
- Equipment

Collision

The most well known and best part of property damage coverage, collision, covers damage to your vehicle in any accident, regardless of who was at fault. However, the amount covered under collision after any accident is limited to the actual cash value of your automobile at the time of the accident. Therefore, keeping a record of your automobile's cash value is imperative if you have added any extra features to your car.

Comprehensive Physical Damage

Comprehensive physical damage covers damage to your vehicle in non-accident situations such as theft, fire, natural disasters and hail.

No Fault and Other Automobile Insurance Coverage

Under a no-fault system, insurance payments become more streamlined because there is no fault in a two party accident. Each driver collects money from their own insurance company, rather than the "at-fault" party's insurance company. Essentially, each insurance company is responsible for his or her own insured person because there is no fault.

Other Insurance Coverage Includes:

- **Road Service Coverage** – Mechanical service in case your automobile breaks down
- **Rental Reimbursement Coverage** – Pays for a rental car if your vehicle is stolen.



Managing Automobile Insurance Costs

Automobile insurance has not, and never will be, an inexpensive service. Automobile insurance premiums are related to the amount of coverage you choose, and other factors like your driving record, your place of residence, and your vehicle type.

Insurance Premium Factors:

- **Vehicle Type** – The year, model, and make of the vehicle will affect the cost of insurance premiums. Premiums for sports cars or cars with complicated repairs will cost more than an average four-door sedan. Also, vehicles that are commonly stolen will oftentimes cause your insurance costs to be higher.
- **Driver Classification** – Driver Classification is based on age, sex, marital status and driving habits. The number of claims filed, accidents, and tickets will all increase your insurance costs. Normally, people under the age of 25 and over the age of 70 are charged more for insurance coverage than people in between the two extremes.
- **Location** – Living in a city will cause your insurance costs to be higher than if you lived in a rural area.

You can reduce your automobile insurance costs by avoiding accidents, tickets, and maintaining a good driving record. As a college student, driver training programs and good grades will reduce your insurance costs.

Other ways to decrease your insurance costs include:

- Installing security devices on your automobile
- Being a nonsmoker
- Insuring two or more automobiles with the same company
- Increasing the amount of your deductible



Health Insurance

Health insurance is protection that helps alleviate the financial troubles resulting from an illness or injury. As an insured person, you will be required to pay premiums based on what type of health insurance you choose. Your insurer then pays the majority of your medical costs. Health insurance also includes disability insurance and can offer you coverage on doctors' visits, medication, hospital time, and even dental care.

Types of Health Insurance Plans

- **Group Health Insurance** – Employer sponsored insurance programs.
 - Makes up the majority of health insurance.
 - The employer carries the burden of paying the premiums.
 - Low cost due to many people in the company being under the same plan.
 - Vary in protection based on the discretion of your employer.

- **Individual Health Insurance** – Individually chosen and paid for insurance program.
 - Normally more expensive than group plans.
 - Bought from a company of your own choosing.
 - No limit on protection
 - Adapted to meet your own needs.

- **COBRA** – The Consolidated Omnibus Budget Reconciliation Act of 1986 allows recently laid-off **government or private company** employees to keep their previous insurance plans with their former company. However, the individual will be responsible for premium payments.

Each type of health insurance plan might offer extremely different coverage. When looking for an individual plan, you should compare different plans and their various rates and determine which plan best fits your needs. Sometimes, health insurance companies may be open to negotiation concerning the various types of coverage they offer.

It should be noted that most companies will provide long-term disability as part of a normal health insurance plan. However, there is normally a six month gap in between the actual injury and activation of a long term disability benefit in your health insurance plan. Therefore, if you're looking to obtain disability insurance immediately, short-term disability insurance will have to be purchased.

Short-term disability will cover the gap in time between the date of the injury and the date long-term disability coverage begins, usually six months with most policies. Therefore, if you do not have enough savings for six months of living expenses, investing in short-term disability will prevent you from serious financial loss.



