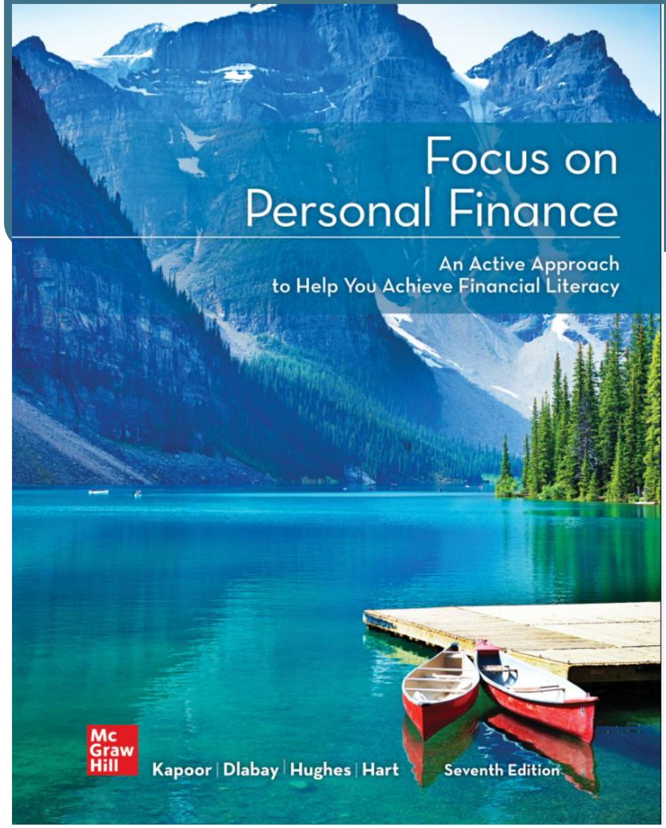
Chapter 5

Consumer Credit: Advantages, Disadvantages, Sources, and Costs



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Consumer Credit
Chapter Learning Objectives

LO5.1 Analyze advantages and disadvantages of using consumer credit.

LO5.2 Assess the types and sources of consumer credit.

LO5.3 Determine whether you can afford a loan and how to apply for credit.

LO5.4 Determine the cost of credit by calculating interest using various interest formulas.

LO5.5 Develop a plan to protect your credit and manage your debts.

What is Consumer Credit?
LO5.1

- **Credit** is an arrangement to receive cash, goods, or services now and pay for them in the future
- **Consumer credit** refers to the use of credit for personal needs (except a home mortgage)
  - Based on trust in people's ability and willingness to pay bills when due
  - Dates back to colonial times
  - *Installment credit*, in which the debt is repaid in equal installments over a specified period of time, exploded in America with the advent of the automobile in the early 1900s

Uses and Misuses of Credit

- Before deciding how and when to make a major purchase, consider the following:
  - Do I have the cash I need for the down payment?
  - Do I want to use my savings for this purchase?
  - Does the purchase fit my budget?
  - Could I use the credit I need for this purchase in some better way?
  - Could I postpone the purchase?
  - What are the opportunity costs of postponing the purchase?
  - What are the dollar costs and psychological costs of using credit?

Advantages of Credit

- Consumer credit enables people to enjoy goods and services now – a car, a home, an education – or it can provide for emergencies
- Credit cards permits the purchase of goods, even when funds are low, and provide shopping convenience
  - Advance notice of sales and the right to order by phone
  - Serve as identification when cashing checks
  - Provides a record of expenses
  - Up to a 50-day “float”
- Credit allows you to shop and travel without carrying a large amount of cash
- Credit indicates stability

Disadvantages of Consumer Credit

- Temptation to overspend
  - Can create serious long-term financial problems, damage family relationships, and delay progress toward financial goals
- Failure to repay may result in loss of income, valuable property, and your good reputation
  - Could lead to court action and bankruptcy
- Ties up future income
- Credit costs money, and paying for purchases over a period of time is more costly than paying with cash

Types of Credit
LO5.2

- **Closed-end credit** are one-time loans that the borrower pays back in a specified period of time and in payments of equal amounts
  - *Installment sales credit* is a loan that allows you to receive merchandise, usually high-priced items
  - *Installment cash credit* is a direct loan of money for personal purposes
  - *Single lump-sum credit* is a loan that must be repaid in total on a specified day, usually within 30 to 90 days
- **Open-end credit** is a line of credit in which loans are made on a continuous basis and the borrower is billed periodically for at least partial payment
  - You may have to pay **interest** or other finance charges

Examples of Closed-End and Open-End Credit

Exhibit 5-1

Closed-End Credit	Open-End Credit
• Mortgage loans • Automobile loans • Installment loans (installment sales contract, installment cash credit, single lump-sum credit)	• Cards issued by department stores, bank cards (Visa, MasterCard) • Travel and entertainment (T&E) (American Express, Diners Club) • Overdraft protection

