

CREDIT TRAINING MANUAL

QUESTIONS AND ANSWERS



ABOUT
OBTAINING AND MANAGING CREDIT

A Consumer Action Publication

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INTRODUCTION

Even for those who budget and live within their income, credit can be an important tool. It offers safety and convenience—there’s no need to carry large amounts of cash or worry that a personal check will not be accepted. It provides access to borrowed money in an emergency. And the wise use of credit can make it possible to get a loan for a car or home in the future. By understanding how credit works, what it costs, and how to avoid accumulating too much debt, consumers can use credit to their advantage.

The “Credit Training Manual” can help answer many questions about credit. This publication is part of a module that includes a multilingual companion brochure, “Staying on Track with Credit” (available in Chinese, English, Korean, Spanish and Vietnamese); a training guide for classes and seminars; PowerPoint slides; and class activities.

The brochure and other materials in this module are free for individuals, non-profits and community-based organizations. For more about these materials, visit the Consumer Action website at www.consumer-action.org or call Consumer Action at 800-999-7981.

TYPES OF CREDIT

What is credit?

Credit is the opportunity to borrow money to use now and then repay it over time at an agreed upon cost.

What is installment credit?

Installment credit, such as car loans or home mortgages, requires the borrower to make a fixed number of monthly payments until the original loan amount is repaid in full.

What is revolving credit?

Revolving credit, also known as open-ended credit, allows you to borrow money, up to an assigned credit limit, over and over again. The amount of available credit shrinks as you use it and grows again as you repay the borrowed money. For example, if you had a \$1,000 credit limit and you used \$200, your available credit would be \$800. If you paid the \$200 when your bill arrived, you would have access to the full \$1,000 again.

With revolving credit, you have the option to pay the entire outstanding balance when the bill is due or to pay a part of the balance and carry over the remainder to the following month. You will pay interest on the debt you carry over. Interest is the lender's fee for allowing you to use its money.

What are some examples of revolving credit?

Examples of revolving credit include credit cards and lines of credit, such as overdraft protection for your checking account and a home equity line of credit (HELOC).

What is secured and unsecured credit?

Secured credit requires collateral (security) for the loan. If you don't repay the loan according to the terms of the credit agreement, the lender can take the collateral. A car loan and a mortgage are examples of secured loans—if you don't make your payments the lender can repossess your car or foreclose on your home.

Credit card debt is unsecured, which means that the card issuer cannot take your property (even the things you buy with the credit card) if you do not make your payments. The card issuer can, however, sue you to recover the money you owe. If the company wins the lawsuit, it may be able to garnish your wages or put a lien on your property.

Because the credit they provide is unsecured, credit cards typically carry higher interest rates than mortgages or car loans.

What is the difference between a credit card and a charge card?

A credit card allows you to repay your charges over time, paying interest on any unpaid portion of the balance. A charge card requires you to pay your bill in full each month. Charge cards often have annual fees, while many credit cards do not. Also, there is no pre-set credit limit on charge cards because cardholders agree to pay the full amount they owe every month.

USES OF CREDIT

Why is having credit important?

Credit can help you through a financial emergency, when you don't have cash to pay for, say, an auto repair or medical expense. It can also enable you to buy a big-ticket item you need now and stretch out the payments over time. And it allows you to do things like rent a car, reserve a hotel room, and buy airline tickets online.

Responsible credit use over time can make it possible for you to take advantage of financial opportunities in the future. A good credit record improves your chances of getting a loan for something that is important to you, such as a car or home.

Poor or no credit history can keep you from renting a home, starting cell phone or utility service, buying insurance or getting a job.

Is it safer to use credit than cash?

It can be. Depending on the type of credit you use, it may:

- Allow you to avoid carrying large amounts of cash, which could get lost or stolen.
- Enable you to dispute a charge (withhold payment) if the product or service you purchase is not delivered, is defective, or is not as you expected.
- Offer an extended warranty on purchases.
- Protect you against merchant and bank billing errors and unauthorized or fraudulent transactions.

What is a grace period?

One advantage of using certain types of credit is the grace period the creditor may offer. The grace period is the time frame during which finance charges do not accrue on your balance. You must pay your bill in full by the due date each month, however, to take advantage of the interest-free use of the creditor's money.

COST OF CREDIT

What is interest?

Interest is the lender's fee for allowing you to use its money. It is expressed as a percentage of the loan amount. For example, a 5% annual percentage rate (APR) on a \$10,000 loan would cost you \$500 per year ($5\% \times \$10,000 = \500). A 7% APR means you would pay \$700 per year for use of the money.

