EPISODE 1818

FT: So Money episode 1818, Ask Farnoosh.

[INTRODUCTION]

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ANNOUNCER: You're listening to Money with award-winning money guru, Farnoosh Torabi. Each day, you get a 30-minute dose of financial inspiration from the world's top business minds, authors, influencers, and from Farnoosh herself. Looking for ways to save on gas or double your double coupons? Sorry, you're in the wrong place. Seeking profound ways to live a richer, happier life? Welcome to So Money.

[EPISODE]

[0:00:31.6]

FT: Welcome to So Money, everybody, I'm Farnoosh Torabi. It's Friday, April 25th, you're listening to Ask Farnoosh. Our Friday edition of the podcast, where we tackle your money questions, and today, the theme is largely about credit health. Many of you are wondering about credit scores, utilization, payment history, how to keep our credit profiles strong, and that's a good thing, where our heads are in the right place.

Credit is, as I'd like to say, the unsung hero of financial resilience. Yes, you need savings, yes, you want to be investing, but having good credit, having a good credit score, it gives us leverage, it helps us borrow better, pay less in interest, negotiate better terms, whether we're looking for a mortgage, or a car loan, or a refinancing old debt, and right now, we don't know the fate of interest rates, do we? We don't know where they're going.

They're kind of up in the air at this point, as we're waiting to see how things are going to shake out with the tariffs, where will inflation go, will we have a recession. We can't control that, obviously, but credit, our credit health, is a tool that we can nurture, and we're going to talk more about how to do that, thanks to some folks in the audience that have questions around that, but before we dive into your questions, I want to start today's episode with a quick roundup of Money News.

Yeah, because it's a lot these days, and I want to just sift through the headlines, especially the ones that really caught my attention, and I think are particularly important and critical for us to hear about, because it affects how we bank, in this case, how we bank, how we borrow, and even how we tip. There was an interesting article in the Wall Street Journal.

[0:02:14.6]

FT: Let me start with that one, actually, because I was going to do that last, but that one is – this is something that you might want to take to your friends this weekend because it – I think it says a lot about our culture, and our fatigue around tipping, but there was an article in the Wall Street Journal this week that revealed how Americans are tipping less than they have in years. They asked a thousand readers.

And many of them said that they are fed up with these tip prompts, especially, when they're, say, at a café or they're in a store, and they're just buying a bottle of water with their credit card and the prompt's like, "Would you like to leave an 18% tip?" I don't hold that against the store sometimes, it's just the way they've programmed, you know, the software, and the software can't know that you just bought a bottle of water, so we're not going to ask you for a tip.

Maybe it could be programmed that way; that wouldn't be a bad idea, but nevertheless, it's left so many Americans upset and over it. Over it, we're done. We're done tipping, this tipflation, you know, it came out of the pandemic where we tipped more, and I think, rightfully so, to support all the service workers, but now, we've got stagflation in many categories. We have these sneaky service fees.

Like, I had no idea that I was getting coffee at this place, all the time, which was always charging me a percentage, 3% or something, every time I used my credit card. They didn't have any signage at this particular coffee shop. It wasn't until I went to one of their other coffee shops in town, there's two of them, and saw the sign that said there is surcharge for credit card usage.

Honestly, I don’t even know if they have a cash register in this coffee shop, would they even be able to take my cash? I don't know.

We've all just gotten used to it, we’ve all gotten used to these baked-in fees. I’m not in the camp of “let’s tip less.” I just want to be clear about that. I think it’s important to tip, especially for good service. If you had bad service, that’s a whole other situation, but even in those cases, I always like to say, like, try to resolve it with your server, and also remember that often, if you server is slow or brings you the wrong food or whatever, or is overwhelmed, like, it’s not actually their fault.

