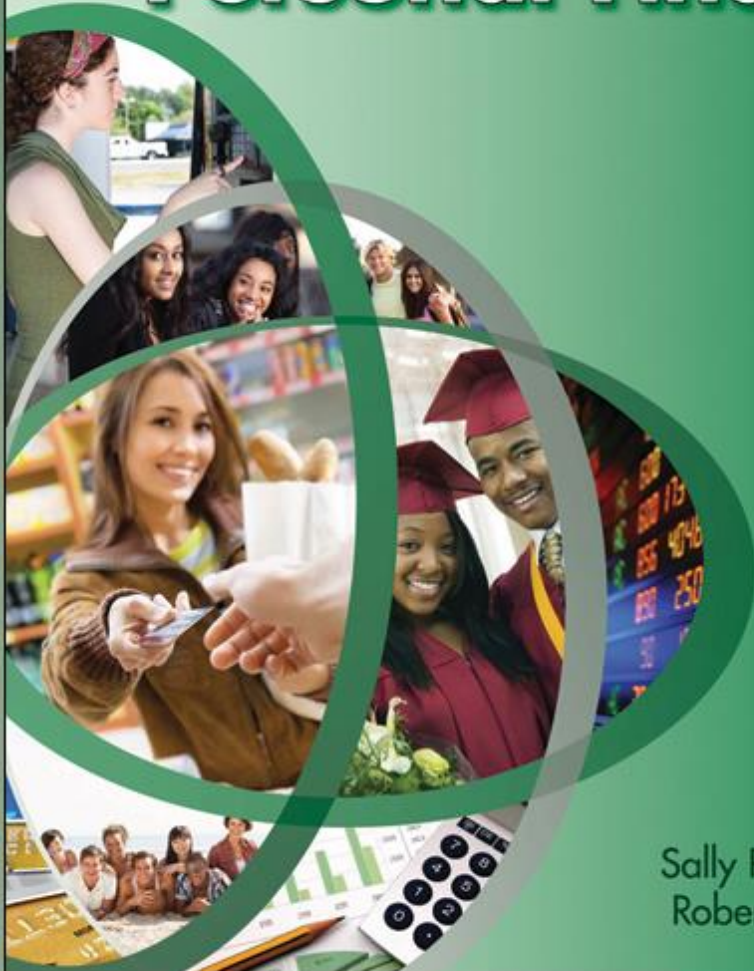


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Foundations of Personal Finance

Ninth Edition



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PowerPoint Presentations for

Foundations of Personal Finance

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Chapter 6

Credit

Section 6.1

USING CONSUMER CREDIT

Objectives

- Explain the advantages and disadvantages of using credit.
- Identify the different types of consumer credit.
- Describe secured and unsecured loans.
- Describe how to establish a sound credit rating.
- Describe situations in which it is smart to use credit and others in which it is not.
- Explain what makes up the cost of credit.

Terms

- credit
- closed-end credit
- finance charge
- contract
- principal
- open-end credit
- line of credit
- secured loan
- collateral
- unsecured loan
- cosigner
- creditworthy
- credit report
- credit score
- annual percentage rate (APR)

Consumer Credit

- **Credit** is a medium of exchange which allows individuals to buy goods or services now and pay for them later
- The *creditor* supplies money, goods, or services in a credit agreement
- The *debtor* is the borrower who agrees to make future payment according to credit agreement
- Consumer credit is the use of credit to buy goods or services for personal, family, or household use

Consumer Credit (Continued)

- **Closed-end credit** is a loan for a specific amount that must be repaid with finance charges by a specific date
 - A **finance charge** is the total amount the borrower must pay the lender for the use of credit
 - A **contract** is a legally binding agreement between the borrower and the creditor; it states the terms of a loan
 - The **principal** is the amount borrowed

Consumer Credit (Continued)

- **Open-end credit** allows the borrower to use a specific amount of money for indefinite period of time
 - **Line of credit** is the preapproved amount that an individual can borrow
 - Examples include bank and store credit cards, home equity lines of credit, and overdraft protection on checking accounts

Types of Loans

- A **secured loan** is a loan that requires collateral
 - **Collateral** is the property that a borrower promises to give up in case of default
 - *Default* is when a borrower fails to pay the debt; the creditor may then take the collateral
 - *Installment loans* are closed-end credit for a specific amount of money that is repaid with interest in regular payments

Types of Loans (Continued)

- An **unsecured loan**, also called a *signature loan*, is a loan made on the strength of a person's signature
 - This type of loan requires a contract and promise to repay according to terms of agreement
 - A strong credit rating is vital for this type of loan
 - A **cosigner** is a person with a strong credit rating who also signs on the loan; the cosigner is responsible for repaying the loan if the borrower defaults

Did You Know?

