



Chapter 6

Introduction to Consumer Credit

Use and Misuse of Credit

- Before you use credit for a major purchase, ask yourself some questions.
 - Do I have the cash for the down payment?
 - Do I want to use my savings for this purchase?
 - Does this purchase fit my budget?
 - Could I use the credit I'll need in some better way?
 - Can I postpone this purchase?
 - What are the opportunity costs of postponing this purchase?
 - What are the dollar and psychological costs of using credit for this purchase?

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What is Consumer Credit?

- Credit is an arrangement to receive cash, goods or services now, and pay for them in the future.
- Consumer credit is the use of credit for personal needs, except a home mortgage, by individuals and families.
- Three ways consumers can finance purchases.
 - Draw on their savings.
 - Use present earnings.
 - Borrow against expected future income.
- Trade-offs with each alternative.
- Consumer credit: Major economic force.

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Advantages of Credit

- Current use of goods and services.
- Permits purchase even when funds are low.
- A cushion for financial emergencies.
- Advance notice of sales.
- Easier to return merchandise.
- Convenient when shopping.
- One monthly payment.
- Safer than cash.

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Advantages of Credit

(continued)

- Needed for hotel, car reservations and shopping online.
- To take advantage of float time/grace period.
- May get rebates, airline miles, or other bonuses.
- Indicates financial stability.

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How to Protect Yourself From Identity Theft

- Provide SSN only when necessary.
- Remove your name from junk mail, telemarketing lists.
- Protect yourself by shredding old credit slips, account statements, and credit offers you receive in the mail.
- Stop preapproved credit card offers by calling 1-888-567-8688.

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Disadvantages of Consumer Credit

- Temptation to overspend.
- Can create long-term financial problems, slow progress toward financial goals.
- Potential loss of merchandise due to late or non-payment.
- Ties up future income.
- Credit costs money - more costly than paying with cash.

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Types of Credit

- Closed-End Credit.
 - One-time loans for a specific purpose that you pay back in a specified period of time, and in payments of equal amounts.
 - Mortgage, automobile, and installment loans for furniture, appliances and electronics.
- Open-End Credit.
 - Use as needed until reaching line of credit max.
 - Credit cards, departments store cards, bank credit cards, incidental credit.
 - You pay interest and finance charges if you do not pay the bill in full when due.

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Credit Cards

- Eight out of ten U.S. households carry one or more credit cards.
- One-third are convenience users- pay balances in full each month.
- Two-thirds are borrowers, carrying a balance over, paying finance charges.
- Some use cards for cash advances - expensive.
- Co-branding - linking a credit card with a business offering rebates on products and services.
- Smart cards have an imbedded computer chip.
- Debit cards: similar impact as writing a check.

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When You Make Purchases Online

- Use a secure browser.
- Keep records of online transactions.
- Review monthly statements-can do so online.
- Read policies of the websites you visit concerning refunds, site security, and privacy.
- Keep personal information private unless you know who is gathering it and why.
- Shop at businesses you know and trust.
- Never give out your password to anyone online.
- Don't download files sent by strangers.

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Protecting Yourself Against Credit Card Fraud

- Sign new cards when they arrive.
- Treat cards like money - keep them secure.
- Shred anything with your account number on it.
- Don't give your number over the phone unless you initiate the call, and don't put it on postcards.
- Get card & receipt after every transaction: compare receipts to bills when they arrive, checking for errors.
- Notify the card issuer if you don't get your billing statement, or if your card is lost or stolen.
 - If stolen call 1-888-EXPERIAN.
- Check credit report.

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Measuring Your Credit Capacity

- Before you take out a loan, ask yourself:
 - Can you afford the loan?
 - What do you plan to give up in order to make the payment?

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General Rules of Credit Capacity

Debt Payments-to-Income Ratio

$\frac{\text{monthly payments}^*}{\text{net monthly income}}$

Consumer credit payments should not exceed a max of 20% of your net income.

*Not including house payment which is a long-term liability

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Cosigning a Loan

- The creditor will give you a notice that tells you...
 - You are being asked to guarantee the debt, so consider if you can afford it if the borrower defaults.
 - If the borrower does not pay you may have to pay up to the full amount and also any late or collection fees.
 - If a payment is missed the creditor can collect the debt from you without first trying to get it from the borrower.