It may be a fault of the restaurant, the backend, the frontend, and the server, sometimes is just trying to do their best, but you know, as anyone who has worked in the restaurant industry, I’m raising my hand, it takes everyone in that restaurant to work in sync for customers to have a good experience, and the servers are on the frontlines, and often, we misinterpret bad service as this server doesn’t know what they’re doing or they’re being negligent.

And I’m not saying that there aren’t negligent servers, but always try to work it out. Usually, restaurants are more than willing to correct a situation or go above and beyond if a customer is unhappy, in my experience, at least. But yeah, if you’re buying a bottle of water from Starbucks, or anywhere, basically, the rule of thumb is if there was no service, in the sense that like, nobody was back there making you something or putting something together for you, or putting any thought into what you’re buying.

You’re just pulling it out of the refrigerator, you’re pulling it off a shelf, and you’re buying it. It’s like, you don’t go to the grocery store and leave a tip, right? For that bottle of water, why would you leave a tip for that bottle of water at a café? And I would love it if these stores would reflect this on their credit card screens, on their payment screens, right? But again, I don't know if this is just a limitation of the software.

But you shouldn’t get angry at them, you know? And you shouldn’t like, and it shouldn’t leave Americans to just not tip. At the end of the day, if you don’t want to tip, you shouldn’t go out there and get serviced. We unfortunately don’t live in an economy where we’re paying our service workers a livable wage. They really do rely on these tips, and if you're going to sit at home, in the convenience of your home, and order Uber Eats.

And expect a driver to go get your food, bring it to your house, you don't have to do anything, like, that person should get a nice tip, and you should pay a service fee for that. You're paying for the convenience. I think it's also interesting that the Wall Street Journal did this survey because a lot of their readers, I know, are on the wealthier end. So, I just I'm not – not to extrapolate here.

But I do wonder, are these people that have the financial capacity to tip, and they're fatigued over it, I don't know. To be continued. I just thought it was an interesting article about over the weekend. Why don't you ask your friends, "How are you tipping these days? What's your tipping protocol?" In other news, there is a very disheartening thing going on in Washington, I know that doesn't really narrow it down.

So, here's what I'm talking about. The Consumer Financial Protection Bureau, also known as the CFPB, is getting gutted, people. There is a quiet dismantling of this consumer watchdog agency that was created after the 2008 financial crash, led by Senator Elizabeth Warren. The CFPB has and still continues to the best of its ability, protect consumers like you and me. They're the reasons some of us got refunds for junk credit card feeds, or for the fact that we were shielded from predatory loans.

They're the people who hold the financial industry accountable when things go sideways, but this week, we learned that the administration is slashing the CFPB's staff by 90%, 9-0. That means fewer investigations, fewer enforcement actions, far less oversight, and in the same week, guess what happened? Congress repealed a rule that would have capped overdraft fees at five dollars.

So now, banks can go back to charging their usual USD 35 per transaction if you overdraw your account even by a few pennies, and that rule would have saved Americans billions of dollars per year. So, now, what does this mean for us? Well, it means that more than ever, we have to be vigilant, be our own watchdogs. Choose your bank wisely, look for transparency, look for fewer fees, insist on good customer service.

If you don't like your bank, I know it's cumbersome to switch banks, but if it's really costing you more than it's affording you, then I would say start searching, and consider all these sorts of financial institutions out there, including credit unions and online banks, and community banks, and we have to read the fine print as always, but especially now, with a magnifying glass, and keep a close eye on your statements.

That's the best way to catch these sneaky fees before they spiral. Go into your apps, look at your expenses, and if something feels off, you got to speak up. You can still file complaints with the CFPB while it's still around. This is where we are, and I think it's just indicative of a larger trend towards deregulation. So, in this climate, more important than ever that you stick with podcasts like these, you talk about money with your partner, with your family.

You read the fine print, you ask the questions, you advocate for yourselves because this advocacy group, the CFPB, which was doing a lot of important work for us while we slept, is pretty much gone now, and then another headline that I thought was really important to highlight today, is that federal student loan collections are going to pick back up on May 5th. So, if you've been in default on your federal student loans, you've probably been okay for about five years.

