CHAPTER

9

Credit

Reading for Meaning

Read the chapter two times. During the first reading, jot down sentences you do not understand. During the second reading, use your notes to focus on areas you need to review more carefully.

credit
creditor
contract
default
principal
annual percentage rate (APR)
closed-end credit
secured loan
collateral
cosigner
open-end credit
creditworthy
credit report
credit card
grace period
repossession
foreclosure
lien
garnishment
bankruptcy
loan shark
easy-access credit
payday loans
pawnshop
rent-to-own
title loan

CHAPTER OBJECTIVES

After studying this chapter, you will be able to

- **explain** the advantages and disadvantages of using credit.
- **identify** the different types of consumer credit.
- **describe** how to establish a sound credit rating.
- **define** the key terms in credit contracts and agreements.
- **compare** credit terms and charges.
- **outline** the steps involved in managing credit.
- **identify** steps to take in resolving credit problems.
- **summarize** the laws that govern the use of credit.

Central Ideas

- Credit is a powerful financial management tool.
- Serious financial problems result from the misuse of credit.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

In a cash transaction, you hand over money in exchange for goods or services. Like cash, credit is a medium of exchange. **Credit** allows you to buy goods or services now and pay for them later. More specifically, it is an agreement between two parties in which one party, the **creditor**, supplies money, goods, or services to the other. In return, the receiving party, or the borrower or debtor, agrees to make future payment by a particular date or according to an agreed-upon schedule.

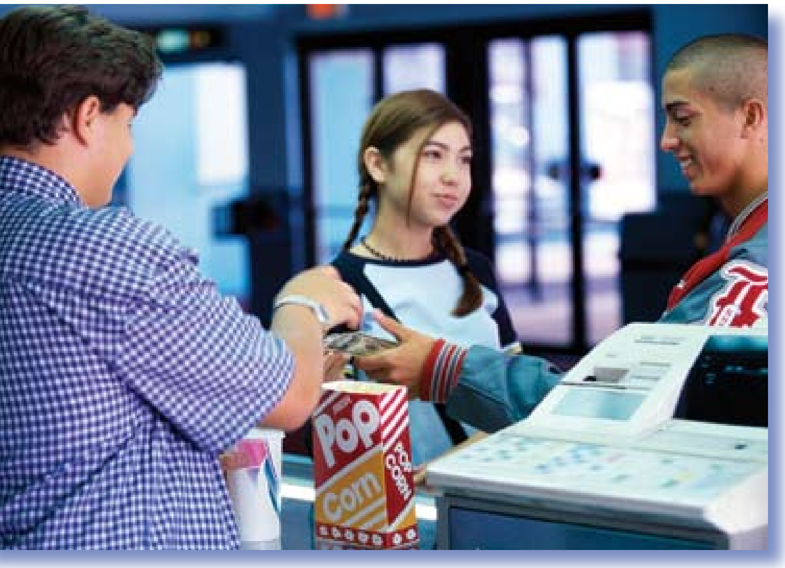
Credit is more costly than cash because fees are usually added to the amount owed. It is costly in another way, too. When you use credit, you spend future income. This means part of your future earnings must be used to pay what you owe. The use of credit reduces future income.

Governments, businesses, and consumers use credit. Credit plays an important role in personal economics. Used carefully and wisely, it can help people get more of the things they need when they need them. Misused credit can lead to financial disaster. It is important for your own financial well being to learn how to manage your credit dollars.

Consumer credit also plays an important role in the economy. It provides the extra buying power needed to support mass production and distribution of goods and services. Therefore, credit helps make more goods and services available to consumers at lower prices.

Understanding Consumer Credit

All credit is based on trust. The creditor believes there is a high likelihood the borrower can and will pay what is owed. For example, suppose you go out to eat with friends. One friend does not have enough money and asks to borrow some of yours. If you trust that friend and can spare the money, you will probably lend it, 9-1.



9-1

People usually feel comfortable lending to friends they trust because they believe the debt will be repaid.

Credit also has an element of risk. When you lend a friend money, a DVD, or a shirt, you risk that he or she will not return it. An unpaid debt between friends can harm a friendship. If a friend does not pay you back, you will probably not lend to him or her again.

Although a car loan is more complicated, it also depends on the creditor trusting that the borrower will repay the debt. The creditor takes a risk, but that risk is minimized in several ways. Before the loan is made, the borrower must sign a **contract**, a legally binding agreement between the borrower and the creditor. The contract states the terms of the car loan. If the borrower **defaults**, or fails to pay the debt, the creditor can take the borrower to court and even take back the car.

Borrowers must pay creditors for the cost of making credit available and for the risk involved in possible defaults. Payment takes the form of interest and other finance charges. This means that a borrower repays not only the **principal**, or amount borrowed, but also the finance charges stated in the contract. That makes buying with credit more costly than paying cash.

Before making credit available, a creditor reviews the borrower's financial history. Just as you may not lend money to someone who does not repay debts, creditors will not lend to a person with a poor credit reputation. Before making a loan offer, creditors already know the likelihood of the borrower defaulting on the loan. If risk of default is high, most reliable creditors will not lend. Less reputable creditors may lend, but with a much higher finance charge and unfavorable terms.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Reasons to Use Credit

You will find it smart to use credit in some situations, but not in others. Several advantages of using credit are listed here.

- ***Use of goods and services as you pay for them.*** Being able to wear a coat or drive a car as you pay for it can be a big plus. This is a common reason for using credit.
- ***Opportunity to buy costly items that you may not be able to buy with cash.*** Many people find it difficult or impossible to save enough to pay for a car or hospital bill in one payment. With credit, you can buy goods and services as you need them and pay for them over a

Linking to... History

Role of Credit in the Computer Industry

Consumer credit can help launch a new product. For example, when personal computers first hit the market, prices were high and sales were low. In 1981, around 750 thousand personal computers were being used in homes across the country. By 1991, the number had increased to almost 28 million.

Today, approximately 75 percent of U.S. households have personal computers and Internet access. Since 1980, personal computers improved dramatically. They are more powerful, efficient, and user-friendly. They are also smaller and less expensive. The vast array of software available continues to grow.

Most buyers used some form of consumer credit to pay for their personal computers in the early 80s. The use of credit made it possible for more people to buy. Increased consumer demand supported mass production and distribution while lowering unit production costs. Manufacturers passed on these savings to consumers in the form of lower prices. Growth in the computer industry also financed research and development.

Lower prices sparked even more sales. The industry grew rapidly, bringing exciting job opportunities. More people were hired to sell and service personal computers. New businesses emerged to produce, sell, and rent software and accessories for these computers.

In the case of personal computers, credit stimulated consumer demand and business growth. It helped maintain a healthy balance between supply and demand. Without consumer credit, the industry would have grown less rapidly. Prices would have stayed higher and sales lower. Fewer jobs would have been created and fewer people employed.

[redacted]

period of time. Borrowing is sometimes the only way consumers can pay for major purchases, such as a car.

- ***Source of cash for emergency or unexpected expenses.*** Even the best money managers face the unexpected. Credit can offer temporary help.
- ***Convenience.*** Credit eliminates the need to carry large amounts of cash. It provides a record of purchases. It usually simplifies telephone, mail, and Internet shopping as well as necessary returns and exchanges.
- ***Sales.*** Credit allows you to take advantage of sale prices on goods or services you need when you do not have enough cash at sale time.
- ***Long-range goals.*** Credit can help consumers make purchases that are part of a long-range financial plan, such as paying for education, furniture, or a vacation.

Drawbacks of Credit Use

To use credit wisely, you need to be aware of its drawbacks as well as its benefits. Consider the negatives when you are deciding how and when to use credit. Here are some disadvantages of using credit:

- ***Reduction of future income.*** By using credit, you spend future income. You thereby reduce the amount of money you can spend later.
- ***Expense.*** Using credit usually costs money. The more credit you use and the more time you take to repay, the more you will pay in finance charges. This reduces the amount you will have to spend for other goods and services.
- ***Temptation.*** Credit makes it easy to spend money you do not have. It can be difficult to resist buying what you cannot afford or can do without when you have ready credit.
- ***Risk of serious consequences.*** Failure to pay debts on time and in full can cause serious financial problems. You will read about these later in this chapter.