Volume of Consumer Credit

Exhibit 5-2

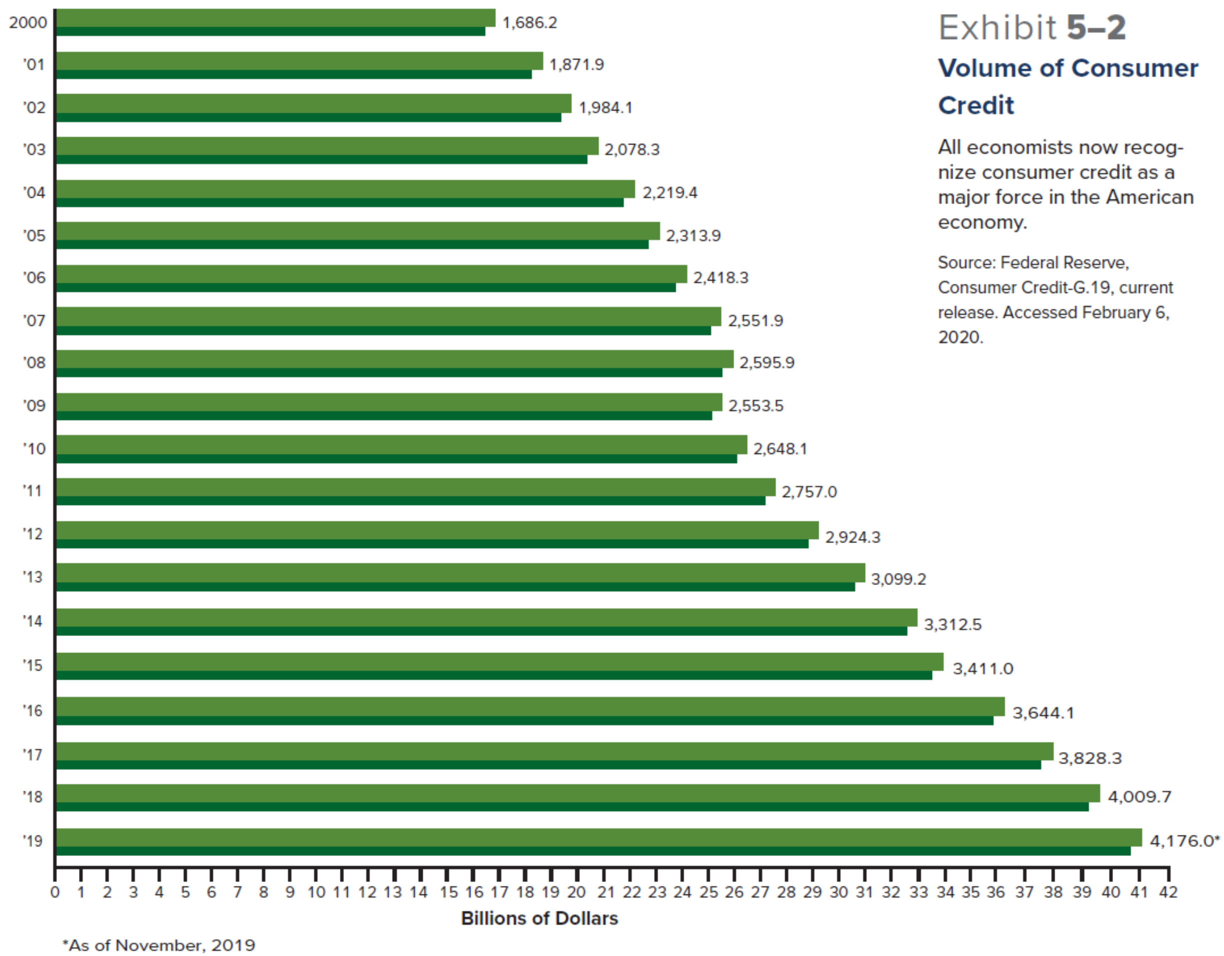


Exhibit **5–2**

Volume of Consumer Credit

All economists now recognize consumer credit as a major force in the American economy.

Source: Federal Reserve, Consumer Credit-G.19, current release. Accessed February 6, 2020.

Source: Federal Reserve, Consumer Credit-G.19, current release. Accessed February 6, 2020.

Open-End Credit
Credit Cards

- Average cardholder has more than nine credit cards, including bank, retail, and gasoline cards
  - *Convenience* users pay off their balances in full each month; *borrowers* do not pay off their balances every month
- Most credit card companies offer a grace period, a time period during which no finance charges will be added to your account
  - **A finance charge** is the total dollar amount you pay to use the credit
  - Beware of “teaser rates”
  - Some credit cards charge annual fees

Open-End Credit (Continued)

- *Debit cards* electronically subtract money from your savings or checking accounts to pay for goods and services
  - Most frequently used at ATMs
- *Stored value cards, gift cards, or prepaid cards* are prepaid, providing you with immediate money
  - Bankruptcy courts treat gift cards the same way they handle unsecured debt
- *Smart cards* are plastic cards equipped with a computer chip that can store 500 times as much data as a normal credit card

Open-End Credit (Concluded)

- *Travel and entertainment (T&E) cards* have balances due in full each month
  - *Example*: Diners Club or American Express cards

- *Smartphones* are now equipped to make purchases
  - **Mobile commerce**, the ability to purchase using a mobile device, has seen a significant increase in interest from consumers, retailers, and finance companies