There was a five-year pause where nothing was collected, but starting on May 5th, the Department of Ed is going to resume collections, and there are more than five million borrowers in default in this country. There are millions who are also delinquent. So, what does that mean when they come after your debts? That means that if you don't have it and you're not paying it, you're going to see wages garnished, tax refunds ceased.

And yeah, they could even tap your Social Security checks. If you are a borrower in this camp, you should be getting an email soon explaining how to get back into good standing, whether that's through loan rehab or enrolling in an income-driven repayment plan. This era of widespread forgiveness is going away, and there's new enforcement. If this applies to you or someone you know, now is the time to get proactive.

Don't wait for your paycheck to take a hit, reach out to your loan servicer, explore your options, and again, be your biggest advocate. In case you miss any of our episodes this week, let's do a rewind. On Monday, I sat down with Brian Kelly, founder of The Points Guy, and author of the New York Times bestseller, *How to Win at Travel*. We talked about points, perks, plane tickets, how to book smarter this year.

I actually went on The Today Show this week and provided some of these tips. If you're flexible and you can book one to two weeks out, this is a pro tip airlines, airlines often release unsold seats at deep discounts one to two weeks out, and I did check this. I went on to an airline app that I use a lot, I checked a flight to the Bahamas, in 10 days, USD 600, compared to later in May, the same flight, USD 1,100.

So, this tip checks out, and I know not all of us can fly last minute, especially families. You want to all sit together, these are not necessarily seats that are all going to be neatly in one row, so keep that in mind. Then on Wednesday, Selena Soo joined me to talk about her book, *Rich Relationships*. This is a very important guide, I think, especially now, as we're looking to take inventory of all of our assets.

As we look towards the second half of this year, a lot of us are worried about getting laid off, we're curious about where our careers are going to take us, maybe we want to do a pivot, and we need relationships to get us there, right? So, Selena is the queen of relationship building, and she's written a guide on how to build meaningful, professional relationships, especially again, for those of us who want to grow our careers.

And here's the thing, how to do it without the sense of transaction, without the "Ick", you know? Selena is all heart and strategy, so please, take a listen to that episode if you haven't yet, and one fun announcement, if you are in the Montclair, New Jersey area, and you want meet Zarna Garg, comedian, whose new book, *This American Woman*, comes out next week. She and I are going to be having a conversation at Loopwell in Montclair on Tuesday, April 29th, in the evening.

You can go into my show notes for that link to register; it's going to sell out. Zarna is on a tear right now. She is one of the funniest humans alive, and can't wait to support her new book. So, if you're in the Montclair, New Jersey area, come out, see us, Tuesday night at Loopwell.

[0:12:55.0]

FT: All right, let's open the mailbag. Our first question comes from Carla, who writes, "Hey Farnoosh, I'm a 30-something who is fortunate to have no debt, other than an auto loan I took out a few months ago for a new car. This is my first time having a car that's all mine, and not shared with family or siblings, which is really exciting. Believe it or not, the dealers' 4.75% APR was better than what my credit union offered at the time, so I went with them."

"This is a 60-month loan, but as a person who's generally debt averse, I told myself I would pay it off ASAP, ideally in a year or less, and I've been pretty aggressive about it, and finally, I'm down to about a thousand dollars left on this USD15,000 loan, and now that I'm almost at the finish line, my question is this: Would there be any negative consequence to paying this loan off early?"

"I did ask about a prepayment penalty when signing for the loan, and I got a document saying that there is no prepayment penalty, but would this affect my credit, like closing a credit card would? And if so, would it be that bad? Especially considering I'm not planning any big purchases anytime soon. I know that many folks in the financial space might say that I would have been better off just paying the loan down more slowly and investing that money instead."

