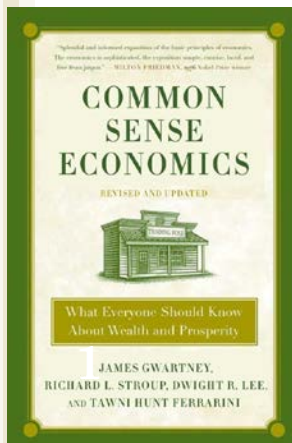


MODULE J: SMART CHOICES FOR MANAGING CREDIT



Common Sense Economics ~ What Everyone Should Know About Wealth and Prosperity

<http://CommonSenseEconomics.com/>



Turn on the learning light!

CREDIT, FINANCIAL INSTITUTIONS, AND FINANCIAL SERVICES

- Read: [What is Credit?](#) by Mark Schug
- Watch: [Mary Poppins- Fidelity Fiduciary Bank](#)



CREDIT, FINANCIAL INSTITUTIONS, AND FINANCIAL SERVICES

What Is Credit?

- Credit is the ability to purchase goods and services today and pay for them later.
- Credit means convincing a lender to provide you with a loan for a promise to pay back the amount plus interest.
- The interest is usually a percentage of the amount that was borrowed.



CREDIT, FINANCIAL INSTITUTIONS, AND FINANCIAL SERVICES

Credit Can Improve Your Quality of Life

- If people waited until they had saved up enough cash to pay for all of their big purchases, they would have a lower standard of living.
- In the past, most credit transactions were based on simple, face-to-face relationships among local consumers and the owners of the stores they used.
- Today, consumers of credit face a wide array of credit choices offered by numerous sources.
- This wide range of choices implies that credit decisions should not be made casually.



CREDIT, FINANCIAL INSTITUTIONS, AND FINANCIAL SERVICES

○ Financial Institutions

- Financial institutions play the role of “middlemen.”
- They reduce transaction costs related to connecting lenders and borrowers.



CREDIT, FINANCIAL INSTITUTIONS, AND FINANCIAL SERVICES

○ Financial Institutions

- People seek a safe place to keep their savings and hope to earn a return.
- Financial institutions channel the savings into loans used by consumers and businesses.
- The result is a growing economy—all parties gain even though that probably was not the intention of any one individual.
- It is another example of the invisible hand at work.



CREDIT, FINANCIAL INSTITUTIONS, AND FINANCIAL SERVICES

Types of Financial Institutions

- Retail banks
- Savings and loans
- Credit unions
- Consumer finance companies



CREDIT, FINANCIAL INSTITUTIONS, AND FINANCIAL SERVICES

Who benefits from credit?

- Borrowers are able to purchase something that may be of value today as well as in the future.
- Lenders are repaid the amount of the loan plus interest.
- Both sides benefit.
- It's a win-win situation!



CREDIT, FINANCIAL INSTITUTIONS, AND FINANCIAL SERVICES

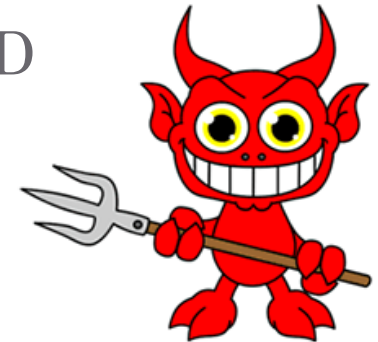


Credit Can Be From Heaven

- Credit can help you to obtain valuable assets and allows you to pay for the assets while you benefit from their use.
- Assets are goods or services that retain value.
- Homes, cars, and post-secondary education are examples of assets.
- Credit can help people acquire assets sooner and thus lead to happier, more prosperous lives.



CREDIT, FINANCIAL INSTITUTIONS, AND FINANCIAL SERVICES



Credit Can Be From Hell

- People have difficulty recovering from using too much credit relative to their income.
- Repayments have to be made out of current income which means having less income available for other important purposes.
- Misusing credit jeopardizes your ability to get low-cost credit in the future.
- Misuse of credit can lead to unhappiness, high levels of stress, bankruptcy, and is a frequent cause of serious marital problems.



CREDIT, FINANCIAL INSTITUTIONS, AND FINANCIAL SERVICES

What does credit cost?

