

# CHAPTER 10

# CREDIT

## You're in Charge

### WHAT'S AHEAD

**10.1** What Is Credit?

**10.2** How to Qualify for Credit

**10.3** Sources of Consumer Credit

**10.4** Credit Rights and Responsibilities

**10.5** Maintain a Good Credit Rating

## LESSON 10.1

# What Is Credit?

## GOALS

- ▶ Identify reasons to borrow and the trade-offs you make when you borrow.
- ▶ Discuss how to plan when and how much to borrow.

# KEY TERMS

- credit
- equity

# Why Borrow?

- ▶ For your goals
- ▶ For a home
  - ▶ A home as an investment
  - ▶ Equity
  - ▶ Taxes and homeownership
- ▶ For your education
- ▶ For your health

# Plan Your Borrowing

- ▶ When to borrow
- ▶ How much to borrow

# CHECKPOINT 10.1

- Why is borrowing an important part of most people's life-span financial plans?
- Why should you be careful not to take on more debt than you can easily repay?

# CHECKPOINT 10.1 ANSWERS

- Why is borrowing an important part of most people's life-span financial plans?
  - Many life-span goals require more financial support than most people are able to pay for through saving.
  - Examples include homes, automobiles, and education.

# CHECKPOINT 10.1 ANSWERS

- Why should you be careful not to take on more debt than you can easily repay?
- Credit can easily lead to out-of-control spending, and debt will increase as will the interest owed.
- Taking on more debt than you can easily repay can make life uncomfortable.



## LESSON 10.2

# How to Qualify for Credit

## GOALS

- ▶ Explain how lenders judge your creditworthiness.
- ▶ Describe the factors that determine your credit rating.

# KEY TERMS

- **creditworthiness**
- **character**
- **credit history**
- **cosign**
- **capacity**
- **capital**
- **credit bureau**
- **credit rating**

# Your Creditworthiness

- ▶ **Character**
- ▶ **Capacity**
- ▶ **Capital**

# Your Credit Rating

- ▶ Loan applications
- ▶ Credit bureaus
- ▶ Credit ratings

# Credit Rating Factors

- ▶ Payment history
- ▶ Current debt
- ▶ Length of credit history
- ▶ New accounts and inquiries
- ▶ Types of credit used

## CHECKPOINT 10.2

- How does a lender use the three C's of credit?
- What kinds of information is a credit bureau collecting about you?

# CHECKPOINT 10.2 ANSWERS

➤ How does a lender use the three C's of credit?

A lender judges your creditworthiness using the three C's of credit:

- Character
- Capacity
- Capital

# CHECKPOINT 10.2 ANSWERS

- What kinds of information is a credit bureau collecting about you?
  - Your past borrowing
  - Your repayment history



## LESSON 10.3

# Sources of Consumer Credit

## GOALS

- ▶ Explain differences between a secured and an unsecured loan.
- ▶ Describe benefits and costs of using credit cards.

# KEY TERMS

- secured loan
- collateral
- installment loan
- unsecured loan
- regular charge account
- revolving charge account
- grace period
- credit limit

# Types of Consumer Borrowing

- ▶ Secured loan
  - ▶ Collateral
  - ▶ Installment loan
- ▶ Unsecured loan

# Sources of Loans

- ▶ **Banking institutions**
- ▶ **Other sources of consumer loans**
  - ▶ **Finance companies**
  - ▶ **Payday loans**
  - ▶ **Life insurance companies**
  - ▶ **Credit card cash advances**
  - ▶ **Pawnbrokers**
  - ▶ **Rent-to-own companies**

# Credit Cards

- ▶ Regular charge accounts
- ▶ Revolving charge accounts
- ▶ Sources of credit cards
- ▶ Credit card incentives

# Credit Card Costs

- ▶ Annual fees
- ▶ Interest
- ▶ Limits and penalties

# Control Credit Card Costs

- ▶ A loan as an alternative
- ▶ The minimum payment trap
- ▶ Choose the least expensive card

## CHECKPOINT 10.3

- What is the difference between a secured and an unsecured loan?
- What should you consider when choosing a credit card?