A cosigner is responsible for the entire loan amount if the person for whom they cosigned fails to make the loan payments. By signing the loan, the cosigner promises to repay the loan if you fail to pay

Three Cs of Credit

- **Character** is based on your financial history, so pay your bills on time
- **Capacity** is your ability to earn money and pay debts as measured by your earning power and employment history
- **Capital** is your financial worth (examples: house, car, savings)

Establishing Credit

- A **creditworthy** person is one who is judged to have the assets, income, and tendency to repay debt
- A **credit report** is a record of a person's credit history and financial behavior
- Credit reports include:
 - Every credit account ever opened
 - Outstanding balances on current credit accounts
 - Delinquent or late payments
 - Overdue taxes

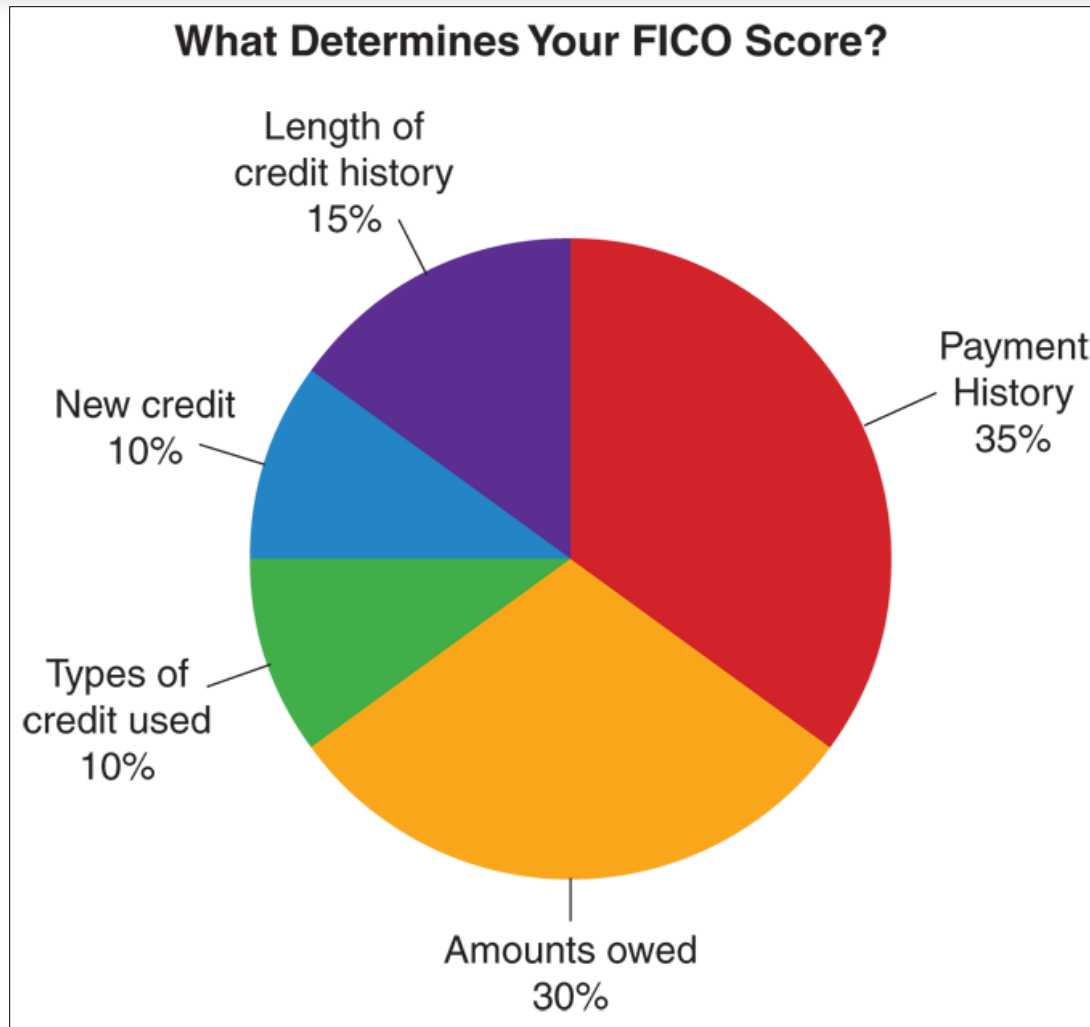
Credit Scores

- A **credit score** rates your creditworthiness at that point in time
- Credit scores may differ depending on the credit-reporting agencies
- A credit score is also called the *FICO* score because the **Fair Isaac Corporation** developed the rating system

Credit Scores (Continued)

- A **credit score** is based on:
 - Payment history—paying bills on time
 - Amounts owed—low debt-to-credit-limit ratio
 - Credit history—long use of well-managed credit account is best
 - New credit—recent applications for new credit can lower your score
 - Types of credit used—mix of loans and credit cards will score higher than only one type of credit

Credit Scores (Continued)



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Did You Know?

