

Sources of Consumer Credit



Identify different options for
getting credit

Describe the benefits and costs of
credit cards



Types of Consumer Borrowing

- Two basic forms of consumer borrowing
 - Loans
 - Get all money at once/make specified payments
 - Credit Card Accounts
 - Purchases added to account balance/pay as you choose
 - Must make minimum payment each month



Secured Loans

- A secured loan is backed by something of value pledged to insure payment
 - Pledged Property is called collateral.
- Most secured loans are installment loans
- An installment loan is repaid in a certain number of payments with a certain interest rate
 - May be called Closed-end Credit



Unsecured Loan

- An unsecured loan is not backed by any collateral
 - Generally charge higher interest rates than secured loan
 - Most credit cards are unsecured
 - Also called open-end credit



Banking Institutions as Sources of Loans

- The most common sources of consumer loans are banks, savings and loan associations, and credit unions.
- Most lend money for various purposes
- Shop around for loans/interest rates
 - Some banks have “loan sales” with lower rates for new customers



Other Sources of Consumer Loans

- Banks etc should be your first source for a loan
- Other options exist
 - Other options more expensive
 - Some other options are MUCH more expensive



Finance Companies

- Finance Companies are usually more willing to lend to people with no or poor credit rating.
 - Loans are riskier
 - Higher interest rate charged



Life Insurance Companies

- You can use a life insurance policy as collateral on a loan
 - If you don't pay back loan before you die, the company deducts what you owe before paying beneficiary
- Interest rates are usually lower than other types of loans



Credit Card Cash Advance

- You can borrow money on your credit card as a *cash advance*
- Interest Rate is very high--17%-24%
 - Easy way to get into financial trouble!



Pawnbrokers

- Your turn property over to pawnbroker
- You must pay back the loan plus fee to get property back
 - If not, pawnbroker can sell property
- Rates are very high.
 - Watch Pawn Stars
 - (History Channel TV Show)



Rent-to-Own Companies

- You make weekly “rent” payments.
- After a certain period of time, you own the item
- Technically no interest
- You don’t own until final payment made
- End up paying a lot to own item
- \$200 vs \$10 week/36 weeks (\$360)



Credit Cards

- When you use a credit card, you are borrowing money
- Must fill out application form to apply for credit card
- Information about your account is stored on magnetic strip on back of card



Charge Accounts

- A regular charge account requires you to pay your balance in full within a specified amount of time
- A revolving charge account allows you to carry a balance from one month to the next
 - Pay interest on balance



Sources of Credit Cards

■ Large Stores

- Kohls, JC Penney, Sears etc
 - Can only use at their store

■ Credit Card Companies

- VISA, MasterCard, Discover, AMEX

■ Other

- Charitable Organizations, Gasoline Companies, Universities, Credit Unions



Credit Card Incentives

- Many companies offer incentives/ rewards for using their card
 - Cash Back
 - Frequent Flier Miles
 - Free Hotel Rooms
 - Gift Certificates
 - Charitable Donations
 - Etc



Credit Card Incentives

- Incentives are designed to encourage you to sign up and use ***their*** card and run up a balance.
- Credit card earns money from the interest you pay when you carry a balance
- Warning! Don't choose/use a card exclusively for rewards



Credit Card Costs

- Annual Fees- some cards charge an annual fee/many don't
- Interest--rates vary a lot, so shop around
 - Can have introductory costs that increase after trial period. Can be 3%-24%
 - You can avoid paying interest by paying balance in full during grace period/by due date
 - Grace Period is the time between billing and due date
 - If you don't pay by due date, you will be charged interest from date of purchase
 - Evaluate Costs Before Signing up for a credit card



Credit Card Costs

- Limits and Penalties
 - Each account has a credit limit
 - The maximum amount you can charge on your account
- Late Fees
- Over Limit Fee
- Some banks earn as much/more from fees than from interest on credit cards



Control Credit Card Costs

- Interest is the greatest cost of using a credit card
- Interest rates on credit cards are higher than almost any other type of consumer credit
- Pay attention!!!! To how you use your credit cards!!!



Control Credit Card Costs

- 1. A Loan as an Alternative
 - Borrow from a bank to pay credit cards
 - Interest is usually less expensive
- 2. The Minimum Payment Trap
 - Largest part of minimum payment is interest so debt doesn't decrease much
 - Pay extra if you want to pay off loan quickly



Control Credit Card Costs

- 3. Choose the Least Expensive Card
 - Best to pay off balance each month
 - Don't charge more than you can pay off
 - A small decrease in interest rate can drastically reduce debt over time.



Activity

- Check online for a credit card payment calculator and determine how long it would take to pay off a \$1000 debt if you only made the minimum payment each month
 - <http://www.bankrate.com/calculators/managing-debt/minimum-payment-calculator.aspx>