

## Section 3 | MANAGING CREDIT

## OBJECTIVES

- Participants will identify the advantages and disadvantages of using credit.
- Participants will recognize what credit is, what it costs, and the basic steps involved in obtaining credit.
- Participants will identify the key features of a credit report and credit scoring.
- Participants will examine ways to improve their credit scores.
- Participants will make distinctions between debit cards and credit cards.
- Participants will analyze cases of people seeking credit and decide whether obtaining credit is a good idea in each case.

## MATERIALS

- Section 3 of the *Your Credit Counts Challenge* participant's guide.
- Transparencies or PowerPoint slides of Visuals 3.1 through 3.28.
- Duplicated copies of Handout 3.1: Be a Credit Advisor.

## PROCEDURE

### Overview

**Display Visual 3.1:** Managing Credit Overview. Explain that the purpose of this session is to explore the advantages and disadvantages of using credit. The exploration includes a look at credit reports, credit scores, and their role in establishing good credit. It also includes suggestions about the use of credit cards and debit cards and ways to recover from bad credit.

### Presentation

1. **Display Visual 3.2:** What Is Credit? Explain that credit is the ability to borrow money from a lender. Stress the idea that loans from banks are based on deposits. The bank has an obligation to protect its depositors by trying to make loans that are likely to be repaid.
2. **Display Visual 3.3:** How to Get Credit. Describe briefly the process of completing a loan application. Note that the creditor will most likely contact a credit bureau as part of the application process.

3. Explain that people often hear about interest rates in the news. **Display Visual 3.4:** What Does Credit Cost? Define *interest*. Explain that interest rates on some loans, like credit card loans, are likely to be higher than those on other loans, like home mortgages. **Display Visual 3.5:** How Is Interest Calculated? Briefly define *Annual Percentage Rate (APR)*. Explain that lenders report interest in terms of the APR. This allows consumers to compare interest rates easily.

4. Explain that banks and other financial institutions are not charities. They are businesses that seek to earn a profit. As a result, they do not offer credit to people casually. **Display Visual 3.6:** Who Gets Credit? Discuss how ability to pay and willingness to pay are key factors in decisions about issuing credit.

5. Explain that financial institutions often rely on credit reports and credit scores to help them decide who gets credit. A credit report is a record of an individual's personal credit history. It tells how much a person has borrowed, from whom, and whether the bills have been paid on time. **Display Visual 3.7:** What Is on a Credit Report? Explain information included on a credit report. **Display Visual 3.8:** What Is Not Included? Show what is not included on a credit report. **Display Visual 3.9:** Who Issues Credit Reports? Show the companies that provide these reports.

6. **Display Visual 3.10:** A Sample of a Credit Report. Note key parts of the report including the identifying information, account records, inquiries, and public record information. **Display Visual 3.11:** Definitions of Key Terms. Define the terms *tax lien*, *judgment*, *collection account*, and *bankruptcy* as common terms used on credit reports. **Display Visual 3.12:** Codes. It also defines information that is often abbreviated on credit reports.

7. Participants often wonder how long negative credit information remains on credit reports. **Display Visual 3.13:** How Long Does Negative Information Remain on a Credit Report? Explain how long judgments, tax liens, and bankruptcies remain on reports. **Display Visual 3.14:** Bankruptcy. Briefly discuss the difference between Chapter 13 and Chapter 7 bankruptcies. Stress that filing bankruptcy is a serious matter. It takes years to recover from a bankruptcy filing. Bankruptcy should be regarded as a last resort.

8. Remind the participants that lenders often use credit scores to help them make lending decisions. **Display Visual 3.15:** What Is a Credit Score? Explain what a credit score is. **Display Visual 3.16:** What Is in a Credit Score? Explain how credit scores work. **Display Visual 3.17:** Ways to Improve Your Credit Score. Suggest ways to improve credit scores such as paying bills on time and paying off credit cards.

