

Ch. 28 - Credit: A Promise to Pay

Objectives:

- Learn what credit is.
- Compare advantages & disadvantages of using credit.
- Outline the process of applying for credit.
- Examine what a credit history is and why it is important.
- Learn how to manage credit responsibility.
- Explore the consequences of excessive debt and how to correct it.
- Learn what to do about an inaccurate credit report.

What is credit?

Credit is a loan that enables you to buy something now that you will have to pay for later.

What Do You Think?

Credit Facts

- 1. Nearly 33% of teens owe money to either a person or company, with an average debt of \$230.**
- 2. About 26% of teens ages 16-18 already have more than \$1,000 in debt.**
- 3. 30% of teens say they understand how credit card interest and fees work.**
- 4. 36% of teens say they know how to establish good credit.**

Credit Terminology

- Creditor-One who lends the money.
- Debtor-One who borrows the money.

Consumer credit - used for personal reasons

Commercial credit - used for business purposes

Advantages of Credit

1. To handle financial emergencies.
2. To improve your general level of living and well-being.
3. To take advantage of seasonal sales and bargains.
4. To purchase large or expensive items and enjoy while paying for them.
5. To make purchasing more convenient.
6. To manage overall expenditures.
7. To establish and enhance a credit rating.
8. To beat inflation.
9. To keep savings intact.
10. To provide goods and services while traveling.

Disadvantages of Credit

1. Finance charges and/or interest.
2. Failure to understand that credit is an increase in debt not an increase in salary.
3. Future earnings are already committed and spent on unnecessary purchases and interest.
4. Impaired ability to think critically about purchases.
5. There is a great temptation to overspend.
6. Credit cards may be stolen, lost or misused by others.
7. Poor credit rating, reputation and/or loss of property.
8. At first provides a false sense of security.
9. Later can contribute to sleepless nights, worry and arguments.
10. Decreases cash savings over time.

Credit Rating

- A measure of a person's ability and willingness to pay.
- Credit Worthiness means to have an established credit record that shows you are a good risk.

Building a Good Credit History

- Always pay your bills on time.
- Demonstrate a consistent savings pattern to creditors by making additional regular deposits into your account.
- Be choosy about your credit cards and loans.
- Maintain a low balance on one card and pay it off each month.

Hurting Your Credit History

- Making late payments.
- Writing checks when you don't have enough money in account to cover them.
- Having numerous credit cards & loans.
- Maintaining high balances on your credit cards and loans.
- Changing credit cards frequently.

The Three C's of Credit

1. CAPITAL
2. CAPACITY
3. CHARACTER

Credit Worthiness is based on the three C's of Credit.

Credit Record is a report that shows the debts you owe, how often you use credit, and whether you pay on time.

Credit Bureau is a company that gathers information on credit users and then sells the information to credit granters.

Capital-Financial resources you have that support your commitment to pay a debt.

ex. Savings, Home, Car, or other Property

Capacity-Your ability to pay your debts.

ex. Job, Sufficient Earnings, and Continued Employment.

Character-Your willingness to repay your debt.

ex. History of paying debts

Prompt payments of debts

Straight forward response to creditors if there has been trouble paying off your debt.

Examples

Loan or Not to Loan?

- John, age 18, has just graduated from high school. He has been employed part-time for the past two years at the same company. He still lives with his parents, but would like to move out. He purchased a car when he was 16 years old, however he borrowed money from his grandfather and makes payments (not a fixed amount) whenever he can to his grandfather. The car is in his parent's name. John would like to get a loan so he can move out on his own. What "Cs" is John lacking? Explain.

Loan or Not to Loan?

- Elizabeth, age 30, rents a duplex. She has a 2002 Toyota Corolla that is paid for. She works part-time jobs here and there. The longest she has ever been at one job is six months. Her hobby is making crafts and would some day like to open up her own craft store. Elizabeth has made a continuous effort for paying her bills on time. Elizabeth has finally decided she would like to go ahead and open up her craft store. She has been doing well at the local craft fairs and thinks she could do fairly well opening her own store. Elizabeth needs to take out a loan to help open her store and pay for some of her expenses. What "Cs" could Elizabeth be lacking? Explain.

