

Understanding Credit

Resource Guide

Brought to you by:

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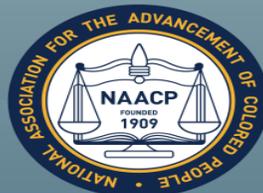


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The purpose of this resource guide is to provide a brief but detailed introduction to the world of consumer credit. If you would like more extensive information on credit, please refer to one or all of the following organizations:

- Annual Credit Report: www.annualcreditreport.com
- Experian: www.experian.com Equifax: www.equifax.com TransUnion: www.transunion.com
- National Foundation For Credit Counseling: www.nfcc.org
- Federal Trade Commission: www.ftc.gov
- Department of Justice: <http://1.usa.gov/2P1Bq4>
- Better Business Bureau: www.bbb.org

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Resources

Credit: Overview

What is Credit?

Credit is money that is generally extended to borrowers whose credit risks are low. Banks assess the risk/reward relationship when considering granting credit as well as the overall profitability of the account.

- There is usually a cost associated with borrowing money, which is called the interest.
- The amount and type of credit that lenders grant you is determined by whether or not you have proven yourself to be financially *trustworthy*.

Understanding Credit Risk:

Credit risk refers to the risk that a borrower will default on any type of debt by failing to make obligated payments. In evaluating whether, and on what terms, to grant credit, banks assess the risks against expected return.

What to consider before using credit:

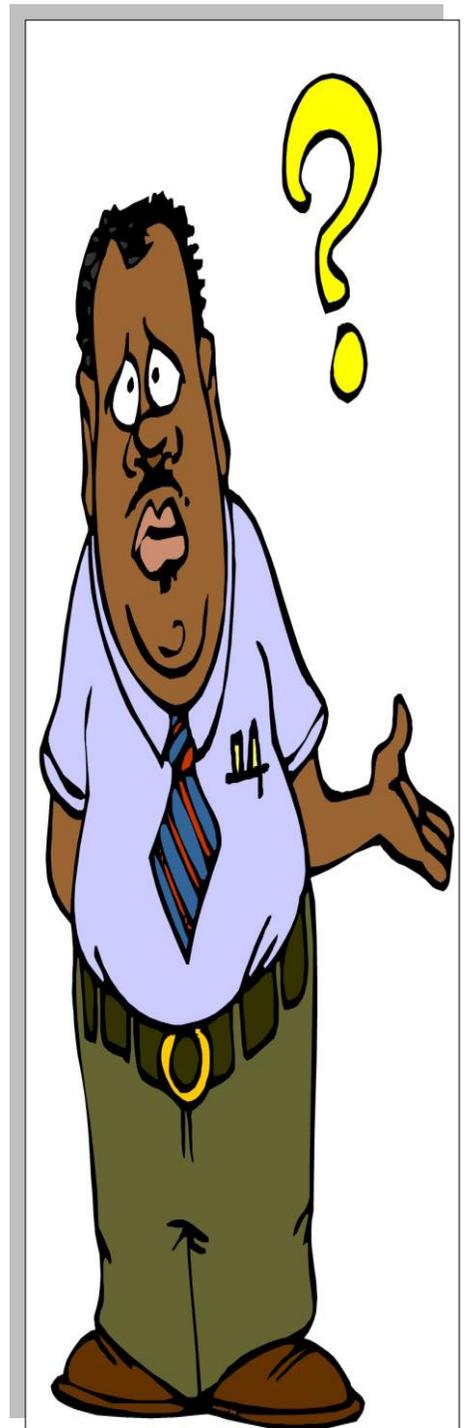
- * *Is this purchase a need or a want?*
- * *Will I still have this item when I finish paying for it?*
- * *How will this credit payment affect my household budget each month?*
- * *How much will this purchase increase your total debt?*

Paying Cash vs. Using Credit:

- The decision whether to utilize credit or not depends on the level of urgency for your need of the intended purchase. This is because, **saving your money and paying cash for an item is less expensive than using credit**. However, having credit allows you to get goods and services immediately. Understanding the trade off is important when considering your financial plan of action.

