DIVORCE

and

YOUR CREDIT

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Rhode Island
DIVORCE MEDIATION CENTER

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The Truth About Credit

Credit impacts our lives in many ways which is why divorcing couples face a virtual mine field when it comes to minimizing the impact their divorce can have on their credit rating. Refinancing an existing mortgage or buying a new home or car, renting an apartment and securing individual credit accounts, *also known as starting over*, all hinge on healthy credit. While there is no way to prevent *any* impact on credit during a divorce the way joint debts, authorized user accounts, mortgages and other types of loans are separated dictates the amount of damage... And how easy or difficult it will be for both spouses to start over.

When it comes to credit scores and how they are tabulated by credit agencies it's fair to say their methods are considered the most guarded secret in the world of finance. This lack of transparency leaves consumers, especially divorcing spouses, disadvantaged when it comes to managing, maintaining or repairing their credit rating.

The three major credit bureaus, *Trans Union, Experian and Equifax*, compute and update consumer credit activity continuously and independently of each other based on information they receive from creditors. Credit scores are a *'snapshot in time'* based on the information on your reports at the time of the credit report request. The inherent flaw in the reporting system is that creditors are not required to report their information to all three bureaus so it's not uncommon for some accounts to be absent on one report but appear on the others, and tthis is why credit scores differ between the bureaus. These factors make it important to obtain credit reports from all three bureaus prior to initiating a divorce and especially before taking steps to refinance a marital home, which I discuss later in this report.

Most people are unaware that there is a right way and a wrong way to disentangle themselves and separate their consumer credit accounts during a divorce, and few people seek the guidance they need to prevent unnecessary damage that can hinder their settlement. But, the fact is, working with experienced professionals can make credit issues during divorce easier.

Once a divorce is finalized I recommend each spouse obtain another credit report from all three bureaus, 3 - 4 months after all divorce-related changes have been completed, to insure their credit profiles are accurate and up to date, reflecting accounts that have been paid,

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Consumers are entitled to one free consumer credit report per year from each of the three credit bureaus, however these free reports will not include your credit score. If you want your scores included you will be charged a fee. If your goal is to just make sure your reports are accurate and they reflect all of the accounts that have been closed or separated, you can obtain the first reports without your scores, then obtain the reports with the scores once you are sure your entire credit file is accurate. I recommend using eithehr *Experian's website* or *annualcreditreport.com* which offers the option of obtaining all three reports and being able to compare them side by side, as opposed to credit report websites which offer 'pay later trial memberships' in exchange for including your credit scores with the reports.

The Ties That Bind You

Disentangling financially in divorce is a daunting task in and of itself, and while many couples struggle with the financial shift of having to pay their debts on one income instead of two, their divorce also forces them to make changes to consumer accounts with limited knowledge of the impact these changes will have on their credit rating. This can present a number of problems when it comes to re-establishing credit or purchasing real estate after a divorce.

Since credit reporting agencies don't provide transparency into the credit scoring process consumers are left guessing at how to best manage divorce related changes that could cost them as much as a 100 point drop in their score just for applying for credit or closing an account at the wrong time. And since creditors aren't required to report to all three bureaus, there's no guarantee all your credit accounts are being accounted for in your overall profile. This may be good news for consumers who can't always pay their accounts on time, but for those who do, they may not be getting the full benefit of their financial diligence.

Most divorcing couples have joint consumer debts typically in the form of:

- mortgage(s)
- joint credit cards
- credit card accounts with one spouse as an authorized user
- installment loans, or
- secured or unsecured lines of credit

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Divorcing requires all of these obligations to be addressed and depending on the terms of the settlement these accounts will need to be closed at some point during or after a divorce. With most credit card companies, accounts can't be closed if there is a balance owed; the account can only be frozen until the balance is paid which is sometimes the only option for divorcing couples. But, it's important to remember that when the account ***is*** closed, it will ding the credit of both spouses. If a joint account must be closed ***after*** a divorce, it must be coordinated and not interfere with the current, pending or approaching financial transactions of either spouse.

Having spent many years working in the world of credit and finance, I consider myself fortunate to have been able to attend several 'industry professionals only' seminars conducted by one or more of the major credit reporting agencies. But even then, while we did receive more information than what's available to consumers, they did not open the door and reveal what consumers really need to know. The information I provide in this guide is compiled from my experience working with credit management issues and the most recent and available information from industry professionals but it should not be perceived as absolute or perfect advice but rather a guide because the credit industry can and does make changes at their discretion and often without any advance notification to the general public.

Consumer Credit Accounts

The first thing divorcing couples need to know is how their consumer accounts are held:

- individually
- jointly, or
- individually with their spouse as an authorized user

This information is easy to obtain by contacting the creditor and asking if the account was opened jointly or if your spouse was added as an authorized user.

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When an account is joint both applicants are contractually responsible for payments regardless of who uses it. Neither spouse can just be removed from a joint account since the extension of credit and the spending limit are based on the income and credit scores of both applicants.

An account held by one spouse with the other spouse as an authorized user has a credit limit based solely on the applicant's credit and income, but the authorized user also has a card with the same charging privileges as the applicant. Unlike joint accounts, authorized users are not financially obligated to the creditor so payments are the sole financial responsibility of the account holder regardless of who makes purchases. Removing an authorized user from an account is simply a matter of the applicant contacting the creditor and requesting the authorized user be removed. In the past, consumer credit accounts such as credit cards only appeared on the credit reports of the applicant however, now, some creditors report the account's activity on the authorized user's credit profile as well depending on the creditor.