Consumers with lower credit scores may be denied credit. If they are granted credit, they will have to pay a higher rate of interest than those with higher credit scores.

Advantages of Using Credit

- Use of goods as you pay for them
- Opportunity to buy costly items that you may not be able to buy with cash
- Source of cash for emergency or unexpected expenses
- Convenience and safety
- Taking advantage of sales
- Long-range goals

Disadvantages of Using Credit

- Reduction of future spendable income
- Expense of credit (interest, finance charges)
- Temptation
- Risk of serious consequences

Cost of Credit

- Finance charges consist of interest and fees
- **Annual percentage rate (APR)** is the annual cost of credit charged by a lender
- Total amount you pay for the use of credit is based on:
 - Interest rate charged
 - Amount of credit used
 - Length of repayment period

Review 6.1

- What are the three Cs of credit?
 - Character
 - Capacity
 - Capital
- What are some steps you can take to build a sound financial reputation?
 - Get a job to prove that you can earn money
 - Open a savings account and save regularly
 - Open a checking account and manage it well
 - Apply to a local department store for a credit card, use it for small purchases, and pay promptly

Section 6.2

USING CREDIT CARDS

Objectives

- Identify and describe the types of credit cards.
- Identify important factors to consider when shopping for a credit card.
- Describe subprime credit cards.

Terms

- credit card
- cash advance
- store credit card
- travel and entertainment card
- regular charge account
- revolving credit account
- acceleration clause
- grace period

Credit Cards

- A **credit card** is a piece of plastic that allows the cardholder to make credit purchases
- A **cash advance** is a loan against the available credit on your account

Types of Credit Cards

- General-purpose cards, also called *bank cards*, are issued by financial institutions (Visa, MasterCard)
- Store credit cards are issued by major department store chains to charge purchases
- Travel and entertainment cards usually require you to pay the entire balance each month

Credit Accounts

- **A regular charge account:**
 - Lets you charge goods and services in exchange for a promise to pay in full within 25 days of the billing date
 - No finance charge if paid in full and on time
- **A revolving credit account:**
 - Choice of paying in full each month or spreading payments over time
 - Minimum payment and finance charge are required if not paying in full

Finance Charges

- Interest is charged if you pay less than the full amount owed each month
- There are three methods for calculating finance charges:
 - **Average daily balance** – interest charges are figured by totaling the balances for each day in the billing cycle and then dividing by the number of days in the cycle (most common)
 - **Adjusted balance** – interest is based on previous balance minus payments received
 - **Unpaid balance** – interest charged on amount owed at end of previous billing period

Finance Charges (Continued)

- Fees
 - Late payments
 - Exceeding credit limit
 - Cash advances
 - Balance transfers

Shopping for a Credit Card

- An **acceleration clause** allows the creditor to require full and immediate payment of the entire balance if you miss a payment or fail to abide by contract
- A **grace period** is the time between purchase billing date and the start of interest charges, during which you may pay the full balance without interest
- Shop around for the best credit card—compare interest, fees, and features

Discussion

Is it a good idea to get a cash advance using your credit card or your cash advance checks?

Credit Card Statement

- You will receive a monthly statement for each credit card that states:
 - Date payment is due
 - Minimum payment due
 - New balance and previous balance
 - Total of new purchases, fees, and advances
 - Finance charges as a dollar amount and APR
 - Total amount of payments and credits
 - Total amount of available credit

Credit Card Safety

- Report lost or stolen credit cards as soon as possible
- Be wary of subprime credit cards

Review 6.2

- Is there generally a grace period for cash advances from a credit card?
 - No
- What is the name given to the category of credit cards that usually have low credit limits, very high interest rates, large annual fees, sign-up fees, and others?
 - Subprime credit cards

Section 6.3

CREDIT MANAGEMENT

Objectives

- Outline the steps involved in managing credit.
- Identify steps to take in resolving credit problems.
- Describe types of easy-access credit.

Terms

- collection agency
- repossession
- foreclosure
- lien
- garnishment
- bankruptcy
- Chapter 7 bankruptcy
- Chapter 13 bankruptcy
- credit counseling service
- loan shark
- easy-access credit
- payday loans
- pawnshop
- rent-to-own
- title loan

Managing Your Credit

- Know your financial personality to help you decide when and if you can use credit safely
- Keep track of spending to avoid overspending
- Alternatives to using credit:
 - Do not buy
 - Pay with savings
 - Postpone purchase and buy later with cash

Managing Your Credit (Continued)

- Check your credit report regularly – you are entitled to one free copy from all three main credit reporting agencies every 12 months
- If you have a low credit score, you may:
 - Be unable to get loans and credit cards
 - Pay higher interest rates
 - Have fewer housing choices
 - Have fewer job prospects

Did You Know?