Cost of Credit

When you borrow $10 from a friend, you probably repay the friend an even $10. If you charge purchases or borrow cash in the marketplace, you usually pay finance charges. You pay these charges because it costs businesses money to grant you credit.

The creditors who do not have cash on hand borrow the money to make credit available. When they borrow, they must pay interest. Creditors with cash on hand lose the chance to invest it when they use their money to give you credit. In a sense, they are investing in you, and the interest you pay is their return on investment.

Creditors must also pay the costs of opening and servicing credit accounts. These costs include employees, facilities, and the materials needed to lend money, send out bills, and record payments.

When consumers fail to pay on time or in full, the creditors' costs go up. The expenses of collecting overdue debts and absorbing the losses of unpaid accounts add up quickly. As a result, the price of credit goes up for all consumers, even those who pay on time.

Case Study: Using Credit

The Credit Game

Chiyo graduated from college recently and has a steady job. She wants the convenience of charging purchases, so she opens a credit card.

Chiyo's first credit card bill is almost $600. Since she did not keep track of her charges, the bill is a surprise. Her paycheck is only $1,035 a month after deductions. After paying rent and other expenses, she has only $30 left to pay on her credit account each month.

Chiyo didn't need most of the credit card purchases. It takes her 24 months to pay off the debt. She pays over $118 in finance charges.

Damian looks at credit as a useful tool. He realizes the importance of establishing credit so he can get loans in the future. Besides, he doesn't think it is realistic to buy everything with cash.

Although Damian is happy to have his credit card, he is a little afraid of it. His family had some debt problems when he was younger.

Damian uses his credit card sparingly and keeps track of his charges. He limits his overall debt to an amount he can repay. He uses credit only for things he really needs. His first purchase is a pair of waterproof boots he buys on sale. Damian uses his credit card because he doesn't have enough cash. If he waited until payday, the boots would no longer be on sale. By using credit wisely, Damian saves $20.

Case Review

1. How does offering credit work in the interest of sellers?
2. How can the use of credit work for consumers? How can it create problems?
3. What advice would you give Chiyo for the future use of credit?
4. What did you learn from Damian's example?
5. How can consumers enjoy the benefits and avoid the problems of using credit?

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Finance Charges

The finance charge is the total dollar cost of credit. It is the dollar amount paid for credit. A finance charge has two parts: interest and fees.

For example, a $1,000 loan may have a finance charge of $50, which is $10 in fees and $40 in interest. When you apply for credit, the interest you pay depends on the *annual percentage rate (APR)*, the amount of credit used, and the length of the repayment period. Here is how these factors work to determine the cost of credit.

Annual Percentage Rate

The finance charge you pay for the use of credit is expressed as a percentage. An **annual percentage rate (APR)** is the annual cost of credit a lender charges. The higher the APR, the more you pay. For example, the interest for a $500 loan repaid in 12 monthly payments would cost

- $50.08 at 18 percent
- $58.72 at 21 percent
- $67.36 at 24 percent

Amount of Credit Used

The more you charge or borrow, the more interest you pay. For example, the interest on a loan repaid in 12 monthly payments at an annual percentage rate of 18 percent would cost

- $50.08 for a $500 loan
- $110.01 for a $1,000 loan
- $220.02 for a $2,000 loan

Length of the Repayment Period

The more time you take to repay the money you borrow, the more interest you will pay. For example, the interest on a $500 loan at 1.5 percent per month (18 percent per year) would cost

- $50.08 if repaid in 12 monthly payments
- $99.44 if repaid in 24 monthly payments
- $150.88 if repaid in 36 monthly payments

Finance

Loan Officers

Loan officers work for financial institutions. They assist in gathering documentation that is needed for loan approval. They analyze and assess the creditworthiness of potential borrowers to determine if they qualify for a loan.

Types of Credit

There are many types of consumer credit and ways to categorize them. The following are widely used terms you should know.

Closed-End Credit

Closed-end credit refers to a loan that must be repaid with finance charges by a certain date. These loans are given for a specific purpose, and include car loans, student loans, and most home loans, 9-2.

Loans are granted by commercial banks, credit unions, finance companies, insurance companies, and credit card agencies. When you take out a loan, you sign a contract stating the amount of the loan, the interest rate, length of the loan, and other provisions of the agreement.

A **secured loan** requires collateral. **Collateral** is property that a borrower promises to give up in case of default. If you fail to pay as agreed, the creditor may take the property to settle the claim against you. You may pay lower finance charges on a secured loan because the creditor takes less risk when collateral is pledged. The car is collateral in an auto loan.

An *unsecured loan* is made on the strength of your signature alone. You sign a contract and promise to repay according to terms of the agreement. It is difficult to obtain a loan of this type unless you have a strong credit rating. If you have nothing to pledge as collateral, you still may be able to get a loan if you have a cosigner. A **cosigner** is a responsible person who signs the loan with you. By signing the loan, the cosigner promises to repay the loan if you fail to pay. Unsecured loans usually have higher interest rates than secured loans.

Most closed-end credit is offered in the form of installment loans. An *installment loan* lets you borrow a given amount of money and repay it with interest in regular installments. Finance charges vary with the size of the loan, the interest rate, and the repayment period. Interest rates vary with different lenders and with the collateral pledged.

9-2

Home loans are a type of closed-end credit that homeowners repay by a certain date.

Open-End Credit

[redacted]

Open-end credit allows the borrower to use a certain amount of money for an indefinite period of time. As long as the borrower makes payments on a schedule, pays any finance charges, and stays within the borrowing limit, he or she can continue to use the credit.

One example of open-end credit is a credit card. Retailers, merchants, banks, credit agencies, and other businesses that issue credit cards to consumers offer open-end credit. Terms may differ slightly with different creditors and in different states.

Two common types of open-end credit are regular charge accounts and revolving credit accounts. A *regular charge account* lets you charge goods and services in exchange for your promise to pay in full within 25 days of the billing date. You receive a bill or statement each month. If you pay on time, there is no finance charge.

REAL LIFE CONNECTIONS

Debt Problems Among Students

As of 2009, it was estimated that one in five 18-to-24-year-olds are living in "debt hardship" and the numbers are growing. The average college graduate leaves school with $19,000 in student loan debt. Some students have as much as $40,000. Those in professional schools such as law, medicine, and dentistry may incur debts as high as $100,000 by graduation. Credit card debt may add another $3,000 to $7,000 to these obligations. The fact is more students drop out of college today for financial concerns than for academic failure. Students should try to explore every possible way to pay for their education without incurring excessive debt. They should consider savings, scholarships, low-tuition schools, work/study programs, part-time jobs, government aid programs, and other means of paying for education and training.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

A *revolving credit account* offers you a choice of paying in full each month or spreading payments over a period of time. If you choose not to pay in full, there is a finance charge.

You must make at least the minimum payment each month. For small balances, the minimum payment is usually a set amount, such as $10. For larger amounts of credit, the minimum payment is usually a percentage of the unpaid balance.

A typical revolving credit account places a limit on the total amount you may owe at any one time. You may make any number of purchases at any time as long as you do not exceed your credit limit. This type of credit is available through many retailers and through issuers of credit cards, such as Visa, MasterCard, and Discover. They can be used to buy goods and services from any seller who honors the card you carry.

Establishing Credit

You may find it difficult to get credit at first. This is because creditors want evidence that you can and will pay your debts. Here are some steps you can take to build a sound financial reputation.

