When you have completed this chapter, you will be able to:

Section 6.1
- Explain the meaning of consumer credit.
- Differentiate between closed-end credit and open-end credit.

Section 6.2
- Name the five C’s of credit.
- Identify factors to consider when choosing a loan or credit card.
- Explain how to build and protect your credit rating.

Section 6.3
- Discuss how to protect yourself from fraud and identity theft.

Section 6.4
- Identify ways to manage debt problems.

To get the most out of your reading:
Predict what you will learn in this chapter.
Relate what you read to your own life.
Question what you are reading to be sure you understand.
React to what you have read.
**Credit Payments**

**Q:** My brother is going to college and has three credit cards with balances totaling $5,000. He is having trouble paying the minimum monthly payments. What should I tell him?  

**A:** He needs a plan to pay down these debts. Have him contact the credit card companies and tell them that he wants to pay the debt and maintain good credit. They may accept payments of interest only for a few months while he finds ways to increase his income or cut spending.

**Ask Yourself** Why would communicating with a debtor (the credit card company) benefit someone who is behind in payments?

Go to [finance07.glencoe.com](http://finance07.glencoe.com) to complete the Standard & Poor’s Financial Focus activity.
What Is Consumer Credit?

Using Consumer Credit Wisely
Why is having good credit important?

When you borrow money or charge an item to a credit card, you are using credit. **Credit** is an arrangement to receive cash, goods, or services now and pay for them in the future. **Consumer credit** is the use of credit for personal needs. It is also an indicator of consumer spending and demand. A common form of consumer credit is a credit card account issued by a financial institution. Merchants may also provide financing for products that they sell. Banks may directly finance purchases through loans and mortgages. A financial institution, merchant, or individual can be a **creditor**—an entity that lends money. Good credit is valuable. Having the ability to borrow funds allows us to buy things we would otherwise have to save for years to afford: homes, cars, or a college education. Credit is an important financial tool, but it can also be dangerous, leading people into debt beyond their ability to repay. That is why using credit wisely is a valuable financial skill.

Today consumer credit is a major force in the American economy, and the use of credit is a basic factor in personal and family financial planning (see Figure 6.1). Sometimes using credit is necessary, and it can be an advantage. However, paying for an item through credit also involves responsibility and risks.

Credit Uses and Misuses
When is it appropriate to use credit?

You can probably think of many good reasons for using credit. For example, maybe you can buy something on credit now for less money than it will cost to pay in cash later. If you live in an area that lacks good public transportation, you may need a vehicle to travel. But when is it appropriate to use credit? If you cannot afford a high monthly payment, it probably is not a good idea to borrow money to buy an expensive sports car when all you need is simple and reliable transportation.

Using credit may increase the amount of money you can spend now, but the cost of credit decreases the amount of money you will have in the future. That is because you will be paying back the money you borrowed along with any charges for borrowing that money.
Chapter 6
Consumer Credit

Consumer Installment Credit

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<tr>
<th>Year</th>
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Colossal Credit
Economists recognize consumer credit as a major force in the U.S. economy. What is one disadvantage of using credit?

Factors to Consider Before Using Credit
What should you know before using credit?

Imagine you want to finance—a give or get money for—a used vehicle. Before you decide to finance a major purchase by using credit, consider:

- Do you have the cash you need for the down payment?
- Do you want to use your savings instead of credit?
- Can you afford the item?
- Could you use the credit in some better way?
- Could you put off buying the item for a while?
- What are the costs of using credit?

When you buy something on credit, you also agree to pay the fee that a creditor adds to the purchase price. For example, if you do not pay your credit card bill in full every month, you will be charged interest on the amount that you have not paid. Interest is the price that is paid for the use of another’s money. It can be a periodic charge for the use of credit. Think carefully before you decide to use credit. Make sure the benefits of making the purchase now outweigh the costs of credit.

As You Read
Did you ever use credit to buy something you could not afford?

RELATE
Everyone likes to have nice things, but using credit unwisely can lead to problems. What should you consider before using credit?

Advantages of Credit

The main advantage of using consumer credit is that it lets you enjoy goods and services now, perhaps when your funds are low, and pay for them later. Credit cards allow you to combine several purchases, making just one monthly payment.

If you are making hotel reservations, renting a car, or shopping by phone or online, you will probably need a credit card. Using credit gives you a record of your expenses. Shopping and traveling without carrying a lot of cash is safer.

Finally, if you use credit wisely, other lenders will view you as a responsible person.

Disadvantages of Credit

Always remember that credit costs money. Perhaps the greatest disadvantage of using credit is the temptation to buy more than you can afford. Using credit to buy goods or services you cannot afford can lead to serious trouble. If you fail to repay a loan, or a credit card balance, you can lose your good credit reputation. You may also lose some of your income and property, which may be taken from you in order to repay your debts.

Using credit does not increase your total purchasing power, nor does it mean that you have more money. It just allows you buy things now for which you must pay later. If your income does not increase, you may have difficulty paying your bills. Therefore, you should always approach credit with caution and avoid using it for more than your budget allows.
Types of Credit

Why will you need more than one type of credit?

There are two basic types of consumer credit: closed-end credit and open-end credit. You may use both types during your lifetime because each has advantages and disadvantages.

Closed-End Credit

Closed-end credit is credit as a one-time loan that you will pay back over a specified period of time in payments of equal amounts. Closed-end credit is used for a specific purpose and involves a definite amount of money.

A mortgage—a long-term loan extended to someone who buys property—is a common use of closed-end credit. Vehicle loans and installment loans for purchasing furniture or large appliances are also examples of closed-end credit. These types of loans usually carry lower interest rates than open-end credit carries.

For example, when the Petsters were ready to move out of their apartment, they decided to buy a three-bedroom house and apply for a mortgage from a bank. They signed a written agreement that indicated how much their monthly payments would be, how many payments they would make, and the cost of the credit over the life of the loan. The bank will hold the title to the house until the Petsters have completed their payments.

Suppose that you want to buy a sofa and loveseat to furnish your living room. You might apply for an installment loan from a furniture company. You would sign a contract promising to repay the balance, plus interest, in equal installments over a specified period.

Open-End Credit

What does open-end credit mean? Open-end credit is credit as a loan with a certain limit on the amount of money you can borrow for a variety of goods and services. A line of credit is the maximum amount of money a creditor will allow a credit user to borrow. Department store credit cards and bank credit cards, such as Visa or MasterCard, are examples of open-end credit. After a credit card company has approved your application for credit and you have received the card, you can use it to make as many purchases as you wish, as long as you do not exceed your line of credit. You are then billed periodically for at least partial payment of the total amount you owe.

Sources of Consumer Credit

What are some sources of consumer credit?

Many sources of consumer credit are available, including commercial banks and credit unions. Figure 6.2 summarizes the major sources of consumer credit. Study and compare the differences to determine which source might best meet your needs and requirements.
Consumer credit is available from several types of sources.

Which sources seem to offer the widest variety of loans?
Loans

A loan is borrowed money with an agreement to repay it with interest within a certain amount of time. If you were considering taking out a loan, your immediate thought might be to go to your local bank. However, you might want to explore some other options first.

Inexpensive Loans  Parents or other family members are often the source of the least expensive loans—loans with low interest. They may charge only the interest they would have earned on the money if they had deposited it in a savings account. They may even give you a loan without interest. Be aware, however, that loans can complicate family relationships.

Medium-Priced Loans  Often you can obtain medium-priced loans—loans with moderate interest—from commercial banks, savings and loan associations, and credit unions. Borrowing from credit unions has several advantages. Credit unions provide personalized service, and they are usually willing to be patient with borrowers who can provide good reasons for late or missed payments. As you learned in Chapter 5, you must be a member of a credit union in order to get a loan from one.

Expensive Loans  The easiest loans to obtain are also the most expensive. Finance companies and retail stores that lend to consumers will frequently charge high interest rates, 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. Most cards charge higher interest for a cash advance and charge interest from the day the cash advance is made. As a result, it is much more expensive to take out a cash advance than to charge a purchase to a credit card.