"But I just don't like debt, and unless there's a major consequence for getting this done, I'd like the peace of mind that comes with not owing any money." Okay, Carla, thanks so much for your question. I totally get the peace of mind piece of this. Look, our emotions matter, and the fact that I have an episode coming up soon with Aja Evans, who is a financial therapist, she's written a book called *Feel Good Finance*.

And how to bridge the gap that we often have between how we feel and how we are managing our money, it's important to build a healthy bridge, and if, for you, Carla, that healthy bridge means I'm going to focus on paying off my debt sooner than later, then so be it, and you should be proud of the fact that you're tackling this loan and you're almost at the finish line. So, let's break this down step by step.

Great work figuring out whether there's going to be a prepayment penalty, really important. If you're going to prepay any loan, your student loans, your mortgage, personal loan, a car loan, read the fine print. Not all financial institutions want you to pay it off early because they were planning to hold on to your money a little bit longer, because they've got investments on their end.

So, you paying it off early, it's not always a guarantee that you can do this without some sort of penalty, so important to check for that before you do it. The prepayment penalty, if there is one, would be in the loan agreement, but if you don't have that, it means you're free to pay it off early without any hidden costs.

Your question is about the credit score impact of closing this account effectively, not having this loan any longer on your credit profile. Paying off the loan early it may have a small temporary impact on your credit score, but I wouldn't lose sleep over this. Now, why would it even impact your credit score? When we're looking at what is the makeup of a credit score, the ingredients that go into a credit score, one of those ingredients is your credit mix.

Companies like FICO and other credit score calculators they like seeing a variety of credit. They like that mix because it suggests that, in theory, that you have the ability to manage different types of credit, that you have a credit card, which is different from a student loan, which is different from a car loan. If you got all of those credits in the mix, they give you extra points for that. They like to see the variety.

But it's a small variable within your credit score calculation. It is only about 10% of your credit score, so the impact is minimal. The impact of removing this car loan from your credit profile, which might have other types of credit, is minimal. The other ingredient that's baked into your credit score is your payment history. This is the biggest factor impacting your score, and paying off the loan won't erase all of your positive on-time payments.

They'll remain on your credit report for up to 10 years, and they'll continue to work in your favor. There is a myth that if I close a credit account, all that good work of paying it off, all the history behind that account will be wiped, and the truth is, it won't. it won't for 10 years, it will stay on your credit report, and it will continue to work in your favor. Closing a term loan, like a car loan or a student loan, different from a credit card, which is revolving credit.

There is no, like, deadline, there's no term on credit cards. Credit cards tend to weigh more in the credit score algorithm. So, when you close a credit card versus a term loan, it's not as impactful when it comes to your credit score. Car loans, like other term loans, they don't contribute to the credit utilization ratio, that's that other important ingredient in your credit score. That's the amount of debt you're carrying versus the credit available.

That's really only applied to credit cards, not your student loans, your mortgage, your car loan, again, these term loans. So, paying it off early is not going to affect this particular ratio, so it won't affect your score in that way. The only real impact here is that you might lose a little bit of that variety in your credit mix, but again, that's just 10% of your credit score, so the impact is not huge, and that's that.

I think you should pay this off, feel good about it, pat yourself on that back, and parting tip now that this debt is out of the picture, imagine what else can I do with this payment, right? If I was already in the habit of paying X dollars a month towards the car loan, where else can I apply this now, where it's going to make a meaningful shift in my financial life? Could it mean putting more in your retirement account?

You're already in the habit of paying this, so now, just shifting it to somewhere else in your financial life that could be meaningful to you, I think, is my parting advice.

[0:19:18.7]

FT: Our next question from Leah, also about credit. Leah is considering canceling a department store credit card, and wants to know what's going to be the impact on my credit score. Will it be significant? I've just reviewed a few of the elements that go into your credit score calculation. In this case, in Leah's question, we're talking about a credit card, which is a different category of credit from Carla's car loan, right?

