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.

EXERCISE 11.1

What Is Credit?

Credit allows individuals to obtain the use of money that they do not have. Obtaining credit means convincing someone else (a lender) to voluntarily provide a loan in return for a promise to pay it back plus an additional charge called interest. People obtain loans to buy cars, homes, and major appliances, improve their homes, pay for college education, and so forth.

Credit decisions can be difficult. Like all difficult decisions, credit decisions involve examining the advantages and disadvantages facing the individual making the choice. The hard part, of course, is figuring out whether the advantages of using credit outweigh the disadvantages.

There is a bright side to using credit. Credit can help people acquire assets. Assets are goods or services that usually retain or increase in value. Ordinarily, a home or post-secondary education is considered an asset. Credit can help people lead happier lives by helping them to obtain the goods and services they wish to have while paying for them. Credit also can help people in an emergency.

There is also a dark side to using credit. Mistakes in using too much credit in relation to your income can be hard ones from which to recover. Many new college graduates, for example, spend a lot of the income from their first jobs repaying large credit card debts they have rolled up while in college. These repayments mean they have to spend a lot of their current income on previous purchases, leaving less money to buy things they currently want. Misusing credit—missing payments or defaulting on loans—has many negative consequences including the inability to get credit later for major purchases, such as homes and cars.

Financial institutions (commercial banks, savings and loans, credit unions, and consumer finance companies) hold money that they, in turn, loan out to others. The owners of financial institutions expect to be compensated when they make a loan. This compensation is called "interest." Interest is the price a borrower pays to a lender for use of the lender's deposits. Interest is the reward lenders receive for allowing others to use their deposits.

Both sides in a credit transaction almost always benefit. Borrowers are able to purchase something that may be of value today and perhaps in the future. Lenders are repaid the money that was loaned, plus interest.

An important factor in determining the rate of interest to be charged is the amount of confidence the lender has that the amount of the loan plus interest will be repaid in the agreed upon time. Higher risk loans—loans where it is uncertain that the borrower can repay—usually result in higher interest rates. Lower risk

EXERCISE 11.1 Continued

loans—loans where it seems evident that the borrower can repay—usually result in lower interest rates.

A loan for an intangible, like a vacation, is likely to cost more in interest than a loan for a tangible item, like a home. Loans that are backed by other assets (your car) are likely to have lower interest rates than loans that are not backed by other assets. An asset used to back a loan is called *collateral.*

Questions

1. What is credit?

2. What is the bright side of using credit?

3. What is the dark side of using credit?

4. What institutions are sources of credit?

5. What is interest?

6. Who most often wins in a credit transaction?

7. How does risk influence the rate of interest?

8. What is collateral?

EXERCISE 11.2

Common Forms of Credit

Directions: Study the chart below and answer the questions that follow.

Type of Credit	Lender	Advantages	Disadvantages
HOME MORTGAGE	• Commercial bank • Savings and loan • Credit union	• Homes often increase in value. • Interest rates for mortgages are relatively low. • The interest paid is tax-deductible.	• Mortgages are long-term commitments. • Obtaining a home loan involves extensive credit checks.
CAR LOANS	• Commercial bank • Savings and loan • Credit union • Consumer finance company	• Cars can make it easier to work and earn an income.	• Cars lose their value relatively quickly. The car you purchase on credit may have little value when the last payment is made.
COLLEGE LOANS	• Commercial bank • Savings and loan • Credit union	• A college education is usually a good investment. • Interest rates can be relatively low.	• Students sometimes borrow more than necessary. • New graduates can face difficulty in repaying large loans.
PERSONAL LOANS	• Commercial bank • Savings and loan • Credit union • Consumer finance company	• Personal loans allow individuals to purchase today that boat or vacation they want.	• Personal loans have relatively high interest rates. • Some young people may borrow more than their income should allow.
CREDIT CARDS	• Commercial bank • Savings and loan • Department store • Oil companies • Other financial institutions, e.g., American Express	• Credit cards are convenient to use and useful in an emergency. • Credit cards provide a record of charges.	• Credit cards have relatively high interest rates. • Some young people may borrow more than their income should allow.

Questions

1. What are the advantages of home loans and college loans compared to credit card and personal loans?

2. What are the disadvantages of credit card and college loans?

EXERCISE 11.3

Credit Research

Directions: Contact by phone, in person, or on the Internet each of the following financial institutions in your community. Ask what the current annual percentage rate (APR) is for each of the loans listed. The APR is the commonly used way in which interest rates are expressed. Record the information in the correct places on the chart and share the results in class.

Credit Research Results

Loan / Institution	APR for a car loan	APR for a college loan	APR for a home mortgage	APR for a credit card	APR for a loan for a vacation
Commercial Bank					
Savings and Loan					
Credit Union					
Consumer Finance Company					

Questions

1. Which local institutions offered the best APR for each type of loan?

2. Which local institutions offered the highest APR for each type of loan?

EXERCISE 12.1

Fickle Financial Advisors

Part I YOUR JOB

You run a small consulting business giving advice to people who are thinking about applying for credit. For a small fee, you offer your customers advice on whether they should apply for a loan. Your business has been successful because you understand clearly the advantages and disadvantages of using various forms of credit. You ask what is most important to the future success of your clients, and you compare the risks of using credit to the benefits using credit can offer.

Advantages to using credit:

- Credit can help people acquire valuable assets.
- Credit can help people lead happier lives.
- Credit can help people in an emergency.

Disadvantages to using credit:

- People may use too much credit in relation to their income.
- Misusing credit can lead to paying more to obtain credit in the future.
- Misusing credit can hurt the ability of people to obtain credit in the future.

After reading each client's case, ask yourself:

Questions

1. Is the loan being used to purchase a valuable asset?

2. Do you think the client is likely to be able to repay the loan?

Some people may think that making credit recommendations based on these two questions is too restrictive — a real killjoy attitude. They may be right. Nevertheless, your company has helped many clients to understand how the careful use of credit can result in improving overall personal wealth.

EXERCISE 12.1 Continued

Part II THE CLIENTS

Client 1

I am 17 years old and a high school senior. I have earned good grades in high school. I have been admitted to a good state university. I would like to go to college full-time and work only a few hours a week. With this schedule, I think that I can complete my college degree in four years. I am planning to major in chemical engineering. My college advisor has told me that chemical engineering is a hard major. My parents have no money to support me in college. I am planning to use college loans to pay for my college tuition and books. I plan to live at home and work in the summer to earn spending money for use during the school year. I will be borrowing about $25,000. Should I apply for the loan?

1. What is the main advantage of getting credit?

2. What is the main disadvantage of getting credit?

3. Do you recommend that this client apply for the loan? Explain.

Client 2

I am 18 years old. I attend the local vocational-technical school. My area of study is commercial heating and cooling. My school tuition is relatively low and the program only takes nine months. I can pay most of my expenses by working full time in the summer and part time during the school year. I am still living at home, and I plan to get an apartment of my own next year. I am an avid sports fan. I have a little 12-inch television set in my room. I'd like to use my credit card to buy a really big 38-inch television set at a cost of $1,500.

1. What is the main advantage of getting credit?

2. What is the main disadvantage of getting credit?

3. Do you recommend that this client apply for the loan? Explain.

Client 3

I am 21 years old and finishing my last year in college. I have been studying hard and have earned relatively good grades. My major is English. A small group of my friends want to bust out for spring break and take a one-week vacation in Florida. I have never really had a vacation while in college except for two trips with my family. If I book my reservations now, I can get relatively low air fare and hotel rates. I am a little low on cash. I am planning to charge the $1,500 for the trip on my credit card.

1. **What is the main advantage of getting credit?**
2. **What is the main disadvantage of getting credit?**
3. **Do you recommend that this client apply for the loan? Explain.**

Client 4

I am 22 years old. I am just about to complete a two-year dental hygienist program at a local vocational school. My first-year pay will be about $25,000 plus fringe benefits including health insurance and a 401k program. My workplace is 20 miles from my apartment and is not on a city bus route. The car I have has 225,000 miles on the odometer, and it burns more oil than gas. Yesterday, I noticed that I can see the road through a hole in the floor in front of the driver's seat! I have saved up $2,000 for a down payment on a new car, but I will need to borrow several thousand more to buy a new but small and dependable car.