Home Equity Loans  A home equity loan is a loan based on your home equity—the difference between the current market value of your home and the amount you still owe on the mortgage. Unlike interest on most other types of credit, the interest you pay on a home equity loan is tax-deductible. Use these loans only for major items such as education, home improvements, or medical bills. If you miss payments on a home equity loan, the lender can take your home. For more information about home equity loans, see Chapters 7 and 17.

Credit Cards

Credit cards are extremely popular. The average cardholder has more than nine credit cards, including bank, retail, gasoline, and telephone cards. Cardholders who pay off their balances in full each month are often known as convenience users. Cardholders who do not pay off their balances every month are known as borrowers.

▼ QUICK CASH Using a debit card can be a convenient way to get cash any time you need it. How is a debit card different from a credit card?
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 credit. Generally, if you pay your balance before the due date stated on your monthly bill, you do not have to pay a finance charge. Borrowers who carry balances beyond the grace period pay finance charges.

The cost of a credit card depends on the type of credit card you have and the terms set forth by the lender. As a cardholder, you may have to pay interest or other finance charges. Some credit card companies charge cardholders an annual fee, usually about $20. However, many companies have eliminated annual fees. If you are looking for a credit card, be sure to shop around for one with no annual fee. **Figure 6.3** gives some other helpful hints for choosing a credit card.

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**Figure 6.3** Choosing and Using a Credit Card

When you choose a credit card, it pays to shop around. Follow these suggestions to find the card that best meets your needs and to use it wisely:

1. Department stores and gasoline companies are good places to obtain your first credit card.
2. Bank credit cards are offered through banks and savings and loan associations. Annual fees and finance charges vary widely, so shop around.
3. If you plan on paying off your balance every month, look for a card that has a grace period and carries no annual fee or a low annual fee. You might have a higher interest rate, but you plan to pay little or no interest anyway.
4. Watch out for creditors that offer low or no annual fees but instead charge a transaction fee every time you use the card.
5. If you plan to carry a balance, look for a card with a low monthly finance charge. Be sure you understand how the finance charge is calculated.
6. To avoid delays that may result in finance charges, follow the card issuer’s instructions as to where, how, and when to make bill payments.
7. Beware of offers of easy credit. No one can guarantee to get you credit.
8. If your card offers a grace period, take advantage of it by paying off your balance in full each month. With a grace period of 25 days, you actually get a free loan when you pay bills in full each month.
9. If you have a bad credit history and have trouble getting a credit card, look for a savings institution that will give you a secured credit card. With this type of card, your line of credit depends on how much money you keep in a savings account that you open at the same time.
10. Travel and entertainment cards often charge higher annual fees than most credit cards. Usually, you must make payment in full within 30 days of receiving your bill, or no further purchases will be approved on the account.
11. Be aware that debit cards are not credit cards but simply a substitute for a check or cash. The amount of the sale is subtracted from your checking account.
12. Think twice before you make a telephone call to a 900 number to request a credit card. You will pay from $2 to $50 for the 900 call and may never receive a credit card.

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**Sources:** American Institute of Certified Public Accountants; U.S. Office of Consumer Affairs; Federal Trade Commission.

**Critical Thinking**

Before you enter the world of credit, you need to understand the various options that are available to you.

Which of these factors would be most important in your choice of a credit card?
Debit Cards  Do not confuse credit cards with debit cards. A debit card allows you to electronically subtract money from your savings or checking account to pay for goods or services. A credit card extends credit and delays payment. Debit cards are most commonly used at automated teller machines (ATMs). They are also used to purchase goods in stores and to make other types of payments.

Smart Cards  Some lenders offer a credit card called a smart card. A smart card is a plastic card equipped with a computer chip that can store 500 times as much data as a normal credit card. Smart cards can store a variety of information. A smart card, for example, can be used to buy an airline ticket, store it digitally, and track frequent flyer miles.

Travel and Entertainment (T&E) Cards  Travel and Entertainment (T&E) cards are really not credit cards because the balance is due in full each month. However, most people think of T&E cards—such as American Express cards—as credit cards because users do not pay for goods or services when they purchase them.

Section 6.1 Assessment

QUICK CHECK
1. What are two advantages and two disadvantages of using credit?
2. What is the difference between closed-end credit and open-end credit?
3. What is an example of an inexpensive loan, a medium-priced loan, and an expensive loan?

THINK CRITICALLY
4. Review Figure 6.3 on page 160. How might you select a card that best meets your needs?

USE MATH SKILLS
5. Cash or Charge?  The use of credit in the United States is widespread. Nevertheless, some people use credit cards and take out loans only in an emergency. Their philosophy is that if they do not have cash to pay for something, they should not take on a debt. Other people believe credit is necessary for everyday living.

Write About It  What is your view on the issue of using credit? Do you plan to obtain a credit card? Would you prefer to pay cash? Write a short essay that explains the role of credit cards and loans in your philosophy of money management.

SOLVE MONEY PROBLEMS
6. Evaluating Credit  Garrett, a high school senior, wanted to get his girlfriend a special birthday gift. A local electronics store had one-day special discounts on stereos, with no payments required until after six months. With income from his part-time job, Garrett felt that he could incorporate the expense into his budget. His mother and sister tried to discourage him from buying the stereo.

Analyze  What should Garrett do in this situation? Explain your reasoning.

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The Costs and Methods of Obtaining Credit

Can You Afford a Loan?

What is a loan?

A loan is money that you borrow and must repay. Loans cost money to the borrower in the form of interest. Taking out a loan can be a substantial financial burden. Before you take out a loan, you need to be sure that you can afford it. Will you be able to meet all your usual expenses plus the monthly loan payments you will have to make? You can answer this question in several ways.

One way is to add up all your basic monthly expenses and then subtract the total from your take-home pay. If the difference is not enough to make a monthly loan payment and still have a little left over, you cannot afford the loan.

A second way is to consider what you might give up to make the monthly loan payment. For example, perhaps you are putting some of your monthly income into a savings account. Would you be willing to use that money to make loan payments instead? If not, would you consider cutting back on unnecessary but fun activities, such as going to movies or eating out? Are you prepared to make this trade-off?

Although you cannot measure your credit capacity exactly, you can use the debt payments-to-income ratio formula to decide whether you can safely take on the responsibility of credit.

Debt Payments-to-Income Ratio

The debt payments-to-income ratio is the percentage of debt you have in relation to your net income. **Net income** is the income you receive (take-home pay, allowance, gifts, and interest). Experts suggest that you spend no more than 20 percent of your net income on debt payments. For example, if your net income is $1,000 per month, your monthly debt payments should total no more than $200. Monthly debt payments include credit card and loan payments. You can calculate your debt payments-to-income ratio by dividing your total monthly debt payments (not including housing payments) by your monthly net income.
Twenty percent is the most you should spend on debt payments, but 15 percent is much better. The higher figure does not take into account emergency expenses, and it is based on an average family’s average expenses. If you are a young adult who is just beginning to experiment with credit, play it safe and stay below the 20 percent limit.

The Cost of Credit
What does it cost to apply for credit?

If you are thinking of taking out a loan or applying for a credit card, your first step should be to figure out how much the loan will cost you and whether you can afford it. Then you should shop for the best credit terms. Two key factors will be the finance charge and the annual percentage rate (APR).

The Finance Charge and the Annual Percentage Rate (APR)

The finance charge is the total dollar amount you pay to use credit. In most cases, you will have to pay finance charges to a creditor on any unpaid balance.

The finance charge is calculated using the annual percentage rate. The annual percentage rate (APR) is the cost of credit on a yearly basis, expressed as a percentage. For example, an APR of 18 percent means that you pay $18 per year on each $100 you owe. Every organization that extends credit of any kind must state the true APR that it charges its customers. This makes it easy to compare the cost of credit at several businesses or among several different credit cards.
To determine the total amount of finance charges that you will pay on $100 borrowed, look at Figure 6.4. Find the APR at the top of the chart and the number of payments at the left side of the chart. The point at which they meet is the total amount you will pay in finance charges for each $100 borrowed.