Loan or Not to Loan?

- Andrew, age 26, is currently unemployed. He opened a savings account when he was 16 years old and it has been collecting interest ever since. He currently rents an apartment in a wealthy neighborhood. He tries to make an effort to pay his bills on time, but every now and then his payment is late. Andrew has decided he needs a little extra cash to take a vacation in the Bahamas. Would you give Andrew a loan? Why or why not?

Interest

- Interest is the price paid for obtaining credit.
 - Interest Rates are determined through interaction of supply and demand.
 - Interest Rates for different types of credit vary.
 - Interest Rates reflect the credit history of borrowers.
 - High risk borrowers will pay higher interest rates.

Where can you obtain Credit?

- Banks & Credit Unions
- Credit Card Companies
- Finance Companies
- Automobile Dealers
- Oil Companies (gas stations)
- Retail & Department Stores
- Federal Government (student loans)

Credit Terminology

- Credit Limit-The maximum amount you may charge on a credit card.
- Finance Charge-The dollar amount paid to use credit.
- Grace Period-The time, usually about 25 days, in which you can pay your credit card bill without paying a finance charge.
- Minimum Payment-The smallest amount you are required to pay the lender each month.
- Annual Fee-A flat, yearly charge for owning a credit card
- Annual Percentage Rate (APR)-A measure of the cost of credit on a yearly basis; expressed as a percentage.
- Average Daily Balance-The most common method of calculating interest. The lender adds up the amount owed for each day of the billing cycle and divides that number by the number of days in the billing cycle.
- Balance-The amount owed to the lender, including purchases, fees, interest, and transaction charges.
- Cosigner-A person who agrees to pay a loan if the borrower fails to do so.
- Cash Advance-The use of a credit card at a bank or automatic teller machine to get a cash loan. VERY HIGH INTEREST RATE.

Responsibilities of Using Credit

- Keep your charge account paperwork and records of your number, expiration date, address and phone number of the card company in a safe, available place.
- Sign your credit card in ink right after it arrives.
- Never sign a blank charge slip.
- Only charge what you can comfortably pay off the next month.
- Don't exceed your credit limit.
- Destroy any carbons that contain your account number.
- Pay promptly and as much of the bill as possible.
- Don't let your total credit card debt exceed 15% of your take-home pay.
- Notify your creditor immediately if your card is lost or stolen.
- Never lend your cards to anyone, no matter what.
- Never give your card number to anyone over the phone unless you initiated the call, or know the caller.
- Open your billing statements immediately and compare them with your saved credit receipts.
- Write your card holder immediately if you have any disputed or questionable charges on your account.

Ch. 29 - Getting Credit and Keeping Credit

Establishing Credit

- Applying for Credit
 - Begins with the three Cs of Credit
 1. CAPACITY to pay
 2. CHARACTER
 3. CAPITAL or collateral

Collateral is a form of security to help guarantee that the creditor will be repaid.

How to establish a credit history:

- Apply for a secured credit card
- Secure a loan
- Obtain a retail credit card
- Become an authorized user on your parent's account or on another person's account

Credit History

- Check your credit history at least once a year.
- Contact one of these three agencies by phone, mail, or email:
 - Equifax credit information services
 - Experian
 - Trans Union

Buying on Credit

- Installment-Regular monthly payments in specific amounts.
- Installment Sales Credit-Credit contract issued by the seller that requires periodic payments.
- Secured Loan-Need collateral
- Unsecured Loan-Signature or character loan; rate is usually high

Rules When Shopping for Credit

- Compare cost
- Try and make a large down payment
- Reduce the length of the loan
- Make large monthly payments
- Seek a low APR

6 Questions to Ask When You Compare Credit

1. What's the interest rate for purchases?
2. How long is the loan for?
3. What's my minimum monthly payment?
4. What's the grace period?
5. What extra fees and penalties may be charged?
6. Which is the best deal for me?

