THEME 4

Spending and Credit Are Serious Business

OVERVIEW

Student Letter

Just about every adult in America uses credit. In 1999, 78 million households in the United States had a credit card. Yet, some people are afraid of using credit. "Neither a lender nor a borrower be" is an old adage such people might quote. Other people are fearless about using credit. They might say, "Hey, it's only plastic! Let's go for it!"

There are problems with both viewpoints. Used in a smart way, credit can be a tremendous help to you now and in the future. Used in a stupid way, credit can result in harassment, broken relationships, and bankruptcy.

What is credit? Credit means obtaining the use of money that you do not have. Obtaining credit means convincing someone else (a financial institution like a bank, savings and loan, credit union, or a credit card company) to voluntarily provide a loan to you in return for a promise to pay it back later plus an additional charge called interest.

Can using credit help you? You bet! Using credit allows you to use a good or a service today and pay for it later. Using credit can help people acquire valuable assets (like a college education or a home). Credit can also add to the enjoyment of life.

Can using credit hurt you? You bet! Loans have to be repaid. Lenders charge interest for the use of their money. Individuals have to sacrifice things they wish to have today because they are required to pay for goods or services they have already consumed.

So, the key is to be smart about the use of credit.

What do lenders look for when they approve a loan to an individual? Ordinarily, they look for the "Three Cs":

- ✔ **Character:** Will the applicant be responsible and repay the loan?
- ✔ **Capacity:** Does the applicant have enough discretionary income to comfortably make the payments on the loan amount requested?
- ✔ **Collateral:** Will the loan be secured, or guaranteed, by collateral that can be used to repay the debt in case the borrower defaults on the loan?

Consumers sometimes make mistakes in using credit. They are not perfect. People in the lending business also make mistakes. They are not perfect either. The world of finance can be complicated. Some business people take advantage of consumers. Several state and federal laws are designed to protect credit consumers from dishonest business practices. Among the more important consumer credit protection laws are the Truth in Lending Act and the Fair Credit Reporting Act.

And then there are the scheme artists and swindlers. Unfortunately, the credit and finance industry sometimes attracts some unsavory sorts who prey on people's greed or financial fears. If you receive a phone call describing an investment that sounds too good to be true, it is. Hang up the phone. Avoid businesses that provide financial services but at very high costs—such as payday loans and rent-to-own plans.

Questions

1. What is credit?

2. What is an advantage to using credit?

3. What is a disadvantage to using credit?

4. What do lenders look for when they approve a loan to an individual?

5. Do credit consumers have legal protections?

FAQs

ABOUT SPENDING AND CREDIT ARE SERIOUS BUSINESS

1. What is APR?

APR is the annual percentage rate. An APR is the interest rate you pay in a single year on the money you borrow.

2. Should you shop for credit cards?

Shopping for credit cards can save you money. Credit cards differ in what they charge for annual fees and the APR. They also differ in the time you have to pay the credit card balance owed without being charged interest (grace period) and the maximum amount you can charge (the credit limit).

3. Obtaining a home mortgage can be complicated. How can I figure out what the payments are going to be?

The amount of a loan payment for a big purchase like a home or a car has already been worked out for you. Use an amortization table to calculate the interest and the monthly payments. Visit the Mortgage Bankers Association at ***www.mbaa.org/cgi-bin/calculators.asp*** *to check one out.*

4. What is the Truth in Lending Act?

The Truth in Lending Act requires that creditors disclose the cost of the credit in simple terms. The lender must state the percentage cost of borrowing in terms of the annual percentage rate (APR), which takes into account all the costs of financing. The Truth in Lending Act also protects against unauthorized use of credit cards.

5. What is the Fair Credit Reporting Act?

The Fair Credit Reporting Act governs the activities of credit bureaus and creditors. Among other things, the Fair Credit Reporting Act requires creditors to furnish accurate and complete information regarding your credit history.

6. What is a payday loan?

A payday loan allows a person to get cash until payday with no credit background check. It is a legal loan. The applicant signs an agreement, writes a postdated check, and gets the cash. The check is held until the loan is repaid—usually about two weeks. The lender then deposits the check. Typically, the interest rate (APR) is quite high. The APR may be 500 percent or higher. It is easy for people in financial trouble to fall behind in paying off a payday loan.

7. What is rent-to-own?

Rent-to-own companies rent and sell appliances, furniture, and electronics to consumers. It is a legal business. Typically, a consumer agrees to rent something for a short period—one week or a month. If the consumer rents the product for a specified period of time (often 18 months), the consumer will become the owner of the product either automatically or by making an additional payment. Purchasing merchandise from a rent-to-own company usually costs 2 to 5 times as much as purchasing the goods from a department store or appliance store.