For example, find the column showing an APR of 8 percent. Follow it down until it meets the row showing 24 monthly payments. You will see that if you borrow $100 at an APR of 8 percent for two years (24 months), you will pay $8.55 in finance charges. Under the Truth in Lending Act, the creditor must inform you, in writing and before you sign any agreement, of the finance charge and the APR.
Tackling the Trade-Offs

When you select your financing, you will have to make trade-offs. You will have to choose among various features, including the length of the loan, the size of monthly payments, and the interest rate. Here are some of the major trade-offs you should consider.

**Term Versus Interest Costs** Many people choose longer-term financing because they want smaller monthly payments. However, the longer the term (the period of time) of a loan at a given interest rate, the greater the amount you will pay in interest charges. Compare the following credit arrangements on a $6,000 loan:

<table>
<thead>
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<th>Term of Loan</th>
<th>Monthly Payment</th>
<th>Total Finance Charge</th>
<th>Total Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Creditor A</td>
<td>$205.07</td>
<td>$1,382.52</td>
<td>$7,382.52</td>
</tr>
<tr>
<td>Creditor B</td>
<td>$163.96</td>
<td>1,870.08</td>
<td>7,870.08</td>
</tr>
</tbody>
</table>

How do these choices compare? The answer depends partly on what you need. The lower-cost loan is available from Creditor A. If you are looking for lower monthly payments, you could repay the loan over a longer period of time. However, you would have to pay more in total costs. A loan from Creditor B provides smaller monthly payments but adds about $488 to your total finance charge.

**Lender Risk Versus Interest Rate** You may prefer financing that requires a minimum down payment, a portion of the total cost of an item that is required at the time of purchase. Another option is to take out a loan that features low fixed payments with a large final payment. Keep in mind that the lender’s goal is to minimize risk, or make sure that you pay back the loan in full. Consumers who want these types of features have to accept the trade-off of a more expensive loan.

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**Finding the Finance Charge**

If you borrow money and do not pay it back right away, you will probably have to pay a finance charge. What is the finance charge that you would pay if you borrowed $100 for 18 months at an APR of 9 percent?
To reduce lender risk and increase your chance of getting a loan at a lower interest rate, consider the following options:

- **Variable Interest Rate**  A variable interest rate is based on changing rates in the banking system. This means that the interest rate you pay on your loan will vary from time to time. If you have a loan with a variable interest rate and overall interest rates rise, the rate on your loan is adjusted accordingly. Therefore, the lender may offer you a lower beginning interest rate than you would have with a fixed-rate loan.

- **A Secured Loan** You will probably receive a lower interest rate on your loan if you pledge collateral. **Collateral** is a form of security to help guarantee that the creditor will be repaid. It indicates that if you lost your source of income, you could repay your loan with the collateral, such as your savings, or by selling some of your property. If you do not pay back the loan, the lender may have the legal right to take whatever you pledged as collateral.

- **Up-Front Cash** Many lenders believe that you have a higher stake in repaying a loan if you make a large down payment. Thus, you may have a better chance of getting the other loan features you want.

- **A Shorter Term** The shorter the period of time (or term) for which you borrow, the smaller the chance that something will prevent you from repaying your loan. This lowers the risk to the lender. Therefore, you may be able to borrow at a lower interest rate if you accept a shorter-term loan, but your monthly payments will be higher.

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**FIGURE GO FINANCIAL MATH**

**SIMPLE INTEREST ON A LOAN**

**Synopsis:** Simple interest, compounded annually, is a percentage of the amount borrowed. The amount borrowed is called principal. Compound interest may be computed daily, monthly, or yearly.

**Example:** Janelle’s cousin agreed to lend her $1,000 to purchase a used laptop computer. She has agreed to charge only 5 percent simple interest, and Janelle has agreed to repay the loan at the end of one year. How much interest will she pay for the year? Use the formula below to help compute Janelle’s loan interest.

**Formula:** Principal \( \times \) Interest Rate \( \times \) Amount of Time = Simple Interest

**Solution:** $1,000 \times .05$ or 5\% \( \times \) 1 = $50 interest

**YOU FIGURE**

You just bought a used car for $3,500 from your aunt. She agreed to let you make payments for 3 years with simple interest at 6 percent. How much interest will you pay?
Calculating the Cost of Credit

To assess your trade-offs, you can also compare loans and credit cards by calculating the interest to find the cost of credit. The most common method of calculating interest is the simple interest formula. Other methods, such as simple interest on the declining balance and add-on interest, are variations of this formula.

**Simple Interest**  
**Simple interest** is the interest computed only on the principal, the amount that you borrow. It is based on three factors: the principal, the interest rate, and the amount of time for which the principal is borrowed. To calculate the simple interest on a loan, multiply the principal by the interest rate and by the amount of time (in years) for which the money is borrowed. (See the Go Figure box on page 166.)

**Simple Interest on the Declining Balance**  
When a simple interest loan 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. The more often you make payments, the lower the interest you will pay. Most credit unions use this method.
**Add-On Interest**  With the add-on interest method, interest is calculated on the full amount of the original principal, no matter how often you make payments. When you pay off the loan with one payment, this method produces the same APR as the simple interest method. However, if you pay in installments, your actual rate of interest will be higher than the stated rate. Interest payments on this type of loan do not decrease as the loan is repaid. The longer you take to repay the loan, the more interest you will pay.

**Cost of Open-End Credit**  The Truth in Lending Act requires that open-end creditors inform consumers as to how the finance charge and the APR will affect their costs. For example, they must explain how they calculate the finance charge. They must also inform you when finance charges on your credit account begin to accrue so that you know how much time you have to pay your bills before a finance charge is added.

**Cost of Credit and Expected Inflation**  Inflation reduces the buying power of money. Each percentage point increase in inflation means a decrease of about 1 percent in the quantity of goods and services you can buy with the same amount of money. Because of this, lenders incorporate the expected rate of inflation when deciding how much interest to charge.

Remember the earlier example in which Damon borrowed $1,000 from his aunt at the bargain rate of 5 percent for one year? If the inflation rate was 4 percent that year, his aunt’s actual rate of return on the loan would have been only about 1 percent (5 percent stated interest minus 4 percent inflation rate). A professional lender that wanted to receive 5 percent interest on Damon’s loan might have charged him 9 percent interest (5 percent interest plus 4 percent—anticipated inflation rate).

**The Minimum Monthly Payment Trap**  On credit card bills and for other forms of credit, the minimum monthly payment is the smallest amount you can pay and remain a borrower in good standing. Lenders often encourage you to make the minimum payment because it will then take you longer to pay off the loan. However, if you are paying only the minimum amount on your monthly statement, you need to plan your budget more carefully. The longer it takes for you to pay off a bill, the more interest you pay. The finance charges you pay on an item could end up being more than the item is worth.

For example, suppose that Natasha is buying new books for college. She spends $500 on textbooks, using a credit card that charges 19.8 percent interest per year, and she makes only the minimum monthly payment of $21.67. Based on that payment amount, it will take Natasha approximately two and one-half years to pay off the loan. Interest charges of $150 will be added to the cost of her purchase.
Applying for Credit

Why does a lender need to know about your credit history to extend credit?

When you are ready to apply for a loan or a credit card, you should understand the factors that determine whether a lender will extend credit to you.

The Five C’s of Credit

When a lender extends credit to consumers, it takes for granted that some people will be unable or unwilling to pay their debts. Therefore, lenders establish policies for determining who will receive credit. Most lenders build such policies around the “five C’s of credit”: character, capacity, capital, collateral, and credit history.

Character: Will You Repay the Loan? Creditors want to know what kind of person to whom they will be lending money. They want to know that you are trustworthy and stable. They may ask for personal or professional references, and they may check to see whether you have a history of trouble with the law. Some questions a lender might ask to determine your character are:

- Have you used credit before?
- How long have you lived at your present address?
- How long have you held your current job?

Capacity: Can You Repay the Loan? Your income and the debts you already have will affect your ability to pay additional debts. If you already have a large amount of debt in proportion to your income, lenders probably will not extend more credit to you.

