Module #3: Establishing Credit

Objectives:

- Participants will recognize the types of available credit.
- Participants will recognize sources of credit.
- Participants will recognize safeguard issues for credit application.
- Participants will recognize the process of applying for credit.
- Participants will identify factors to consider when shopping for a credit card.
- Participants will compare critical factors when shopping for a credit card.

Context

Establishing credit can be frustrating, especially when you do no have any credit history. However, it is important to know what your options are before you rush to make a decision for which you can later regret. There are different types and sources of credit.

Handouts & Resources Needed:

- Handout 3.1: Types of Credit
- Handout 3.2: Sources of Credit
- Handout 3.3: Credit Safeguards
- Handout 3.3A: Steps to Take to Avoid Abusive Lending
- Handout 3.3B: Questions to Ask When Applying for Credit
- Handout 3.4: Parts of a Credit Application
- Handout 3.5: Factors to Consider When Shopping for a Credit
- Handout 3.5A: Factors to Consider When Shopping for a Credit
- Handout 3.5B: Questions to Ask When Shopping for a Credit Card
- Handout 3.6: Credit Card Shopping Comparison
- Sheet of paper- one for each participant
- Pens/pencils
- Journals – one per students
- Flip chart/blackboard
- Sample credit applications collected from a local financial service institute

Activity #1: Recognizing Types of Credit (55 min)

Procedure:

- Icebreaker
- Use Handout 3.1: Types of Credit as a matching exercise to build an awareness of the different types of credit available to consumers.
- As the definition of each type of credit is identified, draw a connecting line between the term and the description. (**Answers:** 1. Revolving Credit; 2. Secured Credit; 3. Sales Credit; 4. Single Payment Credit; 5. I.O.U.; 6. Installment; 7. Other Types of Credit; 8. Cash Credit). Caution participants that lenders often have unique names for their credit options, so participants will not always see these exact terms. Therefore, it is their responsibility to know the descriptions and ask questions prior to making any commitment.
- Hold up sample applications to illustrate the types of available credit. Do not distribute at this point; the applications are needed later in the activity.
- Debriefing

Activity #2: Recognizing Sources of Credit (55 min)

Procedure:

- Icebreaker
- Ask for a show of hands of participants who have applied for credit. Ask them how stressful they felt it was to apply for credit, on a scale of 1 to 5, with 1 being low and 5 being high. Informally encourage participants to share some of their experiences. In discussions such as this, be careful not to pass judgment on any contribution made by participants.
- Ask those participants who have applied for credit to share where they went to obtain credit. Allow for a few responses to establish a participatory environment and then move to the next step.
- Use Handout 3.2: Sources of Credit to identify places that an individual can go to obtain credit. This handout lists six sources. Encourage participants to add additional sources. Be careful not to pass judgment on sources that are recommended. Responses will vary but should include some of the following: consumer finance companies, insurance policies, check-cashing stores, family and friends.
- Explain that consumer credit can be obtained from a variety of sources including banks, credit unions, finance companies, many retailers, and service providers such as utility companies and physicians. In addition, some investors may be able to tap their investment accounts or retirement accounts. Policy holders who have a cash-value life insurance policy can obtain loans based on the cash value built up in the policy. Pawnshops check cashers, and rapid-refund services are some of the “alternative lenders” that extend credit.
- Before moving on, ask the question at the bottom of the handout, “What sources should a person avoid when seeking credit?”

- Discuss the dangers of loan sharks, cash advances from credit cards, pawnbrokers, and other such operations. These sources provide credit with particularly high interest rates and make it difficult, if not impossible, to build wealth.
- Ask the questions:
    - Are all credit sources reliable?
    - Should all credit sources be trusted?
    - Encourage discussion. Take care to avoid too many “war stories” from participants.
- Debriefing

Activity #3: Recognizing Safeguard Issues for Credit Application (55 min)

Procedure:

- Icebreaker
- Use Handout 3.3: Credit Safeguards When Applying for Credit to review critical legal protection afforded to all consumers when using credit.
- Tell participants that they will soon look at specific credit applications. Beforehand, though, they will become aware of warning signs of unfair lending practices that may or may not be readily visible. They want to be aware of these dishonest practices before they get into trouble with one of them.
- Distribute Handout 3.3A: Steps to Take to Avoid Abusive Lending. Cover the content with participants so that they are aware of what to watch out for and what to do if they are targeted.
- After the discussion, encourage participants to keep the handout handy and check carefully for such practices before agreeing to any type of credit.
- Stress that although all creditors are required to provide the applicant with information about the loan, it is also the applicant’s responsibility to ask questions before making any commitment.
- Ask those who have credit cards to share the questions they asked the lender before accepting a credit card. Responses will vary, but research tells us that the majority of individuals never ask critical questions about the use of a credit card before accepting its use.
- Use Handout 3.3B: Questions to Ask When Applying for Credit to emphasize those types of questions.
- Ask participants if additional questions should be asked. Add those questions to the list.
- Debriefing