1. ***Start with a job.*** Prove that you can earn money.
2. ***Open a savings account.*** Saving regularly shows a responsible attitude toward financial matters. Your savings also may serve as collateral for a loan.
3. ***Open a checking account.*** A well-managed checking account shows you have experience in handling money.
4. ***Apply to a local department store or a gasoline company for a credit card.*** If you are granted credit, make small purchases and pay promptly. This will give you a record of steady payments.

If you have never used credit, you will need to establish a credit rating from scratch.

Your Credit Rating

Creditors decide whether or not to grant people credit based on their credit ratings. A *credit rating* is the creditor's evaluation of your willingness and ability to pay debts. It is measured by the three Cs:

- ***Character***—based on your reputation for honesty and your financial history. The person who has a record of paying bills on time and of assuming financial responsibility will rate high on character.
- ***Capacity***—your ability to earn money and pay debts. It is measured by your earning power and employment history.
- ***Capital***—your financial worth. People with land, a home, cars, savings, or anything of value have capital. Capital gives a person a more favorable credit rating.

A **creditworthy** applicant is judged to have the assets, income, and tendency to repay debt.

The Credit Report

How do lenders get the information to evaluate a consumer's creditworthiness? They look at the application and whether the prospective borrower has a job. They may contact references listed on the application. An important factor is the length of the credit history. If you are unemployed or never have used credit, it may be difficult to get a loan or credit card.

Most lenders also turn to *credit reporting agencies*. A *credit reporting agency*, or credit bureau, is an organization that collects information about the financial and credit transactions of consumers. Businesses notify the credit reporting agencies when a consumer opens a new account, closes an account, or skips or makes late payments.

There are three major national credit reporting agencies: Equifax, Experian, and TransUnion LLC. Once you begin to use credit, you will automatically establish a record at a credit-reporting agency. These agencies sell credit reports to creditors.

A **credit report** is a record of a person's credit history and financial behavior. It includes every credit account ever opened and outstanding balances on current credit accounts. It also lists negative information such as *delinquent* or late payments and overdue taxes. The information on credit reports from the different agencies does not always match up. Carefully review your credit report and check key information in each section, 9-3. If you find errors, contact the credit reporting agency for instructions on filing a dispute.

Your credit report largely determines whether you can get credit when you need it. With a poor report, you will have trouble getting credit and may have to pay higher finance charges.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

9-3

A credit report shows if a person has used credit wisely.

How to Read a Credit Report	
Section	**What to Check**
Personal Information	Verify your personal information, such as your name, address, phone number, date of birth, and Social Security number.
Credit Summary	This section summarizes your revolving and installment accounts and any home loans. Check the balances and your total amount of outstanding debt.
Account Information (also called *Credit Items)*	Make sure all accounts listed belong to you. This section may be lengthy, but it is important to check all details for accuracy, including payment history, balance, and account status. Late payments and accounts taken over by collection agencies appear in this section.
Public Records (also called *Negative Information or Items*)	Any bankruptcies, garnishments, or liens are shown here. Ideally, this section should be blank.
Inquiries (also called *Credit History Requests*)	Look over the list of creditors that recently viewed your credit report. Applying for a credit card, taking out a loan, submitting an apartment application, or applying for insurance can trigger inquiries.

[redacted]

Credit Scores

Creditors also evaluate creditworthiness by looking at *credit scores*. A credit score is a numerical measure of a loan applicant's creditworthiness at a particular point in time. It is generated primarily by credit reporting agencies.

Your credit score may differ from one credit reporting agency to another. Each agency has access to different information and uses different mathematical formulas to calculate scores. However, the scores for the same person are usually similar. A credit score is based on the following:

- ***Bill paying.*** You score high here if you have a record of paying your bills on time.
- ***Debt-to-credit-limit ratio.*** Your debt is the total of all you owe on credit cards, car loans, home loans, and so forth. Your credit limit is the total amount you are allowed under credit card maximums and your original loan amounts. A lower ratio is best.
- ***Credit history length.*** The longer you have used well-managed credit card accounts, the better.
- ***Recent credit application.*** Several applications for new credit accounts can have a negative effect on your credit score.

- *Different types of credit.* Having a mix of loans and credit cards is slightly favored over using only one type of credit.

The higher a credit score, the greater a person's creditworthiness. However, what is considered a good credit score varies. For example, the credit-reporting agency Experian uses a scoring system based on letters, such as the grades you receive in class, 9-4.

What one creditor considers a good score may not be good enough for another. What a creditor considers a good score today may be too low for that same creditor tomorrow. When credit is tight, creditors look for higher credit scores before granting a credit request. A person's credit score changes as his or her financial history and obligations change.

Credit Score Ratings

This is how Experian rated credit scores in early 2009.

- **A: 901 to 990.** Consumers in this group have a low risk of defaulting on loans and lenders offer them the best rates and terms.
- **B: 801 to 900.** Consumers in this group have managed their credit well and are offered good rates and terms by lenders.
- **C: 701 to 800.** Lenders may consider consumers in this group for loans, but often require more information.
- **D: 601 to 700.** Consumers in this group have a higher default rate. Lenders may give them credit, but only at a higher interest rate.
- **F: 501 to 600.** Consumers in this group have a high risk of defaulting on loans. Lenders will often deny them credit. If they get credit, they pay higher interest rates.

9-4

In early 2009, the U.S. average credit score, according to Experian, was 692.

Getting a Credit Card

Credit cards are most often used to buy goods and services on a time-payment plan. You pay for the purchase later, plus interest. Some credit cards may also be used to obtain cash. There are three common types of credit cards:

- *General-purpose cards*, such as Visa or MasterCard, are issued by banks, credit unions, and other financial institutions. You can use these cards around the world at the many places where they are accepted. Very often, you can also obtain cash at automated teller machines using these cards. They carry a credit limit and require minimum monthly payments. Finance charges and other fees vary.
- *Company or retail store cards*, issued by service stations, local merchants, or chain stores, permit you to charge purchases only with the merchant issuing the card. Normally, you have a credit limit and are required to repay a minimum amount each month. Finance charges vary.
- *Travel and entertainment cards* usually require you to pay the entire balance each month. Some cards allow you to pay over a longer period for travel- and vacation-related expenses such as airfare, tours, cruises, and hotel bills. On these balances, you usually pay a high interest rate and must make minimum monthly payments.

[redacted]?

How Credit Cards Work

This example illustrates how a typical credit card is used. Valerie opens a revolving charge account at a local department store. She is issued a credit card. In May, she charges $85 on her credit card. This amount is more than she wants to pay in June when the bill comes. She decides to pay

[redacted]
[redacted]6.

the minimum payment of $10. During June, she charges another $15 worth of merchandise.

In July, the bill totals $91.13. This includes the $75 unpaid balance from June, a 1.5 percent finance charge of $1.13, and $15 for new purchases.

Case Study: Using Credit

Ty's "Deal"

Ty is buying a motorcycle. He's so excited about his new bike that he closes the deal right away and finances with the seller.

He rides away on his new bike feeling great until he runs into his friend Sara. She explains how credit charges differ from lender to lender. The chart below compares Ty's deal with two other sources for a $2,000 loan financed over a 24-month period. Failing to shop for credit was an expensive mistake.

Comparing Credit Sources

	Ty's Deal	Source 1	Source 2
Annual Rate	15%	10%	12%
Monthly Payment	$96.35	$92.01	$93.75
Total Payments (monthly × 24)	$2,312.40	$2,208.24	$2,250.00
Down Payment	$250.00	$250.00	$250.00
Total Paid	$2,562.40	$2,458.24	$2,500.00
Finance Charges (total payments less $2,000)	$312.40	$208.24	$250.00

Case Review

1. What should Ty have done before financing through the seller of the motorcycle?
2. How much money could Ty have saved by financing at a 10 percent annual rate?
3. How many months would you take to pay off a loan of this type? How would this affect your finance charges?
4. How much time would you be willing to spend looking for the best loan terms?
5. How would you have handled Ty's situation differently?

Now Valerie can continue to make minimum payments or pay her account in full.