Credit cards do play a bigger role in shaping your credit score. So, let's break this down. Canceling a credit card it does have an impact on your credit score, but will it be significant, depends on a few key factors. The first is going back to that credit utilization ratio. This is a measure again of how much you have in available credit that you're using. Canceling one card reduces the total available credit on that card, which could increase the ratio.

So, if you're effectively decreasing the denominator in this ratio, which if, simple math, it means that your percentage goes up, everything else being held the same. For example, if you have 20,000 dollars in total available credit across multiple credit cards, and canceling this store credit card, which they tend to have lower limits, let's just say 5,000 dollars. Let's say you get rid of it; now your total drops to 15,000 dollars' worth of available credit.

If you're spending stays the same, then your utilization ratio will go up, and the key here is you want to keep this ratio under 30%, ideally under 10%, to maintain a strong credit score. So, if you are paying off your balances every month, Leah, this is basically a non-problem for you, right? Because your credit utilization, at least at the end of every month or billing cycle, is zero percent.

The only time I would say to be careful about your credit utilization ratio, even if you are in the habit of paying off your balances in full every month is that if you are in the market for a new loan and your credit score is going to get pulled, that credit score can get pulled in the middle of the month when you've just bought like a 6,000-dollar round trip family flights to Greece or something, right?

And you are planning to pay that off, but right now, your credit utilization is high, perhaps, and your credit score will reflect that in that moment. So, just keep that in mind if you're somebody who is going to be shopping for other kinds of debt, and your credit score is going to get pulled, your credit utilization ratio will be important, and I will be paying off my balances a little bit faster in that case.

So, that at any point if the credit score gets pulled, it won't show sort of an artificial ratio, right? Because, like you were planning to pay off that debt, it should really be zero percent, knowing your habits, but unfortunately, the technology is not that smart. So, credit utilization ratio, the question for you, Leah, is if you cancel this credit card, how will it affect that ratio? How much higher will your utilization rate jump to?

Length of credit history is also important; the average age of your accounts is what we mean by the length of your credit history. If that department store credit card is one of your older accounts, canceling it could reduce your average age over time. Closed accounts, however, do, as I mentioned earlier, stay on your credit report for up to 10 years. So, the impact won't be immediate. I assume you have other credit cards.

If it's not someone that you've had for many years, less to worry about. If you listen to everything I say and you're like, "Okay, I'm a little spooked, I don't want to cancel it, but I also don't want to have it in my life anymore." A couple of options, you can just put it away. You can put it in a sock drawer, in the old days, like it would freeze their credit cards, you can put it in the freezer, or you could ask to change the terms.

So, maybe you're canceling this card because they're going to start charging you an annual fee. Ask if the credit card issuer can give you a no-fee version, if there is another card that better suits your needs, and a lot of times, issuers will work with you to keep you as a customer. Coming up after the break, we're going to talk about investing and maximizing your emergency fund this year. Stay tuned.

[BREAK]

[0:23:53.4]

FT: Welcome back. Our next question comes from Sierra, who is ready to start investing after she has hit her emergency fund goals. She says, "Farnoosh, I finally hit my goal of six months in savings, plus a little bit for future home repairs. I want to invest part of these savings and keep part in a high-yield savings account. Currently, I am using Wealthfront, and they are offering a portfolio of index funds auto-managed for 0.25% annual fee."

"The average return on this portfolio is 14% over the past three years. Is paying 0.25% annually a reasonable management fee, and do you have any other advice for me?" All right, Sierra, congrats on reaching your emergency fund goal. That is no small feat, huge milestone. So, this 0.25 annual management fee from Wealthfront is reasonable for what they're providing you, which is robo-advisement.

It's not like a handheld human who is meeting with you like a financial adviser. In that case, your fee is one percent, 1.25%. So, this is reduced because it's an automated platform. That 14% return, though, that you mentioned over the past three years, is great, but I just want to point out that it's just a three-year snapshot, and that's all it is, and that period included a very strong post-COVID market recovery.