Sources of Consumer Credit

Credit Source	Type of Loan	Lending Policies
Commercial banks	Single-payment loan Personal installment loans Passbook loans Check-credit loans Credit card loans Primary mortgages Second mortgages	• Seek customers with established credit history • Often require collateral or security • Prefer to deal in large loans, such as vehicle, home improvement, and home modernization, with the exception of credit card and check-credit plans • Determine repayment schedules according to the purpose of the loan • Vary credit rates according to the type of credit, time period, customer's credit history, and the security offered • May require several days to process a new credit application
Consumer finance companies	Personal installment loans Primary mortgages Second mortgages	• Often lend to consumers without established credit history • Often make unsecured loans • Often vary rates according to the size of the loan balance • Offer a variety of repayment schedules • Make a higher percentage of small loans than other lenders • Maximum loan size limited by law • Process applications quickly, frequently on the same day the application is made
Credit unions	Personal installment loans Share draft-credit plans Credit card loans Primary mortgages Second mortgages	• Lend to members only • Make unsecured loans • May require collateral or cosigner for loans over a specified amount • May require payroll deductions to pay off loan • May submit large loan applications to a committee of members for approval • Offer a variety of repayment schedules
Life insurance companies	Single-payment or partial-payment loans	• Lend on cash value of life insurance policy • No date or penalty on repayment • Deduct amount owed from the value of policy benefit if death or other maturity occurs before repayment
Federal savings banks (savings and loan associations)	Personal installment loans (generally permitted by state-chartered savings associations) Home improvement loans Education loans Savings account loans Primary mortgages Second mortgages	• Will lend to all creditworthy individuals • Often require collateral • Loan rates vary depending on size of loan, length of payment, and security involved

Consumer credit is available from several types of sources. Which sources seem to offer the widest variety of loans?

Sources of Consumer Credit

- **Loans** involve borrowing money with an agreement to repay it, as well as interest, within a certain amount of time
- *Inexpensive loans* are loans with low interest, and the sources of these loans are often family members
- *Medium-priced loans* are loans with moderate interest, and the sources of these loans are often commercial banks, savings and loan associations, and credit unions
  - Provide personalized service and are usually patient with borrowers who can provide good reasons for late or missed payments

Sources of Consumer Credit (Continued)

- *Expensive loans* are loans with high interest rates, often ranging from 12 to 25 percent
  - Banks also lend money to their credit card holders through *cash advances* – loans that are billed to the customer’s credit card account
- *Home equity loans* are loans based on your home equity – the difference between the current market value of your home and the amount you still owe on the mortgage
  - Interest is tax-deductible
  - Should only be used for major items such as education, home improvements, or medical bills, and *you must use them with care*

Example
Home Equity Loan

EXAMPLE: Home Equity Loans

Depending on your income and the equity in your home, you can apply for a line of credit for anywhere from $10,000 to $250,000 or more.

Some lenders let you borrow only up to 75 percent of the value of your home, less the amount of your first mortgage. At some banks, you may qualify to borrow up to 85 percent! This higher lending limit may make the difference in your ability to get the money you need for home improvements, education, or other expenses.

Use the following chart to calculate your home loan value, which is the approximate amount of your home equity line of credit.

	Example	Your Home
Approximate market value of your home	$ 200,000	$ ______
Multiply by 0.75	× 0.75	× 0.75
Approximate loan value	150,000	______
Subtract balance due on mortgage(s)	100,000	______
Approximate credit limit available	$ 50,000	$ ______

Can You Afford a Loan?
LO5.3

- *Equal Credit Opportunity Act (ECOA)* states that race, color, age, sex, marital status, and certain other factors may not be used to discriminate against you in any part of a credit dealing
- Before you take out a loan, ask yourself:
  - Can you meet all of your essential expenses and still afford the monthly loan payments?
  - What do you plan to give up to make the monthly loan payment?

General Rules of Credit Capacity

- **Debt payments-to-income ratio** is calculated by dividing your monthly debt payments (excluding your house payment) by your net monthly income
  - Experts recommend spending no more than 20 percent of your net income on consumer credit payments
- **Debt-to-equity ratio** is calculated by dividing your total liabilities by your net worth
  - Do not include the value of your home and the amount of its mortgage
  - A debt-to-equity ratio of 1 is the upper limit of debt obligations

The Five C's of Credit

- Most lenders build policies to determine who will receive credit based on the "five Cs of credit":
  1. **Character** refers to the borrower's attitude towards his or her credit obligations
  2. **Capacity** is the borrower's ability to pay additional debts
  3. **Capital** is the borrower's assets or net worth
  4. **Collateral** is a valuable asset that is pledged to ensure loan payments
  5. **Conditions** affect a borrower's ability to repay a loan

Your Credit Report

- *Credit report*, or *credit file*, is a record of your complete credit history
- **Credit Bureaus are a**gencies that collect information on how promptly people and businesses pay their bills
  - *Experian*, *TransUnion* and *Equifax* are the 3 major credit bureaus
  - Credit bureaus obtain information from banks, finance companies, stores, credit card companies, and other lenders
- Typical credit bureau file contains the following personal information:
  - Name, address, Social Security number, and birth date
  - Employer, position, and income
  - Previous address and employer
  - Spouse's name, Social Security number, employer, and income
  - Whether you rent your own home
  - Checks returned for insufficient funds