Since Valerie's credit limit is $1,000, she can continue to charge merchandise until her unpaid balance reaches that limit. As her unpaid balance goes up, so will the minimum monthly payment and the finance charge.

Making minimum payments increases the cost of credit and the amount of time it will take to pay it off. Pay off the balance in full each month to avoid finance charges.

Shopping for a Credit Card

Shopping for credit is as important as shopping for the goods and services you buy with it. When you want to borrow cash or use credit to finance a purchase, shop around for the best credit terms. The more you borrow, the more you pay. The higher the annual percentage rate, the more you pay. The longer you take to repay, the more you pay in credit charges.

The Contract

When you apply for credit, you will be asked to fill out a credit application form like the one in 9-5. This form helps creditors evaluate your financial standing and credit rating.

Using credit involves certain responsibilities for you and the creditor. These are spelled out in credit contracts and agreements. The terms outlined in a written agreement are legally binding. They can be enforced in courts of law if you or the creditor fails to carry out the terms of the contract. It is very important to understand exactly what you are agreeing to do before you sign any contract.

Read the contract thoroughly. Be sure all blank spaces have been filled. None should be left open for someone to fill later. Make sure the annual percentage rate and the dollar cost are stated clearly and accurately. Ask questions if there are any terms you do not fully understand.

Study the contract to find out what action the creditor can take if you pay late or fail to make a payment. Also find out if you can pay in advance. If so, check to see if part of the finance charges will be refunded.

Contract Clauses to Avoid

Watch for an *acceleration clause* that allows the creditor to require full and immediate payment of the entire balance if you miss a payment or fail to abide by the terms of the contract.

For a home loan or an installment loan, find out whether the contract calls for a *balloon payment*. This is a final payment considerably larger than the regular monthly or periodic payments and it is required to retire the loan. If a balloon payment is required, find out the amount and your options if you are unable to make this final payment. Can you refinance? If so, under what terms?

Be wary of *add-on clauses* that allow you to buy additional items before paying in full for goods you have already purchased. The clause may allow

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

9-5

This application form helps creditors evaluate your credit worthiness. Note the questions on the form.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

BELK CREDIT APPLICATION

EMPLOYEE NO. DATE

Type of Account Requested: ☐ INDIVIDUAL ☐ JOINT

PLEASE TELL US ABOUT YOURSELF

FIRST NAME (TITLES OPTIONAL) | MIDDLE INITIAL | LAST NAME | AGE

STREET ADDRESS (IF P.O. BOX — PLEASE GIVE STREET ADDRESS) | CITY | STATE | ZIP

☐ OWN ☐ RENT ☐ LIVE WITH RELATIVE ☐ OTHER | MONTHLY PAYMENT $ | YEARS AT PRESENT ADDRESS | HOME PHONE NO. ( ) | NO. OF DEPENDENTS

PREVIOUS ADDRESS | CITY | STATE | ZIP | HOW LONG

NAME OF NEAREST RELATIVE NOT LIVING WITH YOU | RELATIONSHIP | PHONE NO. ( )

ADDRESS | CITY | STATE

NOW TELL US ABOUT YOUR JOB

EMPLOYER OR INCOME SOURCE | POSITION/TITLE | HOW LONG EMPLOYED YRS. MOS. | MONTHLY INCOME $

EMPLOYER'S ADDRESS | CITY | STATE | TYPE OF BUSINESS | BUSINESS PHONE ( )

MILITARY RANK (IF NOW IN SERVICE) | SEPARATION DATE | UNIT AND DUTY STATION | SOCIAL SECURITY NO.

SOURCE OF OTHER INCOME (Alimony, child support, or separate maintenance need not be revealed if you do not wish to have it considered as a basis for repaying this obligation) | SOURCE | INCOME $ | ☐ MONTHLY ☐ ANNUALLY

AND YOUR CREDIT REFERENCES ARE

NAME AND ADDRESS OF BANK/SAVINGS AND LOAN ☐ CHECKING ☐ SAVINGS ☐ LOAN | PREVIOUS BELK OR LEGGETT ACCOUNT? ☐ YES ☐ NO ACCOUNT NO. HOW IS ACCOUNT LISTED?

List Bank cards, Dept. Stores, Finance Co.'s, and other accounts:	NAME	ACCOUNT NO.	BALANCE	PAYMENT
			$	$
			$	$
			$	$
			$	$

INFORMATION REGARDING JOINT APPLICANT

COMPLETE THIS AREA IF ☐ JOINT ACCOUNT IS REQUESTED ☐ YOU ARE RELYING ON SPOUSE'S INCOME OR CREDIT HISTORY TO OBTAIN CREDIT

FIRST NAME | MIDDLE INITIAL | LAST NAME | AGE | RELATIONSHIP | SOCIAL SECURITY NO.

JOINT APPLICANT'S ADDRESS IF DIFFERENT FROM APPLICANT ADDRESS | CITY | STATE | ZIP

JOINT APPLICANT'S PRESENT EMPLOYER | ADDRESS | HOW LONG EMPLOYED YRS. MOS.

BUSINESS PHONE ( ) | POSITION/TITLE | MONTHLY INCOME $

YOUR SIGNATURE PLEASE Store Stamp Below

I have read and agree to the Terms and Conditions of the Belk Retail Charge Agreement as set forth on attached. Belk is authorized to investigate my credit record and exchange credit experience with other creditors and Credit Reporting Agencies. This information is given to obtain credit, and is true and complete.

Applicant's Signature Date

Joint Applicant's signature (required if joint applicant section completed) Date

FOR OFFICE USE ONLY

Letter ____

CB. RPT. ____

EMP. VER ____

DATE | EMP. | #CARDS | T/C | CR/LN. | APPROVED

the seller to hold a security interest in the items purchased first until you pay for later purchases in full. For example, you buy a washer and dryer, but before paying for them you add a refrigerator. The seller can hold title to the washer and dryer until you also pay for the refrigerator.

Read credit contracts thoroughly with particular attention to possible fees, penalties, and consequences of failing to carry out all the terms of the agreement. Do not sign until you fully understand all the terms and the obligations you are assuming.

Disclosures

By law, credit card offers must include certain disclosures or credit terms, 9-6. Before accepting and using any of these cards, you need to read the fine print on any contract you sign and ask questions. Knowing the exact cost of credit can help you compare finance charges and find the best

Annual percentage rate (APR) for purchases	2.9% until 11/1/XX after that, 14.9%
Other APRs	Cash-advance APR: 15.9% Balance-Transfer APR: 15.9% Penalty rate: 23.9% See explanation below.*
Variable-rate information	Your APR for purchase transactions may vary. The rate is determined monthly by adding 5.9% to the Prime Rate.**
Grace period for repayment of balances for purchases	25 days on average
Method of computing the balance for purchases	Average daily balance (excluding new purchases)
Annual fees	None
Minimum finance charge	$0.50
Transaction fee for cash advances: 3% of the amount advanced Balance-transfer fee: 3% of the amount transferred Late-payment fee: $25 Over-the-credit-limit fee: $25	
* Explanation of penalty. If your payment arrives more than ten days late two times within a six month period, the penalty rate will apply. ** The Prime Rate used to determine your APR is the rate published in the Wall Street Journal on the 10th day of the prior month.	

Adapted from the brochure *Choosing a Credit Card*,
Board of Governors of the Federal Reserve System

9-6

On credit card application forms, disclosures are usually shown in a box similar to this one.

deal. It also helps you decide how much credit you can afford to use. The application should include the following information.

Annual Percentage Rates

The APR must be disclosed. This is the finance charge on unpaid balances. There is usually one rate for purchases and a higher rate for cash advances.

The issuing companies often offer an attractive "introductory rate" that lasts only three to six months, after which you pay the considerably higher regular rate. In this case, it is important to check how long the introductory rate lasts and what the regular rate is.

In addition, know the terms of the rate. Can the credit card company raise the rate for any reason, such as missing a payment on this card?