Common Terms Found in Insurance Contracts

As with any important decision, it is important to evaluate your insurance policy before entering into a contract. In order to better understand insurance, below are some common terms found in health care offerings:

- **Benefits:** services included in a health insurance policy to which the insured person is entitled
- **Catastrophic Health Insurance:** an optional, but recommended type of insurance, with a high deductible, which covers an injury or illness that involves medical expenses above the normal limits of health insurance
- **Claim:** the health-related bill which is submitted for payment to the health insurance company, either by the individual policy holder or the provider
- **Co-payment:** dollar amount required by the policy that the policyholder pays for each visit to a medical service provider; amount varies with each insurance policy
- **Coverage:** a service which qualifies as a benefit under the specified terms of an insurance contract
- **Deductible:** the amount of money required by the policy to be paid by the policyholder before insurance starts to pay its part. Usually expressed as a yearly amount and may range from several hundred to several thousand dollars per year, depending on the terms of the insurance policy
- **Maximum Limits:** the highest possible dollar amount an insurance plan will pay for a single claim and over the lifetime of the insured person
- **Network:** doctors/facilities that contract with a health care organization
- **Out-of-Network:** doctors and facilities which either do not work for or which do not contract with a health care organization
- **Policy:** legal agreement between an insurance company and insured person, in which the company agrees to pay the medical services included in the contract and the insured person agrees to pay the specified price
- **Pre-existing Condition:** physical or mental condition that existed before the person applied for the policy, usually medical care has already been recommended or received; may not be covered by insurance at all, or only after a specified time lapse
- **Premium:** money paid by an insured person for the health insurance policy
- **Prescription Plans:** organized plan where prescription needs are provided to group members at a lower cost
- **Provider:** physician, hospital, medical care facility, or other type of medical personnel who provide health care to the insured
- **Referral:** method in which a physician directs a patient to the services of another physician



Types of Health Insurance Coverage

Health insurance programs can cover a wide variety of expenses. Some expenses such as hospital expense coverage and physician expense coverage are common, while others such as vision and dental care may not be as widely available. The following list represents the types of expenses that may be covered by health insurance:

- **Hospital Expense** – Coverage of hospital expense will pay for part or all of the costs accrued during a hospital stay. Nursing care, medical supplies, and hospital facilities are also covered. However, some insurance companies will set a maximum amount of coverage per day in the hospital. Therefore, it is wise to know the intricacies your health insurance policy incase you get injured.
- **Surgical Expense** – Coverage of surgical expenses pays for part or all of the surgeon’s fees for an operation. Oftentimes, policies will have specific, set amounts depending on what type of surgery is performed. If the entire amount is not covered, you will have to pay the difference.
- **Physician Expense** – Coverage of physician expenses pays for part or all of the treatment in hospitals and doctors offices that do not involve surgery. Normally, this coverage is used for co-pays and facilities in use at the doctor’s office or hospital.
- **Major Medical Expense** – Major medical plans are usually more expensive than basic health insurance coverage, requiring higher or even separate insurance premiums altogether. This is because major medical accounts for far more than does basic health care insurance. Normally, major medical is used for serious illnesses and accidents. High costs outside of the range of basic health insurance such as long hospital stays and emergency surgeries are accounted for under major medical coverage, leaving you with a smaller bill to pay overall.
- **Dental Expense** – Dental expense insurance provides for the expenses of dental services and supplies. Normally, oral examinations, fillings, root canals, dentures, and braces are covered.
- **Vision Expense-** Vision expense insurance can cover glasses, eye examinations, contact lenses, eye treatment, and eye surgery.
- **Long-Term Care** – Long-term care insurance provides you with coverage for the daily expenses of assistance you need if become seriously ill or you are unable to take care of yourself. Long-term care insurance is often used with long stays at nursing homes or assistance inside your home with daily activities.



Disability Income Insurance

Disability income insurance protects you from missed paychecks due to injury or illness. Under most circumstances, disability income insurance will provide regular cash income while you are unable to work due to non-work-related accidents, illness, or pregnancy. Most insurance companies offer disability insurance and coverage varies from company to company based on the severity of your injury or illness. Essentially, a good disability plan will provide income for you if you simply cannot work at your regular job. A bad disability plan will only provide income for you if you are severely injured.