Fair Credit Reporting

- Fair Credit Reporting Act
  - In 1971, the U.S. congress enabled the Fair Credit Reporting Act, which regulates the use of credit reports
  - Requires out-of-date information to be deleted
  - Gives consumers access to their files, as well as the ability to correct misinformation
  - Places limits on who can obtain your credit report

Your Credit Report (Continued)

- Only properly identified persons have access to your credit report for approved, legitimate purposes
  - May be supplied in response to a court order or by your own written request
  - May be provided for use in connection with a credit transaction, underwriting of insurance, or some legitimate business need
- Most information in your credit file may be reported for only seven years
  - Personal bankruptcy may be reported for 10 years
  - Credit reporting agencies cannot disclose information in your credit file than is more than 7 or 10 years old unless you're being reviewed for a credit application of $75,000 or more, or unless you apply to purchase life insurance of $150,000 or more

Your Credit Report (Concluded)

- Credit bureaus are required to follow reasonable procedures to ensure the information in their files is correct
  - You may request a copy of your credit information within 60 days of being denied credit
- You have legal rights to sue a credit bureau or creditor that has caused you harm by not following the rules established by the Fair Credit Reporting Act

Credit Scores

- A **credit score** is a number that reflects the information in your credit report
    - Score summarizes your credit history and helps creditors predict how likely it is you will repay a loan and make timely payments
- FICO credit score ranges from 300 to 850
    - The higher the score, the less risk you pose to creditors
    - Available for a fee
- VantageScore is a scoring technique, the first to be developed collaboratively by the three credit reporting companies
    - Common score range of 501 to 990

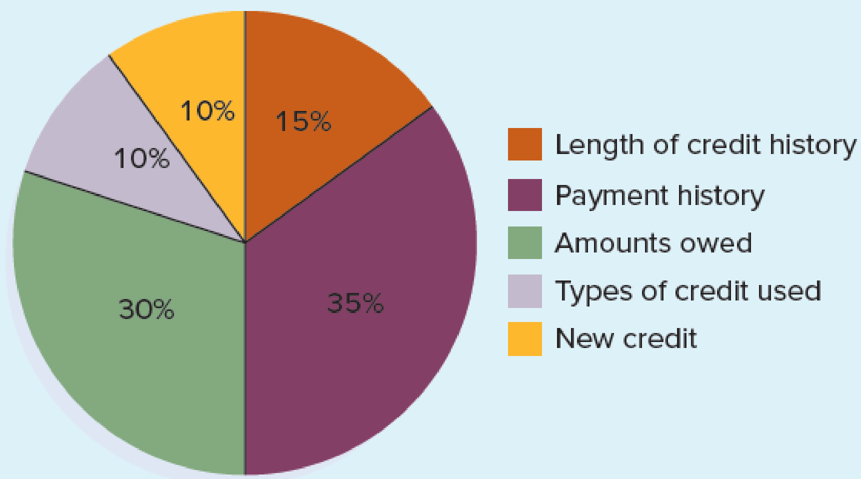
What’s in Your FICO Score?

Money Minute Focus

money minute focus

WHAT’S IN YOUR FICO® SCORE?

The data from your credit report is generally grouped into five categories. The percentages in the pie diagram reflect how important each of the categories is in determining your FICO® score.



Source: “How Your FICO Credit Score Is Calculated,” FICO, **http://www.myfico.com/CreditEducation/**.