What is fixed rate interest?

Fixed rate interest does not fluctuate according to changes in an underlying index. The most common index used is the prime rate, though some card issuers tie variable interest rates to the London Interbank Offered Rate (LIBOR) or the federal funds rate.

A fixed rate on a credit card can still change at any time with 15 days' notice. It can also change if you make a late payment or do anything else that triggers a penalty rate increase.

What is a default or penalty interest rate?

Many cards impose a much higher default or penalty rate if a cardholder does not honor the terms of the credit agreement. That could include doing such things as making a late payment, exceeding the credit limit, or allowing your credit score to drop. To avoid the increase, understand exactly when it could be imposed and avoid doing anything that could trigger it.

What is variable rate interest?

Unlike fixed rate interest, a variable rate moves up and down based on changes in an underlying interest rate index. Typically, a variable interest rate will be quoted as a certain number of percentage points above the index. For example, if your quoted rate is prime + 7.99%, and prime is currently 6%, then your rate would be 13.99% ($6\% + 7.99\% = 13.99\%$ APR). If prime increases to 8%, then your rate would increase to 15.99% ($8\% + 7.99\% = 15.99\%$ APR).

Some credit cards impose a “rate floor.” This means that the card company has a minimum APR—no matter what happens to the index, your APR will never go lower than that.

What is the periodic interest rate?

The periodic interest rate is your APR divided by 365 (days per year). For example, an 18% interest rate divided by 365 equals a periodic rate of approximately .04931%. The credit card company multiplies that rate by your average daily balance (all your charges, minus your payments, divided by the number of days in the month) to obtain your monthly finance charges.

What is a “minimum payment”?

The minimum payment is the minimum amount you have to pay to meet the terms of your credit agreement and avoid a fee or penalty rate increase. According to guidelines, a minimum payment should cover interest, any fees or extra charges and at least 1% of the principal balance—this results in a minimum payment of about 4% of the balance.

How can I figure out how long it will take me to pay off a balance?

The easiest way to estimate how long it will take you to get out of debt is to use one of the many free calculators available online, such as the one at Bankrate.com (<http://www.bankrate.com/brm/calc/MinPayment.asp>). When you input your APR, balance and minimum payment, the calculator reveals how long it will take you to get out of debt by paying only the minimum or by making larger payments.

OBTAINING CREDIT

Who provides credit?

Credit is available from many legitimate sources—banks, credit unions, credit card companies, finance companies, retailers, mortgage lenders and others.

There are also many lenders that offer loans designed to make the most money off the borrower. They prey on people who are not aware of other loan options or who might have a hard time qualifying for credit from a reputable lender.

How do I get credit?

If you are just beginning to establish credit, try:

- Applying for a retailer's credit card or a gas card, which can be easier to qualify for than a Visa or MasterCard.
- Applying for credit with a lender you already do business with, such as your bank or credit union.
- Establishing utility and other services in your name.
- Finding a friend or relative with good credit to co-sign your credit application. (A co-signer promises to pay the debt if you don't.)
- Getting a secured credit card.

It's very important that the businesses you make payments to report your activity to one or more of the three national credit reporting companies. If it's not reported, you won't establish a record for future lenders to base their decisions upon.

How can I get more credit?

If you already have credit, you could ask for a credit limit increase. Or you could apply for new credit. If you manage your credit responsibly, you may also get offers for new credit.

CREDIT CARDS

What should I look for in a credit card?

When shopping for a credit card, look for a competitive interest rate and no annual fee. Also consider transaction fees (such as late, over-limit, cash advance, bounced check and currency conversion fees) and reasons why your interest rate would increase.

Remember that low introductory rates are temporary, and may be good only for balance transfers and not for purchases. Look for the lowest introductory rate that lasts the longest time. Be aware that many companies will cancel your introductory rate if you make one or more late payments.

Rewards cards—those that earn you points, miles, cash back or other rewards for spending—can be tempting. But sometimes cards that pay rewards cost more in annual fees and higher interest rates than the rewards are worth.

How do I find a good credit card?

Compare any offers you receive in the mail with those at credit card company websites. You can also compare cards using Consumer Action's annual credit card survey (www.consumer-action.org) or by visiting www.bankrate.com, www.cardtrak.com and www.cardratings.com.

My application was turned down. How can I get a credit card?

Not everyone who applies for a credit card gets one. If you have been denied a conventional credit card, you may be able to get a secured credit card instead.