Variable-Rate Information

Interest rates can be fixed or variable. A *variable interest rate* fluctuates with the ups and downs of the economy. It can start out low and reset to a higher rate. A *fixed interest rate* stays the same, although under certain conditions such as a late payment, it can change.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Grace Period

A **grace period** is the time between the billing date and the start of interest charges. You have that time to pay the full balance without interest.

In a few states, a grace period is mandatory on any new charges made each month. Interest may only be figured on outstanding balances from the prior month. There are no interest charges on credit card balances that are paid in full by the due date each month.

Method of Computing the Balance

It is important to understand how interest is calculated. If you pay less than the full amount owed each month, you will pay interest on the unpaid balance. Creditors compute interest charges in different ways. Their methods can result in very different actual finance charges, 9-7. You need to read the fine print on credit agreements and monthly statements to learn what methods are used to calculate interest. Creditors are required by law to provide an explanation.

Annual Fee

Find out whether you must pay an annual fee for the privilege of using the card. These fees can be as much as $50 or more. It pays to look for cards with low or no annual fees.

Other Fees

It pays to know what extras can be charged to your account and how you can avoid these charges. These may include fees for

- late payments
- exceeding your credit limit
- cash advances
- balance transfers

Shop around for the best credit card deal. You can compare cards, interest rates, fees, and features online as well as by contacting individual credit card issuers.

Rewards

You may want to find out whether there are any perks or rewards associated with using a certain credit card. These may include cash-back offers, no-interest introductory offers, credits for purchases of certain goods and services, and other incentives. You want to weigh the value of any rewards against the costs and fees associated with each card.

Subprime Credit Cards

Subprime credit cards are cards offered to people who have a poor credit history. Often they carry very high interest rates, large annual fees, sign-up fees, participation fees, late payment penalties, and other charges.

Calculating Interest on Revolving Credit Accounts

- *Average Daily Balance*. The creditor starts with the beginning balance for each day in the billing period and subtracts any payments or credits to your account on that day. Then the balances for each day in the billing cycle are totaled. The total is divided by the number of days in the cycle to arrive at the average daily balance. Interest charges are figured on that amount. New purchases may or may not be added to the daily totals. This is the most common method of computing charges.
- *Adjusted Balance*. The creditor determines the balance by subtracting payments or credits received during the billing period from the outstanding balance at the end of the previous billing period. Purchases you make during the current billing period are not included. This is the most favorable method for consumers but rarely used by creditors.
- *Previous Balance*. The creditor computes interest charges on the amount you owed at the end of the previous billing period. Payments, credits, and new purchases during the current billing period are not included.
- *Two-Cycle Balances*. The creditor calculates interest charges on average daily balances and account activity over the last two billing cycles. This is the most costly method for the consumer. There is pending legislation that would prohibit two-cycle balances.

9-7

Actual finance charges can vary depending on the method used to calculate interest.

The credit limits are generally low—$250 to $300. Some card issuers limit the credit to an amount equaling the deposit made in a collateral savings account. In other words, if you deposit $300, that is your credit limit; deposit $5,000 and that is your limit.

Subprime cards generally are easy to get, but very costly. For example, you are issued a card with a $300 limit. It comes with a sign-up fee of $85, a monthly participation fee of $8, and an annual fee of $50. This leaves $157 of credit. Terms vary with different credit card issuers. Be wary because you almost always lose more than you gain with a subprime credit card. It is better to deal only with reputable creditors.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Managing Your Credit

Credit can make it possible for you to spend more than you earn—temporarily. With careful planning, credit can help you get more of the things you want when you want them. Without planning, credit can create serious, long-lasting financial and legal problems. The following tips will help you handle credit responsibly.

Know Your Financial Personality

A close look at your financial personality can help you decide when and if you can use credit safely. Your financial personality is a combination of your attitudes about money and your spending patterns. You express your financial personality by the way you handle cash and credit.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Financial personalities vary greatly. Some people spend money freely. Others find it hard to part with a dollar. Some think through each purchase, while others buy on impulse. What are your money attitudes and habits?

- Do you find it easy to control spending?
- Do you save regularly?
- Do you follow a spending plan?
- Do you consider purchases carefully, particularly major purchases?
- Do you pay bills promptly?
- Do you buy only what you can afford?
- Do you make long-range financial plans?
- Do you handle financial matters with confidence?
- Do you see credit as a tool to use with care and caution?

If you answered "yes" to most of these questions, credit is probably a safe tool for you to use.

Keep Track of Spending

Since many credit problems result from poor money management, the development of good management skills outlined in Chapter 6 can help you avoid serious credit problems. This includes creating a budget or spending plan. Try not to use more credit than you can pay off each month. You only pay interest charges if you roll over a balance to the next month.

Since overspending is easy with a credit card, it is important to keep track of your charges and account balance. Save your receipts. You may want to keep a paper or an electronic log of credit charges so you always know how much you have spent. If you have more than one card, keep track of the total credit spent on all cards.

ECONOMICS in ACTION

Excessive Credit and the Economy

Excessive use of credit can throw the economy off balance and foster inflation. When consumers use credit to buy goods and services, it increases the demand for whatever they are buying. If the demand increases faster than the supply, prices will increase. When government and business join consumers in the excessive use of credit, demand surpasses supply and inflation results. The economy is weakened and fewer job opportunities exist.

Remember Alternatives to Using Credit

Usually you have three alternatives to using credit. You may choose

- not to buy
- to pay with savings
- to postpone buying now, and buy later with cash

The choice you make will depend on what you want to buy and what you want to achieve with your cash and your credit. Here are some questions to help you evaluate your choices.

How important is making the purchase? If you can do without something, you might be wise to not buy it. Is having the purchase now instead of later worth the extra price you pay for credit?

Are you willing to use all or some of your savings to buy now? Unless you have planned to use money you have saved to make the purchase, reducing or eliminating your savings could be risky. Often it is difficult to replace the savings used for unplanned purchases. You may be left unprepared for unexpected emergencies or financial difficulties.

Can you save your money and buy later? This will depend on how long you can wait to make the purchase. It will also depend on your ability to save money. Many people find it easier to make monthly credit payments than to put money in savings.

By waiting and saving, you may miss the satisfaction or pleasure of having what you want now. For example, suppose you want to take a vacation with friends. They are leaving next month for a week at the beach. According to your savings plan, you need three more months to save enough money for the trip. If you wait three months, you will not be able to share the vacation with your friends. In this case, you may decide to use credit to help you finance the vacation.

On the other hand, waiting may help you get more satisfaction from a purchase. Suppose you want to buy a pool table. You want it now, but you do not have enough money. Also, you are not sure what type of pool table you want. You decide to wait and save. As you are saving, you do some comparison shopping. You decide what features you want and where to get the best deal. When you finally buy the pool table, your satisfaction is greater than if you had rushed into a credit purchase. A waiting period can make the purchase more valuable to you.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