When an account is held individually no action is required. However; regardless of how an account is held, most states consider the balance(s) of consumer accounts a joint financial responsibility which must be addressed during the financial settlement process. If either spouse wants to retain the relationship with a particular creditor of joint account, or transfer the balance (or partial balance) of the joint account to an individual account, a new application must be submitted to the creditor. This is also required for mortgages and home equity lines of credit (HELOCs), secured installment loans and automobile loans/leases.

Separating joint automobile loans and leases, secured personal loans and any type of mortgage is more complex and poses a bigger risk to credit scores. Since these loans are based on combined income and credit scores it can be more difficult or impossible to separate them. In the case of automobiles, a lease can not be rewritten without penalties, if at all, and if they can the other party must qualify for financing based on their own credit and income. When it comes to automobile loans, mortgages and HELOCs these types of loans must be refinanced with the new borrower qualifying for financing based solely on their credit and income. The only exception is a mortgage that contains an *assumption* clause, which is not common and typically only allows a relative to take over the mortgage without needing to refinance the loan, but strict guidelines apply.

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The importance and complexity of credit in a divorce cannot be overstated and couples should take all the necessary steps to understand how to best work with their unique circumstances.

Credit Facts and Figures

Financial difficulties relating to a job loss, reduction of hours, illness or divorce are common and indirectly impact credit scores. The inability to meet monthly financial obligations on time comes with greater penalties than in the past because most credit card companies now charge a late fee if your payment isn't received on the date it was due in comparison to years past when that fee was only assessed if your payment was 30 days late. These tightened rules also include more penalizing action where creditors can decease the credit limit of an account without prior notification to the consumer if payments are not made on the due date.

This is problematic for consumers because if the decreased credit limit causes the balance of an account to exceed 30% of the total available credit, it increases what's called a *credit utilization risk*. In other words, the closer an account balance is to the amount of credit available, the more negative the impact is on credit scores. According to many industry professionals, credit history used to be the big factor in determining credit scores, but today that has been replaced by the credit utilization risk factor.

The following factors also contribute to consumer credit scores:

- payment history
- the amount of time an account has been open
- applying for new/additional credit
- the number of open credit accounts
- the types of credit accounts open, ie: mortgages, revolving, installment
- closing accounts
- the number and frequency of hard inquiries

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Credit balances and closing accounts aren't the only financial matters that can complicate divorce and credit. Marital homes also present problems when the balance of a mortgage exceeds the home's value. When neither spouse will remain in the home, either because they choose not to or they can't afford to, the options are either bankruptcy, a short sale, foreclosure or a Deed in Lieu of Foreclosure. From a credit perspective any of these will adversely impact credit. Recently Fair Isaac - the company that developed credit scores - finally pulled the curtain back a bit on how mortgage delinquency problems can impact consumer credit scores depending on the consumers entire credit profile and history which is illustrated in the range of impact below.

30 days late	40 - 120 point drop
90 days late	70 - 135 point drop
foreclosure, short sale or deed-in-lieu	85 - 160 point drop
bankruptcy	130 - 240 point drop

Separating Joint Credit

One fact about jointly held accounts is that both spouses are contractually responsible for the debt regardless of any court order or decisions made by a couple - the contract with the lender trumps a divorce decree. Since most creditors will only freeze a joint account if there is a balance owed, some couples aren't able to fully resolve their joint obligations until after their divorce when the debt can be paid in full.

If accounts will be closed during or after a divorce is final the same care must be taken to minimize the impact on both spouse's scores. This requires coordination and the cooperation of both parties. Since I've already shared that all credit activity impacts scores here is how to best manage separating your credit. Activity of any kind on credit matters so the goal is to keep it to a minimum.

Your credit will take a hit for every account that is closed so contact the creditors and request the closure of accounts all on the same day, preferably before the end of the first week of the month. This will result in activity in your credit file being limited to a few days. Even though your credit will take the hit it will recover quickly because all the activity occurred in a short period of time. When accounts are closed randomly there are multiple hits to a credit profile with each one causing a drop in the score. This lengthens the time it takes for scores to recover.

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Making The Best Choices

When most people hear the term *divorce preparation* they assume it's for people who have lots of assets or own businesses... But the truth is, if couples have ANY assets - or children - they should prepare for their divorce. But what exactly does divorce preparation mean and why should it be part of your process?

Preparing for your divorce means gathering whatever information and facts you'll need to make informed decisions. That's it.

It's easy to underestimate the impact of a divorce when your overwhelmed. The last thing anybody looks forward to doing is collecting mounds of financial documents, however; I can personally attest to the fact that the impact of not being prepared is far more painful and costly than the amount of time it takes to be informed and prepared.

The problem is most people don't know where to start... So they either take advice from other people - like friends, family or lawyers, or they try to go it alone. I don't recommend either of these options and here's why.

First, no two divorces are the same. Financial circumstances, parenting issues and a myriad of other factors make every divorce unique. Second, other people, as well meaning as they may be typically don't have expertise in financial matters and, yes, this includes most attorneys.

Whether your credit is great, good or no so good, you need guidance that helps you maintain or improve your current circumstances, but you have to be willing to put in the effort. After all, it's your quality of life we're talking about.

The biggest mistakes I made were in the financial aspects of my divorce and I learned some hard lessons after the fact, but you don't have to make the same mistakes I made.

Take your time, get your facts, and work with experienced professionals who can help you solve whatever problems your divorce is creating, make the process less stressful and direct you to the best possible outcome.

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