Types of Credit

- **Revolving Credit**
 - *Allows you to borrow money at any time up to a set limit. The most common types are credit cards.*
- **Installment Credit**
 - *A loan that must be repaid over a specific period of time. This type of credit is common for larger purchases such as a home, car, or education.*
- **Non- Installment Credit**
 - *Allows you to pay for a used service at a later date usually without an interest charge (i.e. utility bill).*
- **Secured Credit:**
 - *Requires you to provide something of value to guarantee that you will repay your debt.*
 - *It is usually used for installment loans. If you fail to repay, the lender takes your item as repayment.*
- **Unsecured Credit:**
 - *Does not require a guarantee (collateral).*



Pros and Cons of Credit

Pros

Helpful for Emergencies

Its Convenient

Increased purchasing power

Cons

Easy to
loose track
of budget

Credit =
Temptation

Credit
Costs \$\$\$

Shopping for Credit

Consider the following as you evaluate your credit options:

- Total Amount to be repaid
 - Add up the cost of the down payment, fees, other charges, and all payments over the life of the loan or contract. Then ask yourself, is this purchase really worth it?
- Interest Rate
 - Consider the interest rate and ask yourself if it is reasonable. Compare the rate to that of the product or service's competitors.
- Monthly payment and maturity
 - Honestly assess if the monthly payments will strain your budget. If you lengthen the maturity, are you comfortable with lower monthly payments for a larger total amount?
- Security pledged
 - Evaluate what you will lose in the event that you are unable to make your payments.
- Warranties, service and repair
 - Consider all the "extras" that are included with the purchase. Ask yourself if you truly need the extras.
- Comparing Costs
 - Remember that the lower price is not always the best purchase. Until you add in the total cost of credit (interest, fees, and taxes) you will not have a good understanding of what that total cost is.

The Credit Report & Score

What is a Credit Report?

- Your credit report serves as your financial “*report card*”. It documents your credit history. It is the most important factor that lenders consider when you apply to borrow money. The better the credit rating, the better the terms and lower interest rates tend to be.

What is a credit score?

- Your credit score is a number, determined by a complex mathematical formula that takes the information on your credit report and ranks you along a scale. The most popular scoring scale is Fair Isaac and Company (FICO) which ranges from 300-850.
- The credit score suggests your level of risk to lenders:
 - A low credit score indicates higher risk
 - A high credit score indicates lower risk

A Credit score is determined by the following:

- 35% Payment History
- 30% Amounts Owed
- 15% Length of Credit History
- 10% Types of Credit in Use



Where to Borrow Money

The following charts explain the difference between non-credit building lending institutions (shown in the first chart) versus institutions that are considered to be credit building (shown in the second chart).

Institution	Mission	Credit Products & Terms
Alternative Finance Services	<p>These for-profit businesses make consumer and commercial loans. They focus on servicing customers with poor credit histories.</p>	<ul style="list-style-type: none"> Alternative Finance Services usually charge higher interest rates and more fees than Traditional Lenders. Loans are often short term. Common Examples: <ul style="list-style-type: none"> Payday loans Car Title Loans Tax Refund Anticipation Loans

Institution	Mission	Credit Products & Terms
Banks	<p>These for-profit financial institutions are the largest source of deposits and credit in the economy.</p>	<ul style="list-style-type: none"> Protects your money because it is insured by the Federal Deposit Insurance Corporation (FDIC) Helps increase your money through competitive interest rates Offer helpful services (i.e. Special Savings Plans for College, etc.)
Credit Unions	<p>These non-profit cooperative financial institutions exist to serve their members' financial needs.</p>	<ul style="list-style-type: none"> Protects your money because it is insured by the National Credit Union Administration (NCUA) Typically offer free accounts with no minimum balance requirements. Interest rates on savings, certificates of deposit, and some checking accounts are often higher than those offered by the banks.

Establishing Credit

In order to establish a credit history, you need to borrow money and pay it back over time. By making your payments on time, you'll begin to establish good credit history. Here are two ways to begin:

1) Apply for a retail store or gasoline credit card

- a. They are usually easier to get than other types of credit. By making a few small purchases and then making timely payments each month, you'll start to build a credit history.

2) Apply for a major credit card with a secured credit limit

- a. If you have less than perfect credit or no credit at all, you may still qualify for a major credit card. Here is how it works:
 - i. As collateral (security deposit) you put a certain amount of cash (say \$1,000) into a frozen bank account. The bank then issues you a credit card with a \$1,000 credit limit. Once you've established a track record of timely, monthly payments, the card issuer will generally wave the collateral and return the security deposit to you.