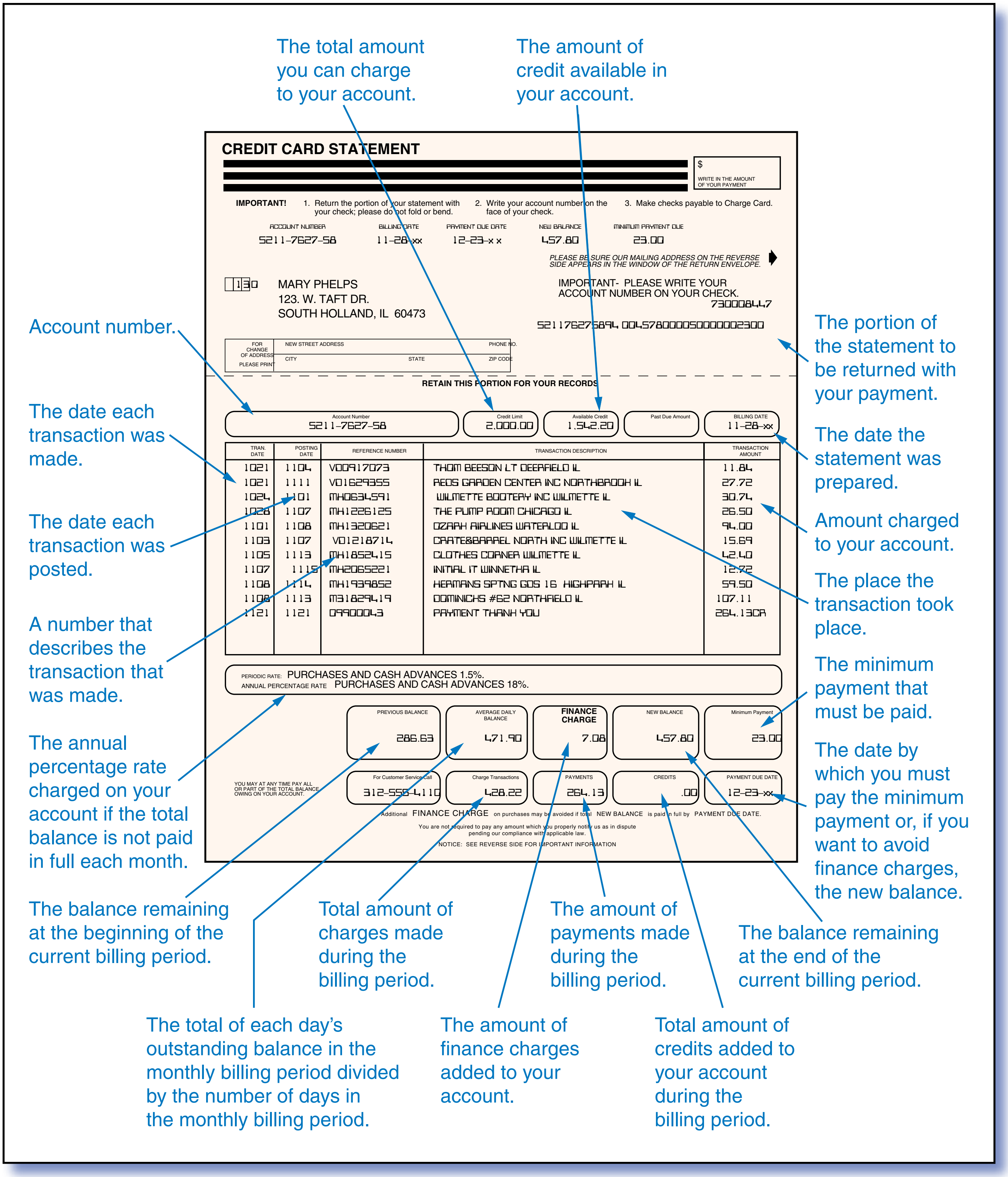
[redacted]

[redacted]

Check Monthly Statements

You get a *monthly statement* for each credit card account. These statements are another form you need to study and understand, 9-8. In addition to the date, amount, and business related to each purchase, the statement should tell you the following:

- date that payments are due
- minimum payment due
- new balance and previous balance
- total amount of new purchases, fees, and advances



9-8

This statement explains the information you will find on monthly credit card bills.

- finance charges as a dollar amount, as well as the periodic and corresponding annual percentage rate
- total amount of payments and credits
- total amount of credit available on the account

Check the statement each month against your own record of charges, payments, and credits.

Check Your Credit Report Regularly

If you make a habit of checking credit reports regularly, you can correct any errors before they cost you a loan, an apartment, or even a job. Checking these reports is the best way to make sure no one has applied for a loan or credit card in your name.

By law, you are entitled to receive one free copy of your credit report from each of the major credit reporting agencies every 12 months. You may receive the report in paper or electronic form. To order your reports, go to www.annualcreditreport.com.

If you find an error or an incomplete entry in a credit report, make sure you correct it right away. Go to the agency Web site for instructions on how to challenge negative information. You will need to contact the agency and provide copies of any documents that back up your claim.

Report Lost or Stolen Cards

If a person's credit cards are lost or stolen, the law offers some protection. The cardholder is responsible for only $50 in charges per card if someone else uses the cards. However, if a cardholder notifies the companies that issued the cards before someone else uses them, the cardholder cannot be held responsible for any charges.

Be sure to report credit card thefts or losses as soon as possible by phone. Follow up with a letter or an e-mail. It is a good idea to keep a list of your credit cards on hand. Include the name of the issuer, account numbers, and telephone number for each card.

Handling Credit Problems

Used unwisely, credit can lead to serious financial difficulties. Chart 9-9 lists some of the danger signals that warn credit users of trouble ahead.

The consequences of having a poor credit report are severe and impact more than the ability to get credit. A person with a low credit score may

- be unable to get loans and credit cards
- pay higher interest rates for credit
- have fewer housing choices because landlords check credit reports and reject people with low scores

Resource

Monthly Credit Statement, Activity E, WB

Activity

Visit a major credit card company Web site to find out what steps they tell their customers to take when questions arise concerning billing.

Enrich

Role-play a phone call reporting a lost or stolen credit card and draft a follow-up letter to the card issuer.

Resource

Managing the Cards in Your Wallet, color lesson slide, TR

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 each month than the amount you can pay.
- Not paying off credit account balances.
- Routinely running out of money before payday.
- Using credit cards or cash advances for everyday living expenses.

9-9

Beware of these warning signals when using credit.

- have fewer job prospects because employers avoid job candidates with financial problems
- pay higher insurance premiums

Accurate negative information, such as missed or late payments, may remain on your report for seven years. Bankruptcies may remain for 10 years.

When debtors fail to pay, lenders and businesses will try to recover what they are owed. Following are some of the actions they may take.

Collection Agencies

When debts go unpaid, businesses and creditors often hire collection agencies. A *collection agency* is a business that specializes in debt collection. Often it is paid with a portion of the money collected. In order to get full payments from you, collection agencies use every lawful means possible. The nonstop pressure they apply causes many debtors to pay in full.

Repossession of Property

Repossession is the taking back of collateral when a borrower fails to repay a loan. For example, companies that repossess autos may tow the cars away without notice. The cars are auctioned and the money goes toward paying the debt.

Perhaps the most serious type of repossession is *foreclosure*. **Foreclosure** is the forced sale of a property. The property, usually a home, is taken back by the lender because the debtor failed to make loan payments. The residents receive a court order to remove their possessions and leave by a specific date.

Finance

Repossession Agents

Repossession agents are often contracted by creditors who cannot recover money owed to them. They locate or recover personal property, such as cars, boats, and appliances, sold under a security agreement.

Liens Against Property

A **lien** is a legal claim on a borrower's property by a creditor who is owed money. For example, if a person fails to pay state taxes, the state can put a lien on his or her home. To sell or take out a loan on the home, the debtor must pay off the lien first.

Garnishment of Wages

The court may order *garnishment* of a debtor's earnings. **Garnishment** is a legal procedure requiring a portion of the debtor's pay to be set aside by the person's employer to pay creditors. This reduces the amount of the debtor's paychecks. Some employers fire employees who have repeated garnishments.

Bankruptcy

When financial circumstances are desperate, some debtors have little choice but to file for personal *bankruptcy*. **Bankruptcy** is a legal state in which the courts excuse a debtor from repaying some or all debt. In return, the debtor must give up certain assets and possessions. The *Bankruptcy Act* allows debtors to file "Chapter 7" or "Chapter 13" bankruptcy.