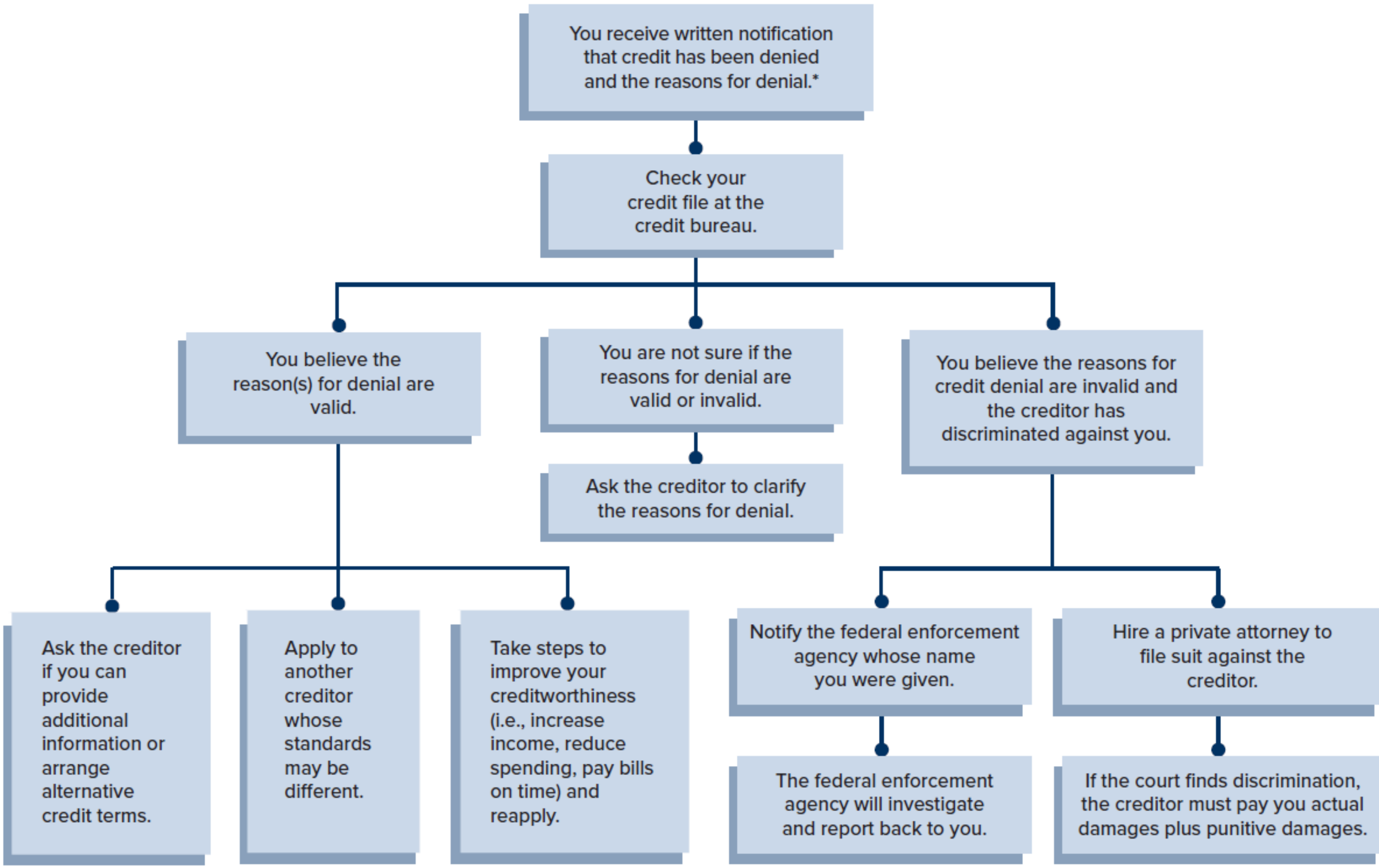
Other Factors Considered in Determining Creditworthiness

- Equal Credit Opportunity Act specifies the following:
  - **Age** may be requested by a creditor on the application, but you cannot be turned down or experience a decrease in credit because of age
  - You may not be denied credit because you receive Social Security or **public assistance**, but this income may be considered in determining creditworthiness
  - *Redlining*, discrimination based on the race or nationality of people in the neighborhood in which you live or want to buy a home, is banned on **housing loans**
  - If lenders use risk-based pricing, they must disclose important details to customers

What If Your Application is Denied?

- If you are denied credit, the ECOA gives you the right to know the reasons
  - If denied is based on a credit report the credit bureau, you are entitled to a free credit report within 60 days
  - You are entitled to ask the bureau to investigate any inaccurate or incomplete information and correct its records

What If You Are Denied Credit?



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What Can You Do to Improve Your Credit Score?

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

The Cost of Credit
LO5.4

- **Finance charge** is the total dollar amount you pay to use credit
  - Includes interest costs and sometimes other costs, such as service charges, credit-related insurance premiums, or appraisal fees
- **Annual Percentage Rate (APR)** is the percentage cost (or relative cost) of credit on a yearly basis
  - Key to comparing costs, regardless of the amount of credit or how much time you have to repay it

It is important to shop for credit!

The Arithmetic of the Annual Percentage Rate (APR)

Figure It Out!

The Arithmetic of the Annual Percentage Rate (APR)

There are two ways to calculate the APR: using an APR formula and using the APR tables. The APR tables are more precise than the formula. The formula, given below, only approximates the APR:

$$r = \frac{2 \times n \times I}{P(N+1)}$$

where:

r = Approximate APR

n = Number of payment periods in one year (12, if payments are monthly; 52, if weekly)

I = Total dollar cost of credit

P = Principal, or net amount of loan

N = Total number of payments scheduled to pay off the loan

Let us compare the APR when a \$100 loan is paid off in one lump sum at the end of the year and when the same loan is paid off in 12 equal monthly payments. The stated annual interest rate is 10 percent for both loans.

Using the formula, the APR for the lump-sum loan is

$$r = \frac{2 \times 1 \times \$10}{\$100(1+1)} = \frac{\$20}{\$100(2)} = \frac{\$20}{\$200} = 0.10, \text{ or } 10\%$$

Using the formula, the APR for the monthly payment loan is

$$r = \frac{2 \times 12 \times \$10}{\$100(12+1)} = \frac{\$240}{\$100(13)} = \frac{\$240}{\$1,300}$$

$$= 0.1846, \text{ or } 18.46 \text{ percent (rounded to } 18.5\%)$$

Tackling the Trade-Offs

- Term versus interest costs
  - Many people choose longer-term financing because they want smaller monthly payments, but the longer term for a loan at a given interest rate, the greater the amount you must pay in interest charges

- Lender risk versus interest rate
  - To reduce the lender’s risk (and the interest rate), you can:
    - *Accept a variable interest rate*
    - *Provide collateral to secure a loan*
    - *Provide up-front cash*
    - *Take a shorter term loan*