1. **What is the main advantage of getting credit?**
2. **What is the main disadvantage of getting credit?**
3. **Do you recommend that this client apply for the loan? Explain.**

EXERCISE 13.1

Reading a Credit Report

Your ability to qualify for a loan depends on a credit report. A credit report is a record of an individual's personal credit history. It is probably a good indicator of the applicant's character and whether he or she will repay the money as agreed.

When a person applies for a loan, the lender will order a credit report to see how well the applicant has managed credit in the past. A credit report will tell, in detail, how much the person has borrowed, from whom, and whether the bills have been paid on time.

Credit reports are compiled by credit bureaus, which regularly collect information on millions of consumers. Credit bureaus get information from a variety of sources, including stores, credit card companies, banks, mortgage companies, and medical providers. When you fill out an application for credit, the information on that application is also sent to a credit bureau.

WHAT ARE CREDITORS LOOKING FOR?

Lenders look for certain qualities in loan applicants. These qualities are called the Three Cs of Credit: *capacity, character,* and *collateral*. A discussion of each follows.

Capacity: The credit application will contain questions that refer to the ability of the consumer to repay the debt. The basic question is: "Have you been working regularly in an occupation that is likely to provide enough income to support your use of credit?" More particular questions might address the following:

- ✔ Do you have a steady job?
- ✔ What is your salary?
- ✔ How reliable is your income?
- ✔ Do you have other sources of income?
- ✔ How many other loan payments do you have?
- ✔ What are your current living expenses?
- ✔ What are your current debts?
- ✔ How many dependents do you have?
- ✔ Do you pay alimony or child support?
- ✔ Can you afford your lifestyle?

Character: Questions will be asked to determine whether you possess the honesty and reliability to pay credit debts. Here are some examples:

- ✔ Have you used credit before?
- ✔ Do you pay your bills on time?
- ✔ Do you have a good credit report?
- ✔ Can you provide character references?
- ✔ How long have you lived at your present address?
- ✔ How long have you been at your present job?

Collateral: Collateral serves as a type of insurance for the creditor. The creditor is interested in determining whether you have any assets that could be sold to pay off your loan in the event that you are unable to do so. Questions may include the following:

- ✔ Do you have a checking account?
- ✔ Do you have a savings account?
- ✔ Do you own any stocks or bonds?
- ✔ Do you have any valuable collections or jewelry?
- ✔ Do you own your own home?
- ✔ Do you own a car?
- ✔ Do you own a boat?

THE IMPORTANCE OF A GOOD CREDIT RATING

A *good* rating on a credit report means that in the past bills have been paid on time.
A *poor* rating indicates overdue or unpaid items.

It is extremely important to build and maintain a good credit history. A good credit report can often make the difference between getting a loan or being turned down. In addition, potential employers and landlords will often check an applicant's credit report before making a final decision about offering a job or a rental.

CREDIT REPORTS MAY CONTAIN ERRORS

Mistakes can and do occur on credit reports. For example, a credit report may contain information about someone with the same name, or paid accounts may be listed as unpaid. The law provides individuals with a means of requesting and reviewing their credit report and having mistakes corrected. Under the Fair Credit Reporting Act you have the right to get a copy of your credit report from a credit bureau. The three largest credit bureaus in 2001 are:

- ✔ Equifax
- ✔ Experian
- ✔ Trans Union

EXERCISE 13.1 Continued

WAYS TO ESTABLISH AND KEEP A GOOD CREDIT HISTORY

There are several steps you can take to establish and maintain a good credit history.

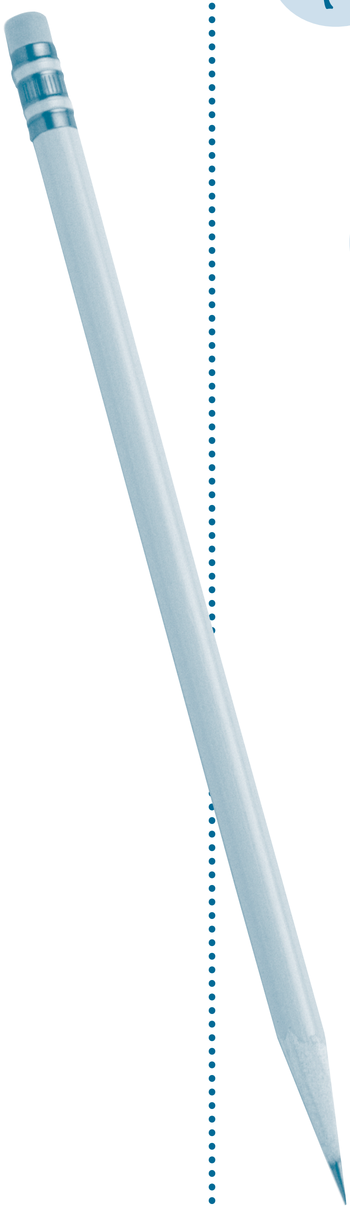
- ✔ Always pay your bills on time.
- ✔ Never borrow more than you can comfortably pay back.
- ✔ Borrow only the amount you need.
- ✔ Know how much you owe at all times.
- ✔ Contact lenders immediately if you expect to have a payment problem.
- ✔ Develop good savings habits to handle financial emergencies without borrowing.
- ✔ Report lost or stolen credit cards immediately.
- ✔ Never give your credit card number over the phone unless you initiated the call.
- ✔ Open a checking account and a savings account.
- ✔ Do not apply for too many credit cards. Even if you don't use them, the credit limits are taken into consideration when you apply for credit.

EXERCISE 13.2

Evaluating a Credit Report

Instructions: Study the credit report in Illustration 13.1 to answer the questions that follow.

Questions



1. **Whose credit report is this?**
2. **How many potentially negative items are listed?**
3. **How many accounts are in good standing?**
4. **On page 2, there are two very negative items. What are they?**

   a.

   b.
5. **Have any of John Q. Consumer's credit cards been lost or stolen?**
6. **Does John Q. Consumer have a good credit record with First Credit Union and National Credit Card?**

   What are the reasons for your opinion?
7. **Who requested John Q. Consumer's credit report in 1999?**

   a.

   b.

   c.
8. **Is John Q. Consumer a homeowner?**
9. **What is the most negative item on this report, and for how many years does that item stay on the credit report?**
10. **If you were a lender, would you grant John Q. Consumer credit?**

    Why or why not?

ILLUSTRATION 13.1

Credit Report of John Q. Consumer

Credit R Us

Prepared for
JOHN Q. CONSUMER
Report number
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Report date
June 01, 1999

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Credit R Us
P.O. Box 9595
Allen TX 75013-9595

Personal Credit Report

About this report

Credit R Us collects and organizes information about you and your credit history from public records, your creditors and other reliable sources. We make your credit history available to your current and prospective creditors and employers as allowed by law. We do not grant credit or evaluate your credit history. Personal data about you may be made available to companies whose products and services interest you.

Important decisions about your creditworthiness are based on the information in this report. You should review it carefully for accuracy.

Report number

Below is a summary of the information contained in this report.

Potentially negative items listed	
Public records	2
Accounts with creditors and others	2
Accounts in good standing	3

If you have questions
For all questions about this report, please call us at: **1-888-000-0000**
M - F 7:30am - 7 pm CT

To learn more about Credit R Us or for other helpful information, including tips on how to improve your creditworthiness, visit our web site: http://www.creditrus.com

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Information affecting your creditworthiness

Items listed with dashes before and after the number, *for example* –1–, may have a potentially negative effect on your future credit extension and are listed first on the report.

Credit grantors may carefully review the items listed below when they check your credit history. Please note that the account information connected with some public records, such as bankruptcy, also may appear with your credit accounts listed later in this report.

Important decisions about your creditworthiness are based on the information in this report. You should review it carefully for accuracy.

Your statement

At your request, we've included the following statement every time your credit report is requested.

"My identification has been used without my consent on applications for credit. Please call me at 999.999.9999 before approving credit in my name."