9. Explain that people sometimes refer to credit cards and debit cards as “money.” **Display Visual 3.18:** How Are Credit Cards Different from Debit Cards? Point out that only debit card transactions are actual payments, by means of withdrawals directly from a cardholder’s checking account. In this respect, debit cards really are money. For many cardholders, the biggest problem with debit cards is keeping track of the transactions. The use of credit cards, in contrast, involves a promise to pay. In credit card transactions, the cardholder takes out a loan each time she or he uses the card.

10. **Display Visual 3.19:** How Do Credit Cards Work? Explain how to use credit cards. **Display Visual 3.20:** Credit Card Tips. Explain the tips for good credit card use. While all the tips are important, having only one card and paying off the balance each month are probably the most important.

11. Explain that some people who attend workshops like this one walk away with the impression that all credit is bad. This is not necessarily the case. Credit can be from heaven or credit can be from hell. **Display Visual 3.21:** Credit Can Be from Heaven or Hell. Explain that many people use credit to help them obtain assets — things that tend to increase in value over time.

12. Elaborate on the point that credit can be from heaven or from hell. **Display Visual 3.22:** When Should You Use Credit? Remind the participants when to use credit. **Distribute Handout 3.1** Be a Credit Advisor. Divide the participants into groups and assign one of the four clients to each group. Remind the participants that the advantages to using credit include:

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

The disadvantages to using credit include:

- People may use too much credit in relationship to their income.

- Misusing credit can hurt the ability of people to obtain credit in the future.

13. After a few minutes, discuss the responses of the group.

14. **Display Visual 3.23:** Client 1. It describes a college student who wants to major in chemical engineering. Ask:

- What is the main advantage of getting credit?  
*(The credit was used to purchase a good asset — a future income as a chemical engineer beginning in four years.)*
- What is main disadvantage of getting credit?  
*(The college loan is for a large amount of money.)*
- Do you recommend that this client apply for the loan?  
*(Yes. The college education sought by Client 1 will enable him or her to earn more over several years of working than the amount of credit being sought.)*

15. **Display Visual 3.24:** Client 2. It describes a vocational-technical student. Ask:

- What is the main advantage of getting credit?  
*(The television set will add enjoyment to life today.)*
- What is the main disadvantage of getting credit?  
*(A television set is not a valuable asset. Also, in a short period of time, Client 2 will be earning a living and moving to an apartment; this will involve many unexpected expenses.)*
- Do you recommend that this client apply for the loan?  
*(No. The television set sought by Client 2 is not a very valuable asset. Client 2 could buy a less expensive television set now or wait and purchase a television set after the move to the apartment.)*

16. **Display Visual 3.25:** Client 3. It describes a dental hygienist. Ask:

- What is the main advantage of getting credit?  
*(Obtaining a car loan will help Client 3 arrive safely and promptly at work each day.)*
- What is main disadvantage of getting credit?  
*(Car loans can be burdensome, and new cars lose their value quickly.)*
- Do you recommend that this client apply for the loan?  
*(We think that Client 3 would be wise to obtain the car loan and buy the car. It is a good investment in the Client’s future earning capacity, and a new car will be a*

*lot safer than the car the client has now. But buying a good used car might be even a better idea.)*

17. **Display Visual 3.26:** Client 4. It describes an upwardly-mobile couple. Ask:

- What is the main advantage of getting credit?  
*(The couple will enjoy driving a great car and feeling prosperous.)*
- What is main disadvantage of getting credit?  
*(The car payments are going to involve giving up other things the client might want to purchase now or later. Cars are assets that lose their value quickly.)*
- Do you recommend that this client apply for the loan?  
*(No. The car is not a good asset, and it involves a large sacrifice for this couple. Here is our suggestion. Drive the old car a while longer. Save the money that would have gone into the new car payment and put it toward a down payment on a new house. Homes are much better assets than cars. Client 4 will eventually benefit more from owning a house than from buying a new luxury car. We know that we are no fun at all, but we give good financial advice.)*

18. Explain that while getting into trouble with credit is relatively easy, recovering from it is difficult. The key thing is to begin to take action right now. Ignoring credit problems — by juggling and missing payments — will only make matters worse. **Display Visual 3.27:** Getting Out of Debt. Review ways to recover from credit mistakes. The first rule — to stop digging — means that individuals need to begin to control their spending. The main point here is that there is no quick way to solve the problem, but delay will only make it worse.