One Is Enough

When you turn 18, you may start receiving applications for credit cards. Be a smart consumer and compare interest rates, annual fees, and any other fees. Decide which credit card best suits your needs and apply for that one. Toss any other applications you get into the trash.

Why should you get the best (or lowest) interest rate for a credit card?

LOOK BEFORE YOU LEAP

Before taking out a loan, you should sit down and figure out your finances. What is perhaps the most important point you should consider?
A creditor may ask several questions about your income and expenses:

- What is your job, and how much is your salary?
- Do you have other sources of income?
- What are your current debts?

**Capital: What Are Your Assets and Net Worth?** You may recall from Chapter 3 that assets are any items of value that you own, including cash, property, personal possessions, and investments. Your capital is the amount of your assets that exceed your liabilities, or the debts you owe. Lenders want to be sure that you have enough capital to pay back a loan. That way, if you lost your source of income, you could repay your loan from your savings or by selling some of your assets. A lender might ask:

- What are your assets?
- What are your liabilities?

**Collateral: What If You Do Not Repay the Loan?** Creditors look at what kinds of property or savings you already have, because these can be offered as collateral to secure the loan. If you fail to repay the loan, the creditor may take whatever you pledged as collateral. A creditor might ask:

- What assets do you have to secure the loan (a vehicle, your home, or furniture)?
- Do you have any other assets (bonds or savings)?

**Credit History: What Is Your Credit History?** Lenders will review your credit history to find out whether you have used credit responsibly in the past. They will probably obtain a copy of your credit report from a credit bureau. Some questions a creditor might ask about your credit history are:

- Do you pay your bills on time?
- Have you ever filed for bankruptcy?

The information gathered from your application and the credit bureau establishes your credit rating.

A **credit rating** is a measure of a person’s ability and willingness to make credit payments on time. The factors that determine a person’s credit rating are income, current debt, information about character, and how debts have been repaid in the past. If you always make your payments on time, you will probably have an excellent credit rating. If not, your credit rating will be poor, and a lender probably will not extend credit to you. A good credit rating is a valuable asset that you should protect.

Creditors use different combinations of the five C’s to reach their decisions. Some creditors set unusually high standards, and others simply do not offer certain types of loans. Creditors also use various rating systems. Some rely strictly on their own instincts and experience. Others use a credit scoring or statistical system to predict whether an applicant is a good credit risk. When you apply for a loan, the lender is likely to evaluate your application by asking questions such as those included in the checklist in **Figure 6.5** on page 172.
Learn to identify and understand the standard financial documents you will use in the real world.

**Investigate: A Credit Card Statement**
A credit card statement lists this information:
- Payments made
- New balance
- Your available credit
- Transactions for the month
- Minimum payment due

**Key Points:** A credit card statement is sent to you each month. It lists all the purchases you have made using your credit card and the amount of each purchase. It also lists the payments you made during the month. In addition, it indicates how much money you can still borrow from the credit card.

**Your Motive:** Understanding how to read your credit card statement is important so you can track where you spend your money each month. You can also verify that the transactions on the statement are accurate.

**Find the Solutions**
1. How many charges or transactions were completed on this statement?
2. How much more can you charge on the credit card?
3. What is the new balance listed on the statement?
4. What is the minimum payment to be paid?
5. What is the due date of the next payment?

---

**CREDIT CARD STATEMENT**

<table>
<thead>
<tr>
<th>Previous Balance</th>
<th>Payments and Credits</th>
<th>New Charges</th>
<th>New Balance</th>
<th>Credit Line</th>
</tr>
</thead>
<tbody>
<tr>
<td>$100</td>
<td>$100</td>
<td>$40.60</td>
<td>$40.60</td>
<td>$5,000</td>
</tr>
</tbody>
</table>

FOR CUSTOMER SERVICE CALL OR WRITE 1-800-555-4553 P.O. BOX 23 SIOUX FALLS, SD

SEND PAYMENTS TO: BANKCENTER P.O. BOX 6575 GOLDEN, NEVADA 88777

---

<table>
<thead>
<tr>
<th>Sale Date</th>
<th>Past Date</th>
<th>Reference Number</th>
<th>Type of Activity</th>
<th>Location</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>01/05</td>
<td>01/07</td>
<td>24036215006661</td>
<td>Daisy Market</td>
<td>Clover, IL</td>
<td>4.30</td>
</tr>
<tr>
<td>01/08</td>
<td>01/10</td>
<td>24692165008000</td>
<td>Chloe’s Coffee</td>
<td>Fielding, CT</td>
<td>2.30</td>
</tr>
<tr>
<td>01/13</td>
<td>01/13</td>
<td>74046585013013</td>
<td>PAYMENT RECEIVED--THANK YOU</td>
<td>100.00</td>
<td></td>
</tr>
<tr>
<td>01/18</td>
<td>01/20</td>
<td>24036215019664</td>
<td>Real Music</td>
<td>Clover, IL</td>
<td>15.50</td>
</tr>
<tr>
<td>02/02</td>
<td>02/03</td>
<td>24275305337531</td>
<td>Books ‘n’ News</td>
<td>Montclair, MO</td>
<td>13.90</td>
</tr>
<tr>
<td>02/01</td>
<td>02/03</td>
<td>2427539531290000</td>
<td>Nick’s Candy</td>
<td>Montclair, MO</td>
<td>4.60</td>
</tr>
</tbody>
</table>

**Periodic Rate**
- Balance Subject to Interest Charge > 0.00%
- Charge Interest Rate > 0.00%

**ANNUAL PERCENTAGE RATE**
- Periodic Rate > 0.00%
- Charge Interest Rate > 0.00%

<table>
<thead>
<tr>
<th>Statement Date</th>
<th>Payment Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>02/03/--</td>
<td>02/28/--</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cash Advance Limit</th>
<th>Available Credit Line</th>
<th>Available Cash Line*</th>
</tr>
</thead>
<tbody>
<tr>
<td>$500</td>
<td>$4,900</td>
<td>$500</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Purchase</th>
<th>Cash Advance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Payment Due: 20.00
Amount Over Credit Limit: .00
Minimum Amount Due: 20.00
Credit and Equal Opportunity

You should also know what factors a lender cannot consider, according to the law. The Equal Credit Opportunity Act (ECOA) gives all credit applicants the same basic rights. It states that a lender may not use race, nationality, age, sex, marital status, and certain other factors to discriminate against you.

**Age** The Equal Credit Opportunity Act (ECOA) is very specific about how a person’s age may be used as a factor in credit decisions. A creditor may request that you state your age on an application, but if you are old enough to sign a legal contract (usually 18 or 21 years old, depending on state law), a creditor may not turn you down or decrease your credit because of your age. Creditors may not close your credit account because you reach a certain age or retire.

**Public Assistance** You may not be denied credit because you receive Social Security or public assistance. However, certain information related to this source of income can be considered in determining your creditworthiness.

**Housing Loans** The ECOA also covers applications for mortgages or home improvement loans. In particular, it bans discrimination against you based on the race or nationality of the people in the neighborhood where you live or want to buy your home, a practice that is called redlining.
What If Your Application Is Denied?

If your credit application is denied, the ECOA gives you the right to know the reasons. If the denial is based on a credit report from a credit bureau, you are entitled to know what specific information in the report led to the denial. After you receive this information, you can contact the credit bureau and ask for a copy of your credit report. The bureau cannot charge a fee for this service as long as you ask to see your files within 60 days of notification that your credit application has been denied. You are entitled to ask the bureau to investigate any inaccurate or incomplete information and correct its records. (See Figure 6.6.)

![Figure 6.6 What If You Are Denied Credit?](Image)

Right the Wrong

The law requires credit card companies to correct inaccurate or incomplete information in your credit report.

Why is it best to request changes of incorrect information by letter rather than by phone?
Your Credit Report

**Why is your credit report important?**

When you apply for a loan, the lender will review your credit history closely. The record of your complete credit history is called your credit report, or credit file. Your credit records are collected and maintained by credit bureaus. Most lenders rely heavily on credit reports when they consider loan applications. **Figure 6.7** provides information on building and protecting your credit history.

