

# Chapter 06

## Introduction to Consumer Credit

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## Chapter 6 Learning Objectives

1. Define consumer credit and analyze its advantages and disadvantages
2. Differentiate among various types of credit
3. Assess your credit capacity and build your credit rating
4. Describe the information creditors look for when you apply for credit
5. Identify the steps you can take to avoid and correct credit mistakes
6. Describe the laws that protect you if you have a complaint about consumer credit

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## What is Consumer Credit?

### Objective 1: Define consumer credit and analyze its advantages and disadvantages

- \_\_\_\_\_ is an arrangement to receive cash, goods or services now, and pay for them in the future
- \_\_\_\_\_ is the use of credit for personal needs, except a home mortgage, by individuals and families

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## What is Consumer Credit?

(continued)

- Three ways consumers can finance purchases
  - Draw on their \_\_\_\_\_
  - Use present \_\_\_\_\_
  - Borrow against expected future income
- *Trade-offs with each alternative*
- Consumer credit: A major economic force

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## What is Consumer Credit?

(continued)

### USE AND MISUSES 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?

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## What is Consumer Credit?

(continued)

### USE AND MISUSES OF CREDIT (continued)

- Before you use credit for a major purchase, ask yourself some questions
  - 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? (con't)

### 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
- \_\_\_\_\_ when shopping

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## What is Consumer Credit?

(continued)

### MORE ADVANTAGES OF CREDIT

- One monthly payment
- Safer than cash
- Needed for hotel, car reservations and shopping online
- Can take advantage of \_\_\_\_\_ time/grace period
- May get rebates, airline miles, or other bonuses
- Indicates financial \_\_\_\_\_

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## What is Consumer Credit?

(continued)

### DISADVANTAGES OF CREDIT

- Temptation to \_\_\_\_\_
- Failure to repay loan may lead to loss of income
- It does not increase total purchasing power
- Credit costs money

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## Types of Credit

**Objective 2: Differentiate among various types of credit**

Closed-End Credit	Open-End Credit
<ul style="list-style-type: none"><li>• Mortgage loans</li><li>• Automobile loans</li><li>• Installment loans (installment sales contract, installment cash credit, single lump-sum credit)</li></ul>	<ul style="list-style-type: none"><li>• Cards issued by department stores, bank cards (Visa, MasterCard)</li><li>• Travel and entertainment cards (Diners Club, American Express)</li><li>• Overdraft protection</li></ul>

- \_\_\_\_\_ **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

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## Types of Credit (continued)

Closed-End Credit	Open-End Credit
<ul style="list-style-type: none"><li>• Mortgage loans</li><li>• Automobile loans</li><li>• Installment loans (installment sales contract, installment cash credit, single lump-sum credit)</li></ul>	<ul style="list-style-type: none"><li>• Cards issued by department stores, bank cards (Visa, MasterCard)</li><li>• Travel and entertainment cards (Diners Club, American Express)</li><li>• Overdraft protection</li></ul>

- \_\_\_\_\_ **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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## Types of Credit (continued)

### CREDIT CARDS

- Eight out of ten U.S. households carry one or more credit cards
- \_\_\_\_\_ are convenience users- pay balances in full each month
- \_\_\_\_\_ are borrowers, carrying a balance over, paying finance charges
- Some use cards for cash advances – expensive
- \_\_\_\_\_ - 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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**Types of Credit** (continued)

**PROTECTING YOURSELF AGAINST DEBIT/CREDIT CARD FRAUD**

- \_\_\_\_\_ 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 \_\_\_\_\_ regularly

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**Types of Credit** (continued)

**When You Make Purchases Online**

- Use a secure browser
- Keep records of online transactions
- \_\_\_\_\_ 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 \_\_\_\_\_ to anyone online
- Don't download files sent by strangers

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**Types of Credit** (continued)

**TRAVEL AND ENTERTAINMENT CARDS**

- These cards are not really credit cards
- Monthly balance is due in full
- American Express recently started issuing credit cards

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## Types of Credit (continued)

### STORED VALUE (OR \_\_\_\_\_) CARDS

- Resemble a debit card.
- Used in lieu of paper gift certificates.
- Used for business purposes (travel expenses).
- \_\_\_\_\_ can make the cards worthless.