- When banks and other financial institutions make loans, they expect to be compensated.
- This compensation is called interest.
- Interest is the price borrowers pay to lenders for the use of the lender's money.
- Loans that are more likely to be repaid (for a home, for example) have lower interest rates than loans that are less likely to be repaid (an emergency payday loan).
- The Annual Percentage Rate (APR) is the interest rate for credit.



CREDIT, FINANCIAL INSTITUTIONS, AND FINANCIAL SERVICES

Who gets credit?

- Borrowers have to demonstrate to lenders that they will repay the loan.
- Lenders look for the three Cs of Credit:
 - **Character:** Will the applicant repay the money as agreed?
 - **Capacity:** Does the applicant have enough income to make the payments?
 - **Collateral:** Is the loan secure (e.g. is it backed by an asset such as a home or car)?



CREDIT, FINANCIAL INSTITUTIONS, AND FINANCIAL SERVICES

How do you get credit?

- A loan application often calls for the following:
 - Your address
 - Length of time at address
 - Employment record
 - Other loans
 - Savings accounts
 - Checking accounts
 - References
- Creditors will wish to have access to your credit report and credit score



CREDIT, FINANCIAL INSTITUTIONS, AND FINANCIAL SERVICES

Alternative Financial Service Providers

- Alternative financial service providers are widely available and conveniently located.
- Alternative financial services include:
 - Payday loan stores
 - Check-cashing outlets
 - Rent-to-own stores
 - Title loans
 - Tax anticipation loans



CREDIT, FINANCIAL INSTITUTIONS, AND FINANCIAL SERVICES

Many Consumers Use Alternative Credit Services

- Services provided by alternative financial suppliers
 - Loans often for small amounts of money
 - Check cashing services
 - Wire transfers
- Potential Advantages of Alternative Financial Providers
 - Most are conveniently located.
 - They offer quick service.
 - Services come with a minimum of paperwork.
 - These financial services, in the event of an emergency, are an alternative to borrowing from friends or family members.



CREDIT, FINANCIAL INSTITUTIONS, AND FINANCIAL SERVICES

Disadvantages of Using Alternative Financial Service Providers

- Fees are often much higher than those available at mainstream financial institutions such as banks and credit unions.
- Alternative financial services often mean dealing in cash which can be easily lost or stolen.
- Few records are kept of such transactions.
- Alternative financial service providers offer no opportunity to save or establish a financial history.



ALL PLASTIC IS NOT THE SAME

- Read: See or review sections on debit cards and credit cards in *What is Credit?* by Mark Schug
- Watch: [Credit and Debit: Two Very Different Cards](#) by Bank of America



ALL PLASTIC IS NOT THE SAME

How do credit cards work?

- Credit cards are offered by many institutions including banks, credit unions, oil companies, finance companies, and airlines.
- Most credit cards charge a fixed rate of interest; many also charge an annual fee.
- Most have a grace period and a credit limit.
- A statement is mailed or sent online each month showing the charges, the total owed, the minimum payment, and the finance charge.



ALL PLASTIC IS NOT THE SAME

- A debit card is much like using cash. The charge is immediately withdrawn from your checking account.
- If funds in the account are insufficient, you may face a high overdraft charge.
- A credit card is a loan that may involve payment of interest and finance charges.
- Payment is not due immediately and there is a grace period.



ALL PLASTIC IS NOT THE SAME

Tips For Wise Use of a Credit Card

- Have only two or three cards.
- Pay off the balance each month.
- Shop for low interest rate and a low annual fee.
- Notify your card issuer immediately if a card is lost or stolen.
- Keep your credit card number secure.
- Immediately report questionable charges to the card issuer.
- Keep an eye on your card when using it for purchases at retail establishments.



CREDIT REPORTS AND CREDIT SCORES

- Read: [Tracking Your Credit History](#) by Mark Schug
- Watch: [How to Build Credit from Scratch](#) by Bank of America
- Watch: [Building Credit and Keeping Yours Healthy](#) by Bank of America



CREDIT REPORTS AND CREDIT SCORES

Lenders Expect to Be Repaid

- Financial institutions that offer credit are profit-seeking businesses.
- They have an interest in providing loans to people who are likely to repay them.
- They are interested in learning about an applicant's credit history to help them make decisions about who gets credit and at what rate of interest.