Calculating the Cost of Credit

- **Simple interest** is the interest computed on principal only and without compounding
  - *Interest = Principal × Interest Rate × Time*
- When simple interest is paid back in more than one payment, the method of computing interest is known as the *declining balance method*
  - You pay interest only on the amount of principal that you have not yet repaid
- With the *add-on interest method*, interest is calculated on the full amount of the original principal, no matter how frequently you make payments

Using the Simple Interest Formula

EXAMPLE: Using the Simple Interest Formula

Suppose you have persuaded a relative to lend you $1,000 to purchase a laptop computer. Your relative agreed to charge only 5 percent interest, and you agreed to repay the loan at the end of one year. Using the simple interest formula, the interest will be 5 percent of $1,000 for one year, or $50, since you have the use of $1,000 for the entire year:

$$I = \$1{,}000 \times 0.05 \times 1$$
$$= \$50$$

Using the APR formula discussed earlier,

$$\text{APR} = \frac{2 \times n \times I}{P(N + 1)} = \frac{2 \times 1 \times \$50}{\$1{,}000(1 + 1)} = \frac{\$100}{\$2{,}000} = 0.05\text{, or } 5\%$$

Note that the stated rate, 5 percent, is also the annual percentage rate.

Calculating the Cost of Credit (Continued)

- *Cost of open-end credit*
  - Truth in Lending Act requires that open-end creditors inform consumers as to how the finance charge and the APR will affect their costs
- Cost of credit and expected inflation
  - Lenders incorporate the expected rate of inflation when deciding how much interest to charge
- Avoid the *minimum monthly payment* trap
  - The longer you take to pay off the bill, the more interest you pay

Protecting Your Credit
LO5.5

- **Fair Credit Billing Act (FCBA)** sets procedures for promptly correcting billing mistakes, refusing to make credit card payments on defective goods, and promptly crediting payments
- Follow these steps if you think a bill is wrong:
  - Notify creditor of error in *writing* and include any information that may support your case
  - Pay the portion of the bill not in dispute
  - Creditor must respond within 30 days
  - Credit card company has two billing periods, but no longer than 90 days, to correct your account or tell you why they think the bill is correct

Billing Errors and Disputes (Continued)

- A creditor may not threaten your credit rating or do anything to damage your credit reputation while you are negotiating a billing dispute
- Creditor may not take any action to collect the amount in question until your complaint has been answered
- If a sincere effort to resolve a problem with an item purchased has been made, but the store is not cooperative, you can ask for your credit card company to stop payment

Identity Crisis: What to Do If Your Identity is Stolen

1. *Contact the credit bureaus*
   - Tell bureaus to flag your file with a fraud alert, including a statement that creditors should call you for permission before they open any new accounts in your name
2. *Contact creditors*
   - Contact the creditors for any accounts that have been tampered with or opened fraudulently.
   - Follow up in writing
3. *File a police report*
   - Keep a copy for creditors

Protecting Your Credit From Theft or Loss

- Follow these tips to protect your credit from theft or loss:
  - Shred any papers that contain personal information
  - Check machines carefully to avoid *skimming*
  - Close your accounts immediately if you suspect an identity thief has accessed the account
  - Stop payments of checks if you suspect fraud
  - Be sure your credit card is returned after a purchase
  - Keep a record of credit card numbers
  - Notify your credit card company immediately if your card is lost or stolen

Protecting Your Credit Information on the Internet

- To protect your credit information on the Internet, follow these tips:
  - Use a secure browser
  - Keep records of online transactions
  - Review monthly bank and credit card statements
  - Read the privacy and security policies of websites you visit
  - Keep personal information private
  - Never give your password to anyone online
  - Do not download files sent to you by strangers

Cosigning a Loan

- *Cosigning* means you agree to be responsible for loan payments if the other party fails to make them
  - Remember, the lender would not require a co-signer if borrower were a good risk
  - Ask yourself if you can afford the loan if the borrower defaults
  - If borrower doesn’t pay, cosigner is liable for the full amount of the debt plus any late fees or collection costs
  - Creditor can collect the debt from you without first trying to collect from the borrower

Complaining About Consumer Credit

- If you believe a lender is not following the consumer credit protection laws, try first to solve the problem directly with the lender
- If that fails, use formal complaint procedures

If you think you've been discriminated against by:	You may file a complaint with the following agency:	
Consumer reporting agencies, creditors, and others not listed below	Federal Trade Commission: Consumer Response Center - FCRA Washington, DC 20580	1-877-382-4357
National banks, federal branches/agencies of foreign banks (word *National* or initials *N.A.* appear in or after bank's name)	Office of the Comptroller of the Currency Compliance Management, Mail Stop 6-6 Washington, DC 20219	1-800-613-6743
Federal Reserve System member banks (except national banks and federal branches/agencies of foreign banks)	Federal Reserve Board Division of Consumer & Community Affairs Washington, DC 20551	1-202-452-3693
Federal credit unions (words *Federal Credit Union* appear in institution's name)	National Credit Union Administration 1775 Duke Street Alexandria, VA 22314	1-703-519-4600
State-chartered banks that are not members of the Federal Reserve System	Federal Deposit Insurance Corporation Consumer Response Center, 2345 Grand Avenue, Suite 100 Kansas City, MO 64108-2638	1-877-275-3342
The law gives you certain rights as a consumer of credit. What types of complaints about a creditor might you report to these government agencies?		