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General Rules of Credit Capacity

(CONTINUED)

Debt To Equity Ratio

$\frac{\text{total liabilities}}{\text{net worth}^*} = \text{Should be } < 1$

*Excluding home value

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Cosigning a Loan

(continued)

- If you do cosign, consider...
 - Can you afford to pay the loan? If not, your credit rating could be damaged.
 - Liability for this debt may prevent you from getting other credit that you want.
 - If you put up collateral, you could lose it if the loan goes into default.
 - Check your state's law to learn about cosigner's rights.
 - Request that a copy of overdue payment notices be sent to you.

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Build and Maintain Your Credit Rating

- Limit your borrowing to your capacity to repay.
- Live up to the terms of contracts.
- Check to see what is in your credit report.
 - Credit bureaus collect information.
 - Experian, Trans Union and Equifax.
 - FTC gets about 12,000 complaints about credit bureaus each year.
 - Bureaus get information from banks, finance companies, credit card companies, merchants, other creditors.

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What If You are Denied Credit? Exhibit 6-6

- Check your credit file at the credit bureau.
- If you believe reasons for denial are invalid: file suit &/or notify federal enforcement agency.
- Ask the creditor to clarify reason for denial. If you believe the denial is valid:
 - Apply to another creditor with different standards.
 - Take steps to improve your creditworthiness.
 - You have the right to provide a 100 word explanation in your file.

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Fair Credit Reporting Act

Is your credit report accurate?

- If denied credit based on your report, you can get a free copy of your credit report w/i 60 days of your request.
- Credit card companies must correct inaccurate or incomplete information.
- Only authorized persons have access to your report.
- Adverse data can be reported for seven years; bankruptcy for ten years.

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What Creditors Look For: 5 Cs

- Character - Do you pay bills on time?
- Capacity - Can you repay the loan?
- Capital - What are your assets and net worth?
- Collateral - What property do you have to pledge that the lender can repossess if you default on the loan?
- Conditions - What economic conditions could affect your ability to repay the loan?

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Avoiding and Correcting Credit Mistakes

Fair Credit Billing Act

- Notify creditor of error in *writing* within 60 days.
- Include your explanation of the error and your account number to the billing inquiries address.
- They must respond within 30 days.
- Credit card company has two billing periods but no longer than 90 days to correct your account or tell you why they think the bill is correct.
- Your credit rating is not affected while item is in dispute.

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What if Your Identity is Stolen?

- Contact the fraud department of each of the three major credit bureaus; tell them to flag your file with a fraud alert, including a statement that creditors should call you for permission before opening any new accounts in your name.
- Contact creditors to check for accounts that have been tampered with or opened fraudulently.
- File a police report, keep a copy.
- Check www.privacyrights.org or call 619-298-3396

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Avoiding and Correcting Credit Mistakes

Fair Credit Billing Act (continued)

- You can withhold payment on damaged or shoddy goods or poor services if you have paid for them with a credit card, if you make a sincere attempt to resolve the problem with your creditor.

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Complaining About Consumer Credit

- First try to solve the problem directly with the creditor.
- If that does not work there are more formal complaint procedures.
- There are a variety of consumer credit protection laws and federal agencies who administer and assist with complaint procedures. See the Exhibit 6-11 "Summary of Federal Consumer Credit Laws" in your text.

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Truth In Lending Rights

The Truth In Lending Act requires creditors to provide you with accurate and complete credit costs and terms.

- Provides specific cost disclosure requirements for the APR and total finance charges.
- Regulates disclosure of other terms and conditions.
- Regulates advertising of credit terms.

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Protection Under Other Consumer Credit Laws

- Equal Credit Opportunity Act.
 - Specifies your rights if you have been refused credit due to discrimination based on sex, marital status, age, race religion, national origin.
- 1997 Consumer Credit Reporting Reform Act.
 - Places burden of proof for reporting on credit issuers.
 - Sets \$8.00 maximum cost for a credit report.
 - Allows consumers to remove themselves from prescreened lists.

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Fair Debt Collection Practices Act

Collection agencies...

- Can't be abusive or threaten.
- Can't call you at work if you say not to.
- Can't tell boss and friends.
- Can't call you at odd hours.
- Must follow set procedures.
- Act does not apply to creditors attempting to collect the debt themselves.

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Class Activity

- Pick up a consumer loan application and a loan note from a bank or online and bring it to class.
- What questions on the application fit under each of the 5 C's of credit?
- Discuss some of the major points in the loan note and in the security agreement.

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Loan Assignment

- Call or stop by a financial institution in your area and get rate quotes for new and used cars.
- Go to www.bankrate.com and find new and used car rates.
- Discuss and compare the rates that you found.

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Credit Card Activity

- Go to www.citicards.com. Look over the different cards they offer.
- What features are important to you in choosing a credit card?

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