Your Financial Action PLAN

12 Simple Steps to Achieve Money Success

G. Cotter Cunningham

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Cotter Cunningham
September, 2004

FOREWORD

When I became involved with Bankrate in 1993, managing one's finances effectively was difficult at best. The ability to obtain timely "apples to apples" comparisons of various banking products such as mortgages, CDs, credit cards, home equity and auto loans was limited mostly to rates published in newspapers and magazines. This information was usually provided by Bank Rate Monitor, our predecessor company. At that time, Bankrate covered only 16 products in just 25 markets. Although there were many options available to consumers, a comprehensive view of the best banking products and rates for their needs was all but impossible to obtain.

All that has changed. Today, Bankrate offers editorial and rate information on 250 products in more than 200 markets nationally—with products and markets being added constantly. Up-to-the-minute rate comparisons and product information are instantaneously available for free to the individual through Bankrate.com. Each year so many people consult Bankrate.com that it has become the leading consumer banking site on the Internet. Its rate information is distributed by 140 newspapers, including nine of the nation's top ten, a roster that includes such luminaries as the *Wall Street Journal*, *The New York Times,* and *USA Today*. Bankrate is even the data source of record for the Associated Press, Bloomberg Financial Markets, and the Federal Reserve.

In recent years, Bankrate has expanded beyond the rates arena to cover an increasingly broad array of consumer finance issues. We have added financial calculators, email newsletters, a weekly Rate Trend Index to help predict interest rate trends, and new channels on investing, taxes and small business.

There is a very high level of trust in the Bankrate brand thanks to its dedication to both high-quality journalism and rigorously checked rates data. Together, they allow consumers to become educated, make valid comparisons and then act with confidence. Today, five million Americans turn to Bankrate each month to help them with their most important financial decisions.

Our years of looking at consumer personal finance issues comprehensively and objectively come together in this book. We have distilled the most fundamental financial needs of consumers into an action plan. With its 12 easy steps, you can be in control of all your finances. I very much hope you will use them.

Peter C. Morse
Chairman, Bankrate, Inc.

introduction
THE HOLE IN YOUR POCKET

What Is Financial Literacy?
Where Does America Stand?

You may have academic smarts and street smarts, and may even be able to pick stocks more wisely than by throwing darts at a wall. If you are not financially literate, however, you are not really smart. A Ph.D. may not keep you out of the Poor House Door if you are not also committed to good personal finance habits.

Sad to say, most Americans are not. They are woefully unprepared, walking around the financial jungle with paper bags on their heads. By being uninterested, they are paying too much interest! They are very likely paying more than they should in fees—and earning less than they could in credits. And all those money concerns may be keeping them up at night.

A record number of Americans have mortgages now, and they turn to the business pages often before even checking out the headline news. Money has become, if not an obsession for many of us, then an overriding preoccupation—how to stretch it, make it, and use it.

Bankrate.com, the leading provider of personal finance information on the Internet, commissioned its first study on America's financial literacy in 2003, and repeated the same set of questions in 2004 to a nationally representative sample of 1,000 Americans. The survey employed the gold standard of polling—random-digit telephone dialing—and has a margin of error of three percent. We commissioned this study to find out how financially sophisticated Americans are so that we could make our Internet site, Bankrate.com, better and more useful to our readers.

We asked Americans if they pay bills on time to avoid late fees, read their bank statements regularly, check their credit reports annually for accuracy, have emergency funds of at least three months' living expenses, and have wills. We probed whether Americans shop around for the best insurance rates and coverage, comparison shop for the best deals on their mortgages, and look around for and switch to credit cards with lower rates. We questioned whether Americans follow monthly budgets, adjust their W-4s annually to make sure they are not giving the government too much money, and whether they contribute to retirement accounts.

When Bankrate released the findings of its benchmark "Financial Literacy" study in 2003 and again in 2004, it captured the interest of print, radio, and television outlets nationwide, all keen to report on the state of America's financial literacy. The seminal finding of the study is that most Americans are aware of what to do when it comes to managing their money. Americans are reasonably well-educated about the basics of money management. However, when Bankrate asked if people were actually doing these things, only 10 percent of our survey respondents got an "A." Most received a "D" or "F."