Consumer Credit Protection Laws

- Consumer protection laws:
  - Truth in Lending and Consumer Leasing Acts
  - Fair Credit and Charge Card Disclosure Act
  - Equal Credit Opportunity Act (ECOA)
  - Fair Credit Billing Act
  - Fair Credit Reporting Act
  - Consumer Credit Reporting Reform Act
  - Electronic Funds Transfer Act
  - Credit Card Accountability Responsibility and Disclosure Act of 2009 (Card Act)

Consumer Financial Protection Bureau

- If you are unable to find a resolution to a credit card situation, the *Consumer Financial Protection Bureau (CFPB)* has created a one-stop shop complaint website for credit card issues
- Website allows you to submit complaint and monitor progress of complaint throughout investigation

Managing Your Debts

- Warning signs of debt problems:
  - Paying only the minimum balance each month
  - Trouble paying the minimum balance
  - Total balance on credit cards increases every month
  - Missing loan payments or paying late
  - Using savings to pay for necessities
  - Getting second or third payment due notices
  - Borrowing money to pay old debts
  - Exceeding the credit limits on your credit cards
  - Being denied credit due to a bad credit report

Debt Collection Practices

- The Federal Trade Commission enforces the Fair Debt Collection Practices Act (FDCPA), which prohibits certain practices by debt collectors – businesses that collect debts for creditors
  - Does not erase the legitimate debts that consumers owe
  - Controls the ways in which debt collection agencies may do business

Financial Counseling Services

- *Consumer Credit Counseling Services (CCCS)* is a non-profit that provides debt counseling services to families and individuals
  - Counseling is usually free, but if CCCS supervised a debt repayment plan, it sometimes charges a small fee to cover administrative costs
  - Emphasizes preventing problems as much as it does solving problems
    - Help people manage money better and set up a realistic budget
    - Educate people about budget planning, pitfalls of unwise credit buying
    - Encourages credit institutions to withhold credit from people who cannot afford it

Other Counseling Services

- Universities, credit unions, military bases, and state and federal housing authorities sometimes provide nonprofit credit counseling services
- Check with your financial institution or consumer protection office for a list of reputable, low-cost financial counseling services

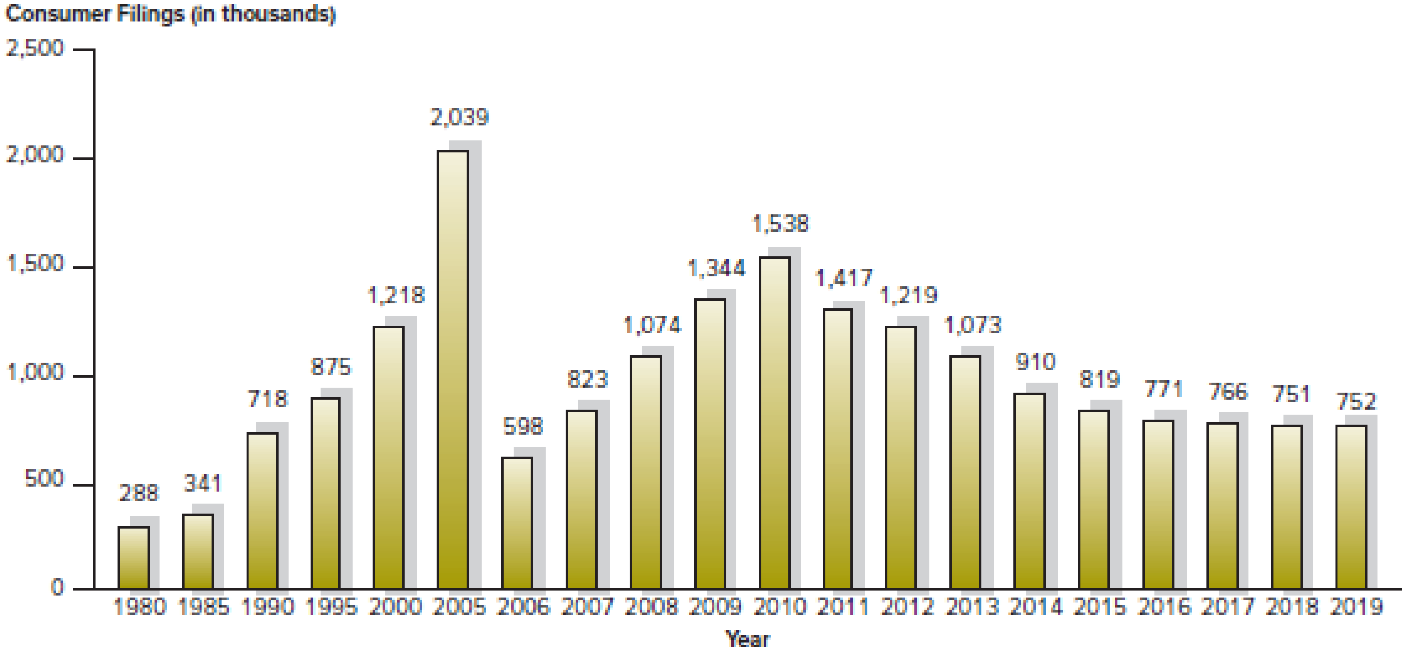
Declaring Personal Bankruptcy

- *Bankruptcy* is a legal process in which some or all of the assets of a debtor are distributed among the creditors because the debtor is unable to pay his or her debts
- ***Bankruptcy should be the last resort because it severely damages your credit rating.***
- Medical bills are the leading cause of bankruptcy
- **U.S. Bankruptcy Act of 1978**
  - Chapter 7 is a straight bankruptcy
  - Chapter 13 is a wage earner plan bankruptcy

