Debt Management Guide 2008

Bad credit

Bad credit can hurt a consumer in many ways. Understand how debt negotiation and bankruptcy work.

Bad credit

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Bad credit hurts in many ways

By Julie Sturgeon • Bankrate.com

Most people understand that low credit scores will translate into higher mortgage and credit card interest rates. But few realize there are plenty of other insidious ways that low scores can add to a person's costs.

Where credit hurts

Car insurance

The fact that some companies base auto insurance premiums on credit scores comes as a surprise to most of the clients working with Trish Lynch, a financial specialist with ClearPoint Financial Solutions in Richmond, Va.

In fact, some national and large regional players apply your scores on the initial application for insurance, others pull your score every three years, said Bruce Hale, a Conning & Co. research analyst.

It boils down to consumers with bad credit paying between 20 percent and 50 percent more in auto insurance premiums than their good-credit neighbors, says Clarence Smith, who authored an insurance study for Conning.

"It's profiling," Lynch says. "Think about it: If you have all these credit issues, a lot of times your mind is not exactly where it should be, like when you're driving."

Homeowners insurance policies also follow this path.

Car loans

In 2004, the Consumer Federation of America announced that its investigation into American Honda Finance Corp. revealed dealers in this car manufacturer's network charged different markups to customers from different credit tiers. Those in the least creditworthy tier could face prices that were 3.5 percentage points higher than their better credit brothers.

Although they have capped their markups at 2.5 percent, General Motors Acceptance Corp. and Ford Motor Credit Corp. take the same approach.

People with poor credit usually pay an interest rate between 19 percent and 26 percent on a new car purchase, compared with the six percent to seven percent average, says Lynch.

People don't equate that into dollars and cents," she says. "That can be a difference of $100 to $200 a month on your car payment. It hits the pocketbook kinda heavy."

Job

The second shock that hits Lynch's clients between the eyes: Employers care about those credit ratings.

Just ask Sanyika Calloway Boyce, a "financial fitness coach" who graduated from Norfolk State University a semester early with honor society membership, several internships and $15,000 in unsecured debt. She says the latter canceled out all of her positives with potential employers. And that was in 1994.

Today, 70 percent of companies will check credit before they decide to hire a candidate, says Doug Borkowski, a financial counselor for Iowa State University's Financial Counseling Clinic. Larger companies are more likely than small ones to check.

The fear is that credit problems at home create tension and distraction at work, Lynch says.

"If you are their employee, will you be getting phone calls from collectors at work? Will the employer have to garnish your wages?" she asks.

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