Public record information about you

Source/ Identification number	*Location number*	*Date filed/ Date resolved*	*Responsibility*	*Claim amount/ Liability amount*	*Comments*
-1- HOLLY COW DIST CT 305 MAIN STREET HOLLY NJ 08060	B312P7659	3-1997/ NA	Joint	$3,756/ NA	Status: civil claim judgement filed. Plaintiff: Dime Savings. This item is scheduled to continue on record until 3-2004. This item was verified on 8-1997 and remained unchanged.
-2- BROWN TOWN HALL 10 COURT STREET BROWN NJ 02809	BK443PG14	11-1997/ NA	Joint	$57,786/ NA	Status: chapter 7 bankruptcy discharged. This item is scheduled to continue on record until 11-2007. This item was verified on 8-1997 and remained unchanged.

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Credit information about you

Source/ Account number (except last few digits)	*Date opened/ Reported since*	*Date of status/ Last reported*	*Type/ Terms/ Monthly payments*	*Responsibility*	*Credit limit or original amount/ High balance*	*Recent balance/ Recent payment*	*Comments*
-3- **FIDELITY BK NA** 300 FIDELITY PLAZA NORTHSHORE NJ 08902 46576000024	6-1994/ 6-1994	12-1996/ 12-1996	Installment/ 10 months/ $0	Individual	$4,549/ NA	$4,549 as of 12-1996	Status: charge off.$4,549 written off in 12-1996. This account is scheduled to continue on until 12-2003
-4- **B.B. CREDIT** 35 WASHINGTON ST. DEDHAM MA 547631236	10-1990/ 4-1995	4-1998/ 4-1998	Installment/ 80 months/ $34	Individual	$8,500/ $8,500	$0 as of 4-1998/ $34	Status: Debt re-included in chapter 7 bankruptcy. $389 written off in 3-1998. Account history: Collection as of 9-1995 thru 6-1996 90 days as of 7-1995 60 days as of 11-1994, 6-1995 30 days as of 9-1994, 1-1995 and 2 other times This account is scheduled to continue on record until 2-2001. This item was verified and updated on 6-1996.

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Credit information about you *continued*

Source/ Account number (except last few digits)	*Date opened/ Reported since*	*Date of status/ Last reported*	*Type/ Terms/ Monthly payments*	*Responsibility*	*Credit limit or original amount/ High balance*	*Recent balance/ Recent payment*	*Comments*
5 **FIRST CREDIT UNION** 78 WASHINGTON LN LANEVILLE TX 76362 129474 Mortgage: 74848347834	3-1996/ 3-1996	11-1998/ 11-1998	Installment/ 48 Months/ $420		$17,856/ NA	$0 as of 11-1998/ $420	Status: open/never late.
6 **AMERICA FINANCE CORP** PO BOX 8633 COLLEY IL 60126 6376001172....	6-1993/ 7-1993	11-1998/ 11-1998	Revolving/ NA/ $400		$0/ $18,251	$0 as of 11-1998	Status: card reported lost or stolen. This account is scheduled to continued on record until 11-2000.
7 **NATIONAL CREDIT CARD** 100 THE PLAZA LANEVILLE NJ 08905 420000638....	6-1993/ 6-1993	11-1998/ 11-1998	Revolving/ NA/ $0	Joint with JANE CONSUMER	$8,000 $8,569	$0 as of 11-1998	Status: open/never late.

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Your use of credit

The information listed below provides **additional** detail about your accounts, showing up to 24 months of balance history and your credit limit, high balance or original loan amount. Not all balance history is reported to Credit R Us, so some of your accounts may not appear. Also, some credit grantors may update the information more than once in the same month.

Source/ Account number	*Date/Balance*
-6- AMERICA FINANCE CO. CORP. 6376001172 *Between 1-1994 and 11-1998 your credit limit was unknown.*	11-1998/$0 10-1998/$4,329 8-1998/$0 5-1998/$0 2-1998/$250 1-1998/$0 12-1997/$2,951 9-1997/$3,451 7-1997/$4,251 5-1997/$4,651 2-1997/$5,451 1-1997/$5,851; 12-1996/$6,251 11-1996/$6,651 9-1996/$7,051 7-1996/$7,451 5-1996/$7,852 3-1996/$8,251 1-1996/$12,651 12-1995/$9,051 11-1995/$9,451 9-1995/$10,251 7-1995/$10,651 5-1995/$11,051
-7- NATIONAL CREDIT CARD 420000638 *Between 6-1993 and 11-1998 your credit limit was $8,000.*	11-1998/$0 9-1998/$542 7-1998/$300 6-1998/$686 4-1998/$1,400 3-1998/$2,500 1-1998/$2,774 12-1997/$599 9-1997/$873 7-1997/$1,413 5-1997/$1,765 4-1997/$2,387 3-1997/$3,400 2-1997/$3,212 1-1997/$4,412 12-1996/$2,453 10-1996/$2,453 10-1996/$1,769 8-1996/$1,200 4-1996/$3,200 2-1996/$4,568 1-1996/$5,582 12-1995/$3,000 10-1995/$3,200 8-1995/$4,500

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Others who have requested your credit history

Listed below are all those who have received information from us in the recent past about your credit history.

Requests initialed by you

You took actions, such as completing a credit application, that allowed the following sources to review your information. Please note that the following information is part of your credit history and is included in our reports to others.

Source	*Date*	*Comments*
ABC MORTGAGE 64 MAPLE ROSEVILLE MD 02849	10-18-1998	Real estate loan of $214,000 on behalf of State Bank with 30 year repayment terms. This inquiry is scheduled to continue on record until 10-2000.

Other requests

You may not have initiated the following requests for your credit history, so you may not recognize each source. We offer credit information about you to those with a permissible purpose, for example, to:

- other creditors who want to offer you pre-approved credit;
- an employer who wishes to extend an offer of employment
- a potential investor in assessing the risk of a current obligation;
- Credit R Us Customers Assistance to process a report for you;
- your current creditors to monitor your accounts (date listed may affect only the most recent request).

We report these requests **only** to you as a record of activities, and we do not include **any** of these requests on credit reports to others.

Source	*Date*
CREDIT R US PO BOX 949 ALLEN TX 75013	3-99
WORLD BANK PO BOX 949 ALLEN TX 75013	3-99, 12-98, 9-98, 6-98, 3-98, 12-97, 9-97, 6-97, 3-97
FIDELITY BK NA 300 FIDELITY PLAZA NORTHSHORE NJ 08902	1-99, 7-98, 1-98, 7-97, 1-97
NATIONAL CREDIT REPORT 100 THE PLAZA LANEVILLE NJ 08905	7-97, 2-97

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JOHN Q. CONSUMER

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Personal information about you

The following information associated with your records **has been reported** to us **by you, your creditors and other sources.** As part of our fraud-prevention program, a notice with additional information may appear in your report.

Names
JOHN Q. CONSUMER

Residences

Our records show you currently are a homeowner. The geographical code shown with each address identifies the state, country, census tract, block group and Metropolitan Statistical Area associated with each address.

Address	*Type of address*	*Geographical code*
7972 PADDOCK CT LANEVILLE, TX 00000	Single Family	0-192053-3-0
1777 BEVERLY AVE SOMEWHERE, NJ 00000	Single Family	0-224681-25-0
250 GARDEN DRIVE ANYWHERE, NJ 00000	Single Family	0-9004-93-0

Social Security numbers
000-00-0000
111-11-1111
222-22-2222

Year of birth
1954

Driver's license number
CA X123456

Spouses name
JANE

Driver's license number
CA X123456

Notices
The first Social Security number listed shows that credit was established before the number was issued.

EXERCISE 13.3

Evaluating Three Loan Applications

These are excerpts from the credit reports of three loan applicants. Based solely on their record of paying credit obligations in the past, decide whether you would approve or decline their loan requests. Check your response and then write the reason for that response.

Status codes given at the end of the reports.

JANICE BROWN ❑ APPROVE ❑ DECLINE ❑ NOT SURE WHY?

Company name	Months reviewed	High credit	Terms	Balance	Past due	Status
Sears	2	2,016	24	838		R3
Dept. of Educ.	7	1,507		1,507	158	I5
Dept. of Educ.	2	512		512	512	I5
ABC Credit Card	8	3,000	29	1363		R1
Record of Month	6			38	38	O3

Prior paying history: 30(01)60(02)90+(04) 8/94-I5 5/94-R4 8/94-I8

TITO SANDERS ❑ APPROVE ❑ DECLINE ❑ NOT SURE WHY?