## REVIEW

**Display Visual 3.28:** Review.

### Ask:

1. What is credit?  
*(The ability to borrow from a lender.)*
2. What does credit cost?  
*(The interest paid is the “cost” of credit. It is commonly expressed as the Annual Percentage Rate [APR]).*
3. What is on a credit report?  
*(Identifying information, credit history, inquiries, and public record information.)*
4. How can you improve your credit score?  
*(Pay bills on time. Keep balances low on credit cards. Apply for new accounts only when necessary. Check credit reports for accuracy.)*
5. When should you use credit?  
*(Often it is wise to use credit to purchase a valuable asset and when you are sure that you are able to repay the loan?)*
6. How can you recover from bad credit?  
*(Reduce spending. Be patient. Pay off bills with high interest rates first. Talk to creditors. Seek professional help.)*



### HANDOUT 3.1 BE A CREDIT ADVISOR

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

#### Advantages of using credit:

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

#### Disadvantages of using credit:

- People may use too much credit in relationship to their income.
- Misusing credit can make it hard for people to obtain credit in the future.

#### After reading each client's case, ask yourself:

1. Is the loan being used to purchase a valuable asset?
2. Do you think the client is likely to be able to repay the loan?

### CLIENT 1

I am 17 years old and a high school senior. I have earned good grades in high school. I have been admitted to a good state university. I would like to go to college full-time and work only a few hours a week. With this schedule, I think that I can complete my college degree in four years. I am planning to major in chemical engineering. My college advisor has told me that chemical engineering is a hard major. My parents have no money to support me in college. I am planning to use college loans to pay for my college tuition and books. I plan to live at home and work in the summer to earn spending money for use during the school year. I will be borrowing about \$50,000 over four years. Should I apply for the loan?

1. What is the main advantage of getting credit? \_\_\_\_\_

\_\_\_\_\_

2. What is main disadvantage of getting credit? \_\_\_\_\_

\_\_\_\_\_

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

\_\_\_\_\_

**CLIENT 2**

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

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

**CLIENT 3**

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

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



**CLIENT 4**

We are a newly married couple. Both of us are 28 years old. We have a fashionable apartment with great furniture. The deck from our apartment overlooks a sumptuous swimming pool and the tennis courts. We have good jobs and good incomes. We are regarded as upwardly-mobile professionals. In our professions, you are what you drive. Currently, we drive a stodgy late-model car that has 75,000 miles on it. We want to look the part of prosperous young professionals. We are thinking about buying a very nice luxury car with all the coolest features. We work hard. We deserve it. To buy this car we will need to borrow about \$35,000. That may sound like a lot, but you haven't seen this car! Besides, the car dealer says we can afford the monthly payments.

1. What is the main advantage of getting credit? \_\_\_\_\_

\_\_\_\_\_

2. What is main disadvantage of getting credit? \_\_\_\_\_

\_\_\_\_\_

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

\_\_\_\_\_



### **Visual 3.1: Managing Credit Overview**

- What is credit?
- How do you get credit?
- What does credit cost?
- What are credit reports? Credit scores?
- What are credit cards? Debit cards?
- When should you use credit?
- Recovering from bad credit.





### **Visual 3.2: What Is Credit?**

- Credit is the ability to borrow money from a lender.
- If you borrow from a bank, your loan is based on the deposits of the bank's savers.
- Credit is the ability to purchase goods and services today and pay for them later.