Credit Bureaus

A credit bureau is an agency that collects information on how promptly people and businesses pay their bills. The three major credit bureaus are Experian, Trans Union, and Equifax. Each of these bureaus maintains more than 200 million credit files on individuals, based on information they receive from lenders. Several thousand smaller credit bureaus also collect credit information about consumers. These firms make money by selling the information they collect to creditors who are considering loan applications.

Credit bureaus get their information from banks, finance companies, stores, credit card companies, and other lenders. These sources regularly transmit information about the types of credit they extend to customers, the amounts and terms of the loans, and the customers’ payment habits. Credit bureaus also collect some information from other sources, such as court records.

Your Credit File

A typical credit bureau file contains your name, address, Social Security number, and birth date as well as other information:

- Your employer, position, and income
- Your previous address
- Your previous employer
- Your spouse’s name, Social Security number, employer, and income
- Homeowner or renter status
- Checks returned for insufficient funds

In addition, your credit file contains detailed credit information. Each time you use credit to make a purchase or take out a loan of any kind, a credit bureau is informed of your account number and the date, amount, terms, and type of credit.

Your file is updated regularly to show how many payments you have made, how many payments were late or missed, and how much you owe. Any lawsuits or judgments against you may appear as well. Federal law protects your rights if the information in your credit file is incorrect.
**Fair Credit Reporting**

Fair and accurate credit reporting is vital to both creditors and consumers. In 1971, the U.S. Congress enacted the Fair Credit Reporting Act, which regulates the use of credit reports. This law requires the deletion of out-of-date information and gives consumers access to their files as well as the right to correct any misinformation that the files may include. The act also places limits on who can obtain your credit report.

**Who Can Obtain a Credit Report?**

Your credit report may be issued only to properly identified persons for approved purposes. It may be supplied in response to a court order or by your own written request. A credit report may also be provided for use in connection with a credit transaction, underwriting of insurance, or some other legitimate business need. Friends, neighbors, and other individuals cannot be given access to credit information about you. In fact, if they even request such information, they may be subject to a fine, imprisonment, or both.

The credit bureaus contend that current laws protect a consumer’s privacy, but many consumer organizations believe that anyone with a personal computer and a modem can easily access credit bureau files.

You may obtain a copy of your credit report free of charge if you have been denied credit. Current law also allows anyone using credit to obtain one free credit report per year.
Time Limits on Unfavorable Data

Most of the information in your credit file may be reported for only seven years. However, if you have declared personal bankruptcy, that fact may be reported for ten years. A credit reporting agency cannot disclose information in your credit file that is more than seven or ten years old unless you are being reviewed for a credit application of $75,000 or more, or unless you apply to purchase life insurance of $150,000 or more.

Incorrect Information

Credit bureaus are required to follow reasonable procedures to make sure that the information in their files is correct. Mistakes can and do occur, however. If you think that a credit bureau may be reporting incorrect data from your file, contact the bureau to dispute the information. The credit bureau must check its records and change or remove the incorrect items. If you challenge the accuracy of an item on your credit report, the bureau must remove the item unless the lender can verify that the information is accurate.

If you are denied credit, insurance, employment, or rental housing based on the information in a credit report, you can get a free copy of your report. Request it within 60 days of the denial.
Legal Action

You have a legal right to sue a credit bureau or creditor that has caused you harm by not following the rules established by the Fair Credit Reporting Act. If the agency or the user is found guilty, the consumer may be awarded actual damages, court costs, and attorneys’ fees. In the case of willful noncompliance, punitive damages in the form of money may also be awarded by the court. The action must be brought within two years of the occurrence or within two years after the discovery of material and willful misrepresentation of the information.

An unauthorized person who obtains a credit report under false pretences may be fined up to $5,000, imprisoned for one year, or both. The same penalties apply to anyone who willfully provides credit information to someone not authorized to receive it.

Section 6.2 Assessment

QUICK CHECK
1. What are some ways to determine whether you can afford a loan?
2. What are the five C’s of credit?
3. What are at least three steps you can take to maintain a good credit rating?

THINK CRITICALLY
4. Summarize ways you can lower lender risk to increase your chances of getting a loan at a lower interest rate?

USE MATH SKILLS
5. Debt Payments-to-Income Ratio
Kim Lee is trying to decide whether she can afford a loan she needs so she can go to chiropractic school. Right now, Kim lives at home and works in a shoe store earning a gross income of $820 per month. Kim also pays $95 on several credit card debts each month. The loan she needs for chiropractic school will cost her an additional $120 per month.

Calculate Help Kim make her decision by calculating her debt payments-to-income ratio with and without the college loan. (Remember the 20 percent rule.)

SOLVE MONEY PROBLEMS
6. Equal Credit Opportunity Act
Eleanor Davis is a single woman. Although she has a good income and uses credit wisely, she has been denied a loan to buy a house and does not know why. She believes that she may have been discriminated against or that there may be some incorrect information on her credit report.

Write About It Using the information in this section on applying for credit, discuss Eleanor’s rights and options for finding out why she was denied credit.
Prototyping Your Credit

Billing Errors and Disputes

What can you do to correct billing errors?

Have you ever received a bill for something you did not buy? Have you ever made a payment that was not credited to your account? If so, you are not alone. You may be a responsible consumer who pays bills promptly and manages personal finances carefully. Even so, mistakes can happen. If you want to protect your credit rating, your time, and your money, you need to know how to correct mistakes that may pop up in your credit dealings.

What can you do to dispute billing errors? Follow these steps if you think that a bill is wrong or want more information about it. First, notify your creditor in writing, and include any information that might support your case. (A telephone call is not sufficient and will not protect your rights.) Then pay the portion of the bill that is not in question.

Your creditor must acknowledge your letter within 30 days. Then within two billing periods (but not longer than 90 days), the creditor must either adjust your account or tell you why the bill is correct. If the creditor made a mistake, you do not have to pay any finance charges on the disputed amount. If no mistake is found, the creditor must promptly send you an explanation of the situation and a statement of what you owe, including any finance charges that accumulated and any minimum payments you missed while you were questioning the bill.

Protecting Your Credit Rating

According to law, a creditor may not threaten your credit rating or do anything to damage your credit reputation while you are negotiating a billing dispute. In addition, the creditor may not take any action to collect the amount in question until your complaint has been answered.

Defective Goods and Services

According to the Fair Credit Billing Act, if you purchase a defective item and the store will not accept a return, you may tell your credit card company to stop payment because you made a sincere attempt to resolve the problem.
PLAYING FAIR  Suppose that you buy something with your credit card, and it turns out to be defective. If you try to get your money back and the store refuses your request, what might you do?

Credit and Stolen Identity
How can someone steal your identity?

Imagine yourself saying: “I don’t remember charging those items. I’ve never been in that store.” Maybe you never charged those goods and services, but someone else did—someone who used your name and personal information to commit fraud. When impostors use your personal information for their own purposes, they are committing a crime, sometimes called “identity theft.”

You may not even know that your identity has been stolen until you notice that something is wrong: You may get bills for a credit card account you never opened, or you may see charges to your account for things that you did not purchase. In addition, a thief may access your bank account and withdraw your money using your ATM information.

If you think that your identity has been stolen and that someone is using it to charge purchases or obtain credit in some other way, you can take action. See Figure 6.8 on page 181 for information on what to do if your identity is stolen.
Protecting Your Credit from Theft or Loss

What should you do when you realize your credit has been stolen?

Some thieves will pick through your trash in the hope of coming across your personal information. You can prevent this from happening by tearing or shredding any papers that contain personal information before you throw them out.

If you believe that an identity thief has accessed your bank accounts, close the accounts immediately. If your checks have been stolen or misused, stop payment on them. If your debit card has been lost or stolen, cancel it and get another with a new Personal Identification Number (PIN). You may also need to close your account and open a new one as a precaution.