Company name	Months reviewed	High credit	Terms	Balance	Past due	Status
Bank of America	24	11,000	60	5,350		I1
ABC Credit Card	6	2,500	36	0		O0
Dept. of Educ.	5	2,000	24	1,380		I1
XYZ Credit Card	12	3,000	24	495		R1

Prior paying history: 30(00)60(00)90+(00)

MARIA MARTINEZ ❑ APPROVE ❑ DECLINE ❑ NOT SURE WHY?

Company name	Months reviewed	High credit	Terms	Balance	Past due	Status
Bank of America	13	7,200	48	5,800		I1
ABC Credit Card	7	2,000	24	488		R1

Prior paying history: 30(01)60(00)90+(02) 3/94 I8 4/95 R9 3/96 I9

STATUS CODES

Type of account

O = Open

R = Revolving

I = Installment

Timeliness of payment

0 = Approved, not used

1 = Paid as agreed

2 = 30 days past due

3 = 60 days past due

4 = 90 days past due

5 = 120 days past due or collection account

7 = Making regular payments under wage earner plan

8 = Repossession

9 = Seriously delinquent/bad debt (paid or unpaid; charged off account)

EXERCISE 14.1

Everything You Wanted to Know About Figuring Interest

Credit isn't free. The cost of credit is called interest or the finance charge. The finance charge may be stated in dollars or as a percentage of the loan. When stated as a percentage of the loan, it is called the interest rate.

The *Truth in Lending Law* makes comparing credit costs simple. This federal law requires that all lenders state their finance charges and interest rates in the same way. This rate is called the *annual percentage rate* or *APR.* An APR is the rate you pay in a single year on the money you borrow. The APR is based on the amount of money you still have to pay back, not the amount of the original loan. In credit language, it is based on the *declining balance* of your loan.

Every loan must also state the finance charge. The *finance charge* is the total dollar amount of interest you must pay on the loan. The amount you borrow is called the *principal* of the loan. You pay back the principal plus the finance charge. The finance charge depends on the APR and the length of the loan. The higher the APR and the longer the period of the loan, the higher the finance charge.

Save Money on Interest—Go Figure

By using your math skills, you can save big bucks on a loan. Let's find out how.

Part I FIGURING SIMPLE INTEREST

First, let's figure some finance charges. The basic formula for figuring out interest is:

I = PRT

I—Interest (Finance charge)
P—Principal
R—Rate (an add-on rate)
T—Time (in years)

In this formula, the rate is an add-on rate with one payment of principal. The principal (amount of loan) and the interest are paid in one lump sum at the maturity date (end of loan period). For example, if you borrowed $2,000 at a 12 percent add-on rate for two years, the interest would be $480 ($480 = $2,000 x .12 x 2). The amount of $2,480 (interest and principal) would be repaid at the end of two years. Now answer these questions:

Questions

1. Gabrielle Daily borrows $1,000 at a 6 percent add-on rate for one year. What is the finance charge?

2. Jesse Candelaria borrows $2,000 at a 10 percent add-on rate for three years. What is the finance charge?

3. Jessica Tate borrows $2,000 at a 10 percent add-on rate for two years. What is the finance charge?

4. Travis Whitaker borrows $2,000 at an 8 percent add-on rate for two years. What is the finance charge?

5. If you want to lower the finance charge, should you shop for a higher or lower interest rate?

   Why?

6. If you want to lower the finance charge, should you pay back the loan more quickly or less quickly?

   Why?

EXERCISE 14.1 Continued

Part II FIGURING MONTHLY PAYMENTS

Most loans are paid back on a monthly basis. Very few are paid back all at once at the maturity value of the loan. The monthly payment is the amount the borrower must pay the lender each month to pay back the loan. The monthly payment covers principal and interest. This is the formula for figuring the monthly payment:

$$MP = \frac{P + I}{N}$$

MP—Monthly payment

P—Principal of the loan

I—Interest (Figure it as you did in the earlier problems)

N—Number of months the loan is for

For example, you borrow $10,000 at an 8 percent add-on rate for four years.

P = $10,000

I = ($10,000 x .08 x 4) or $3200

$$MP = \frac{(\$10{,}000 + \$3200)}{48} \text{ or } \$275$$

Questions

1. David Kim borrows $8,000 at an 8 percent add-on rate for two years.

- **What is the interest?**
- **What is the monthly payment?**

2. Maria Torres borrows $8,000 at an 8 percent add-on rate for four years.

- **What is the interest?**
- **What is the monthly payment?**

3. If a borrower takes longer to pay back a loan, what happens to the monthly payment?

4. If a borrower takes longer to pay back a loan, what happens to the interest?

5. What are the costs and benefits of taking longer to pay off a loan?

Part III DETERMINING THE APR

In the past, lenders advertised interest rates in various ways. In some instances, people were paying higher rates than they thought because lenders were figuring the rates differently. Consumers had difficulty shopping for credit because of these variations in figuring rates.

Let's look at a couple of examples to illustrate what was being done. Suppose George secures a $1,200 loan at 10 percent add-on interest for one year that he would pay off (interest and principal) at the end of the year. At the end of the year, he would pay $1,320 to the lender ($1,200 principal with $120 interest). The interest rate that was advertised for this loan was 10 percent.

Now suppose that Sheila secured a $1,200 loan with 10 percent add-on interest paying $110 a month. She would be paying a total of $1,320 as well. Before the Truth in Lending Law, the lender probably would have advertised this loan as a 10 percent interest loan, just like the lender for George's loan. In reality, are both of them paying the same interest rate?

EXERCISE 14.1 Continued

They are certainly paying the same amount of interest, but they are not paying the same rate of interest. Why? In the first situation, the person receiving the loan has the full $1,200 for the entire year. In the second situation, part of the $110 a month is going toward the repayment of the loan. Sheila has less of the loan each month because of the monthly payments.

The Truth in Lending Law was established so that individuals shopping for credit could have a common basis for comparing loans. According to this law, the interest rate must be stated as an Annual Percentage Rate (APR), based on the declining balance of the loan. The Truth in Lending Law also requires that the full amount of finance charges (interest plus other charges) must be indicated to the consumer.

The formula for determining the APR for any loan is:

$$\text{APR} = \frac{2MI}{P(N+1)}$$

M—Number of payments per year
(For monthly payments this is always 12)

I—Interest

P—Principal

N—Total number of payments

Let's figure out the APR for Sheila's loan by first looking at the interest that she pays.

$120 = $1,200 (principal) X .10 (interest rate) X 1 (number of years)

Now let's figure the annual percentage rate using the APR formula .

$$\text{APR} = \frac{2 \times 12 \times \$120}{1{,}200 \times 13} = \frac{2{,}880}{15{,}600} = 18.46\%$$

Notice that the APR for Sheila is much higher than the 10 percent that was probably quoted to her by the lender. If you use the formula for George's loan, you will see that it will come out to 10 percent APR since there was no declining balance on the loan. He always had $1,200 available on the loan.

Questions

Now let's figure some APRs. All these loans are paid back on a monthly basis.

1. Lisa Rosas borrows $5,000 at a 5 percent add-on rate for one year.

What is the finance charge?

What is the APR?

2. Brett Olson borrows $6,000 for three years at a 7 percent add-on rate.

What is the finance charge?

What is the APR?

3. What is the relationship of an APR for an add-on rate for a one-payment loan compared to an add-on for a monthly installment loan?

EXERCISE 15.1

Comparing Credit Cards

Americans love credit cards. Here are some statistics that show how widespread credit card use was in the United States in 1999.

- The average American household with at least one credit card carried a total credit card balance of $7,564. In 1990, the typical American household with at least one credit card had a balance of $2,985.
- Seventy-eight million of the 105 million households in the United States had at least one credit card.
- The average annual percentage rate on all bank credit cards was 17.11 percent.
- The revolving balance of credit card debt totaled $580 billion. That included $490 billion on bank credit cards and $90 billion on store credit cards.
- Americans charged more than one trillion dollars on their VISA, MasterCard, Discover, and American Express cards.
- There were 506 million VISA, MasterCard, Discover, and American Express cards in circulation in the United States. There were another 800 million debit and credit cards in circulation.