### **Visual 3.3: How to Get Credit**

- Complete a loan application
  - Address
  - Length of time at address
  - Employment record
  - Other loans
  - Savings account
  - Checking account
- Creditors frequently contact a credit bureau to check your credit history.



### **Visual 3.4: What Does Credit Cost?**

- When banks and other agencies make loans, they expect to be compensated.
- This compensation is called interest.
- Interest is the price borrowers pay to lenders for use of the lender's money.
- Loans that are more likely to be repaid (for a home, for example) have lower interest rates than loans that are less likely to be repaid (dinner out charged on a credit card).



### **Visual 3.5: How Is Interest Calculated?**

- The Annual Percentage Rate (APR) is the interest rate for credit.
- The APR is the cost of credit figured on an annual basis.



### **Visual 3.6: Who Gets Credit?**

Borrowers have to demonstrate to lenders that they will repay the loan.

- Ability to pay is based on comparing income each month with other expenses.
- Willingness to pay is based on checking to see if the borrower pays other bills on time.



### Visual 3.7: What Is on a Credit Report?

- Identifying information:
  - Social Security number, address, date of birth, and so forth.
- Credit history:
  - Account records with creditors.
- Inquiries:
  - Who has requested your credit report?
- Public record information:
  - Collections accounts, bankruptcies, late child support, and so forth.



**Visual 3.8: What Is not Included?**

- Checking and savings account balances
- Income
- Medical history
- Purchases made with cash or check
- Race, gender, religion, or national origin
- Driving record



### **Visual 3.9: Who Issues Credit Reports?**

- Equifax (800) 685-111
- Experian (888) 397-3742
- TransUnion (800) 888-4213



## Visual 3.10: A Sample of a Credit Report

### EQUIFAX CREDIT REPORT

#### Personal Data

John Q. Public  
2351 N. 85th Ave.  
Phoenix, AZ 85037

Social Security Number: 022-22-222  
Date of Birth: 1/11/1960

#### *Previous Address(es):*

133 Third Avenue  
Phoenix, AZ 85037

#### Employment History

Cedant Hospitality FR

Location:  
Phoenix, AZ

Employment Date:  
2/1/1989

Verified Date:  
1/3/2001

#### *Previous Employment(s):*

SOFTWARE Support Hospitality Branch

Location:  
Atlanta, GA

Employment Date:  
01/3/2001

Verified Date:  
01/3/2001

#### Public Records

No bankruptcies on file  
No liens on file  
No judgements on file  
No garnishments on file  
No secured loans on file  
No marital statuses on file  
No financial counseling on file  
No financial counseling on file  
No foreclosures on file  
No non-responsibility entries on file

#### Collection Accounts

No collections on file



## Visual 3.10: A Sample of a Credit Report, Continued

### Credit Information

Company Name	Acct No. & Whose Account	Date Opened	Last Activity	Type of Acct. & Status	High Credit	Items as of Reported	Date	Past Due	Date Reported
						Terms	Balance		
Americredit Financial Services	40404XXX JOINT Acct.	03/1999	03/2000	Installment REPOSSESSION	\$16933	\$430	\$9077	\$128	2/2000

### Prior Paying History

30 days past due 07 times; 60 days past due 05 times; 90+ days past due 03 times  
INVOLUNTARY REPOSSESSION AUTO

Capital One	412174147128XXXX INDIVIDUAL Acct.	10/1997	01/2001	Revolving PAYS AS AGREED	\$777	15	\$514		01/2001
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### Prior Paying History

30 days past due 02 times; 60 days past due 01 times; 90+ days past due 00 times  
CREDIT CARD

Desert FCU Schools	423325003406XXXX INDIVIDUAL Acct.	07/1997	06/1998	Revolving PAYS AS AGREED	\$500	\$0			07/1999
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### Prior Paying History

30 days past due 02 times; 60 days past due 00 times; 90+ days past due 00 times  
ACCOUNT PAID  
CLOSED ACCOUNT

