

CHAPTER 6 Consumer Credit

Reviewing Key Terms: Complete the Sentence



DIRECTIONS: Using terms from the following list, complete the sentences below. Write the letter of the item you have chosen in the space provided.

- | | | |
|----------------------|---------------------------------|----------------------------|
| A. credit | D. line of credit | G. simple interest |
| B. consumer credit | E. finance charge | H. minimum monthly payment |
| C. closed-end credit | F. annual percentage rate (APR) | I. cosigning |
| | | J. grace period |

1. The total dollar amount you pay to use credit is the _____.
2. The use of credit for personal needs is called _____.
3. _____ is computed only on the principal, which is the amount that you borrow.
4. A(n) _____ is a time period during which no finance charges will be added to your account.
5. The _____ is the rate at which credit costs you on a yearly basis, expressed as a percentage.
6. _____ a loan means that you agree to be responsible for loan payments if the borrower fails to make them.
7. A one-time loan that you will pay back over a specified period of time in payments of equal amounts is called _____.
8. An arrangement to buy something now and agree to pay for it later is called _____.
9. The maximum amount of money that a creditor makes available to a person is the _____.
10. The smallest amount you can pay on a credit card bill and remain a borrower in good standing is the _____.

CHAPTER 5 Banking

SELF-ASSESSMENT QUIZ

DIRECTIONS: Identify the letter of the choice that best completes the statement or best answers the question.

1. A possible drawback to using an ATM for your daily cash needs is (A) uncertainty about how much you will need (B) the service fee for its use (C) running up a large bill (D) interest charges.
2. The most commonly used payment service is a (A) savings account (B) certificate of deposit (C) checking account (D) mutual fund.
3. An automatic payment is when your (A) employer deposits your paycheck (B) bank withdraws money for a bill (C) friends use your PIN (D) local ATM accesses your account.
4. Using a debit card to pay for a meal at a restaurant is called (A) a point-of-sale transaction (B) a trade-off (C) a direct deposit (D) an online transaction.
5. Which financial institutions generally charge the highest interest rates on loans? (A) credit unions (B) mutual savings banks (C) commercial banks (D) finance companies
6. The interest rate varies from month to month on money in a (A) regular savings account (B) money market account (C) certificate of deposit (D) U.S. Savings Bond.
7. The rate of return on an investment would be greatest when the interest was compounded (A) daily (B) weekly (C) monthly (D) yearly.
8. What is the annual percentage yield on a deposit of \$200 in an account that pays 8 percent interest compounded twice a year? (A) 4% (B) 8% (C) 8.16% (D) 16%
9. An activity account usually requires a (A) fee for each check (B) minimum balance (C) direct deposit of paychecks (D) certain balance in a savings account.
10. If a check is lost or stolen, you might ask the bank for (A) overdraft protection (B) copies of canceled checks (C) a stop-payment order (D) a bank reconciliation form.

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Understanding Key Concepts



DIRECTIONS: On a separate sheet of paper, answer the following questions.

1. Virginia is trying to decide whether to finance her purchase of a used Mustang convertible. What seven questions should Virginia ask herself before making her decision?
2. To finance a sofa for his new apartment, Calvin signed a contract to pay for the sofa in six equal installments. What type of consumer credit is Calvin using?
3. List the advantages and disadvantages of using credit.
4. Drew's monthly net income is \$800. What is the maximum he should use on debt payments?
5. Aiku plans to spend \$7,000 on video equipment. She is willing to spend some of her \$10,000 in savings. However, she wants to finance the rest and pay it off in small monthly installments out of the \$400 a month she earns working part-time. How might she obtain a low interest rate and make low monthly payments?
6. Janina has always paid cash for her purchases, including a Corvette and a truck she uses for her catering business. Now she wants to apply for a mortgage to buy a town home. For which one of the "five Cs of credit" does Janina qualify and for which one does she not qualify? What questions is a creditor likely to ask her to find out about the other "Cs"?
7. How might you prevent a thief from stealing personal credit information from your trash?
8. Which law allows a borrower to sue a creditor or credit bureau that verifies incorrect data about his or her credit history?
9. What does the Consumer Credit Counseling Service offer?
10. The DeWitts underestimated earnings from their family-owned business last year and neglected to make large enough quarterly income-tax payments. At tax time, they charged the \$20,000 still owed to the government. Now the DeWitts owe a large credit card debt. Would you recommend that they apply for bankruptcy? Why or why not?

Student _____

Date _____

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Activity 1: Help a Friend Make a Decision



SKILLS ACHIEVED

Reading, Writing, Reasoning, Problem solving, Responsibility, Interpreting and communicating information

OBJECTIVE: Determine the issues you need to think through before getting a credit card.

You have just received an offer for a credit card. Based on what you learned in this chapter, make a list of four questions you need to ask yourself or the credit card company in order to make a wise decision. Write your questions in the left-hand column of the chart. In the right-hand column, explain why the question is important to ask.

Question	Why It's Important

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Activity 2: Obtaining an Inexpensive Loan



SKILLS ACHIEVED
 Writing, Creative thinking, Problem solving, Responsibility, Organizing and maintaining information

OBJECTIVE: Think through the process of obtaining a loan.

As you read in Chapter 6, many factors affect how much a loan will cost you. Some of these factors are listed below. For each factor, determine whether it would drive the overall cost of a loan up or down. Put those items which will make a loan more expensive on the "Up" arrow and those factors which would make a loan less expensive on the "Down" arrow.