Simple Interest

- Simple Interest

$$\text{Cost of Credit} = \text{Principal} \times \text{Rate} \times \text{Time}$$

Principal is the amount you initially borrow.

Credit Problems can Lead To:

- Garnishment of wages-Allows creditor to take part of your wages if you miss a payment.
- Repossess of Item-Legal right for the creditor to take back the collateral.

Types of Credit Cards

- Bank Charge Cards-Charge purchases; billed at the end of the month. Ex. Visa, Mastercard
- Travel & Entertainment Cards-For entertainment services. Ex. Diner's Club, Carte Blanche, American Express
- Oil Company Cards-Issued for use at their affiliates. Ex. Texaco
- Retail Cards-Can be used only at that store. Ex. Target, J.C. Penny's, Sears

Three Types of Charge Accounts

- Open Charge-Expects payment in full at the end of a specified period.
- Budget Charge-Payments of a certain fixed amount; amount is paid over several months.
- Revolving Charge-Can be charged at any time but at least part of the debt must be paid each month.

Warning Signs of Charge Card Abuse:

- Life would be terribly difficult if they took away all my credit cards.
- I pay my bills on time. But, I have to keep using my credit cards because I run out of cash between paychecks.
- I usually borrow from friends and relatives to make ends meet each month.
- When I come home from shopping, I usually hide the things I bought so my family won't see them.
- The balance in my savings account is shrinking and it's hard to save money.
- I'm a good juggler. I can always find a way to put off paying a bill so I can pay my charge cards on time.
- I have two Visas and two MasterCard.
- Yes, I've used the cash advance on one credit card to make payments on my other credit cards.
- Hey, my credit card payments are eating up more than 20% of my monthly income.
- I usually pay only the minimum monthly payment on my credit cards.
- Someday I'll get the money to pay off all my charge cards.

Ch. 30 - Credit and the Law

Protecting Your Credit Rights

- Usury Laws
 - Laws restricting the amount of interest that can be charged for credit.
 - Nebraska's legal rate of interest is 6%; the general usury limit is 16%.

Consumer Credit Protection Act

- Truth-in-Lending Disclosure Act
- Equal Credit Opportunity Act
- Fair Credit Reporting Act
- Fair Credit Billing Act
- Fair Debt Collection Practices Act

Truth-in-Lending Disclosure Act

- Requires that all costs of borrowing be made known to the consumer.
 - Costs must be expressed in two ways; the dollar cost of credit (total finance charge), and is the percentage rate (APR).
 - Also outlines credit terms and conditions.

Equal Credit Opportunity Act

- Must be judged only on the basis of financial responsibility.
- Can't be discriminated against on the basis of age, sex, marital status, race, religion, or nationality.
- Only three reasons for denying credit: low income, large current debt, and poor record of payments in the past.

Fair Credit Reporting Act

- Gives you the right to know what is in your credit file.
- Must be notified when an investigation is being conducted.
- Privacy, only authorized persons may see a copy of your report.

Fair Credit Billing Act

- States the steps to follow when there is an error in your account.
 - Notify the creditor in writing
 - While waiting for a reply, you don't have to pay the part in question.
 - Also allows consumers the ability to stop a credit card payment for a damaged or defective product given that the consumer has tried unsuccessfully to return the item.

Fair Debt Collection Practices Act

- Made practices of late night calling, seizing property, and even trying to collect more than what is owed illegal.
- Collection agents must identify themselves.
- Can't tell others about the debt.
- Cannot contact people at work, if that is not permitted by employer.

Federal Trade Commission

- The FTC
- Has responsibility to enforce the laws of credit

Problems with Credit?

- Seek advice and assistance from a **credit counselor**.
- Bring your debts together into one loan, called a **consolidation loan**. Two dangers with this is that it carries a higher interest rate & can create a false sense of security for the debtor.
- Your last resort is to file for **bankruptcy**.

Bankruptcy

- A legal process in which some or all of the assets of the debtor are distributed among the creditors.
- Chapter 7 - family or personal; stays on credit report for 10 years.
- Chapter 13 - family or personal; stays on your credit report for 7 years.
- Chapter 11 - business