Name Period

Credit and Consumerism Reading

Preview Questions

- What is a consumer credit?
- What is a credit score?
- What should I do when shopping for a car?
- Why should I compare credit cards?
- Why do I need insurance?

Concepts

consumer credit, disclosures, interest, credit score, interest rate, insurance

What is Consumer Credit?

Consumer credit is a credit sale or loan which meets all of the following conditions:

- the credit is extended by a person who does so regularly;
- the borrower is an individual or individuals;
- the credit is primarily for a personal, family, or household purpose, and not primarily for a business, investment, or agricultural purpose;
- either a finance charge is made or the debt is payable in five or more installments besides the down payment; and
- the amount borrowed does not exceed fifty thousand dollars ($50,000) or the credit is secured by real estate.

Consumer credit is a credit sale if the seller of goods or services arranges or extends the credit, such as when an automobile dealer sells you a car and obtains financing for you. Consumer credit is a loan if a lender, such as a bank or finance company, extends the credit directly to you. Consumer credit may be either closed-end or open-end. With closed-end credit, you borrow a fixed amount for a set term and pay that amount back in installments with interest. The most common example of open-end credit, sometimes referred to as revolving credit, is a credit card.

What are disclosures?

The privilege of borrowing money to be repaid at a later date will cost you something. This cost is called a finance charge, commonly known as **interest**. It is possible that on some loans you could end up paying more in finance charges than you borrowed in the first place.

The Federal Truth-in-Lending Act require that the finance charge be disclosed to you in terms of a dollar amount and as an annual percentage rate (APR). The APR is the cost of credit expressed as a yearly rate of interest.

Creditors are required to disclose the cost of credit so that you can compare costs from several different creditors. Different creditors will charge different amounts and rates even for the same types of credit. It is up to YOU, as a consumer concerned about the costs associated with credit, to shop around for the best deal.

The creditor usually will not give you this disclosure until you are just about ready to sign the loan papers. You should begin your comparison shopping much sooner than that.

What is a credit score?

For years, creditors have been using credit scores to determine if you'd be a good risk for credit cards and auto loans. More recently, credit scores have been used to help creditors evaluate your ability to repay home mortgage loans. Scoring is a system creditors use to help determine whether you will be able to pay your future bills on time. Here's how scoring works.

Information about you and your financial experiences, such as your bill-paying history, the number and type of accounts you have, late payments, collection actions, outstanding debt, and the age of your accounts, is collected from your application and your credit report.

Using a statistical program, creditors compare this information to the past performance of consumers with similar profiles. A scoring system awards points for each factor that helps predict who is most likely to repay a debt. A total number of points -- a credit score -- helps predict how creditworthy you are, that is, how likely it is that you will repay a loan and make the payments when due.

Because your credit report is an important part of many credit scoring systems, it is very important to make sure it's accurate before you submit an application. To get copies of your report, contact the three major reporting agencies, Equifax, Experian (formerly TRW), and Trans Union.

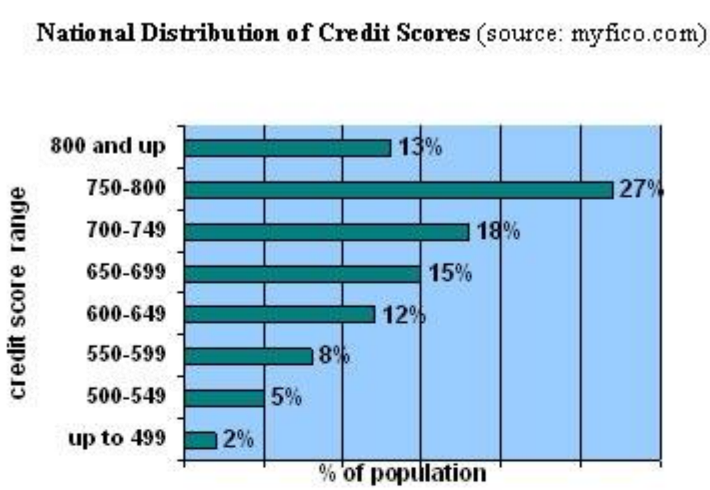
A credit score is based on real data and statistics, so it usually is more reliable than subjective or judgmental methods. It treats all applicants objectively. Judgmental methods typically rely on criteria that are not systematically tested and can vary when applied by different individuals.

To develop a credit score model, a creditor selects a random sample of its customers, or a sample of similar customers if their sample is not large enough, and analyzes it statistically to identify characteristics that relate to creditworthiness.

Then, each of these factors is assigned a weight based on how strong a predictor it is of who would be a good risk. Each creditor may use its own scoring model, different scoring models for different types of loans, or a generic model developed by a scoring company.