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## Types of Credit (continued)

### \_\_\_\_\_ LOANS

- Based on the difference between current market value of your home and the amount owed on the mortgage
- Borrow up to 85% of the value of the home
- It is set up like a revolving line of credit

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## Measuring Your Credit Capacity

### **Objective 3: Assess your credit capacity and build your credit rating**

- 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?
    - Are you prepared to make this trade-off?

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## Measuring Your Credit Capacity

### GENERAL RULES OF CREDIT CAPACITY

Debt \_\_\_\_\_ Ratio

monthly payments\*

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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## Measuring Your Credit Capacity

(continued)

### GENERAL RULES OF CREDIT CAPACITY

\_\_\_\_\_ Ratio

total liabilities = Should be \_\_\_\_\_

net worth\*

\*Excluding home value

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## Measuring Your Credit Capacity

(continued)

\_\_\_\_\_ 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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## Measuring Your Credit Capacity

(continued)

If you do co-sign, 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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## Measuring Your Credit Capacity

(continued)

### **BUILDING AND MAINTAINING YOUR CREDIT RATING**

- Limit your borrowing to your \_\_\_\_\_ to repay
- Live up to the terms of contracts
- Check to see what is in your credit report

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## Measuring Your Credit Capacity

(continued)

### \_\_\_\_\_ BUREAUS

- Credit bureaus collect information
- Experian, Trans Union and Equifax
- FTC gets about 12,000 complaints about credit bureaus each year

### **WHO PROVIDES DATA TO CREDIT BUREAUS?**

- Bureaus get information from banks, finance companies, credit card companies, merchants, other creditors

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## Measuring Your Credit Capacity (continued)

### Fair Credit Reporting Act

- This act regulates the use of credit reports
- Credit card companies must correct inaccurate or incomplete information
- Only authorized persons have access to your report
- Adverse data can be reported for \_\_\_\_\_ years; bankruptcy for \_\_\_\_\_ years

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## Measuring Your Credit Capacity (continued)

### What If You are Denied Credit?

- Check your credit file at the credit bureau
- If you believe reasons for denial are invalid: file suit and/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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## Applying for Credit

**Objective 4:** Describe the information creditors look for when you apply for credit

### What Creditors Look For: 5 Cs

- **C**\_\_\_\_\_ - Do you pay bills on time?
- **C**\_\_\_\_\_ - Can you repay the loan?
- **C**\_\_\_\_\_ - What are your assets and net worth?
- **C**\_\_\_\_\_ - What property do you have to pledge that the lender can repossess if you default on the loan?
- **C**\_\_\_\_\_ - What economic conditions could affect your ability to repay the loan?

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## Applying for Credit

How to \_\_\_\_\_ your credit score:

1. Get copies of your credit report-review for accuracy.
2. Pay your bills on time.
3. Understand how your credit score is determined.
4. Learn the legal steps to improve your credit report.
5. Beware of credit-repair scams.

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## Avoiding and Correcting Credit Mistakes

**Objective 5:** identify the steps you can take to avoid and correct credit mistakes

### Fair Credit Billing Act

- Notify creditor of error in \_\_\_\_\_ 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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## Avoiding and Correcting Credit Mistakes (continued)

### Fair Credit Billing Act

- You can \_\_\_\_\_ 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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## Avoiding and Correcting Credit Mistakes (continued)

### What if Your Identity is Stolen?

- Contact the \_\_\_\_\_ department of each of the three major credit bureaus
  - tell them to flag your file with a fraud alert
  - include 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

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## Avoiding and Correcting Credit Mistakes (continued)

### What if Your Identity is Stolen? (continued)

- File a \_\_\_\_\_, keep a copy
- Check [www.privacyrights.org](http://www.privacyrights.org) or call 619-298-3396
- File a complaint with the Federal Trade Commission  
1-877-FTC-Help

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## Complaining About Consumer Credit

**Objective 6:** Describe the laws that protect you if you have a complaint 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”

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## Complaining About Consumer Credit

(continued)

### UNDER CONSUMER CREDIT LAWS

- Truth in Lending and Consumer Leasing
- Equal Credit Opportunity Act
- Fair Credit Billing Act
- Fair Credit Reporting Act
- Consumer Credit Reporting Reform Act
- Credit Card Accountability, Responsibility and Disclosure Act.

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