CREDIT REPORTS AND CREDIT SCORES

Gathering Credit History

- Credit histories are described in credit reports.
- Credit reports are gathered by credit reporting agencies:
 - Equifax (800) 685-1111 or equifax.com
 - Experian (888) 397-3742 or experian.com
 - Trans Union (800) 916-8800 or transunion.com



CREDIT REPORTS AND CREDIT SCORES

What is on a credit report?

- Identifying information
 - This includes your Social Security number, address, date of birth, and so forth.
- Trade Lines:
 - These are credit accounts.
- Inquiries
 - Everyone who has requested your credit report.
- Public Record and Collection Information:
 - This includes public record information from state and county courts, and information on overdue debt from collection agencies. This includes bankruptcies, foreclosures, suits, wage attachments, and so forth.



CREDIT REPORTS AND CREDIT SCORES

What is on *not* a credit report?

- Checking and savings account balances
- Income
- Medical history
- Purchases made with checks or cash.
- Race, gender, religion, or national origin
- Driving record



CREDIT REPORTS AND CREDIT SCORES

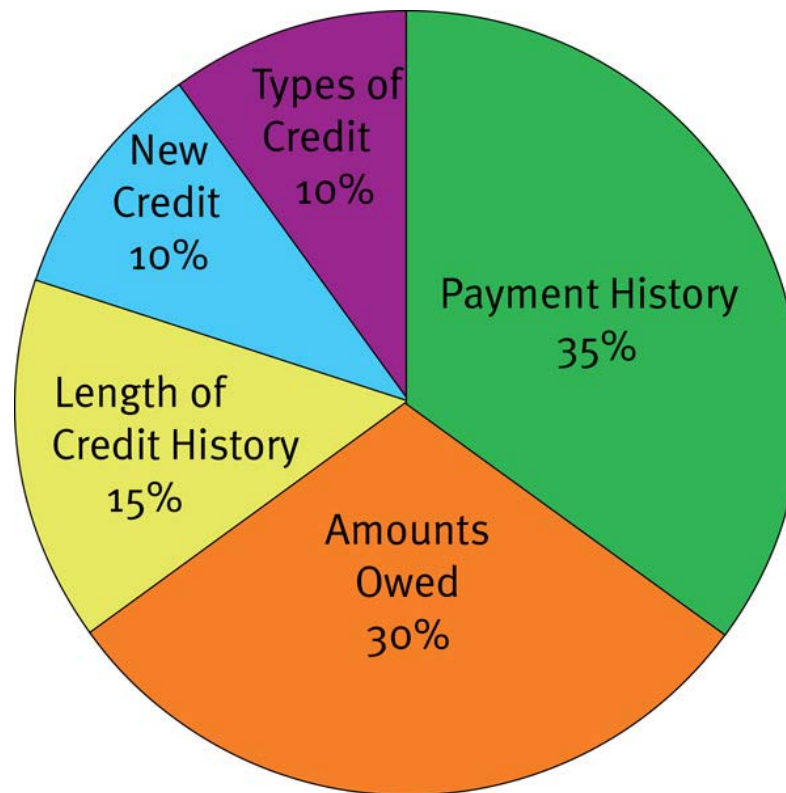
What is a credit score?

- A credit score is a number lenders use to help them decide whether to make a loan to an individual.
 - FICO scores are the most commonly used credit score.
 - FICO scores range from 300 (high credit risk) to 850 (low credit risk).



CREDIT REPORTS AND CREDIT SCORES

What is on a credit score?



CREDIT REPORTS AND CREDIT SCORES

Is your credit at risk?

- Do you pay the bill from one company one month and then pay the bill from another company the next month?
- Do you frequently receive overdue notices from creditors?
- Have you reached the limit on your credit cards?
- Do you pay only the minimum on your credit-card balances?



CREDIT REPORTS AND CREDIT SCORES

Is your credit at risk?

- Do you sometimes write bad checks?
- Do you use your credit card to pay for everyday expenses because you have run out of cash?
- Do you use alternative financial services like payday loan stores?



CREDIT REPORTS AND CREDIT SCORES

Take Action Now To Improve Your Credit Score!

- Reduce your spending.
- Pay bills on time.
- Do not take out any new lines of credit.
- If unable to make promised payments on a loan, contact the lender to see if better terms can be arranged.
- Pay down your credit card balances.
- Keep your oldest credit lines.