Helig-Meyers Company	7360300XXXX INDIVIDUAL Acct.	03/1998	07/1999	Revolving PAYS AS AGREED	\$1000	\$0			07/1999
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### Prior Paying History

30 days past due 02 times; 60 days past due 01 times; 90+ days past due 00 times  
CREDIT CARD  
AMOUNT IN H/C COLUMN IS CREDIT LIMIT

SEARS	806050211XXXX	08/1998	07/1999	Revolving PAYS AS AGREED	\$720	\$0			07/1999
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### Prior Paying History

CHARGED  
AMOUNT IN H/C COLUMN IS CREDIT LIMIT

WELLS FARGO	503830276150XXXX	11/1996	12/2000	Installment PAYS AS AGREED	\$17146	\$401	\$4058		12/2000
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### Prior Paying History

AUTO



## Visual 3.10: A Sample of a Credit Report, Continued

### Credit Inquiries

Companies that Requested your Credit File

04/29/2001	EFX Credit Profile Online
06/30/2001	Automotive
06/16/2000	AR-Associates National Bank
01/18/2000	Desert Schools Federal C.U.
01/15/2000	Desert Schools Federal C.U.
07/02/1999	Time Life, Inc.

### THE FOLLOWING INQUIRIES ARE NOT REPORTED TO BUSINESSES:

PRM – This is a promotional inquiry in which only your name and address were given to a credit grantor so you could be solicited with an offer such as a credit card. (PRM inquiries remain on file for 12 months.)

AM or AR – These inquiries indicate a periodic review of your credit history by one of your creditors (AM and AR inquiries remain on file for 12 months.)

EQUIFAX, ACIS or UPDATE – These inquiries indicate Equifax's activity in response to your contact with us for either a copy of your credit file or a request for research.

PRM, AM, AR, INQ, EQUIFAX, ACIS and UPDATE inquiries do not show on credit files that businesses receive, only on copies provided to you.

Your confirmation number is 10999333931. Please keep this number in your records for future communication with us.

Equifax Consumer Services, Inc.



### Visual 3.11: Definitions of Key Terms

- **Tax Lien:** A claim against property filed by the government for unpaid taxes.
- **Judgment:** A court order placing a lien on a debtor's property as security for a debt owed a creditor.
- **Collection Account:** A past-due account that has been referred to a collection agency.
- **Bankruptcy:** A legal proceeding that can legally release a person from repaying debt.



**Visual 3.12: Codes**

**J** = Joint account

**I** = Individual account

**O** = Open account

**R** = Revolving account

**I** = Installment account



### Visual 3.13: How Long Does Negative Information Remain on a Credit Report?

<b><i>Negative Information</i></b>	<b><i>Maximum Time on Credit Report</i></b>
Civil Judgments	7 years from date filed
Tax Liens	7 years from date paid
Chapter 13 Bankruptcy	7 years after discharged
Chapter 7 Bankruptcy	10 years after discharged



### Visual 3.14: Bankruptcy

- **Chapter 13:** Debtor keeps property and makes regular payments on debts after filing.
  - To qualify for Chapter 13, an individual must have regular income.
- **Chapter 7:** The debtor gives up all nonexempt property and keeps exempt property.
  - Nonexempt and exempt property are determined by state law.
- Be skeptical of folks pushing bankruptcy as an easy solution to your financial problem.