Lost credit cards are a key element in credit card fraud. To protect your card, you should take the following actions:

- Be sure that your card is returned to you after you make a purchase. Unreturned cards can sometimes find their way into the wrong hands.
- Keep a record of your credit card number. You should keep this record separate from your card.

Notify the credit card company immediately if your card is lost or stolen. Under the Consumer Credit Protection Act, the maximum amount that you must pay if someone uses your card illegally is $50. If you manage to inform the company before the card is used illegally, you have no obligation to pay at all. However, many credit card companies do not require the cardholder to pay even the maximum amount if the card is used.

Keeping Track of Your Credit

A big problem with credit or identity theft is that you may not know your credit has been stolen until you notice that something is wrong. As discussed in Section 6.2, you might get bills for a credit card account you never opened. Your credit report may include debts you never knew you had; a billing cycle may pass without you receiving a statement; or you may see charges on your bills for which you did not sign or did not authorize.

Steps to Protect Other Accounts  If you believe an identity thief has accessed your bank accounts, checking account, or ATM card, close those accounts immediately. When you open new accounts, insist on password-only access. If your checks have been stolen or misused, stop payment on them. If your ATM card has been lost, stolen, or otherwise compromised, cancel the card and get another one with a new PIN. Stay alert to new instances of identity theft. Notify the company or creditor immediately, and follow up in writing.
If someone has stolen your identity, the Federal Trade Commission recommends that you take three actions immediately:

1. **Contact the Credit Bureaus**
   Tell them to flag your file with a fraud or security alert, including a statement that creditors should call you for permission before they open any new accounts in your name.

2. **Contact the 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 of the police report in case your creditors need proof of the crime. If you are still having identity problems, stay alert to new instances of identity theft. You can also contact the Privacy Rights Clearinghouse.
Government Agency Protection  If you continue to experience identity-theft problems after taking these steps, contact the Privacy Rights Clearinghouse of the Federal Trade Commission (FTC), which provides information on how to network with other victims.

The U.S. Secret Service has jurisdiction over financial fraud cases. Although the service generally investigates cases that involve substantial monetary loss, your information may provide evidence of a larger pattern of fraud that requires its attention.

The Social Security Administration may issue you a new Social Security number if you are still having difficulties after trying to resolve problems resulting from identity theft. Unfortunately, however, there is no guarantee that a new number will resolve the problem.

The Federal Trade Commission cannot resolve individual problems for consumers, but it can act against a company if it sees a pattern of possible law violations. You can file a complaint with the FTC through a toll-free consumer help line; by mail; or at its Web site, using the online complaint form.

Protecting Your Credit

Information on the Internet

The Internet is becoming almost as important to daily life as the telephone and television. Increasing numbers of consumers use the Internet for financial activities, such as investing, banking, and shopping.

When you make purchases online, make sure that your transactions are secure, that your personal information is protected, and that your “fraud sensors” are sharpened. Although you cannot control fraud or deception on the Internet, you can take steps to recognize it, avoid it, and report it. Here’s how:

- Use a secure browser.
- Keep records of your online transactions.
- Review your monthly bank and credit card statements.
- Read the privacy and security policies of Web sites you visit.
- Keep your personal information private.
- Never give your password to anyone online.
- Do not download files sent to you by strangers.

Cosigning a Loan

Why would someone ask a friend or relative to cosign a loan?

If a friend or relative ever asks you to cosign a loan, think twice. Cosigning a loan means that you agree to be responsible for the loan payments if the other person fails to make them. When you cosign, you are taking a chance that a professional lender will not take. The lender would not require a cosigner if the borrower were considered a good risk.
If you cosign a loan and the borrower does not pay the debt, you may have to pay up to the full amount of the debt as well as any late fees or collection costs. The creditor can even collect the debt from you without first trying to collect from the borrower. The creditor can use the same collection methods against you that can be used against the borrower. If the debt is not repaid, that fact will appear on your credit record.

**Complaining About Consumer Credit**

**When should you complain about a lender?**

If you believe that a lender is not following the consumer credit protection laws, first try to solve the problem directly with the lender. If that fails, then you should use more formal complaint procedures. This section describes how to file a complaint with the federal agencies that administer consumer credit protection laws.

**Consumer Credit Protection Laws**

If you have a particular problem with a bank in connection with any of the consumer credit protection laws, you can get advice and help from the Federal Reserve System. You do not need to have an account at the bank to file a complaint. You may also take legal action against a creditor. If you decide to file a lawsuit, you should be aware of the various consumer credit protection laws described below.

**Truth in Lending and Consumer Leasing Acts** If a creditor fails to disclose information as required under the Truth in Lending Act or the Consumer Leasing Act, or gives inaccurate information, you can sue for any money loss you suffer. You can also sue a creditor that does not follow rules regarding credit cards. In addition, the Truth in Lending Act and the Consumer Leasing Act permit class-action lawsuits. A class-action suit is a legal action on behalf of all of the people who have suffered the same injustice.

**Equal Credit Opportunity Act (ECOA)** If you think that you can prove that a creditor has discriminated against you for any reason prohibited by the ECOA, you may sue for actual damages plus punitive damages—a payment used to punish the creditor who has violated the law—up to $10,000.

**Fair Credit Opportunity Act** A creditor that fails to follow the rules that apply to correcting any billing errors will automatically give up the amount owed on the item in question and any finance charges on it, up to a combined total of $50. This is true even if the bill was correct. You may also sue for actual damages plus twice the amount of any finance charges.
Fair Credit Reporting Act  You may sue any credit bureau or creditor that violates the rules regarding access to your credit records or that fails to correct errors in your credit file. You are entitled to actual damages plus any punitive damages the court allows if the violation is proven to have been intentional.

Consumer Credit Reporting Reform Act  The Consumer Credit Reporting Reform Act of 1997 places the burden of proof for accurate credit information on the credit bureau rather than on you. Under this law, the creditor must prove that disputed information is accurate. If a creditor or the credit bureau verifies incorrect data, you can sue for damages.

The Federal Reserve System has set up a separate office, the Division of Consumer and Community Affairs, in Washington to handle consumer complaints. This division also writes regulations to carry out the consumer credit laws, enforces these laws, and helps banks comply with these laws.
Your Rights Under Consumer Credit Laws

If you believe that you have been refused credit because of discrimination, you can take one or more of the following steps:

1. Complain to the creditor. Let the creditor know that you are aware of the law.
2. File a complaint with the government. You can report any violations to the appropriate government enforcement agency, as shown in Figure 6.9.
3. If all else fails, sue the creditor. You have the right to bring a case in a federal district court. If you win, you can receive actual damages and punitive damages of up to $10,000. You can also recover reasonable attorneys’ fees and court costs.

Section 6.3 Assessment

QUICK CHECK
1. What should you do if you think that a bill is wrong or want more information about it? How should your creditor respond to your attempt to resolve the situation?
2. How can you protect yourself against credit card theft or loss?
3. How does the Fair Credit Reporting Act protect you?

THINK CRITICALLY
4. Recall the suggestions for protecting your credit information on the Internet. Predict the problems that could result from not following the guidelines.

USE COMMUNICATION SKILLS
5. Cosigning a Loan Suppose that a close friend has asked you to cosign a loan she needs to start up a children’s clothing store. You would like to help if you can. However, your friend is currently unemployed, and you are concerned that she will not be able to repay the loan. After much thought, you decide not to cosign the loan.

Write About It Write a letter to your friend explaining why you have decided not to cosign her loan. In the letter, point out what the consequences to you will be if she is unable to repay the loan.

SOLVE MONEY PROBLEMS
6. Putting a Stop to Fraud Joel went to the ATM the other day to withdraw some cash. When he checked his receipt, he noticed that the balance on his savings account was $500 less than it should have been. After discussing the matter with a customer service representative at his bank, he realized that someone else had gained access to his account number and Personal Identification Number (PIN).

Role-Play Using what you have learned about protecting yourself from fraud, explain to Joel the steps he should take to stop any further damage from being done. Partner with another student to role-play the conversation.
Managing Your Debts

Signs of Debt Problems

How do you know when you are getting in financial trouble?