- borrowing from family members
- borrowing from credit union
- high APR
- collateral
- large down payment
- shorter term
- simple interest on declining balance
- making minimum monthly payments

- borrowing from retail stores
- borrowing from finance companies
- low APR
- add-on interest
- minimal down payment
- longer term
- simple interest

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Student _____

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Your friend Serena is a musician and wants to buy a baby grand piano. She has found one at a good price, \$8,500, but she only has \$42.66 in her savings account. She is thinking about taking out a loan and has come to you for advice. Drawing on what you have learned about the factors affecting the overall cost of a loan, list four different ways that Serena might obtain an inexpensive loan.

1. _____

2. _____

3. _____

4. _____

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Finance Online: Consumer Credit

The Consumer Credit Counseling Service is a lifesaver for many people in debt. Who else benefits from this nonprofit community service? Who pays for the services it offers?

For this activity, use an Internet search engine to find branches of the Consumer Credit Counseling Service across the country. Choose one in your area and one in another part of the country. Visit their Web sites to find out who funds the offices.

Keywords Used	Site Names	Web-Site Addresses	Information Offered

1. What is the location of the Consumer Credit Counseling Service nearest you?

2. Where does this office get most of its funding?

3. Using information from the different Web sites, compare the services and funding sources offered by the offices.

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Your Financial Portfolio Worksheet

Credit Cards: Getting the Best Deal



Research two credit card companies. List their fees and any advantages they offer. Record your findings on the form below.

Credit Card Company		
Phone number		
Annual percentage rate (APR)		
Introductory rate		
Annual fee		
Grace period		
Cash advance fee		
Late payment fee		
Credit limit for new customers		
Premium offers and services:		
Travel accident insurance		
Protection if the card is lost or stolen		
Cash rebates on purchases		
Extensions on manufacturers' warranties		
Airline frequent flier miles		
Discounts on car rentals		
Can be linked to bank account		
Other gifts or incentives:		

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If you wanted a credit card, which company would you prefer? Explain why.

Would you be influenced by the offer of airline miles or long-distance discounts? Why or why not?

CHAPTER 6 Consumer Credit

Software
Activity
(Optional)

Quicken Application

Calculating the Total Cost of a Financed Purchase



OBJECTIVE: Determine the total cost of a financed purchase and understand the impact of debt payments on personal net worth.

Practice Situation

Ralph purchased a stereo system from Circuit City. The store offered him a credit account to make the purchase, at an interest rate of 16.9 percent, compounding monthly. Ralph has agreed to pay the total amount due in one year. The stereo cost including tax and warranty is \$3,546.35. Assume Ralph made the purchase on January 1. Ralph's monthly net income is \$3,500. He wants to use Quicken to track his payments to Circuit City. He has already set up the loan from Circuit City and has recorded his new asset, labeled "Stereo System" in Quicken. Review the loan summary in the software application, print the payment schedule, and answer the questions that follow. Compute his debt payments-to-income ratio.

Quicken Directions

1. Start your Quicken software program and open the file SA06.qdf.
2. Click on the side navigation tab, **Property & Debt**. As you can see, the *Property and Debt Accounts* contain Ralph's "Stereo System" and "Circuit City" accounts.
3. Review the *Loan Accounts Summary* information next to *Property & Debt Accounts*. Verify that the terms of the credit agreement are properly reflected.
4. Click on the **Make a Payment** button. Click the **Payment Schedule** tab.
5. Print Ralph's Payment Schedule by clicking on **Print** in the top menu bar of the View Loans window. You will use this schedule to answer the questions that follow.
6. Close your Quicken software program.

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Interpreting Results

1. In order for Ralph to pay off the total amount for his stereo system, what monthly payments are necessary?

2. If Ralph adheres to his payment plan, how much total interest will he pay on the stereo purchase?

3. What amount will Ralph's final payment be on the stereo? In which month will this final payment occur?

4. Assuming that Ralph has made only one credit purchase, what is Ralph's debt payments-to-income ratio?

Drawing Conclusions

1. What total amount, including interest, did Ralph pay for his stereo system?

2. Is Ralph's debt payment-to-income ratio within the recommended range? Explain.

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SELF-ASSESSMENT QUIZ

DIRECTIONS: Circle the letter of the choice that best completes the statement or best answers the question.

1. The periodic charge for using credit is called (A) financing (B) interest (C) installment payments (D) a credit limit.
2. The greatest disadvantage of using credit cards is (A) having a record of expenses (B) being in physical danger (C) proving to be a responsible spender (D) being tempted to overspend.
3. You will probably find the least expensive loan from (A) a commercial bank (B) a finance company (C) family members (D) a home equity loan.
4. The usual trade-off of choosing small payments is (A) having a short payment period (B) paying more in interest (C) having variable interest rates (D) pledging collateral.
5. No matter how often you make payments, interest is calculated on the full amount of the original principal with the (A) simple interest method (B) declining balance method (C) add-on interest method (D) up-front cash method.
6. Which of the "five Cs of credit" does your income affect? (A) capacity (B) character (C) collateral (D) credit history
7. Which law gives a borrower the right to stop payment? (A) Equal Credit Opportunity Act (B) Fair Credit Reporting Act (C) Fair Credit Billing Act (D) Truth in Lending Act
8. Under the Equal Credit Opportunity Act, you may sue a creditor if the creditor (A) discriminates against you (B) fails to disclose information (C) gives inaccurate information (D) hires a collection agency.
9. The legal process in which some or all of a debtor's assets are distributed among creditors because the debtor cannot pay his or her debts is called (A) debt collection (B) credit counseling (C) adjusted repayment (D) bankruptcy.
10. Chapter 7 bankruptcy relieves an individual from debts arising from (A) alimony (B) credit card charges (C) child support (D) fraud.