U.S. Consumer Bankruptcy Filings

Exhibit 5–9 U.S. Consumer Bankruptcy Filings, 1980–2019

Consumer bankruptcies have increased significantly over the past 40 years. Consumer bankruptcy filings rose from about 288,000 in 1980 to over 2 million in 2005. Bankruptcies decreased after the Bankruptcy Abuse Prevention and Consumer Protection Act was passed. However, poor economic conditions between 2006 and 2010 caused the numbers to increase yet again, despite the legislation. However, the level of filings is still 51 percent below the 1.54 million reached in 2010.



Source: Administrative Office of the U.S. Courts, http://www.uscourts.gov, accessed January 31, 2020.

Chapter 7 Bankruptcy

- Must submit a petition to the court that lists assets and liabilities and pay a filing fee of $350
- Many, but not all, debts are forgiven
- Assets sold to pay creditors, but debtor can keep some assets (Social Security payments, unemployment compensation, net value of home, vehicle, etc.)
- Release from debt does not affect alimony, child support, certain taxes, fines, certain debts arising from educational loans, or debts that you fail to disclose properly to the bankruptcy court
- Debts arising from fraud, driving while intoxicated, or certain other acts or crimes may also be excluded

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

- *“Under this law, Americans who have the ability to pay will be required to pay back at least a portion of their debts.”*- President George W. Bush
  - Debtors seeking to erase all debts have to wait eight years from their last bankruptcy to file again
  - Clamps down on “bankruptcy mills” that seek to game the system
  - Includes provisions for consumer education on debt management and financial planning
  - May require that states should develop personal finance curricula designed for use in elementary and secondary schools

Chapter 13 Bankruptcy

- Debtor with regular income proposes a plan for using future earnings or assets to eliminate his or her debts over a period of time
- Debtor normally keeps all or most of his or her property
- Information provided to the court is the same as what is required under Chapter 7
- Plan may last up to five years
- Debtor makes payments to a court-appointed trustee

Effects of Bankruptcy

- Obtaining credit may be more difficult after filing for bankruptcy, but some find the process easier because they have removed the burden of prior debts
- Obtaining credit may be easier for Chapter 13 filers who have repaid some debt versus Chapter 7 filers who made no effort to repay

Chapter Summary

LO5.1: Analyze advantages and disadvantages of using consumer credit.

- Consumer credit is the use of credit by individuals and families for personal needs.
- The advantages of using credit include:
  - The ability to purchase goods when needed and pay for them gradually
  - The ability to meet financial emergencies
  - Convenience in shopping
  - Establishment of a credit rating
- The disadvantages of using credit include:
  - Credit costs money
  - Encourages overspending
  - Ties up future income

Chapter Summary

LO5.2: Assess the types and sources of consumer credit.

- Closed-end and open-end credit are two types of consumer credit.
- Major sources of consumer credit include commercial banks, savings and loan associations, credit unions, finance companies, life insurance companies, and family and friends.
  - Parents or family members are often the source of the least expensive loans.

Chapter Summary

LO5.3: Determine whether you can afford a loan and how to apply for credit.

- Two general rules for measuring credit capacity:
  - Debt payments-to-income ratio
  - Debt-to-equity ratio
- In reviewing your creditworthiness, creditors seek information from one of the three national credit bureaus or a regional credit bureau.
- Creditors determine creditworthiness on the basis of the five Cs: character, capacity, capital, collateral, and conditions.

Chapter Summary

LO5.4: Determine the cost of credit by calculating interest using various interest formulas.

- Compare the finance charge and the annual percentage rate (APR) as you shop for credit.
- Under the Truth in Lending Act, creditors are required to state the cost of borrowing so that you can compare credit costs and shop for credit.

Chapter Summary

LO5.5: Develop a plan to protect your credit and manage your debts.

- If a billing error occurs on your account, notify the creditor in writing within 60 days.
- If the dispute is not settled in your favor, you can place your version of it in your credit file.
- You may also withhold payment on any defective goods or services you have purchased with a credit card as long as you have attempted to resolve the problem with the merchant.
- If you have a complaint about credit, first try to deal directly with the creditor. If that fails, you can turn to the appropriate consumer credit law.

Chapter Summary

LO5.5: Develop a plan to protect your credit and manage your debts, continued.

- If you cannot meet your obligations, contact your creditors immediately.

- A debtor's last resort is to declare bankruptcy, permitted by the U.S. Bankruptcy Act of 1978.
    - Consider the financial and other costs of bankruptcy before taking this extreme step.
    - A debtor can declare Chapter 7 (straight) bankruptcy or Chapter 13 (wage earner plan) bankruptcy.