Carl Reynolds is in his early 20s. A recent college graduate, he has a steady job and earns an annual income of $40,000. With the latest model sports car parked in the driveway of his new home, it would appear that Carl has the ideal life.

However, Carl is deeply in debt. He is drowning in a sea of bills. Almost all of his income is tied up in debt payments. The bank has already begun foreclosure proceedings on his home, and several stores have court orders to repossess practically all of his new furniture and electronic gadgets. His current car payment is overdue, and he is behind in payments on all of his credit cards. If he does not come up with a plan of action, he will lose everything.

Carl's situation is all too common. Some people who seem to be wealthy are just barely keeping their heads above water financially. They may lack self-discipline and do not control their impulses. They use poor judgment or fail to accept responsibility for managing their money. Carl and others like him are not necessarily bad people. They simply have not thought about their long-term financial goals.

The Warning Signs

There are some warning signs of being in financial trouble. If you are experiencing two or more of these warning signs, it is time for you to rethink your priorities.

- You make only the minimum monthly payment on credit cards.
- You are having trouble making even the minimum monthly payment on your credit card bills.
- The total balance on your credit cards increases every month.
- You miss loan payments or often pay late.
- You use savings to pay for necessities such as food and utilities.
- You receive second or third payment due notices from creditors.
- You borrow money to pay off old debts.
- You exceed the credit limits on your credit cards.
- You have been denied credit because of a bad credit report.
Debt Collection Practices

Are debt collection practices regulated by laws?

When people are in debt and getting behind in payments, they may worry about debt collection agencies. Creditors will often turn their bad debts over to such companies. However, a federal agency protects certain legal rights of debtors in their dealings with these types of agencies.

The Federal Trade Commission enforces the Fair Debt Collection Practices Act (FDCPA). This act prohibits certain practices by debt collectors—businesses that collect debts for creditors. The act does not erase the legitimate debts that consumers owe, but it does control the ways in which debt collection agencies do business and deal with consumers in debt.

Financial Counseling Services

What are sources of financial counseling?

If you are having trouble paying your bills and need help, you have several options. You can contact your creditors and try to work out an adjusted repayment plan. In addition, you can contact a non-profit financial counseling program, such as the Consumer Credit Counseling Service, which operates nationwide.
Consumer Credit Counseling Service

The Consumer Credit Counseling Service (CCCS) is a nonprofit organization affiliated with the National Foundation for Consumer Credit (NFCC). Local branches of the CCCS provide debt counseling services for families and individuals with serious financial problems. The CCCS is not a charity, a lending institution, or a government agency. CCCS counseling is usually free. However, when the organization supervises a debt repayment plan, it sometimes charges a small fee to help pay administrative costs.

According to the NFCC, millions of consumers contact CCCS offices each year for help with their personal financial problems. To find an office near you, check the white pages of your local telephone directory under Consumer Credit Counseling Service, or call 1-800-388-CCCS. All information is kept confidential.

Credit counselors know that most individuals who are overwhelmed with debt are basically honest people who want to clear up their unmanageable indebtedness, the condition of being deeply in debt. Too often, such problems arise from a lack of planning or a miscalculation of earnings. The CCCS is concerned with preventing problems as much as it is with solving them. As a result, its activities are divided into two parts:

- Aiding families with serious debt problems by helping them manage their money better and setting up a realistic budget
- Helping people prevent indebtedness by teaching them the importance of budget planning, educating them about the pitfalls of unwise credit buying, and encouraging credit institutions to withhold credit from people who cannot afford it

Other Counseling Services

In addition to the CCCS, universities, credit unions, military bases, and state and federal housing authorities sometimes provide nonprofit credit counseling services. These organizations usually charge little to nothing for their assistance. You can also check with your bank or local consumer protection office to see whether it has a listing of reputable financial counseling services.

Declaring Personal Bankruptcy

Why do people declare personal bankruptcy?

What if an individual suffers from an extreme case of debt problems? Is there any relief? As a last resort, an individual can declare 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 may also include a plan for the debtor to repay creditors on an installment basis. Declaring bankruptcy is a last resort because it severely damages your credit rating.
Prakrit Singh illustrates the new face of bankruptcy. A 43-year-old freelance photographer from California, she was never in serious financial trouble until she began running up big medical costs. She reached for her credit cards to pay the bills. Because Prakrit did not have health insurance, her debt quickly mounted and soon reached $17,000—too much to pay off with her $25,000-a-year income. Her solution was to declare personal bankruptcy and enjoy the immediate freedom it would bring from creditors’ demands.

In 1994, the U.S. Senate passed a bill that reduced the time and cost of bankruptcy proceedings. The bill strengthened creditor rights and enabled more individuals to get through bankruptcy proceedings without selling their assets. Today legislators have enacted new tougher bankruptcy law reforms that are intended to end perceived abuses of the current bankruptcy system.
The U.S. Bankruptcy Act of 1978

Figure 6.10 on page 189 illustrates the rate of personal bankruptcy in the United States. The vast majority of bankruptcies in the United States, like Prakrit Singh’s, are filed under a part of the U.S. bankruptcy code known as Chapter 7. You have two choices in declaring personal bankruptcy:

- Chapter 7 (a straight bankruptcy)
- Chapter 13 (a wage-earner plan bankruptcy)

Both choices are undesirable, and neither should be considered an easy way to get out of debt.

Chapter 7 Bankruptcy  In a Chapter 7 bankruptcy, an individual is required to draw up a petition listing his or her assets and liabilities. A person who files for relief under the bankruptcy code is called a debtor. The debtor submits the petition to a U.S. district court and pays a filing fee.

Chapter 7 is a straight bankruptcy in which many, but not all, debts are forgiven. Most of the debtor’s assets are sold to pay off creditors. Certain assets, however, receive some protection. Among the assets usually protected are Social Security payments, unemployment compensation, and the net value of your home, vehicle, household goods and appliances, tools used in your work, and books.

The 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. Furthermore, debts arising from fraud, driving while intoxicated, or certain other acts or crimes may also be excluded.

Chapter 13 Bankruptcy  In a Chapter 13 bankruptcy, a debtor with a regular income proposes a plan to the court for using future earnings or assets to eliminate his or her debts over a specific period of time. In such a bankruptcy, the debtor normally keeps all or most of his or her property.

During the period when the plan is in effect, which can be as long as five years, the debtor makes regular payments to a Chapter 13 trustee, or representative appointed by the court, who then distributes the money to the creditors. Under certain circumstances, the bankruptcy court may approve a plan that permits the debtor to keep all of his or her property even though he or she repays less than the full amount of the debts.

Using a Lawyer

Choosing a bankruptcy lawyer may be difficult. Some of the least reputable lawyers make easy money by handling hundreds of bankruptcy cases without considering individual needs. Recommendations from friends, family, or employee assistance programs are most useful.
Effects of Bankruptcy

People have varying experiences in obtaining credit after they file for bankruptcy. Some find the process more difficult, whereas others find it easier because they have removed the burden of prior debts or because creditors know that they cannot file another bankruptcy case for a certain period of time. Obtaining credit may be easier for people who file a Chapter 13 bankruptcy and repay some of their debts than for those who file a Chapter 7 bankruptcy and make no effort to repay any of their debts. Bankruptcy reports are kept on file in credit bureaus for ten years, a fact that is likely to make getting credit more difficult during that time. Therefore, you should take the extreme step of declaring bankruptcy only when you have no other options. Of course, the best way to solve your financial problems is to avoid them by maintaining good credit.

Section 6.4 Assessment

Quick Check
1. What are some of the warning signs of debt problems?
2. What consumer credit counseling services are available?
3. What are the differences between declaring Chapter 7 and Chapter 13 bankruptcy?

Think Critically
4. Consider your own financial situation and determine whether any of the warning signs of debt problems might apply to you or to someone you know. Analyze what you might do to correct them or how you might advise someone else.

Use Math Skills
5. Declaring Bankruptcy Unfortunately, bankruptcy has increased.