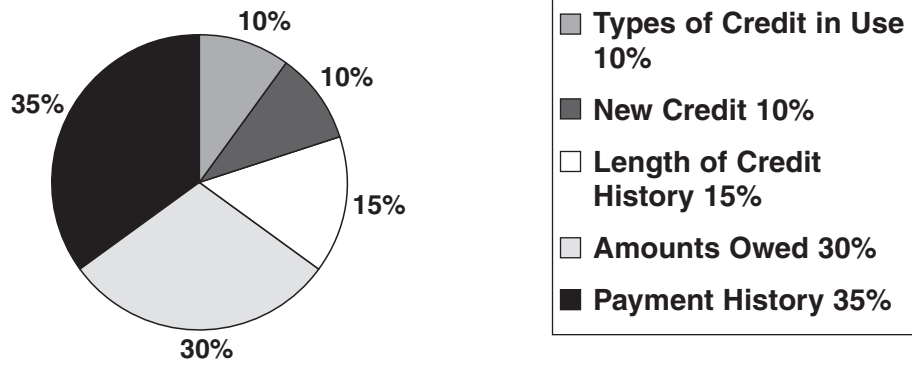


### **Visual 3.15: What Is a Credit Score?**

- A credit score is a number lenders use to help them decide whether to make a loan to an individual.
- Scores range from 300 to 850.
- High scores are good.
- You can purchase your credit score (FICO score) at [www.myfico.com](http://www.myfico.com).



**Visual 3.16: What Is in a Credit Score?**





### **Visual 3.17: Ways to Improve Your Credit Score**

- Pay bills on time.
- Keep balances low on credit cards.
- Apply for new accounts only when necessary.
- Check credit reports for accuracy.





### **Visual 3.18: How Are Credit Cards Different From Debit Cards?**

- **Debit Cards**
  - Same as money
  - It is a direct payment
  - No “float” or grace period
  
- **Credit card**
  - Loan
  - Promise to pay



### **Visual 3.19: How Do Credit Cards Work?**

- Issued by a bank, finance company, department store, or oil company.
- Borrowers may charge up to a set amount.
- A statement is mailed each month showing what was charged, total owed, minimum to pay, and the finance charge.
- The finance charge is the total cost of the loan including interest and any fees.
- If the total amount is paid, there are no finance charges.



### **Visual 3.20: Credit Card Tips**

- Have only one card.
- Pay off the monthly balance.
- Shop for a low interest rate.
- Shop for no fee or a low annual fee.
- Use for an emergency.
- Use for record keeping or travel.
- Avoid using for minor purchases.



### **Visual 3.21: Credit Can Be From Heaven or Hell**

- **Consider using credit to acquire assets**
  - Duplex
  - Home
  - College education
  
- **Resist using credit for non-assets**
  - Vacation
  - Everyday purchases

**Visual 3.22: When Should You Use Credit?**

- To purchase an asset
- If you are sure that you can repay the loan in the agreed-upon time



### Visual 3.23: Client 1

- 17 years old
- Good grades in high school
- Admitted to a good state university
- Wants to attend school full-time and complete a degree in four years
- Major in chemical engineering
- Parents can't help
- **Should I borrow \$25,000 for college?**



**Visual 3.24: Client 2**

- 18 years old
- Attending a local vocational school
- Tuition is low and the program will take nine months
- Plans to get an apartment after school is completed
- Avid sports fan
- **Should I use my credit card to buy a 38-inch TV?**



### Visual 3.25: Client 3

- 22 years old
- Completed dental hygienist program
- Has a first job that pays \$25,000 per year
- The job is 20 miles from home
- The car has 225,000 miles on it
- Has saved \$2,000 for a new car
- **Should I borrow \$12,000 for a new car?**



### Visual 3.26: Client 4

- Married couple, both are 28 years old
- Good jobs and incomes
- Live in a fashionable apartment with great furniture
- Own a stodgy old Chevy with 75,000 miles
- We are what we drive!
- Want a car loan to buy a new Lexus
- **Should they borrow \$35,000 for the Lexus?**



### **Visual 3.27: Getting Out of Debt**

- First rule of digging a financial hole: stop digging.
- Be patient.
- Pay off the loan with the highest interest rate first.
- Talk to creditors.
- Get professional advice.
  - Consumer Credit Counseling Service  
(1-800-388-2227)

**Visual 3.28: Review**

- What is credit?
- What does credit cost?
- What is on a credit report?
- How can you improve your credit score?
- When should you use credit?
- How can you recover from bad credit?