Activity #4: Recognizing Credit Application Process Activity (55 min)

Procedure:

- Icebreaker
- Distribute the sample credit applications collected from a local financial service institute. If there are not enough credit applications for each participant to have an individual sample, divide the group into teams as small as possible.
- Distribute Handout 3.4: Parts of a Credit Application to each participant.
- Explain that the group will use the handout to compare and discuss information on typical credit applications.
- Emphasize that the information may be located in different physical spaces on different applications. The placement is the creditor's choice, not mandated by law.
- Move through the handout by identifying each section and allowing participants sufficient time to locate the information on their sample applications.
- Respond to questions they raise and encourage discussion.
- Encourage participants to keep the handout for future reference should they need to complete a credit application.
- Debriefing

Activity #5: Determining Questions to Ask for Credit Card Shopping (55 min)

Procedure:

- Icebreaker
- Use Handout 3.5: Factors to Consider When Shopping for a Credit Card to illustrate some of the many topics that should be discussed before accepting a credit card. Ask for general definitions from participants.
- Distribute Handout 3.5A: Factors to Consider When Shopping for a Credit Card to each participant and review the definition of each term.
- Distribute Handout 3.5B: Questions to Ask When Shopping for a Credit Card to each participant.
- Have participants determine what questions they should ask when shopping for a credit card.
- Encourage participation with this exercise, as it will be extremely helpful to all individuals who accept credit cards.
- Encourage participants to write their questions in the space provided and to use them as a reference if they shop for a credit card.
- Ask participants if additional questions should be asked. Add those questions to the list.
- Debriefing

Activity #6:   Comparing Critical Factors for Credit Card Purchase (55 min)

Procedure:

- Icebreaker
- Distribute Handout 3.6: Credit Card Shopping Comparison to each participant.
- Ask participants to review the items on the worksheet to see if they have any questions regarding the factors to be compared when shopping for credit cards.
- Ask participants to use the worksheet to shop for a credit card after club meeting. Ask participants to share their credit card shopping information when they return for the next club session.
- Debriefing

Activity #7: Evaluation (20 min)
Students should be asked to complete the evaluation for this unit.

Handouts:

- *3.7A Evaluation Form-Student*
- *3.7B Evaluation Form-Facilitator*

Handout 3.1

TYPES OF CREDIT

Can you match the type of credit with its correct description?

TYPES	DESCRIPTION
Cash Credit **Sales Credit** **Secured Credit** **Revolving Credit** **I.O.U.** **Single Payment Credit** **Installment Credit** **Other Types of Credit**	1. A predetermined line of credit that is constantly renewed as it is repaid. __________________________ 2. Requirement to promise something of value to guarantee repayment of credit. __________________________ 3. Buying goods and services now with the promise to pay for them in the future. __________________________ 4. Buying goods and services now with the promise to pay "in full" at a predetermined time. __________________________ 5. A written promise to pay a debt. __________________________ 6. Buying goods and services with the agreement that payment will be made at fixed intervals over a period of time, with each payment carrying interest charges. __________________________ 7. Utility bills, rent, and similar payments that help establish credit. __________________________ 8. Receiving money as a loan. __________________________

Handout 3.2

SOURCES OF CREDIT

- Banks
- Credit Unions
- Retail Stores
- Finance Companies
- Savings & Loan Associations
- Internet
- Stores

What are other sources of credit?

What sources of credit should be avoided? Why?

Handout 3.3

CREDIT SAFEGUARDS

These safeguards are important to know when applying for credit.

Truth in Lending Act (1968)

Consumers must be fully informed about the cost and conditions of borrowing.

Equal Credit Opportunity Act (1974)

Prohibits discrimination in giving credit on the basis of sex, race, color, religion, national origin, marital status, age, or receipt of public assistance.

Handout 3.3A

STEPS TO TAKE TO AVOID ABUSIVE LENDING

1. **Have you shopped around for the best deal?**
Rates, fees, costs, etc. vary depending on the financial institution, the type of loan, your credit history, your ability to repay, etc. Call around to several financial institutions, explain what you want, and discuss interest rates, fees, options, etc., that are available.