Calculate Using the graph in Figure 6.10 on page 189, determine the percent increase of total personal bankruptcies from 1990 to 2003. Do you think this figure will rise? Why?

Solve Money Problems
6. Making Financial Decisions Deanne is a customer service representative for a popular fitness club. Her income is modest, but that does not stop her from satisfying her most important desire—to travel. Deanne takes two vacations a year, and she has been all over the world. She has paid for most of her trips to faraway places with her credit card. However, when she received the bills for her last trip to India, reality hit hard. Her monthly debt payments are actually greater than her monthly net income.

Write About It According to what you have learned in this section, what can Deanne do to solve her problem? Consider the options she might have, and write a plan.
• Consumer credit is the use of credit for personal needs. Credit is an arrangement to receive cash, goods, or services now and to pay for them later.
• Closed-end credit is credit as a one-time loan that you pay back over a specified period of time in payments of equal amounts. Open-end credit is credit as a loan with a limit on the amount of money that you borrow for goods and services.
• The five C’s of credit include character, capacity, capital, collateral, and credit history. Creditors use the five C’s to determine who will receive credit.
• When choosing a loan or credit card, consider factors such as length of the loan, amount of monthly payments, and interest rate.

To build and protect good credit, pay your bills and loans promptly and manage your personal finances carefully. Also, correct mistakes related to your credit bills and credit reports. Dispute billing errors in writing and pay amounts that are not in question.
• If your credit or identity has been stolen, contact all your credit card companies; close and open new bank accounts; and change all PINs. Notify law enforcement agencies and credit bureaus. If purchasing online, never share your PINs, Social Security numbers, or passwords.
• Manage debt problems by contacting creditors and/or debt counseling services. Bankruptcy is a last resort.

Communicating Key Terms
Imagine you are applying for a loan to buy a new car. In a paragraph, write a conversation you would have with a loan officer while applying for the loan, using at least ten key terms:

- credit
- consumer credit
- creditor
- closed-end credit
- open-end credit
- line of credit
- grace period
- finance charge
- net income
- annual percentage rate (APR)
- collateral
- simple interest
- minimum monthly payment
- credit rating
- cosigning
- bankruptcy

Reviewing Key Concepts
1. Explain the concept of consumer credit.
2. Differentiate between open-end credit and closed-end credit.
3. Identify the five C’s of credit using a graphic organizer. Then rate yourself.
4. Discuss the factors to consider when choosing a loan or credit card.
5. Identify ways you can build a good credit rating.
6. Discuss the steps you should take if your identity is stolen.
7. Explain the role of consumer counseling services.
**ACADEMIC SKILLS**

**Language Arts**  You have just received a telephone bill for $225. Usually your bill is about $35 a month. You read it closely and discover two long-distance calls to Japan at $100 and $92, both of which you did not make.

**Write About It**  Write a brief letter to the phone company explaining why you should not be charged.

**YOUR FINANCIAL FIGURES**

**Billing Errors**  Miguel read his credit card statement and discovered that a store charged him twice for the same item. His total bill was $658.22:

- Lane Electronics  207.33
- Brewster Cable TV  127.45
- Lane Electronics  207.33
- Empress Wok    38.87
- Office Supplies, Inc.   77.24

1. **Calculate** how much Miguel should subtract from his bill and calculate his actual balance.
2. **Compute** by using spreadsheet software to show what Miguel’s bill will be next month if he pays $25 this month with 18 percent interest.

**Connect With Ethics**  Your credit score determines whether you receive credit and at what interest rate. The credit-score scale runs from 300 to 850. Most people in the United States have scores between 600 and 800.

1. **Research**  Use an Internet search engine to find information on credit scores.
2. **Think Critically**  Explain why credit scoring may increase fairness in getting credit. Explain why it may be unfair.

**Internet CONNECTION**

**Student Loans**  Many students finance their college educations with their own earnings, savings, family help, grants, scholarships—and loans.

**Log On**  Use an Internet search engine to find out about student loans. Check the colleges that interest you. Click on their Financial Aid links. Answer the following questions:

1. What is the interest rate for a government student loan and how long can you take to repay a student loan?
2. How could this monthly payment affect your debt payments-to-income ratio?

**BusinessWeek ONLINE**

**Newsclip: Student Credit Cards**  Many credit companies offer credit cards to students 18 years and over. As a result, many students have heavy debts. Debt advisers say students should have a low maximum limit.

**Log On**  Go to finance07.glencoe.com and open Chapter 6. Learn more about managing credit, and then write a list of ways to avoid credit card debt.
YOUR CREDIT PROFILE

Do you know how to use credit wisely? On a separate sheet of paper write the letter that best describes your answer to the following questions.

1. I pay any bills I have when they are due _____.
   a. always
   b. most of the time
   c. sometimes

2. If I need more money for my expenses, I borrow it _____.
   a. never
   b. sometimes
   c. often

3. If I want to see a copy of my credit report, I can contact _____.
   a. a credit reporting agency
   b. a bank
   c. the principal of my school

4. If I default (do not repay) on a loan, it will stay on my credit report for _____.
   a. 7 years
   b. 2 years
   c. 6 months

5. If I have serious credit problems, I should _____.
   a. contact my creditors to explain the problem
   b. contact only the most persistent creditors
   c. not contact my creditors and hope they will forget about me

6. I can begin building a good rating by _____.
   a. opening a savings account and making regular monthly deposits.
   b. paying most of my bills on time
   c. opening a checking account and bouncing checks

**Scoring:** Give yourself 3 points for each “a,” 2 points for each “b,” and 1 point for each “c.” Add up the number of points.

If you scored 6–9 points, you might want to take a closer look at how credit works before you get over your head in debt.

If you scored 10–13 points, you are off to a good start, but be sure you know the pitfalls of opening a credit account.

**Source:** How to Be Credit Smart (Washington, D.C., Consumer Education Foundation, 1994).
Credit Cards: Getting the Best Deal

Melanie’s parents want to give her a credit card she could use for emergencies. They made it clear that if she could eat it, wear it, or listen to it, it was not an emergency. They asked Melanie to do the homework to find the best deal. She called the bank where she has a savings account and another neighborhood bank and asked about the following credit card information.

Melanie chose the credit card with Imperial Bank because there was no annual fee, and the APR was lower. She did not think she would spend enough to make Peabody Bank’s offer of airline miles useful. Melanie was surprised at the high penalty for late payments, so she made a mental note to be sure to make her payment on time.

If you wanted a credit card, which company would you choose? Explain why. Would you be influenced by the offer of airline miles?

Research

On a separate sheet of paper, research two credit card companies. List their fees and any advantages they offer.

Melanie’s Credit Card Comparison

<table>
<thead>
<tr>
<th>Credit Card Company</th>
<th>Peabody Bank</th>
<th>Imperial Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Phone number</td>
<td>800/555-1274</td>
<td>800/555-9201</td>
</tr>
<tr>
<td>Annual percentage rate (APR)</td>
<td>19.9%</td>
<td>10.9%</td>
</tr>
<tr>
<td>Introductory rate</td>
<td>2.9% on transferred balances</td>
<td>5% for first 6 months</td>
</tr>
<tr>
<td>Annual fee</td>
<td>$50</td>
<td>none</td>
</tr>
<tr>
<td>Grace period</td>
<td>18 days</td>
<td>25 days</td>
</tr>
<tr>
<td>Cash advance fee</td>
<td>19.8%</td>
<td>19.9%</td>
</tr>
<tr>
<td>Late payment fee</td>
<td>$25</td>
<td>$29</td>
</tr>
<tr>
<td>Credit limit for new customers</td>
<td>based on income</td>
<td>based on income</td>
</tr>
<tr>
<td>Travel accident insurance</td>
<td>$150,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>Other travel-related services</td>
<td>airline miles; lost luggage insurance; emergency travel services</td>
<td>lost luggage insurance; emergency travel services</td>
</tr>
<tr>
<td>Protection if the cards are lost or stolen</td>
<td>yes</td>
<td>yes</td>
</tr>
</tbody>
</table>