What is a secured credit card?

A secured credit card is backed by money you deposit with the card issuer. If you don't make your credit card payments, the money in that account can be used to cover the debt. If you use a secured card responsibly for at least a year, you may have a better chance of being approved for a regular, unsecured credit card.

How do I choose a secured card?

When shopping for a secured card, look for a competitive interest rate, a low annual fee (they can range from as little as \$15 to as much as \$75 per year), no up-front application or processing fees and an interest-bearing account for your deposit.

CREDIT REPORTS AND SCORES

What is a credit report?

A credit report is a detailed record of how you've paid your bills and managed your credit over time. Lenders use the information in your credit report to help them decide whether to grant you credit and, if so, how much and what interest rate to charge you.

The three largest national credit reporting companies are Equifax, Experian and TransUnion.

How do I get my credit report?

By law, you can receive a free copy of your report from each of the three credit reporting companies once every 12 months. Request your report online (www.annualcreditreport.com) or by calling 877-322-8228. Be sure to check your credit reports regularly to catch any data errors that could be damaging.

You can buy additional copies by contacting the companies directly:

Equifax: (800) 685-1111, www.equifax.com

Experian: (888) 397-3742, www.experian.com

TransUnion: (800) 888-4213, www.transunion.com

What is a credit score?

A credit score is a three-digit number that summarizes the data in your credit report. Lenders and others assess your creditworthiness (the likelihood that you will pay your bills) based on where your score lies on a scale. Those with a higher credit score should be more likely to have their credit request approved and pay a lower interest rate than those with a lower credit score.

Credit scores also speed up the credit approval process—the lender doesn't have to analyze the data in your credit report—making it possible to get “instant credit” when you need it.

Do all lenders use the same credit score?

Although there are several scoring systems, the best known and most widely used is the FICO score, ranging from 300 to 850.

The three credit reporting companies also have developed a joint scoring model, called VantageScore. This score assigns a letter grade (A, B, C, D or F), like a report card. VantageScore is not widely used by lenders.

Additional scoring models have been developed by the credit reporting companies, lenders and others.

Can I get my credit score free?

If your mortgage loan application is denied based on a credit score, the lender must give it to you if you ask for it.

Can I buy my FICO credit score?

You can purchase your FICO scores directly from FICO, at www.myfico.com. The fee is about \$16 per score (or approximately \$48 for all three). The only reason to purchase all three FICO scores is to see how much they vary among the credit bureaus. This knowledge may be useful if you are planning to apply for a home loan, since some mortgage lenders use the average of the three credit scores to qualify you for the loan. Many other lenders use the middle of the three scores.

You can purchase credit scores directly from the three credit reporting companies and at

AnnualCreditReport.com, too, but not all of the scores you receive will be FICO scores—some are based on other scoring models.

Some sellers of credit scores require the purchase of additional products and services, such as identity theft monitoring. Before subscribing to a service that allows you to monitor your credit report and score frequently, consider carefully if it is worth the monthly or annual fee.

Why are my scores different?

Your scores will vary from source to source because the formula being used may differ and because there are differences in the underlying data being used. (Not all lenders send customer information to all three credit reporting companies, and the companies do not share the data they collect.)

Why does having a good credit score matter?

The higher your credit score is, the more likely it is your credit application will be approved and the lower your interest rate should be. Lenders also look at your credit score when deciding whether to change the interest rate or credit limit on an existing account, or if they will offer you new credit.

Even a small difference in the rate on a large loan can mean a savings of hundreds or thousands of dollars in finance charges over the life of the loan. A chart at myFICO.com lists prevailing interest rates by approximate FICO score. The built-in calculator allows you to compare monthly loan payments for different credit scores. For example:

Jill has a FICO score of 750. On a car loan of \$20,000, she would pay \$611 per month (6.259% APR).

Jack's credit score is 615. His monthly payment would be \$684 (14.007%).

Each year, Jack would pay \$876 more than Jill for the same loan.

How can I improve my credit score?

Some ways to improve your score include:

- Paying bills on time.
- Keeping outstanding credit balances low relative to the amount of credit available—below 50%, if possible.
- Paying down debt.

- Making up any past-due payments and staying current.
- Limiting creditor inquiries (requests for your credit report) by doing your shopping for a loan within a limited period of time. (Multiple inquiries for a single type of credit, such as an auto loan, within a short period are treated as a single inquiry.)
- Opening new credit accounts only when you need them.

USING CREDIT WISELY

What does it mean to use credit wisely?