- ***Chapter 7 Bankruptcy.*** The court declares the person unable to meet financial obligations. Most debts are discharged or forgiven. This is also referred to as *straight bankruptcy*. The court then takes and sells the debtor's property and possessions. Proceeds from the sale are divided among the creditors. The law exempts certain assets and possessions: a small equity in a home, an inexpensive car, and limited personal property.
- ***Chapter 13 Bankruptcy.*** This plan permits debtors with regular incomes to pay all or a portion of their debts under the protection and supervision of the court. The court sets up a three- to five-year repayment schedule. It also establishes the monthly amount to be paid toward debts. Once the court accepts the debtor's petition, creditors may not take action against the debtor. This plan has three advantages over straight bankruptcy. The debtor fulfills credit obligations, keeps most of his or her own property and possessions, and maintains a reasonably sound credit rating.

Some types of debt cannot be wiped out by declaring bankruptcy. These include most student loans, alimony, child support, and many types of taxes.

The consequences of filing bankruptcy can haunt a debtor for many years. Once a court declares that people are bankrupt, a report stays in the credit records for 10 years. They may be denied loans or credit cards, or only be granted credit at inflated interest rates. They may be denied a job, a business loan, insurance, or housing by anyone who sees their credit report.

Bankruptcy, even for unavoidable reasons, often carries a stigma. People who file bankruptcy may be viewed as dishonest or untrustworthy. They may be considered irresponsible for not paying their debts. For these reasons, bankruptcy is a last resort.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

The Easy-Access Credit Trap

You have probably heard the term **loan shark**. It refers to someone who loans money at excessive rates of interest. They usually use predatory lending tactics and offer easy-access credit. **Easy-access credit** refers to short-term loans granted regardless of credit history at high interest rates. Even people who are poor credit risks can get these loans if the practice is considered legal in their state. Easy-access credit includes the following:

- **Payday loan.** These are short-term, high interest loans that must usually be repaid on the borrower's next payday. Repayment is guaranteed by the borrower's personal check at the time of the loan or by

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

access to the borrower's bank account. Payday loans carry extremely high finance charges, but some states have laws that limit them.

- **Pawnshops.** A pawnshop is a business that gives customers high-interest loans with personal property, such as jewelry, held as collateral. Some pawnshops offer payday loans, too.
- **Rent-to-own.** This is an arrangement in which a consumer pays rent for the use of a product and eventually owns it. The advantage is little or no initial payment. The disadvantage to the consumer is paying much more than the product's purchase price by the time the final payment is made.
- **Title loan**. A short-term loan is made using a borrower's car as collateral. The cost of these loans is high and the borrower risks losing his or her car.

Here is an example of how easy-access credit differs from legitimate sources of credit. Suppose you borrow $1,000 by using a credit card cash advance. The APR is 21.99 percent. That is equivalent to a monthly interest rate of 1.833 percent (APR divided by 12). If you repaid the money in a month, you would pay an $18.33 finance charge.

Contrast that to what you would pay if you borrowed from a payday loan company. Finance charges are often $15 or more for every $100 borrowed. At $15, you would pay $150 to borrow $1,000. To get the loan, you write a check for $1,150. You get $1,000 and must pay this back in two weeks.

If you do not have the money, like many borrowers, you can roll the loan over for another two weeks for an additional finance charge. You owe the lender another $150. After one month, you have paid $300 in fees. What is the annual equivalent of this interest rate? If you continued to roll over the loan for a year, the APR would be 350 percent, or $3,600!

Inform Creditors

If you have trouble paying your bills, notify creditors promptly. Many reputable creditors will work with you. They may help you by renegotiating repayment schedules, or setting up a repayment program you can handle. They may be willing to extend your repayment schedules to lower the size of your monthly payments. Of course this will cost you more in credit charges in the long run, but it may help you get through a difficult period.

The quicker you realize you are having financial problems, the quicker and easier it will be to correct them. It pays to tackle these problems before they get beyond your control.

Finance

Debt Counselors

Debt counselors help clients resolve financial difficulties. They provide financial counseling about debt, credit, money management, budgeting, and housing issues.

Get Credit Counseling

With a sound financial spending and savings plan, some people can correct their own financial problems. However, when financial problems get out of control, it is time to look for outside help. Following are some possible options. Be cautious of "credit doctors" and for-profit credit repair clinics that promise to fix your credit rating for a fee. These companies promise what no one can deliver. Read on for more reliable options.

One reliable source of help for people with credit problems is a *credit counseling service*. A credit counseling service is an organization that provides debt and financial management advice and services to people with debt problems at little or no cost. The National Foundation for Consumer Credit sponsors several hundred credit counseling services throughout the United States and Canada. The credit counseling services, with the support of local merchants and financial institutions, offer aid in two forms.

9-10
Credit counselors help clients develop a plan to get out of debt.

The service helps a debtor with a stable income work out a practical financial program for repaying debts, 9-10. The service also helps the debtor plan and control current expenses to avoid further debts.

When debtors are very deep in debt, the counseling service offers another alternative. It tries to arrange new repayment plans with creditors. If creditors agree, the debtor gives the counseling service a set amount from each paycheck, and the service pays the creditors. Credit counseling services of this type help about five of every six applicants.

Finding a Reputable Company

[redacted]

[redacted]

[redacted]

[redacted]

Unfortunately, some of the businesses that claim to be nonprofit credit counseling services are not. These include debt negotiation or debt adjusting businesses that charge high fees. The fees cause their clients to fall deeper into debt.

A company that charges high fees or demands that the debtor pay them rather than their creditors should be avoided. Debtors should pay little or nothing for the help they receive. Claims that are too good to be true indicate a problem. This might be a guarantee that they can make debt disappear or dramatically reduce total debt. Also be suspicious of those who claim an ability to remove accurate negative information from credit reports.

Consumers can contact their local consumer protection agency to get a referral to a reputable consumer credit counseling service. The U.S. Trustee Program of the Department of Justice maintains a list of credit counseling agencies approved for prebankruptcy counseling. The list is found on their Web site. It also is a good idea to check with the local Better Business Bureau or the state attorney general's office for reports of consumer complaints against specific companies.

Consumer Credit Legislation

Over the years a number of federal laws have been passed to protect consumers when they use credit. The key points of the most important credit legislation are outlined in the following sections.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Truth in Lending Law

The *Truth in Lending Law*, passed in 1969, requires creditors to tell consumers what credit will cost them before they use it. Under this law, credit contracts and agreements must include

- the amount financed or borrowed
- the total number, amount, and due dates of payments
- the finance charge in dollar amount and annual percentage rate
- all charges not included in the finance charge
- penalties or charges for late payment, default, or prepayment
- a description of any security held by the creditor

For merchandise purchased on time, creditors must provide additional information. This includes a description of the merchandise, the cash price and the deferred payment price, and the down payment or trade-in. The Truth in Lending Law also prohibits creditors from issuing credit cards you have not requested.

Equal Credit Opportunity Act

The *Equal Credit Opportunity Act*, passed in 1975, prohibits credit grantors from discriminating against consumers on the basis of sex, marital status, race, national origin, religion, age, or the receipt of public assistance. This means credit can be denied only for financial reasons and not for any of the factors listed above. When applicants are turned down, creditors must provide a written explanation of why credit was denied.

Fair Credit Reporting Act

Passed in 1971 and revised in 1977, the *Fair Credit Reporting Act* requires accuracy and privacy of information contained in credit reports. If you are refused credit because of information supplied by a credit reporting agency, this law gives you the right to

- receive the name and address of the reporting agency that sent the report
- find out from the reporting agency what facts are on file, the source of the information, and who has received the information
- require a recheck of any information you find to be false
- receive a corrected report if errors are found
- require the agency to send the corrected report to all creditors who received false information

Fair Credit Billing Act

The *Fair Credit Billing Act*, passed in 1975, protects consumers against unfair billing practices. It outlines the procedures to follow in resolving billing errors or disputes. The law requires creditors to send customers a written explanation of steps to take when questions arise concerning bills. The customer has 60 days after receiving a bill to notify the creditor of an error, 9-11. The creditor must answer within 30 days. Within 90 days, the creditor must either correct the bill or explain if it is accurate. Creditors may take no collection action on amounts in question until billing disputes are resolved. However, the customer must pay any amount not in question.