Tips for Improving your Credit:

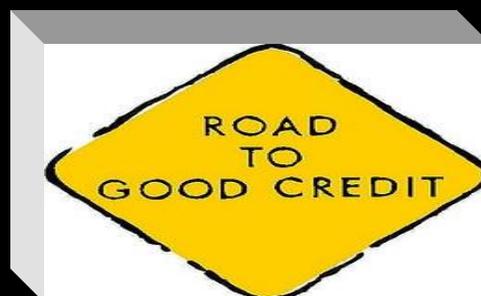
Tip 1: Pay your bills on time

Tip 2: Contact your lenders immediately if you foresee a problem

Tip 3: Borrow at a minimum

Tip 4: Do not overdraw accounts

Tip 5: Understand loan terms/agreements before signing



Protecting your Finances

Protection Tips:

- Keep the original copies of your documents in a safe place
- Keep your important computer files safe
- Make Copies of all your important documents
- Keep a copy of your important papers in a safe or storage that is secure and outside of the home, in case of emergency
- Monitor your accounts regularly

Know your rights

- Each of the nationwide consumer reporting companies Equifax, Experian, and TransUnion- is required to provide you with a free copy of your credit report once every 12 months, if you ask for it.
- It doesn't cost anything to dispute mistakes or outdated items on your credit report
- No one can legally remove accurate and timely negative information from a credit report.

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Key Financial Terms:

Annual fee: A yearly fee, typically associated with a credit card or revolving credit plan.

Annual Percentage Rate (APR): The cost of your credit expressed as a yearly rate. APR is generally not the same as the contract interest rate.

Balance: The amount of money outstanding in an account.

Budget: A financial plan to manage the spending and saving of money.

Cash advance: Cash charged against a credit card. Since the advance is really a loan, interest is charged from the date of the advance.

Charge card: A card that charges no interest, but that requires you to pay your bill in full each month.

Charged-off: Loans or credit card debt written off as uncollectible from the borrower. The debt, however, remains valid and subject to collection.

Closed-End loan: A loan in which money is borrowed in one lump sum for a specified period of time.

Collateral or security: An asset pledged to ensure payment of debt.

Compound interest: Interest computed on the balance of a loan, in which the balance includes all unpaid interest.

Co-signer: A person who signs a loan agreement along with the borrower and assumes equal responsibility for repayment on extending credit. The three major credit reporting agencies are Equifax, Experian and TransUnion.

Credit: A promise to pay at a later date for goods or services purchased today.

Credit card: A plastic card issued by a bank authorizing payment for purchases. Interest is charged on the outstanding balance.

Key Financial Terms:

Credit bureau: A company that compiles credit histories on prospective borrowers and provides credit reports to lenders. Lenders use these reports when making decisions

Credit counseling: Professional counseling provided by organizations who help consumers find ways to repay their debts - through careful budgeting and management of

Credit limit: The maximum amount of money that may be charged on a credit card account.

Credit line (Or personal line of credit): The maximum loan amount a consumer can borrow against in an account. As a credit line is partially or fully repaid, the consumer can borrow against the account again.

Credit report: A record of someone's credit history, including debt repayments, late payments and any bankruptcies that is compiled by a credit reporting agency.

Credit risk: refers to the risk that a borrower will default on any type of debt by failing to make obligated payments.

Creditor: A person or business from whom you borrow, or to whom you owe, money.

Debit card: A plastic card issued by a bank and used for making purchases. The purchase amount is deducted directly from one's checking account.

Debt: Money owed to another party.

Debt consolidation: A strategy sometimes used by consumers to better manage their debt problems. Rather than paying off several separate bills each month, a consumer consolidates his or her debts with a financial institution that will arrange for one lower monthly payment extending over a period of time.

Default: Failure to repay a loan or otherwise meet the terms of a loan agreement.

Delinquency: Failure to make payments on time.

Discretionary income: Individual or family earnings not allocated for necessities such as food and shelter.

Equal Credit Opportunity Act: A federal law prohibiting lenders from discriminating against applicants for credit.

Equity: The market value of a person's home or real estate, less the value of all existing liens.

Fair Credit Reporting Act: A federal law giving consumers the right to learn what information credit reporting agencies have on file about them, and to dispute any inaccurate data in the file.