(These statistics were provided by CardWeb.com, a credit card research company. Its web site is **www.cardweb.com**. The statistics are for 1999.)

Shopping for a credit card can save you money. Not all credit cards are alike. Here are some ways in which they differ.

1. **The annual fee**. Some credit cards charge an annual fee, and some do not. The amount of the annual fee also can vary.
2. **Other fees.** Credit cards usually have stated fees for late or missed payments, going over your credit limit, or certain transactions such as cash advances.
3. **The annual percentage rate**. The APR can vary from card to card by several percentage points. Furthermore, some credit cards offer a low APR for the first few months and then increase it after three or six months.
4. **The grace period**. This is the amount of time a cardholder has to pay the credit card balance without paying interest. The longer the grace period, the more interest-free days the cardholder has. If the entire balance is paid within the grace period, no interest is due.
5. **The way interest is figured**. There are three methods of calculating credit card interest. These are:
   - ✔ Average daily balance: The interest rate is calculated each day on the average of each day's balance for the billing cycle. This is the most frequently used method.
   - ✔ Adjusted balance: The interest rate is calculated on the opening balance after subtracting the payments made during the month.
   - ✔ Previous balance: Interest is calculated on the opening balance regardless of payments made during the month.
6. **The credit limit.** This is the maximum amount of money a cardholder can charge. A higher credit limit gives the cardholder flexibility but can also lead to credit card balances that are difficult to pay off.

Credit cards also differ in the types of services offered; this can be a reason to choose one card over another. Some of these services are:

- ✔ High or no credit limits.
- ✔ Rewards for the cardholder such as cash back, free gifts, frequent flyer airline miles, or a discount on a new car.
- ✔ The number of merchants who accept the card.
- ✔ Travel services such as covering the rental car insurance deductible, discounts on hotels, travel life insurance, or check-cashing privileges.

Question

1. **What characteristics should you look for if you want to save money on a credit card?**

EXERCISE 15.2

Reading a Credit Card Statement

A credit card statement reveals a lot about what it costs to charge stuff and then pay interest on the loan. Let's see what information is found on a typical statement. Take a look at the credit card statement below:

Credit Is U
AMERICA'S CREDIT CARD COMPANY

Cardmember Name:
Tim Gray
1562 W. Wells Way
Lakeland, FL 33803

Credit Is U

Account Number: 000 000 0

Payment Due Date: 2-19-01

Minimum Payment: .00

Total Amount Due: 1124.17

Amount Enclosed: __________

Mail Payment to: PO Box 00000000
Newark, DE 19716

Detach and mail this portion with your check or money order to the address above. Do not staple or fold.

Account Number	Billing Date	Payment Due Date	Days in Billing Period
000 000 0	01-25-01	02-19-01	32
Date	**Reference Number**	**Description**	**Amount**
1-14-01	01010101	CD Haven	22.30
1-21-01	02020202	Pizza, Etc.	8.33

Credit Line: $7,500 Credit Available: $6.336

Previous Balance	– Payments & Credits	+ Finance Charge	= New Balance	Minimum Payment
$1,072.30	.00	21.24	1,124.17	.00

The finance charge is determined by applying a periodic rate of	Which is an ANNUAL PERCENTAGE RATE of	To that part of the balance subject to finance charge of up to	Balance computation methods shown on reverse side
.05754% Daily	21.00%	Entire Balance	Average daily balance

Purchases, returns, and payments made just prior to billing date may not appear until next month's statement

Inquiries: Send inquiries (not payment) to : PO Box 222, Denver, CO 80202
Notice: See reverse side for important information.

Questions

1. How much did Tim Gray charge in the month of the statement?

2. Did Tim make a payment in the previous month? If so, how much was the payment?

3. What is the total credit available on this credit card?

4. How much of that credit was available at the time of this statement?

5. How does Tim's previous balance compare to the new balance shown on this statement?

6. Was Tim charged a finance charge this month? If so, what was the amount of the finance charge?

7. What is the annual percentage rate for credit on this account?

8. Looking at this statement, do you think Tim is handling his credit well? Why or why not? What would you recommend?

EXERCISE 16.1

Using the Computer to Calculate Payments for a Loan

Computers can be very helpful in figuring out various aspects of a loan. In the following situation, you will be working with mortgages, which are big loans on houses. Payments are extended over many years, such as 15 or 30 years. Repayments on mortgages are generally made on a monthly basis.

The Internet has many mortgage calculators that can assist you in comparing the costs of various mortgages. If you cannot find a mortgage calculator, check with your teacher for help in securing one that you can use.

Let's analyze four different mortgages with different down payments, annual interest rates, and time periods. All of the homebuyers are purchasing a $125,000 house.

1. Sean and Amber Johnson pay 20 percent down and take out a $100,000 mortgage. It is a 30-year fixed-rate mortgage with an annual interest rate of 7 percent.
2. Alvin and Emily Jin qualify for a special mortgage program where the down payment is only 5 percent of the cost of the home. They take out a $118,850 mortgage. It is a 30-year fixed-rate mortgage with an annual interest rate of 7 percent.
3. Benny and Silvia Ramirez qualify for a special program that lowers their fixed annual interest rate to 6 percent. They make a 20 percent down payment and borrow $100,000 for 30 years.
4. Emily McGill knows that paying off a mortgage more quickly will save her money. She makes a down payment of 20 percent and borrows $100,000 at a fixed rate of 6.5 percent. Because she will pay off the mortgage in 15 years, her annual interest rate is lower than she would have paid for a 30-year mortgage.

Compare these four mortgages by completing the chart on the next page. Notice that the monthly payment and total payment (principal plus interest) are blank. You will fill these in using a mortgage calculator.

Using a mortgage calculator is easy. Just plug in the principal, annual interest rate, and term (in years) for each of the four mortgages. Check monthly payment amounts and total payments. Now use a mortgage calculator and fill in the rest of the chart. If your teacher does not give you a web site, try the Mortgage Bankers Association web site at **www.mortgagestogo.com/calculators.asp.**

Mortgage Chart

	Mortgage 1	Mortgage 2	Mortgage 3	Mortgage 4
Home price	$125,000	$125,000	$125,000	$125,000
Down payment %				
Down payment $				
Principal				
Annual interest rate				
Term				
Monthly payment				
Total interest				
Total payment (down payment, principal, and interest)				

Based on your chart, answer the following questions.

Questions

1. What happens to the monthly payment and total payment for a loan with a smaller down payment?

2. What happens to the monthly payment and total payment for a loan with a lower annual interest rate?

3. What happens to the monthly payment and total payment if the term of the mortgage is 15 years rather than 30 years?

4. What is the trade-off if you get a 15-year mortgage rather than a 30-year mortgage?

5. How can you reduce your cost of buying a home?

EXERCISE 17.1

Getting the Best Deal on Your Auto Loan

Jill Winston shopped carefully for a new car. She found the model she wanted and negotiated a price of $18,000. She applied her old car's trade-in value to the down payment, which came to $6,000. Jill had to borrow $12,000 to buy the car.

Jill knew she should shop for credit just like she shopped for the car. She took the following steps:

Checked her credit rating. Jill made sure her credit rating was good and that there were no mistakes in her credit report.

Made comparisons. She checked rates at her bank and at one other bank. She also checked the rate the car dealer offered. She checked the rates at a finance company that advertised easy terms. Finally, she checked online for car loans offered at several web sites.

Compared loans for the same time period. Jill found an array of rates for different time periods. She decided that she should compare the rates for loans for the same time period. She chose a 3-year loan because longer loans mean higher finance charges. She also thought she might buy a new car in three years and wanted the loan paid off.

What Jill Found

The Last National Bank, where Jill has her checking account, offered her a loan with a 7.49 percent APR and a finance charge of $1,434.90. An online lending site offered Jill a loan with an 8.41 percent APR and a finance charge of $1,619.17. The car dealer offered her a loan with an APR of 9.5 percent and a finance charge of $1,838.23. Finally, the Friendly Finance Company offered her a loan with an APR of 13.95 percent and a finance charge of $2,754.25.