We have a gap between attitude and action. And it is this gap that contributes to Americans' anxieties about money. Twenty-four percent of Americans profess to be dissatisfied with their personal financial situations. Another 44 percent are only somewhat satisfied. Perhaps more revealing is that while three out of five people believe they are in control when dealing with their personal finances, that same number has neither refinanced their mortgages in the last few years, nor do they know how much life, auto, and health insurance to carry.

In *Your Financial Action Plan*, Bankrate.com, which collects and distributes information on more than 200 financial products, offers a 12-step self-analysis guide so readers can determine how financially literate they are. We then provide 12 simple steps to help people forge the financial futures they want.

Unlike other books in the money bin, *Your Financial Action Plan* is *not* about stocks and bonds and investments. It's about the gap between what you know and what you need to do in your day-to-day encounters in personal finance—a gap that is costing you money. Using Bankrate's expertise and easy-to-understand guides, closing this gap is not difficult. But the benefits are monumental.

In January 2004, Bankrate.com again commissioned RoperASW to survey 1,000 adult Americans about what they know about money matters and how well they manage their finances. Sad to say, our report card is not improving. With a grade of 66 out of 100, Americans get a "D" in the subject, almost flunking.

You may never have to translate Beaudelaire, determine the chemical composition of gases, or untangle the symbolism in *Alice in Wonderland* once you leave school. But you will always have to deal with money matters. And if you have poor habits and do not follow through on the basics, it can really hurt you.

What you know about financial matters really matters, not just for the more comfortable bottom line that invariably accompanies good habits, but because of the more comfortable sleep you will derive from peace of mind. Those who have a solid grasp of financial issues are richer in many ways. For example, financially literate people paid substantially less for their home loans than those with little financial literacy. Students at the top of the financial class locked in mortgages with a mean interest rate of 5.95 percent. Those at the bottom of the financial class ended up with loans carrying a 6.8 percent rate—a 14 percent difference amounting to thousands of dollars a year in saved interest expense.

Most Americans are laggards when it comes to financial fitness—and pay lavishly for their ignorance in their bottom lines and comfort. Where do you stand—or slide—on the issues? Take our 12-step self-analysis test to see if, financially speaking, you are in as sorry a state as much of the rest of the union. At the end, you can grade yourself. But remember, even if you in your finances resemble the overweight person who perpetually vows to start dieting next week, you *can* draw the line in the sand. Taking this self-assessment is the first step.

Get out a piece of paper and a pen. Then read each of the twelve questions carefully and rate yourself using the following scale:

If your response is . . .	***. . . give yourself this many points***
All the time (or Yes for questions 4, 6, and 10)	3
Sometimes	2
Rarely	1
Never (or No for Questions 4, 6, and 10)	0

1. Do you keep an emergency fund of at least three months' living expenses?
2. Do you regularly pay your bills on time?
3. Do you faithfully follow a monthly budget?

4. Did you contribute to either a company-sponsored retirement account or an Individual Retirement Account (IRA) within your past working year?
5. How often do you read your bank account statements?
6. Have you prepared a will?
7. How regularly do you shop around for the best insurance quotes and coverage?
8. Do you regularly look for and switch to credit cards with lower rates?
9. Do you check your credit report annually for accuracy?
10. How regularly do you make more than the minimum payments on your credit cards?
11. Do you comparison shop for the best deal on your mortgage?
12. Do you adjust your W-4 form annually to make sure you are not giving the government too much money?

How do you compare? Grade yourself.

Example

Total points scored	28
Number of questions answered	12

Add up your total number of points. Divide by the number of questions you answered. Multiply the answer by 33.333 to convert your score to a percentage score.

Grade yourself on a 100-point scale: 90–100 is an “A,” 80–89 a “B,” 70–79 a “C,” 60–69 a “D,” and 59 and below an “F.” In the example given, 28/12 × 33.3333 = 77.78, or “C+”.

Overall, Americans scored a “D” for financial literacy, which is no better than in 2003. The grading curve broke down like this:

Score	*Grade*	*% of Americans who "made the grade"**
90–99.99	A	7
80–89.99	B	19
70–79.99	C	20
60–69.99	D	19
0–59.99	F	36

*Adds to more than 100 due to rounding

What follows are eleven findings from the survey.