And historically, a diversified portfolio of index funds tends to return anywhere from seven to 10% annually over the long run, like I'm talking decades. So, Wealthfront's portfolio, like other portfolios that track a similar index, they probably performed really well in the last three years. The S&P 500, if you were just investing in that, in 2023 and 2024, your portfolio is up 23, 24% every year.

That's not going to be every year, by the way, right? For the rest of your investing course. So, just bear that in mind, it's a nice percentage that they're putting on in their marketing material, because it's true, but it doesn't necessarily mean that it's going to extend throughout your investing life. I would plan for more conservative growth going forward, and I would even expect some down years.

As far as how to divide the saving versus investing, how much to put in the high yield, how much to invest, I would say put in your high-yield savings account whatever you need for the short term. Your home repairs, your upgrades, anything you want to tackle within the next year to three years. High-yield savings accounts they're earning around 4% right now, so your savings will grow steadily while staying liquid.

Liquidity is key because once you put the money in the stock market, it's not to say that you can't take it out, but it won't be as simple as just transferring money from a checking account to a savings account. This is really where you're putting money in here that you don't really need for at least five years because you have savings, and you have liquidity in other ways, and you want to build wealth, and you want to put this money to more work.

I like the idea of investing in low-fee index funds. If you are in your 20s or 30s, being aggressive and having most of that portfolio, most of those index funds, tracking stocks would ensure that you'll have higher returns over time. There will be market volatility, there will be some risk, but you can afford it more than somebody who say, like, in their 50s and 60s. For those folks, I would say be more conservative, maybe it's a split of 50% stocks and 50% bonds.

But Sierra, you're on the right track. Wealthfront's fee, I think, is fair. I've actually seen higher costs in their space. So, I think this is really reasonable, and then splitting your funds between savings and investments, thinking about what do I need for the short term, that goes in high yield, long-term, I can invest, and go from there. I am excited for you. Keep us in the loop with all your progress and continue to – feel free to ask questions as you move through the year.

[0:28:18.3]

FT: And finally, we have a question from Chelsea about a financial app that can help with budgeting. So, she says, "Farnoosh, please, remind me of the app that you mentioned on the show, where you can see a summary of all your financial accounts in one place. I'm trying to start my 2025 budget." The app you're thinking of is probably Personal Capital, which is now called Empower.

It's an excellent tool, it's free for tracking all your financial accounts, checking, savings, credit cards, they even have a hookup to Zillow, if you want to include your home worth, and then at the top of the dashboard, it shows your overall net worth, and then it breaks it down by category of finances. So, it's like your savings, your investments, or you could put all sorts of things onto that dashboard, and it's great to keep a running number in your mind of what you owe or what you're worth.

You can track your spending in by category and compare it to your monthly goals. It will tell you like, "You spent this much more this month or this week than last week." Empower also offers free tools to analyze your retirement savings. They really want to get you to the paid side, though. Once in a while, you'll get a pop-up that's, "Hey, let's chat." They're a full-service retirement planning and investment firm.

This is their gateway to get clients in. I haven't moved further from their dashboard, but I'm a fan, and if Empower isn't the right fit for you, there are others. There's You Need a Budget, that's more for hands-on budgeting. You'll be able to track every single dollar. Some people don't like that, and I get it. There's also, we talked about Wealthfront. They have some tools, and wherever you're investing or banking, again, they probably have some free tools for customers.

Chelsea, good luck with your 2025 budget, and it's January, so you're already ahead of the game, getting organized early. I love it.

[END OF DISCUSSION]

[0:30:21.9]

FT: And that's our show, thank you for tuning in. Thank you for your questions. We've talked about paying off car loans, canceling credit cards, balancing your savings with your investments, and then some tools to help you stay on top of your money. Not a bad way to kick off Ask Farnoosh 2025.

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