Now fill in the chart below to figure the best loan. Remember the total cost of the loan is the principal ($12,000) plus the finance charge. The monthly payment is the total cost of the loan divided by the number of months (36).

Kind of loan: ______________ **Principal:** ______________ **Repayment period:** ______________

Name of Place	APR	Finance Charge	Total Cost	Monthly Payment
Last National Bank				
Online lending site				
Car dealer				
Friendly Finance Company				

Answer the following questions about Jill's loan:

Questions

1. Which loan is the best deal?

2. Which loan is the worst deal?

3. Jill took the best loan. How much extra did she pay because she financed her car instead of buying it for cash?

4. How much money did Jill save by taking the best deal rather than the worst deal?

EXERCISE 17.2

Shopping Online for an Auto Loan

Now it's time to shop online for a loan. Assume you want a new car loan; you will search for car loans and visit several web sites. Your new car costs $20,000. Your trade-in and down payment are $5,000. Therefore, the principal of the loan is $15,000. The repayment period is four years.

Kind of loan: ______________ Principal: ______________ Repayment period: ______________

Web site	APR	Finance Charge	Total Cost
1.			
2.			
3.			
4.			

Questions

1. Which loan is the best deal?

2. Which loan is the worst deal?

3. How much money will you save by taking the best deal rather than the worst deal?

EXERCISE 17.3

Shopping in Your Community for an Auto Loan

Now it's time to shop for a loan at lending institutions in your community. Some possible places are banks, savings and loans, credit unions, and finance companies.

Again assume that you are buying a new car for $20,000. Your trade-in and down payment are $5,000, and the principal of the loan is $15,000. The repayment period is four years.

Kind of loan: ______________ Principal: ______________ Repayment period: ______________

Name of Place	APR	Finance Charge	Total Cost
1.			
2.			
3.			
4.			

Questions

1. Which loan is the best deal?

2. Which loan is the worst deal?

3. How much money will you save by taking the best deal rather than the worst deal?

4. Did any lender offer a lower APR if you had a checking or savings account at that institution?

5. Would you get the best deal from a local lending institution or from an online source?

6. Name one advantage and one disadvantage of shopping for a loan in your local community compared to shopping for a loan on the Internet.

EXERCISE 18.1

Consumer Credit Protection

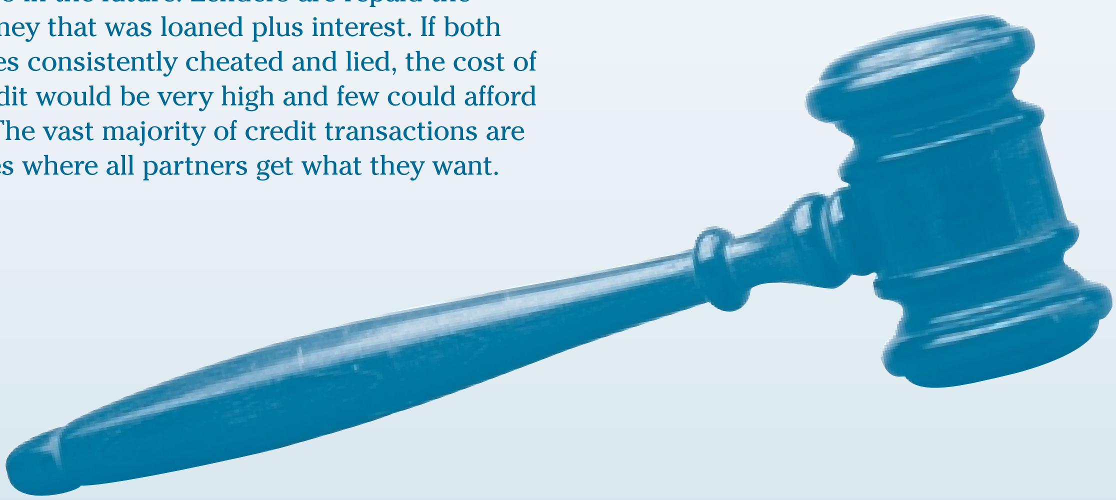
Credit problems are an important source of difficulty for young adults who are just getting started out of high school. Young adults sometimes make bad spending choices. They might live beyond their means. Excessive credit card debt is a common problem. So are high monthly car payments, high monthly rent payments, and the inability to save. For young couples, financial problems are often cited as the factors contributing to separation and divorce.

Financial problems, however, are not reserved for the young. People of all ages can face financial problems. An unexpected illness, loss of a job, divorce, or loss of child care are some of the factors that might tip a household into financial trouble.

Almost always, both sides benefit in a credit transaction. Borrowers are able to purchase something that may be of value today and perhaps in the future. Lenders are repaid the money that was loaned plus interest. If both sides consistently cheated and lied, the cost of credit would be very high and few could afford it. The vast majority of credit transactions are ones where all partners get what they want.

But the world is not a perfect place. Sometimes consumers of credit make mistakes or are dishonest with the credit provider. Sometimes credit providers make mistakes or are dishonest with the credit consumer.

Several state and federal laws are designed to protect credit consumers from dishonest business practices. State credit protection laws, of course, vary from state to state. You might want to contact your state bureau that handles such matters to learn more. The federal government has several laws regulating consumer credit. These include the *Truth in Lending Act*, *Fair Credit Reporting Act*, *Equal Credit Opportunity Act*, *Fair Credit Billing Act*, *Fair Debt Collection Practices Act,* and, most recently, the *Electronic Fund Transfer Act*.



FEDERAL CONSUMER CREDIT PROTECTION

The **Truth in Lending Act** requires that creditors disclose the cost of credit in simple terms. The lender must state the percentage costs of borrowing in terms of the annual percentage rate (APR), which takes into account all the cost of financing. The lender must also disclose the total finance charges for the loan. The **Truth in Lending Act** also protects against unauthorized use of credit cards. If your card is lost or stolen, you are liable for no more than $50 of charges made by someone else. You cannot be held responsible for any charges after notifying the issuer. The **Truth in Lending Act** also requires that if a business advertises one credit feature (such as how many months to pay or the amount of the monthly payment), it must mention all other credit terms.

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. If you are refused credit, you have a right to see your credit report file from the bureau that submitted the negative information on which the decision was based. The **Fair Credit Reporting Act** requires credit bureaus to investigate if you disagree with information on your credit report. If your claim is valid, your report must be corrected. Finally, the **Fair Credit Reporting Act** requires that only people with a legitimate business purpose can obtain a copy of your credit report.

The **Equal Credit Opportunity Act** requires that all consumers will be given an equal chance to receive credit. The **Equal Credit Opportunity Act** states that it is illegal to discriminate against applicants on the basis of sex, marital status, race, national origin, religion, age, or because they receive public assistance income.

The **Fair Credit Billing Act** requires creditors to mail your bill at least 14 days before payment is due. It establishes procedures for correcting billing errors on your credit card accounts. This includes fraudulent charges on your credit card.

The **Electronic Fund Transfer Act** provides consumer protection to people who use ATM and debit cards. The act limits your liability when your card is lost or stolen. How quickly you report the loss determines the amount for which you are held responsible. If you report your ATM card lost or stolen within two days of discovering the loss or theft, your losses are limited to $50. If you wait up to 60 days, you are liable for up to $500. If you wait more than 60 days, you could lose all the money that was taken from your account.

The **Fair Debt Collection Practices Act** forbids collection agencies from using threats, harassment, or abuse to collect debts. This act does not apply to creditors who are collecting their own debts.

EXERCISE 18.1 Continued

Questions

1. What credit problems are common among young adults?

2. What are common causes of credit problems among other age groups?

3. What levels of government offer consumer credit protection?

4. Why do most credit transactions benefit both the borrower and the lender?

Questions (continued)

5. What act protects consumers from unauthorized use of credit cards?

6. What act forbids collection agencies from using harassment to collect debts?

7. What act requires creditors to bill you at least 14 days before payment is due?

8. What act protects credit consumers against discrimination on the basis of sex or race?

9. What act sets a process for consumers to correct inaccuracies in their credit report?

10. What act offers some protection when using a debit card?

EXERCISE 18.2

Credible Credit Counselors

Part I YOUR JOB

You are a credit counselor. You specialize at explaining to your clients their rights under federal law and their responsibilities as borrowers. You offer your customers advice on possible actions they should take in regard to their credit problems.