9-11
Under the Fair Credit Billing Act, customers have a certain amount of time to resolve billing disputes.

Electronic Funds Transfer Act

Electronic Funds Transfer (EFT) systems use electronic impulses to activate financial transactions instead of cash, checks, or paper records. The *Electronic Funds Transfer Act* protects consumers in these transactions by

- prohibiting the distribution of unrequested EFT cards. You receive a card only if you ask for it.
- requiring issuers of EFT cards to provide cardholders with written information outlining their rights and responsibilities for the card and its use.
- limiting to $50 the liability for unauthorized transfer. The cardholder must notify the issuer of card loss or misuse within two business days.
- requiring issuers to provide cardholders with printed receipts of EFT transactions.
- requiring issuers to promptly investigate and correct EFT errors.

Fair Debt Collection Practices Act

Passed in 1978, the *Fair Debt Collection Practices Act* protects consumers against unfair methods of collecting debts. According to this law, debt collectors may not

- reveal or publicize a debtor's debt to other people
- contact debtors at inconvenient times (before 8 a.m. or after 9 p.m.) or places (such as work)
- use threats or abusive language
- make annoying, repeated, or anonymous phone calls

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

- make false or misleading statements about the collector's identity or the consequences of nonpayment
- collect unauthorized fees or charge debtors for calls and telegrams

Preservation of Consumers' Claims and Defenses Ruling

The *Preservation of Consumers' Claims and Defenses Ruling* was issued by the Federal Trade Commission. It protects debtors from being forced to pay for goods and services when they have a legitimate dispute with the seller of those goods or services.

This applies when a retailer sells consumer credit obligations or contracts to a third party creditor. The consumer then owes the third party. If the goods or services purchased with credit are unsatisfactory, the debtor still owes the third party rather than the seller. For this reason, the seller does not feel obligated to correct any problems with the goods or services.

This ruling greatly limits the "holder-in-due-course doctrine." That doctrine says the holder of a consumer contract has a right to collect a debt regardless of any unfair practices on the part of the seller.

Here is an example to show how the rule protects you. Suppose you buy a $500 TV from the Viewing Center. You sign an installment contract calling for 18 monthly payments. The Viewing Center offers credit through a sales finance company. Therefore, you owe the finance company rather than the seller.

After the television is delivered, you find that it does not work. You can get sound but no picture. When you complain, the seller refuses to correct the problem. You threaten nonpayment. The seller says that is not the Viewing Center's problem because you owe the finance company.

You complain to the finance company, but they tell you the television is the seller's responsibility. Legally, you owe the finance company regardless of the seller's performance.

The Preservation of Consumers' Claims and Defenses Ruling protects you in this type of situation. Under the ruling, you have a right to a legal defense in court if you refuse to pay a creditor because you have a dispute with a seller.

Bankruptcy Abuse Prevention and Consumer Protection Act

The main goal of federal law, passed in 2005, was to make the bankruptcy system fairer to both debtors and creditors. However, it has been criticized for disproportionately benefiting the credit card industry.

It made filing for Chapter 7 bankruptcy more difficult. Those who are allowed to file must pass a "means test" that takes into account factors such as income and assets. Those who do not pass the means test must file for Chapter 13 bankruptcy that requires some repayment of debt. Another provision of the law requires debtors to get credit and financial counseling before filing for bankruptcy.

Chapter Summary

Using credit has both advantages and disadvantages. Knowing when to use it and understanding the different types of credit can help consumers enjoy the benefits of using credit and avoid credit problems. Credit use impacts a person's credit rating. Credit reporting agencies use credit scores to summarize a person's payment history, debt owed, and credit account use.

Opening a credit card and using it responsibly is one way to build a good credit rating. When shopping for a credit card, read each contract carefully, know the clauses to avoid, and compare disclosures. Before using credit, consider other alternatives. Some ways to avoid credit problems include tracking spending, checking monthly statements, reviewing credit reports annually, and reporting lost or stolen cards.

Consumers can resolve credit problems by informing creditors when serious financial problems arise and seeking credit counseling. Federal laws protect consumers in many ways, including requiring creditors to disclose the cost of credit, preventing unfair billing practices, and regulating debt collection methods.

Review

1. How does a credit transaction differ from a cash transaction?
2. List three advantages and three disadvantages of using credit.
3. What three factors determine the amount you pay in finance charges?
4. Explain the difference between closed-end and open-end credit. Give an example of each.
5. What steps can you take to build a sound credit rating?
6. What is the function of a credit reporting agency?
7. What factors influence a person's credit score?
8. What contract clauses should be avoided when applying for a credit card? Explain each clause.
9. Explain the difference between variable interest rates and fixed interest rates.
10. What are subprime credit cards?
11. What are some alternatives to using credit?

Answers to *Review*

[redacted]

12. How can consumers obtain free copies of credit reports? How often are free copies available?
13. What are the advantages of filing bankruptcy under Chapter 13 instead of Chapter 7?
14. How can credit-counseling services help debt-troubled individuals and families?
15. What is the purpose of the Equal Credit Opportunity Act?

Critical Thinking

16. How can the use of credit have a positive influence on the economy?
17. How can the use of too much credit contribute to inflation?
18. Suppose you buy a 10-speed bike using credit. After two weeks, the bike only runs on five speeds. Although the bike has a two-year warranty, the seller refuses to do anything about the problem. Your credit contract has been sold to a finance company and the seller has been paid. Describe your rights if you refuse to pay the creditor.
19. How can your financial personality help you decide when and if you can use credit safely? How would you describe your financial personality?
20. Why do you think so many students and young people today are incurring so much

[redacted]

debt? What are some steps that could be taken to deal with this problem?

Academic Connections

21. **Financial literacy, math.** Suppose you want to buy a $600 television on credit. Find out what the credit terms would be if you obtained the credit from the seller, a cash loan, or a credit card. Find out about finance charges, annual percentage rate, monthly payments, length of the repayment period, and late payment charges. Where would you get the best deal?
22. **Financial literacy.** Ask a representative from a credit-counseling agency to speak to your class about how to use credit wisely. Prepare a list of questions to ask the speaker. You may want to include some of the following:
    A. What are the most common problems connected with the use of consumer credit?
    B. What are the most common causes of credit problems?
    C. How can consumers avoid credit problems?
    D. How can credit counseling help consumers with financial problems?
23. **Financial literacy, writing.** Pick up an application for a credit card or charge account from a local bank or store. Fill it out and explain why creditors require the information requested on the application.
24. **Writing.** Write a definition of the following and explain how each could affect your use of credit.
    - acceleration clause
    - balloon payment
    - add-on clause
    - repossession
    - garnishment

Answer to *Math Challenge*

[redacted]

25. **Research, social studies.** Research the current status of debt among college students and young adults. Report your findings to the class and discuss possible remedies.

Math Challenge

26. Fiona's credit card balance is $5,000. The APR is 18 percent and the minimum payment is 5 percent of the balance. What is the minimum payment due? How much of the minimum payment goes to interest? to the principal? If Fiona makes the minimum payment this month and does not use her card to make any more purchases, what will her balance be next month? What is next month's minimum payment due?

Tech Smart

27. Find out how consumer financial behavior affects credit scores. Go to www.vantagescore.experian.com and find the Credit Score Illustrator tool. Explore the different consumer scenarios.
28. Go to www.consumercredit.com and find the Credit Card Interest Calculator. Use the calculator to illustrate the benefits of paying more than the minimum due on a credit card. Enter the following numbers into the calculator:
    Dollar amount charged: 1,000
    Annual interest rate: 18
    Minimum payment percent: 4
    Leave *minimum payment* blank and compute the results.
    Reset the calculator and enter the following numbers:
    Dollar amount charged: 1,000
    Annual interest rate: 18
    Minimum payment: 50
    Leave *minimum payment percent* blank and compute the results.
    How much time and money can you save by paying more than the required 4% each month?