When choosing your insurer you must weigh different options and decide what type of coverage is most important to you. Some tradeoffs are listed below:

- **Waiting Periods** – Higher premiums (payments) mean that you will not have to wait as long to start receiving your disability benefits. However, if you're paying lower premiums, your waiting period may increase significantly and more income will be lost as a result.
- **Duration** – Every policy will name a specified period during which benefits will be paid. Policy duration ranges from a few years to full life coverage. When choosing a disability insurer, you should consider full life coverage.
- **Amount of Benefit** – Aiming for 60% or more of your take home pay is a healthy goal when choosing your disability plan. However, premiums rise as your percentage increases.
- **Sickness Coverage** – Nearly all disability plans pay for non-work-related accidents. However, coverage for sickness is not as prominent. Acquiring sickness coverage will increase your premium, but provide more protection.

The main goal when looking for a disability insurance provider is to replace the benefits that you would need to meet your day to day expenses if you become injured or sick. Most people idly disregard the need for disability insurance and do not realize that the losses in income and benefits are more costly to the average American citizen than hospital bills. As a student, it would be wise to establish a solid disability plan during or upon graduation as you begin to earn a significant income.



Basics of Sample Employee Benefits

Upon graduation, you will be faced with decisions about your employment, your healthcare, and the planning of your financial future. Knowing the basics about the different options available will greatly ease the stress of making important decisions about how to begin saving for your future.

Common Types of Retirement Plans Offered

There are basically two types of retirement plans: Defined benefit plans and defined contribution plans.

Defined benefit plans promise you a specified benefit at retirement. The plan may state this promised benefit as an exact dollar amount (for example \$100/month) or it may calculate your benefits through a plan formula that considers salary and length of service (for example 1% of your average salary per year of service with your employer).

Defined contribution plans do not promise a specified amount of money at retirement. Rather, you or your employer (or both) contribute to an individual account. These contributions are invested for you. At retirement, you receive the balance in your account, which is based on contributions plus or minus investment gains or losses. The value of your account will change with the value of your investments.

Below are some examples of common retirement plan offerings.

- A **401(k) plan** is a defined contribution plan where you choose to contribute a specified portion of your salary to the plan. Your money is then put into an investment portfolio. This money will not be taxed until you receive it. Your employer may also choose to match your contributions up to 50%. There are special rules about the operations of a 401(k) plan, such as the dollar limit on the amount you may put into the plan each year and the amount your employer can contribute. If your employer offers this type of plan, it is wise to read and understand the conditions of the plan before choosing to participate. Also, you may be allowed access to the funds in the plan before you retire. While this may be tempting, you should always leave the funds alone until retirement, except in extreme cases.
- If you become employed by a public school or university, church, or non-profit organization, you may be offered a **403(b) Tax-Sheltered Annuity Plan**, which is similar to a 401(k) plan. Like the 401(k), this plan lets you defer some of your salary. The money is not taxed until it is distributed. Although the tax benefits of this plan are useful, there are fewer investment options available with this plan than with a 401(k) and there may be a penalty for withdrawals made by an employee under the age of 59 ½.
- **Employee stock ownership plans** are defined contribution plans in which the employee's investment are primarily in the form of employer stock. These plans

were created as a way to encourage employee participation in corporate ownership and involve the employee in the company in a more personal way.

- A **profit-sharing plan**, also known as a stock bonus plan, is a defined contribution plan which may provide a set amount or an amount determined each year to a plan based on profits of the company. The conditions of the plan will contain a formula for the amount you receive based on your individual contribution. The profit sharing plan may also include a 401(k) plan.
- An **Individual Retirement Account (IRA)** allows you to make contributions from your income into a personal investment account. Often employers will take these tax-deferred deductions directly from your pay, and may match part of your contribution. IRA's are generally a very safe investment but the amount of the money you actually receive depends on the financial market. There are stiff penalties for early withdrawal, and you may be required to pay income tax on any money taken out, depending on the type.

There are three types of IRA's: Roth IRA's, Simple IRA's, and Education IRA's.

- 1) **Roth IRA:** The money you put into a Roth IRA is taxed as you contribute it. Your earnings grow and qualified withdrawals are tax free. When you withdraw the money from this fund, you do not have to pay taxes at that time, as it has already been paid. These types of accounts are best for low to middle income levels.
- 2) **Simple IRA:** Under a Simple IRA plan, employees may choose to make contributions from their salaries and the employer makes matching contributions. These contributions are taxed at the time your earnings are withdrawn, so they can be distributed tax-free at the end of the account.
- 3) **Education IRA:** A modified IRA used for parents to save for higher education. Nondeductible contributions can be made for a child under the age of 18 and withdrawn tax-free when they are needed for educational purposes.