After reading each client's case, answer the following questions:

Questions

1. **According to federal law, what are the legal rights of your client?**
2. **Are your client's legal rights being violated?**
3. **Is your client being responsible or irresponsible?**
4. **What should your client do?**

Part II THE CLIENTS

Client 1

I am 18 years old and I just started college. My parents gave me a debit card. I lost it. I didn't use it much. I didn't know that it was lost until my mother called and told me that she found all these outrageous charges on her statement. The card was used to charge over $5,000. Mom said that she contacted the card issuer the day she found the outrageous charges, which was about 3 weeks after I must have lost it.

Client 2

I am 23 years old and a recent graduate from a technical school and have my first office job. I have fallen behind in making my car payments. My bank has now contacted a collection agency to collect the loan. Now, I don't answer the telephone. The collection agency calls me every hour of the day and night. I am getting calls at work, and it is embarrassing to have other people see the messages left by the collection agency. Keeping this job is my best chance to get the money to start paying the loans but that will take a few weeks.

Client 3

I am 21 and have a new apartment. I am looking for a new sofa. I was reading newspaper ads to see what kinds of financial terms I could get. One full-page ad caught my attention. It said, "No money down, only $9.99 a month." I thought this sounded too good to be true, but the ad said nothing more about how much the sofa costs, how many monthly payments would have to be made, or the interest rate.

Client 4

I am 31 years old and recently separated from my spouse. I applied for a credit card in my own name. Today, I received a letter from the credit card company. It said, "We are sorry. Your application for credit has been denied." How could that be? I have always paid my bills on time. My former spouse sometimes had credit trouble but not me. The letter was no help at all.

Client 5

I am 22 years old. I reached into my pocket today and my wallet was gone. I don't know exactly when it disappeared. I could have lost it when I was in a crowded movie theater a couple of nights ago. I lost $75 in cash, my driver's license, and two credit cards. I am going to the Department of Motor Vehicles today to get a new driver's license. I will get around to calling the credit card people in a few days.

Client 6

We are a newly married couple. We are shopping for a car and a loan with which to buy it. The first lender we spoke to told us that the rate for the loan was only 7 percent. However, in addition to the interest charged on the loan, there was a loan fee of $200 to consider. Can they do that?

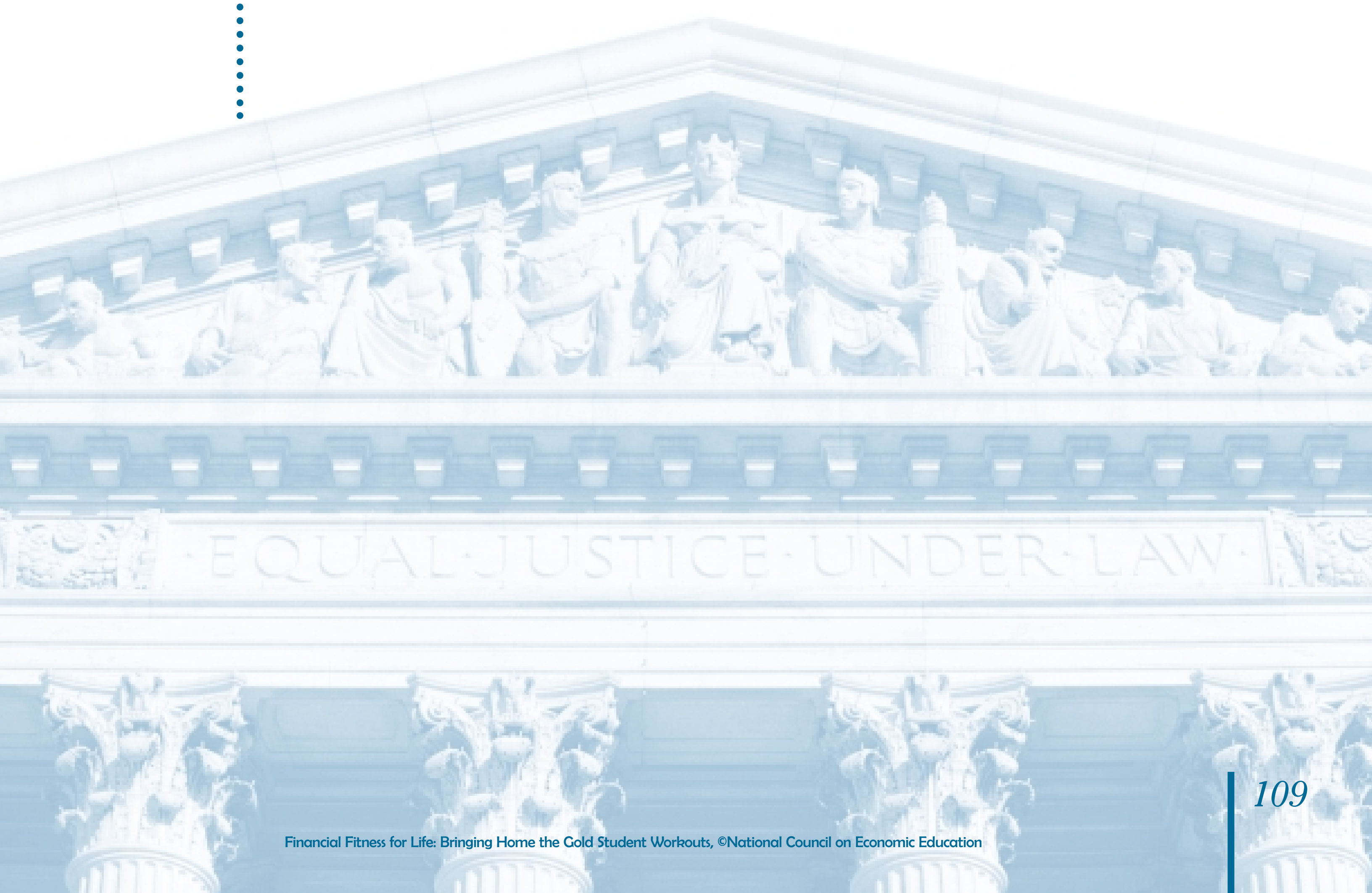
EXERCISE 18.3

Legal Protection for Borrowers

Directions: Listed below are several problems. Place a check mark in the correct column indicating which federal law addresses the problem.

Federal Legislation ▶ Problem ▼	Truth in Lending Act	Fair Credit Reporting Act	Equal Credit Opportunity Act	Fair Credit Billing Act	Electronic Fund Transfer Act	Fair Debt Collection Practices Act
1. A collection agency is making harassing telephone calls about a collection.						
2. A creditor refuses to give you credit because you receive public assistance income.						
3. Your credit card is lost or stolen; you are liable for $50 of charges made by someone else.						
4. A creditor refuses to lend to you because you are African-American.						
5. A bank refuses to tell you why you were turned down for credit.						
6. You disagree with statements made in your credit report. A bank refuses to tell you why you were turned down for credit.						

Federal Legislation ▶ Problem ▼	Truth in Lending Act	Fair Credit Reporting Act	Equal Credit Opportunity Act	Fair Credit Billing Act	Electronic Fund Transfer Act	Fair Debt Collection Practices Act
7. You are liable for $50 on your debit card if a loss or theft is reported immediately.						
8. The first bill for your car payment arrives and you realize that you have only five days to pay it.						
9. A creditor tells you that the interest rate for vacation loans is only 7% per month.						



EXERCISE 19.1

Scams and Schemes

Millions of credit transactions are completed each day. In the vast majority of cases, both sides benefit. But the world is not a perfect place. The credit industry, like any other industry, has a few people who operate on the edge. Some of these people are flat-out thieves. Others operate businesses that are completely legal but can place people who are already in financial trouble into a position from which it will be hard to recover.

Not all financial scams and schemes involve credit. Some deal with investments. They appeal to your desire to make a bundle of cash overnight. But, if it sounds too good to be true, it probably is.

Here are some of the more common scams and schemes.