Under the law, a credit score may not take into account certain characteristics such as race, sex, marital status, national origin, or religion as factors. However, creditors are allowed to use age in properly designed scoring systems. But any scoring system that includes age must give equal treatment to elderly applicants.

A number between 300 and 850 that measures an individual's creditworthiness based on credit history. Scores are calculated using mathematical methods that incorporate credit history, amount of credit used and available, number of late and on-time payments, whether any payments due are in default, and other variables. Also called a credit rating, which can be broadly categorized simply as poor, fair, good or excellent.



Your credit score is like your grade: you earn it. But, unlike your grade, it doesn't start over at the end of the grading period. It's with you for life.

How can I improve my credit score?

Your credit score is a very important number that lenders use in order to determine whether or not to extend credit to you, and what the interest rate and terms of the credit or loan are. The lower your score, the less likely you will be approved for loans. If you are approved, you may have to pay a high interest rate. Your credit score is broken down into five categories:

- Payment History – 35%
- Total Amounts Owed – 30%
- Length of Credit History – 15%
- New Credit – 10%
- Type of Credit in Use – 10%

The things you can do to improve your credit score are:

1. <u>Make Your Payments On Time</u>: The single most important thing you can do to keep your score high, or improve upon your score is to make your payments on time. Payment history is the largest factor that is used to determine your credit score. Payments that are 30 days or more past due will show up on your credit report and negatively impact your score. These negative marks generally stay on your report for seven years.

2. <u>Keep Your Total Debt Under Control</u>: With the second largest factor of your credit score being the total amount you owe, it is important to keep borrowing under control. If you currently have a significant amount of outstanding debt, your priority should be to stop borrowing and work toward lowering the balance. This isn't always easy, but the only way to improve your debt situation is to stop borrowing or using credit cards and continue to make timely payments that reduce your balance.

In addition, you want to consider how much of your available credit is utilized. For example, having many credit cards that are maxed out, or very close to their limits will negatively impact your score. Two credit cards with a $5,000 limit and a $1,000 balance on each will look much better than a single card with a $2,500 limit and a $2,000 balance

3. <u>Keep Old Accounts Open</u>: Length of credit history is another important credit score factor, so it can be to your advantage to keep older accounts in good standing open. While you want to keep the total number of accounts manageable, sometimes it can hurt your score more to close an old account than to keep it open, even if that means you have more open accounts.

4. <u>Be Careful When Opening New Accounts</u>: While new credit is the least important factor in your score, it is still an important issue to consider. When you are shopping for a new loan or credit card, do your shopping in a relatively short amount of time. You don't want to have your report show that you are constantly looking for credit.

You also don't want to open credit accounts you don't intend to use. It may be tempting to get that additional 10% off when you open that new retail store card, but the little bit of money you save may be insignificant when multiple new accounts such as these actually lower your credit score.

Could My Credit Score Affect My Employment?

When you apply for a job with an employer that considers your credit report as a part of the application process, you will be asked to sign a form giving the company permission to request your report. According to the Federal Trade Commission, companies cannot get your report without this permission. They may request it from one of the three major credit bureaus (Equifax, Experian and TransUnion), or they may get a combination report.

According to the Privacy Rights Clearinghouse, prospective employers use credit reports to judge a person's responsibility level. They consider a poor bill payment record to be an indicator that a person might not be reliable on the job. The company may give you a chance to explain problems on your credit report, but if it refuses to hire you because of information in your credit report, the Federal Trade Commission says that it must let you see the report and tell you how you can get your own copy from the credit bureau. You're entitled to a free copy, as long as you request it within 60 days of the company's rejection.

Although negative items on your credit report may keep you from getting a job, the company's inquiry will not show up on your credit report. Because a large number of requests to view your report may be seen as negative information, this will protect you from being turned down by creditors due to an excessive number of inquiries by potential employers.

What is insurance?

Insurance is a means of providing protection against financial loss in a great variety of situations. It is a contract in which an insurance company agrees to pay for a financial loss resulting from a specified event. Insurance works on the principal of sharing losses. If you wish to be insured, against any type of loss, agree to make regular payments, called premiums, to an insurance company. In return, the company gives you a contract, the insurance policy. The company promises to pay a certain sum of money for the type of loss stated in the policy.

Why do I need insurance?

To pay for things that are so huge they would wipe you out financially.

What are my tasks?

This unit is made up of four sections:

1. Analyze Your Credit: Allows you to find your approximate credit score without giving personal indetification information.
2. Buying A Car: Comparing interest rates and payments over different periods of time and with or without a downpayment.
3. Credit Cards: Allows you to compare two credit cards side-by-side while reading the fine print.
4. Insurance: Students have to research different types of insurance and insurance termonology.