1. Two out of three people say it is very important to keep at least three months' living expenses in an emergency fund and another 26 percent consider it somewhat important. (After all, rainy days happen and people lose jobs and have car accidents.) Yet only 40 percent actually follow through on this ideal and another 28 percent do so only sporadically.
2. Although 93 percent of all Americans agree it is "very important" to pay bills on time to avoid late fees, only 80 percent claim to do it consistently. For some credit card companies, late payment penalty fees are an onerous $39, with the average late fee around $26.
3. People give budgeting lip service. They understand the value of a budget, but most do not make one. Nor do they track their expenses.
4. While most people acknowledge that they *should* regularly contribute to an individual retirement account (IRA), fewer than one in three is doing so regularly. If you are under age 50 and earned $3,000 in that year, you can deposit up to $3,000 annually in your IRA; those 50 and older can plunk in $3,500. Under tax legislation passed in 2001, the contribution amounts for individuals younger than 50 will increase incrementally

until hitting a $5,000 contribution level in 2008. Older workers also will be able to invest more in their IRAs each year, with the catch-up amount topping out at $1,000 in 2008. In a traditional IRA, that cache grows tax-free until it is withdrawn, usually after age 59½. Money withdrawn before age 59½ will usually get hit with a ten percent penalty, but there are some exceptions. In a Roth IRA, money invested will grow, and can be withdrawn in retirement, tax-free.

5. Seventy-four percent of people say they regularly read their bank account statements. Unfortunately, there are some people who are not even sure what type of account they have! An interest-bearing checking account, for example, usually requires you keep a minimum balance. A non–interest-bearing checking account may not require a minimum balance, but you earn zero interest on your deposits.

   Those who do not read their statements cannot sync them with their checks, recognize fees such as monthly service charges, or make sure they have sufficient funds to cover a check. Knowing when your checks are paid and deposits are available can prevent you from overdrawing your checking account and facing some nasty fees.

6. Despite the saying, "Where there's a will there's a way," more than 40 percent of people 35 and older do not have one. Where there's not a will, there's a way for a dispute to arise. People need wills to ensure that their assets go to whomever they choose.

7. Some 61 percent of Americans say it is very important to shop around for the best insurance quotes and coverage, but just 39 percent actually do it. (Amazingly, 59 percent admit they do not know how much life, auto, and health insurance they have—or should carry.) And when it comes to credit cards,

most Americans know that switching to one with a lower interest rate is a good idea, yet 31 percent never bother to do it. Indeed, 24 percent say that as long as they can afford their payments, they do not worry much about the interest rates they are paying. This is akin to tossing money out the window.

8. Whether you are applying for a loan or credit, knowing what your credit report says about you will determine not just whether you get the loan but how much you will pay for it. Yet while 44 percent believe that it is very important to check their credit report annually for accuracy, only 30 percent do it.
9. Almost three-quarters of Americans say they always make more than minimum payments on their credit cards. This is very good news. Now we just have to make it a habit to pay off the balance each month!
10. A fourth of those with mortgages did not comparison shop for them, despite the fact that a mortgage is the biggest single financial transaction most people make in their lifetimes.
11. Some 54 percent of Americans say it is very important to adjust their W-4 forms annually to make sure the correct amount is being withheld from their paychecks for income taxes, but just 38 percent do it.

Did you make the dean's list? Only a quarter of Americans did. More than a third failed the quiz. The reason is that most of us know what we should do when it comes to personal finances, but a lot of us do not do it. We tend to put off today the financial chores that we can do tomorrow.

A record 1.65 million consumers filed for bankruptcy in 2003. Many more are expected to take that drastic step in the next few years. Do not let yourself be one of them. Close the gap between what you know you should be doing financially and what in fact you are doing.

This book gives you useful facts you need to know to become a smart money manager. Our chapters are easy to follow, organized by the questions in the financial literacy quiz you just took. You can read the book straight through or focus only on the chapters that cover areas where you scored poorly. Either way, you will find valuable tools to help you take control of your finances.

While money may not actually buy happiness, knowing how to manage money effectively provides greater peace of mind. Overwhelmingly, those who are financially savvy are much more likely to be satisfied with the state of their personal finances and much more in control. When so much in life is out of our control, the reduced stress that financial literacy affords is, to borrow a MasterCard phrase, priceless. Let's put the "fun" back in *funds!*

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