Common Types of Health Care Offered by Employers

Health insurance plans are a common benefit offered to employees. Depending on your current physical condition, some of the offerings may not apply to you, but as with any major decision, it is important to understand the terms of a contract you are signing. Basic descriptions of common employee health care plans are listed in the next section.

What is a HMO?

A Health Maintenance Organization (HMO) is a type of Managed Care Organization providing health insurance coverage that is fulfilled through hospitals and doctors contracted by the HMO and included in the HMO network.

- Care provided through the HMO generally follows a set of guidelines provided by the network. The health care providers provide services at a discount. This allows lower monthly premiums than traditional insurance companies do.
- Most HMOs require members to choose a primary care physician to act as a "gatekeeper" to medical services. Medical needs go through this PCP, who authorizes referrals to specialists. Exceptions to the "gatekeeper" rule include emergency medical care and women may be allowed to select an OB/GYN, whom they may see without a referral. In special cases, a chronically ill patient may be allowed to select a specialist as a PCP.
- HMOs manage all aspects of their patients' health care and can reduce unnecessary services.
- HMOs provide preventive care for a lower fee, in order to keep members from developing preventable conditions that may involve a great deal of medical care in the future. These services may include, but are not limited to mammograms, immunizations, physicals, and well-baby checkups. Costly services found to be unnecessary are generally not included, such as elective plastic surgery.

Common Types of HMOs

- In the **staff model**, physicians are direct employees of the HMO and have offices in HMO buildings. In this model, the physicians only see patients of the HMO.
- In the **group model**, individual physicians are members of a contractual group and the HMO pays the group, rather than the individual physician. The group is responsible for the distribution of the money paid by the HMO.

- In the **open-panel HMO**, physicians contract with an independent practice association (IPA), which contracts with the HMO. In this situation, a physician will generally keep a private office and may see non-HMO members.
- In the **network model**, an HMO contracts with any combination of groups, IPAs, and individual physicians. This model has become more popular in recent years and benefits both the HMO patients and physicians.

What is a PPO?

A Preferred Provider Organization (PPO) is a group system organized by a health care insurance company.

- Physicians of all specialties and hospitals contract with the system and agree to provide healthcare to the PPO's patients. These medical providers accept the fee schedule and guidelines developed by the PPO for its managed medical care.
- Rather than paying a monthly fee for the service, the member pays a co-payment at the time of actual medical service. Each member also pays a yearly deductible before the PPO will begin paying medical fees. Once this deductible has been met, the insurance usually pays a high percentage of the cost of medical care within the network, while the patient is responsible for the remainder of the charges.
- If the patient prefers to see a doctor that is not in the network, the deductible will generally be higher and the insurance company will pay a smaller percentage of the fees. This encourages the people insured with a PPO to use the physicians from within their network.
- The advantages of a PPO include flexibility of seeking any type of health care without having to get approval from the primary care physician. PPO networks also include prescription plans, which allow the patient to receive prescription drugs at a reduced cost. The overall cost a PPO is less than individual health care coverage and will usually include more types of medical services.



Other Benefits Offered by Employers

In addition to the above common types of benefits discussed above, the law requires employers to provide employees with certain benefits. These include:

- Time off to vote, serve on a jury, and perform military service.
- All workers' compensation requirements will be complied with.
- Withholding of FICA taxes from paychecks and payment of the employer's portion of FICA taxes, providing employees with government sponsored retirement and disability benefits.
- Payment of state and federal unemployment taxes, in order to provide benefits for unemployed workers.
- Contribution to state funded short-term disability programs where applicable
- Compliance with the Federal Family and Medical Leave (FMLA).

Aside from those legal obligations and the retirement plans and health insurance plans already discussed, often additional benefits are offered. Common benefits offered by employers are listed below.

- Dental or vision plans
- Life insurance plans
- Paid holidays: Many employers provide paid holidays for New Year's, Memorial Day, Independence Day, Labor Day, Thanksgiving Day and Christmas Day. Many employers also allow their employees to take time off without pay or use vacation days for other religious holidays.
- Paid vacation: Most full-time employees expect one to two weeks paid vacation time per year. Additionally, most employers allow two to four days' leave for deaths of close family members.
- Paid sick leave



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