Credit is not always the best choice for every individual or under all circumstances. Unless you pay your bill in full before finance charges accrue, purchases made with credit will cost more than those made with cash. Sometimes it is impossible to avoid finance charges because interest begins accruing immediately.

If you do use credit, always make the minimum monthly payment by the due date. And try to pay off your debt as soon as possible.

If you have a home equity line of credit, use it only for a financial emergency or for major expenses like a car, home improvements, or education costs, and only if you can afford to make the monthly payments until the balance is paid off.

How do I avoid accumulating too much debt?

Here are some ways to avoid getting deep into debt:

- Use cash or a debit card to purchase everyday items such as groceries, gasoline, clothes and restaurant meals. (A debit card provides many of the conveniences of credit, but the money you spend comes out of your checking account immediately, so you can't build up debt.)
- If you choose to take advantage of a rewards-type credit card to make everyday purchases, try to pay the balance in full each month.
- When you want to make a large purchase—a television or a piece of furniture, for example—wait until you have saved enough money to buy it. That way, even if you use a credit card to make the transaction, you will be able to pay the bill in full and avoid finance charges.
- Build up an emergency fund—savings earmarked for an emergency such as a major car repair. This will help you avoid financing a large, unexpected expense.

How do I avoid fees and interest rate increases?

Always pay at least the minimum required payment by the due date each month. Do not exceed your credit limit. Read your credit agreement or ask the creditor what other actions or circumstances can trigger an interest rate increase or a fee—and avoid them.

What happens if I miss payments on my home equity line of credit?

A HELOC is secured by your home. That means the lender can foreclose (repossess your home) if you do not make your payments. If you take out a home equity line of credit, be very careful with it. If funds are limited and you cannot afford to pay all your bills, always pay your mortgage or HELOC before you pay unsecured creditors.

At the first sign you may miss a mortgage or HELOC payment, contact a housing counseling agency. A housing counselor can give you information that could help save your home from foreclosure. Counseling services are usually free or low cost. To find a local HUD-approved housing counseling agency, visit www.hud.gov/offices/hsg/sfh/hcc/hccprof14.cfm or call 800-569-4287 (or 800-877-8339/TDD).

I'm having trouble paying my bills. What can I do?

You may want to contact a credit counseling service. After completing a free or low-cost counseling session, you might find that one of your options is to participate in a debt management plan (DMP) administered by the credit counseling service. In a DMP, your monthly payments are consolidated into a single payment that you make to the agency, which then disburses the funds to your creditors as scheduled. As part of the plan, the agency negotiates lower interest rates and monthly payments with your creditors. DMP clients typically pay a monthly fee for participating.

To find a reputable, non-profit credit counseling organization, check the listings at the National Foundation for Credit Counseling (NFCC) (www.nfcc.org; 800-388-2227) and the Association of Independent Consumer Credit Counseling Agencies (AICCCA) (<http://www.aiccca.org>; 866-703-8787).

Be aware that notifying your credit card company about your financial troubles could trigger an interest rate increase.

Are there any kinds of credit I should avoid?

Some types of credit are a much better deal for the lender than for you. For example, payday loans, which extend a cash advance on a post-dated check or the next direct deposit into your

account, charge exorbitant interest rates that make it difficult to get out of debt. Another type of loan—car title pawn—requires you to sign over the title to your car as security for a high-interest, short-term loan representing just a fraction of the vehicle’s value. If you can’t repay the loan and fees, the lender can take your car.

Generally speaking, avoid any credit that charges high interest rates, includes high fees and imposes unfriendly terms (such as an unusually short or long repayment period or a prepayment penalty) in comparison to similar types of credit. Borrow only from reputable lenders. Be wary of any loan offer that asks you to pay money up front. Read the credit agreement before you agree to it, or have someone you trust review it with you.

CONSUMER RIGHTS

What information is a creditor required to disclose about a credit card or other loan product?

The Truth in Lending Act (TILA) is a federal law that requires clear disclosure of credit terms, including fees, interest rates, grace period, and other details about how much you will pay for the credit and how those charges are calculated. This information will help you compare credit offers and make the best choice.

TILA also protects you when you take out a secured loan naming your home as collateral. You have until midnight of the third business day after signing a home-secured loan contract to cancel it. You must be told of your right to cancel and be given a cancellation form when you sign the contract.

What is a cardholder agreement?

The cardholder agreement is a legal document that spells out the terms and conditions of your credit card account. By accepting and using the card, you agree to comply with the terms of the agreement.