2. **Do you feel the lender pressured you to take the loan?**
A loan is abusive if the lender charges more than a reasonable amount for your loan. Many times, the lender uses aggressive sales techniques to pressure the individual. A “good deal” today should be a “good deal” tomorrow.

3. **Do you understand the terms of the loan?**
NEVER sign any agreement that you do not understand. If you do not receive a satisfactory answer to your question, ask someone you trust to review the document and give you advice. BEFORE you agree to any loan, check it out. Talk to people you trust.

Handout 3.3B

QUESTIONS TO ASK WHEN APPLYING FOR CREDIT

1. What is the **annual fee**, if any?

2. What is the **annual percentage rate (APR)**?

3. When are **payments** due?

4. What is the **minimum payment** required each month?

5. Is there a **grace period**?

6. Are there **other fees** associated with the credit, such as annual fees or minimum finance charges?

7. What is the **credit limit**?

8. What are the penalties for **late or missed payments**?

Handout 3.4

PARTS OF A CREDIT APPLICATION

CATEGORIES	
Reason for Loan **Personal Identification Information** • Name • Address • Phone Number (day and night) • E-mail Address • Social Security Number **Employment Information*** • Place of Employment • Length of Employment • Job Position • Salary **If you've had your current job for less than five years, you will probably be asked about previous jobs.* **Mortgage/Rental Information** Current information about length of residence, monthly housing costs, etc. **Documentation Required (for some applications)** May be a requirement to "show" documents such as last bank statement, copies of loans, etc.	**Current Debts** List of current creditors and amount owed to each. **Credit References** List of businesses where current credit exists, to demonstrate bill-paying habits. **Collateral (for some applications)** There may be a requirement to use something of value as security so that the credit will be repaid. **Bank References** Bank where individual does business, which can document current individual's financial status. **Signature and Date** • Current date • Signature (print + script)

Handout 3.5

SHOPPING FOR A CREDIT CARD

ANNUAL FEE?

APR?

COMPUTATION METHOD?

GRACE PERIOD?

FINANCE CHARGE?

CARD INCENTIVES?

CREDIT LIMIT?

MINIMUM PAYMENT?

Handout 3.5A:

FACTORS TO CONSIDER WHEN SHOPPING FOR A CREDIT CARD

Shop around when you choose a credit card. Card issuers differ in the fees, charges, and benefits they offer. Watch out the following factors when shopping.

Annual Fees. Some card issuers charge an annual fee to use their credit card. These fees range from $15 to $55. However, some cards have no annual fee.

Annual Percentage Rate (APR). APR is the cost of credit expressed as the yearly interest rate (used to figure the finance charge on the outstanding balance for each billing period). The cost of credit depends on where you borrow, your credit history, how much you borrow, and how long you take to repay it. Credit costs will vary from lender to lender. Before you borrow, compare the costs at several places. Some credit card agreements allow the issuer to change your APR based on changes in economic indicators. These indicators are called indexes. These plans are called “variable rate” programs. The card issuer must tell you that your credit card rate may change and how the rate is determined. They must tell you which “index” is used and what additional amount (margin) is added to your new rate. You should also receive information about any limitation on how much and how often your rate may change. The APR may also be raised if you fail to pay your bill on time or violate some other provision of your credit agreement/contract. Be sure to read and understand all of the “fine print.”

Balance Computation Method. It is the method to compute the Balance for the Finance Charge. If you carry a balance from month to month on your credit card, it is important to know what method is used to calculate the finance charge. There are four common methods of computing finance charges, defined below and compared in Table 4-A on next page.

• **Adjusted Balance (least expensive)**. Usually this method is most advantageous for card holders. The balance is determined by subtracting payments or credits received during the billing period from the balance at the end of the previous billing period.
Purchases made during the billing period are not included.

• **Previous Balance**. Finance charges are based on the amount you owed at the end of the previous billing period. Payments, credits, and new purchases made during the current billing period are not included.

• **Average Daily Balance (most commonly used)**. This method credits your account from the day payment is received by the credit issuer. The issuer starts with the beginning balance for each day in the billing period and subtracts any credits made to your account that day. Depending on the plan, new purchases may or may not be added to the balance. Typically cash advances are included. The resulting daily balances are added for the billing cycle. Then the total is divided by the number of days in the billing period to get the average daily balance.

• **Two-cycle balances (most expensive)**. This method uses the account activity for the last two months to calculate finance charges. This is probably the most expensive if you carry a balance from month to month.