1. WHAT IS IDENTITY THEFT?

Can you be electronically kidnapped? Yes. Scam artists get your name, Social Security number, credit card number, or some other piece of personal information. They use this information to open a new credit card account, using your name, date of birth, and Social Security number. When they use the credit card and don't pay the bills, the failure to pay is reported on your credit report. The scammers may call your credit card issuer and, pretending to be you, change the mailing address on your credit card account. Then they make charges on your account. Because your bills are being sent to a new address, you may not realize there's a problem. Scheme artists can do all sorts of other damage. They may open cellular phone service in your name. They might open a checking account in your name and write bad checks. Identity theft is illegal.

2. WHAT IS A LOAN SCAM?

An advertiser runs an ad offering a personal debt consolidation loan, taking all your credit payments and rolling them into one. Rarely is a company name or street address given. Instead, the "lender" has an 800 or 900 telephone number for you to call. When a consumer calls, the company representative asks only minimal information about the loan you want and about your financial history. He or she explains that the customer will be called back to indicate whether or not the loan was approved. All the loans, of course, are approved. The consumer is then instructed to send in a fee in return for the promised loan. The loan, of course, never arrives. A loan scam is illegal.

3. WHAT IS A CREDIT REPAIR SCHEME?

A company advertises that it can erase your bad credit history or remove bankruptcy from your credit records. The company requests that a fee be paid up-front for which the company promises to "repair" the consumer's credit report. However, there is little, if anything, such a business can do to "repair" a customer's poor credit record. There are no quick or easy ways to repair a poor credit history. A credit repair scheme is illegal.

4. WHAT IS A COLLEGE FINANCIAL AID SCAM?

A company advertises that millions of dollars in scholarships go unclaimed every year. The company promises that it will do the research to find a scholarship. The company requests that a fee be paid up-front, usually $200-$400. The company promises that if it can't find a $2,000 scholarship, it will return the fee. What will a college student get in return? Probably some scholarship information that is available at no cost to anyone who wishes to look. Guidance counselors and college financial aid officers are good sources of reliable scholarship information available at no charge to you. The scam is illegal.

5. WHAT IS A PYRAMID SCAM?

The key to a pyramid scam is that first participants receive payment for recruiting additional members. The problem with pyramid scams is that there are not enough potential members to keep pyramids growing steadily for even a few months. These plans often promise that if you sign up as a distributor of, say, telephone calling cards, you will receive commissions—not only on your sales but also on the sales of the people you recruit as distributors. Pyramid scams, however, can take several forms. They can be disguised as games, buying clubs, chain letters, mail order operations, or multi-level business opportunities. A pyramid scheme is illegal.

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 and it can help some people in an emergency. An applicant for a payday loan typically provides paycheck stubs, savings account, and checking account numbers to the lender. The person receiving the loan writes a postdated check that is given to the lender. It is written for more money than the amount of the loan. The check is postdated so that it can be cashed later—generally two weeks after the loan was made. The check is then cashed by the lender after the date on 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. They wind up taking out another loan and then another. Soon the finance and interest payments are more than the amount they borrowed.

7. WHAT IS RENT-TO-OWN?

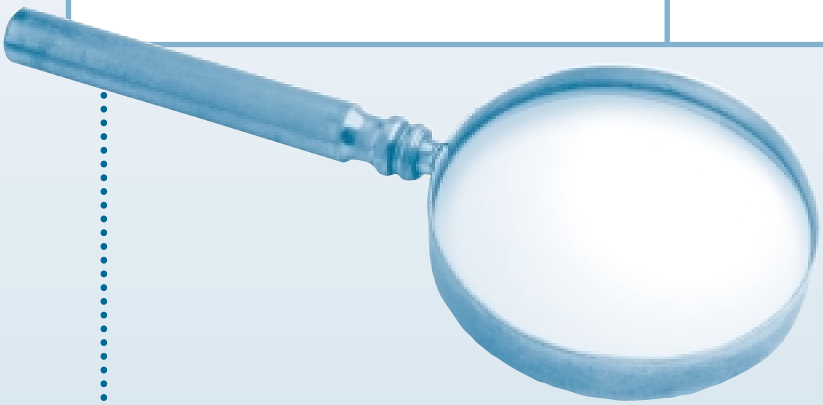
Rent-to-own companies rent and sell appliances, furniture, and electronic products to consumers. Rent-to-own is a legal business. It allows consumers some advantages, such as returning an appliance or furniture after a short period of time. Typically, a consumer agrees to rent something for a short period—one 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. How might this business practice become a scheme? 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. If the difference in the total payments and a fair price for the product were expressed as an interest rate, the rate could commonly be over 100%.

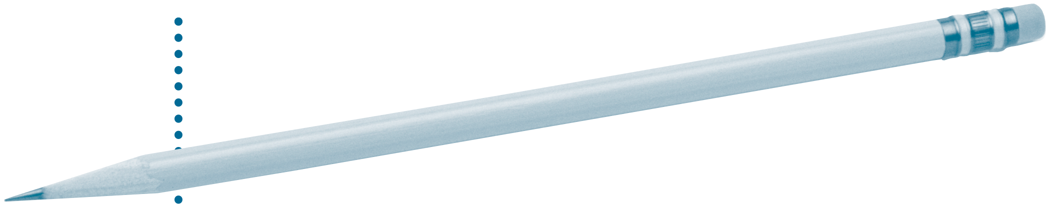
EXERCISE 19.1 Continued

Match the Scam/Scheme to Its Definition

Directions: Match the name of the scam/scheme in the column on the left to its definitions on the next page.

Scam or Scheme	Definition
Rent-to-own	
Credit repair scheme	
College financial aid scam	
Pyramid schemes	
Payday loan	
Identity theft	
Loan scam	





A. A fraudulent company offers to erase a bad credit history or remove bankruptcy information from credit records. It collects an up-front fee and can do nothing to "repair" a customer's poor credit record.

B. A fraudulent company offers to find a student a scholarship. It collects an up-front fee and fails to provide the scholarship.

C. Scam artists get your name, Social Security number, credit card number, or some other piece of your personal information and use this information to open a new credit card account, cellular phone account, or checking account.

D. A fraudulent company offers a personal debt consolidation loan, collects an up-front fee, and never provides the loan.

E. A legal loan that allows a person to get cash until payday with no credit background check. Typically, the interest rate (APR) is quite high.

F. A fraudulent company in which the first participants receive payment for recruiting additional members.

G. A legal scheme offered by some businesses where the consumer pays a lot more money for appliances, furniture, and electronic products because of first renting the item and then buying it.

EXERCISE 19.2

Name That Scam

Directions: Read the scam described in Column A and match it to one of the names of the scams listed to the left. Place the letter of the correct answer in Column B.

A. Identity theft
B. Loan scam
C. Credit repair scheme
D. College financial aid scam
E. Pyramid scheme
F. Payday loan
G. Rent-to-own

Column A "The Pitch"	Column B "The Scam"
1. Make big money on your home computer. Join our eel burger distribution network. Cash in on this new health food craze. E-mail your friends. They can be distributors too.	
2. Need cash today? Can't wait until you get paid? You can get $50 to $500 in 15 minutes. No credit checks!	
3. Tired of the broken-down CD player with lousy speakers? Want to step up to a new system but are short of cash? We can make it happen today!	
4. Here is the deal of a lifetime guaranteed to make you and your friends rich in weeks. Pay $100 to play Jack Pot. In weeks you will make hundreds more. Don't miss out. This is your chance!	
5. You receive an outrageous telephone call from the collection agency saying you have failed to pay a bill for nearly $20,000. You explain that the correct name was used but the billing address for the account was wrong. Soon you hear from a bank in another state that you are overdrawn by $5,000 in a checking account you didn't know you had.	
6. Credit problems? You need not suffer forever! Let us help. We can remove bankruptcies, liens, and bad loans from your credit file forever! Join our hundreds of satisfied customers.	
7. Over your head in debt? Bill collectors harassing you? Can't sleep? We can help. We can find credit for you. It's guaranteed! Call 1-800-123-4567.	
8. Every year, thousands of college scholarships go unclaimed. Are you skimping along simply because you don't have "connections"? We can help. We guarantee you that we will find you a $1,000, $2,000, or even $5,000 scholarship. All your money is returned if you are not satisfied!	