Credit card companies must send a “change of terms” notice to you at least 15 days before a change will take effect. These notices often are included with your monthly statement.

What can I do if I am denied credit?

If you are denied credit, you have a legal right to know why. You’re also entitled to a free credit report if a company denies your application for credit and you request the report within 60 days. The lender must provide you with the name and contact information for the credit reporting company that provided the credit information.

How can I get a free copy of my credit report?

A web site has been established to give consumers access to free annual copies of their credit reports from each of the three major credit reporting bureaus—Equifax, Experian and TransUnion. The easiest way to get your credit report is online at www.annualcreditreport.com.

There are two other ways to get your reports:

1. You can call 877-322-8228 and request your copies on the phone. Or you can download an application from the web and send it by mail.
2. For mail requests, enter <https://www.annualcreditreport.com/cra/requestformfinal.pdf> in your web browser address bar. This will download a form that you can print, complete and mail to:

Annual Credit Report Request Service

P.O. Box 105281

Atlanta, GA 30348-5281

If the web address does not work, the URL for the PDF form may have changed since this brochure was printed. If so, go to the web site at www.annualcreditreport.com and click on “Request your report by mail.” You can find this link in the text in the middle of the home page.

What if I find an error in my credit report?

The Fair Credit Reporting Act (FCRA) gives you the right to correct mistakes in your credit report. To dispute incorrect information, follow the instructions that come with your report. If the information is proven to be a mistake, it will be removed from your credit file.

If the company that provided the information you are disputing maintains the information is correct, it will remain in your credit report. In this case, you have the right to attach a 100-word explanation about the issue to your file. Anyone who accesses your file in the future will see your statement.

You also have the option to directly contact the company that provided the information about you. If you can provide proof that the information is erroneous, the company must remove it from your credit report at all credit bureaus to which it was reported.

Should I pay someone to help me fix my bad credit?

No one can remove negative information from a credit report if it is accurate and timely. Generally speaking, derogatory (negative) but accurate information remains on your credit report for seven to 10 years. You can have inaccurate information removed yourself—free.

Can I be denied credit because I am not married?

The Equal Credit Opportunity Act (ECOA) prohibits a creditor from denying a request for credit based on factors such as race, gender, marital status, national origin or religion. If you are denied, you have a legal right to know why.

There is a mistake on my credit card bill. What should I do?

Under the Fair Credit Billing Act (FCBA), you have the right to dispute any errors (the wrong amount, something you didn't accept, or an item or service that was not delivered) on your credit or charge card bill within 60 days of when the bill was mailed. The company must acknowledge your letter within 30 days unless the error is resolved in your favor. And within two billing cycles, it must correct the error or explain why it believes the amount is correct. During the investigation, the company cannot report the amount to a credit bureau as delinquent.

If you find a mistake on your bill, call the credit card company immediately to file a formal dispute. You have the right to withhold payment on the disputed amount while your complaint is being investigated. You still must pay any part of the bill that's not in dispute, including finance and other charges.

What agencies can I contact if I have a complaint about one of my credit accounts?

Always try to resolve billing errors and other problems directly with your creditor. If you are not able to resolve a dispute, ask the creditor for the name of its regulatory agency. Then contact the appropriate agency below. In addition to handling consumer complaints, these regulatory agencies offer free consumer educational resources.

Federal Trade Commission (FTC)

Phone: 877-382-4357 (877-FTC-HELP)

Web site: www.ftc.gov

Regulates stores, finance companies, mortgage companies, credit bureaus and non-FDIC-insured financial institutions. Provides free credit education materials.

Federal Reserve System

Phone: 888-851-1920

Web site: www.federalreserve.gov

Investigates complaints against state-chartered banks that are members of the System.

Federal Deposit Insurance Corporation (FDIC)

Phone: 877-275-3342

Web site: www.fdic.gov

Regulates state-chartered banks that are not members of the Federal Reserve System.

National Credit Union Administration (NCUA)

Phone: (800) 755-1030

Web site: www.ncua.gov

Regulates federally chartered credit unions.

Office of Thrift Supervision

Phone: 800-842-6929

Web site: www.ots.treas.gov

Regulates federal and state savings banks and savings and loan companies.

Comptroller of the Currency

Phone: 800-613-6743

Web site: www.occ.treas.gov

Regulates banks with “National” in the name, or N.A. after the name.

U.S. Department of Housing and Urban Development (HUD)

Phone: 800-669-9777

Web site: www.hud.gov

Handles complaints alleging discrimination in housing and mortgage lending.

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