Table 4-A: Four Methods of Computing Finance Charges on Open-end Credit Accounts[1]

Method	Amount Owed at Start of Billing Cycle (Feb. 1)[2]	Payment (Feb. 14)	Amount Outstanding at End of Cycle (Feb. 28)	Basis for Finance Charge $1\frac{1}{2}$%	Actual Finance Charge for Month
Adjusted Balance	\$400	\$200	\$200	\$200	\$3.00
Previous Balance	\$400	\$200	\$200	\$400	\$6.00
Average Daily Balance	\$400	\$200	\$200	\$300	\$4.50
Two-Cycle Average Daily Balance	\$400	\$200	\$200	\$300	
	Average daily balance from last billing cycle			+\$200	
	Sum of current and last period daily balance			\$500	\$7.50

[1]Open-end credit includes credit cards, department store charge plates and check overdraft accounts. Open-end credit can be used continuously, generally until the pre-arranged credit limit is reached. Truth-In-Lending laws require that creditors tell you the method of calculating the finance charge and the date the finance charge begins.
[2]Assuming that January 31 was the closing date of the original cycle.

Source: Sharon B. Seiling, Ph.D., and Carolyn McKinney, Ph.D., Money Talks, Ohio State University Extension, 12/89.

Grace Period. The time between the date of purchase and the date interest starts being charged on that purchase is the grace period. If you pay your current balance in full within the stated grace period, no interest is charged for the new purchase. Some card companies offer no grace period, and the finance charge is imposed from the date you used your card or from the date the transaction was posted on your account. If you carry a balance rather than paying off your card in full, you won't get a grace period on new purchases. Cash advances generally have no grace period.

Finance Charges. This may include transaction fees and 0ther Charges. Some card companies charge a fee for cash advances, fees for being over the balance limit, fees for late payment, or may charge a fee for every month you use the card.

Truth-In-Lending. The law requires that a lender provide you with the following in formation:

- The annual percentage rate (APR).
- How the APR will be determined (if it is a variable rate).
- The method of computing the balance at the end of each month.
- The annual fee to be charged, if any.
- The minimum finance charge.
- Any transaction fee for purchases or cash advances.

Handout 3.5B

QUESTIONS TO ASK WHEN SHOPPING FOR A CREDIT CARD

Annual Fee	• Annual charge for using a particular credit card. • Most common with general label credit cards.
What question should you ask?	
APR (Annual Percentage Rate)	• Annual cost of credit on a loan. • May include up-front fees and other internal costs. • Expressed as a percentage rather than a dollar amount. • True gauge of the cost of borrowing. • Truth in Lending law requires lender to tell the APR.
What question should you ask?	
Computation Method	• How finance charges are determined. • Methods may include previous balance, average daily balance, or something similar.
What question should you ask?	
Grace Period	• Period of time after purchase date when balance may be paid in full to avoid finance charges
What question should you ask?	
Finance Charges	• Dollar amount of interest paid on money borrowed, plus fees for arranging the loan. • Also known as interest paid on unpaid balances.
What question should you ask?	
Card Incentives	• Special rewards when the card is used. • Could be a refund of money, free tickets to special events, or rewards for use with hotels, airlines, restaurants, or purchases.
What question should you ask?	

Handout 3.6

CREDIT CARD SHOPPING COMPARISON

Factor	Card 1	Card 2	Card 3
Fixed Annual Percentage Rate (APR)			
Introductory Variable Annual Percentage Rate (APR) Time Frame – e.g. 6 mos., 9 mos.			
Method of Computing Balance of Finance Charge*			
Grace Period			
Annual Fee			
Balance Limit			
Transaction Fees / Cash Advance			
Over the Limit Fees			
Late Payment Fees			
Other Benefits Offered: Rebates, airline miles, credit card protection, discounts, etc.			
Other Advantages or Disadvantages			

* 1) Adjusted Balance – Least expensive method of calculation.
2) Average Daily Balance – Most common method of calculation.
3) Previous Balance
4) Two-cycle Average Daily Balance – Most expensive method of calculation.

Remember, if you pay your balance in full each month you won't incur finance charges.

Handout 3.7A: EVALUATION

Evaluation Form for Student

Indicate three new things you learned about ASPIRA.

How will you use this new knowledge in the future?

Were the handouts useful?

How could this workshop have been improved?

Handout 3.7B: Evaluation Form for Facilitator

1. Did the workshops run smoothly? Why?

2. What aspects of the workshops did not work? What would you change?

3. Was it easy to understand?

4. How would you make it more culturally relevant?

5. What visuals would you add?

How would you make it more hands-on for youth?