A person with a low credit score may pay higher insurance premiums.

Collection Agencies

- Collection agencies are businesses that specialize in debt collection for other businesses
- They apply nonstop pressure to get debtors to pay in full

Credit Problems

Credit Warning Signals

- Stalling one creditor to pay another.
- Receiving past due notices with billing statements.
- Paying only the minimum required each month.
- Charging more than the amount you can pay each month.
- Not paying off credit account balances.
- Routinely running out of money before payday.
- Using credit cards or cash advances for everyday living expenses.

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Credit Problems (Continued)

- **Repossession** is taking back collateral when borrower fails to repay a loan
- **Foreclosure** is a forced sale of a property (home)
- A **Lien** is a legal claim on a borrower's property by a creditor who is owed money
- **Garnishment** is a legal procedure that reduces debtors' paychecks to pay their creditors

Credit Problems (Continued)

- **Bankruptcy** is when the court excuses debtor from some or all of debt in return for debtor giving up certain assets and possessions
 - Chapter 7 is most common
 - The court sells the debtor's possessions with proceeds divided among creditors
 - Home and car may be excluded.
 - Chapter 13
 - Court sets up a 3- to 5-year repayment schedule
 - Creditors may not take action against the debtor.

Did You Know?

Bankruptcy stays in your credit record for ten years and student loan debt will never be wiped out by bankruptcy.

Credit Problems (Continued)

- Inform your creditors as many will work with you to set up a repayment program
- A **credit counseling** service provides debt and financial management advice and services at little or no cost

Easy-Access Credit Trap

- **Loan shark** lends money at excessive interest rates
- **Easy-access credit** is short-term loans regardless of credit history at high interest rates

Easy-Access Credit Trap (Continued)

- Types of easy-access credit include:
 - **Payday loans**—short-term, high interest loan; borrowers must provide personal check, or access to their bank account
 - **Pawnshops**—provides high-interest loans with personal property held as collateral
 - **Rent-to-own**—agreements that require consumers to pay much more than the product's purchase price
 - **Title loan**—high-cost loan in which the borrower's car is collateral

Review 6.3

- Can your credit card company raise your interest rate if you are late on your credit card payments?
 - Yes
- Can the bank from which you got your car loan repossess your car if you do not make your loan payments?
 - Yes

Section 6.4

CONSUMER PROTECTION

Protecting Your Credit

- *Truth in Lending Act* requires creditors to tell consumers what credit will cost them
- *Equal Credit Opportunity Act* prohibits creditors from discrimination
- *Fair Credit Reporting Act* requires accuracy and privacy of credit report information

Protecting Your Credit (Continued)

- *Fair Credit Billing Act* protects consumers against unfair billing practices
- *Electronic Funds Transfer Act* protects consumers in electronic funds transfers
- *Fair Debt Collection Practices Act* protects consumers against unfair debt collection methods

Protecting Your Credit (Continued)

- *Preservation of Consumers' Claims and Defenses Ruling* protects debtors from being forced to pay for goods/services when they have a legitimate dispute with the seller
- *Bankruptcy Abuse Prevention and Consumer Protection Act* made filing for bankruptcy more difficult, and requires debtors to get credit and financial counseling before filing for bankruptcy

Credit Fraud

- **Credit fraud** is fraudulent use of someone else's credit information
- **Identity theft** is stealing someone's personal information and using it to commit theft or fraud
- **Phishing** is e-mails that seek your personal information by claiming to be a business where you may have an account

Discussion

Should you respond to e-mails that ask you for personal information such as account numbers?

Protect Yourself

- Do not carry your Social Security card
- Shred credit card receipts/financial statements
- Do not give your Social Security, bank account, or credit card numbers to anyone without making sure the information is necessary, and never in response to a phone or e-mail request

Protect Yourself (Continued)

- Periodically order a copy of your credit report
- Carry only the credit cards you really need
- Make photocopies of the items in your wallet (front and back of the cards) in case your wallet gets lost or stolen

Move Quickly

- Promptly report missing credit cards, checks, or debit cards
- File a police report if you are a victim of theft
- Report your missing credit cards and identifying information to the credit-reporting agencies

Move Quickly (Continued)

- Contact the Social Security Administration if your card or number is stolen
- If your identity is stolen, contact:
 - Federal Trade Commission's Identity Theft Clearinghouse
 - Identity Theft Resource Center

Review 6.4

- If a financial institution turns down a loan application, is it required to provide the applicant with a written explanation of why credit was denied?
 - Yes
- Are financial institutions allowed to send you an EFT card if you have not asked for one?
 - No