# CHECKPOINT 10.3 ANSWERS

- What is the difference between a secured and an unsecured loan?
- A secured loan is backed by a thing of value (collateral).
  - Borrowers risk the loss of their pledged collateral if they are unable to repay the loan.
  - An unsecured loan has no such collateral.
  - Unsecured loans generally carry high interest rates because of the increased risk taken on by the lender.

# CHECKPOINT 10.3 ANSWERS

- What should you consider when choosing a credit card?
  - The cost of the card (annual fees, interest rates)
  - Limits and penalties associated with the card
  - Whether the card offers incentives or supports organizations you consider valuable

## LESSON 10.4

# Credit Rights and Responsibilities

## GOALS

- ▶ Discuss ways that laws protect your credit rights.
- ▶ Describe how to take responsibility for your own financial health.

# KEY TERMS

- **finance charge**
- **annual percentage rate (APR)**

# Consumer Credit Rights

- ▶ Truth in lending
- ▶ Equality in lending
- ▶ Protect your credit history
- ▶ Act if you are refused credit
- ▶ Resolve billing and product quality problems
- ▶ Protection from abusive collection practices

# Consumer Credit Responsibilities

- ▶ Accept responsibility
- ▶ Know your debt capacity
- ▶ Credit and family
- ▶ Self-control with credit
  - ▶ Pay more than the minimum
  - ▶ Avoid too many credit cards
  - ▶ Pay cash
  - ▶ Keep accurate records

## CHECKPOINT 10.4

- How do laws pertaining to consumer credit protect your rights and help you make good credit decisions?
- Describe a common sense approach for determining whether you can responsibly handle more debt.

# CHECKPOINT 10.4 ANSWERS

- How do laws pertaining to consumer credit protect your rights and help you make good credit decisions?
- Truth in Lending Act (1968) ensures that all lenders calculate credit costs in the same way so that consumers can more easily compare rates.
- Fair Credit Reporting Act (1971)
- Equal Credit Opportunity Act (1975)
- Fair Debt Collections Practices Act (1977)
- Consumer Credit Reporting Reform Act (1996)
- Fair Credit Billing Act



# CHECKPOINT 10.4 ANSWERS

- Describe a common sense approach for determining whether you can responsibly handle more debt.
- If nothing is left after this calculation, you can't afford more debt:

$$\text{Take-home pay} - \text{Fixed expenses (rent, utilities, etc.)} - \text{Other expenses (food, gas, clothes, etc.)} - \text{Savings} \leq 0$$

- Credit cards require self-control because it is tempting and easy to buy too much or repay too little.

## LESSON 10.5

# Maintain a Good Credit Rating

## GOALS

- ▶ Explain how to establish a positive credit history.
- ▶ Discuss how to avoid credit problems and get help if you need it.

# KEY TERMS

- acceleration clause
- balloon payment
- identity theft
- debt consolidation loan
- bankruptcy

# Establish Your Credit History

- ▶ Start small
- ▶ Establish your own credit
- ▶ Avoid common credit mistakes
- ▶ Read what you sign
- ▶ Be aware of identity theft

# Help for Credit Problems

- ▶ Debt consolidation loans
  - ▶ Cost of a debt consolidation loan
  - ▶ It's a bandage, not a cure
- ▶ Credit counseling services
- ▶ Bankruptcy

## CHECKPOINT 10.5

- What steps should you take to establish a positive credit history?
- If you experience credit problems, what steps can you take to get out of debt?

# CHECKPOINT 10.5 ANSWERS

- What steps should you take to establish a positive credit history?
- Start small by opening a store credit account
  - Pay your bills on time
  - Save regularly
  - Charge small amounts and pay them off immediately
  - Live in the same place
  - Don't change jobs often

# CHECKPOINT 10.5 ANSWERS

- If you experience credit problems, what steps can you take to get out of debt?
- Obtain a debt consolidation loan
  - Get credit counseling
  - Use bankruptcy as a last resort