Types of Credit

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Concept of Credit is Old

- Credit legislation dates back to 1800 BC
- Records show that the king of ancient Babylonia decreed that all loans had to be accompanied by a written contract setting forth the terms of the loan.

Evolution of Money

- Prehistory – agricultural products
- 700 BC Gold Coins
- 1661 Modern paper money
- 1700 Checks and bank drafts
- 1916 The concept of installment loans was born
- 1959 Credit cards first came on the scene
- 1988 ATMs
- 1991 Debit Cards
- 1996 Chip Cards – Smart Cards
- Stored Value Cards

Consumer Credit is Relative New

- Consumer credit is a relatively new concept.
- It has been within the past 50 years that use of credit to buy clothing, food, furnishing and transportation as we know it today, has been acceptable.

Daniel Webster said:

- “Credit has done a thousand times more to enrich mankind than all the gold mines in the world.”
- It is as American as apple pie. Credit has made us a nation of homeowners, car owners, and owners of many other things. Credit has helped give birth to the highest standard of living in the world.

What is Consumer Credit?

- Credit is using tomorrow's money today!
- When we use credit we discount the future.
- Credit is an arrangement to receive cash, goods or services now, and pay for them in the future.

Types of Credit

- Closed-End Credit
  - – For a specific purpose and amount.
    - Mortgage loan.
    - Automobile loans.
    - Installment loans.

Types of Credit

- Open-End Credit
  - – Use as needed up to credit limit.
  - – You pay interest and finance charges if you do not pay the bill in full when due.
  - – Revolving check credit – prearranged loan.
  - – Home equity loan.

Did You Know?

- Over a trillion dollars a year are spent by using credit cards.
- A typical cardholder carries 8 to 10 credit cards with the average monthly balance of $3,900.
- According to Kapoor, Dlabay and Hughes total household debt is very close to 98% of total disposable income.

Credit Cards

- Nearly 8 out of 10 American households carry one or more credit cards.
- One-third are convenience users. They pay their balance off in full each month.
- The other two-thirds are borrowers.
- Co-branding – linking a credit card with a business offering rebates on products and services.
- Smart cards have an imbedded computer chip.
- Debit cards are not credit cards.
- Stored Value cards.

College Students & Credit

- 80% of college and universities permit some form of on-campus credit card solicitation.
- 77% of full-time undergraduates have credit cards.
- Only 44% of college students clearly understand the term budget.

College Students & Credit

- Only 34% of college students clearly understand the concept of buying on credit.
- The average credit card limit for a student is $6,122.
- The average outstanding balance for a student is $2,226.
- 54% of college students expect their parents to help support them after graduation.

Sources of Consumer Credit

- Inexpensive loans.
  - Loans secured by assets, such as a CD.
  - Parents and family members.
- Medium-priced loans.
  - Commercial banks, savings and loan associations, and credit unions.
- Expensive loans.
  - Finance companies.
  - Retailers such as car or appliance dealers.
  - Bank credit cards and cash advances.

The Cost of Credit

- Finance charge includes interest and fees, such as service charges or credit-related insurance.
- The annual percentage rate (APR) is the percentage cost of credit on a yearly basis.
- The APR provides the true rate of interest for comparison with other sources of credit. This rate lets you compare like with like when shopping for rates.

Cost of Open-End Credit

- Adjusted balance.
  - The assessment of finance charges after payments made during the billing period have been subtracted.
- Previous balance.
  - Method of computing finance charges that gives no credit for payments made during the billing period.
- Average daily balance.
  - Uses a weighted average of the account balance through the current billing period. If you carried over a balance new purchases may be included in your average daily balance calculation.

Choosing and Using a Credit Card

- If you plan to pay each month in full look for a card with no annual fee.
- Look for a low interest rate if you plan to carry a balance.
- The interest you pay on consumer credit is NOT tax deductible.
- Avoid the minimum monthly payment trap.
- Early repayment: The Rule of 78s.
- Credit insurance.
  - Pays off loan if person dies or becomes disabled

Credit Card Tip

- When can a smaller annual fee cost you MORE?
  - Sometimes a low annual fee card comes with a high interest rate. It pays to look at all the fees and charges when choosing a credit card that's right for you: the annual fee, interest rate, grace period, late fees over-limit and other special fees and charges.

Credit Card Tip

- Shopping wisely for a credit card can make a difference. For example, you save $57 in the first year when you switch a $1,000 balance from a 19.8% interest rate card to a 14% card, and you are out of debt a year and half sooner.
- Ask the issuer for a lower rate or to waive the annual fee.

Credit Card Tip

- When you charge more than your credit limit allows, your credit card issuer may charge you an “Over the Limit” fee of up to $70.
- Your card issuer may allow you to exceed your credit limit without telling you, and you may not know you have done so until you receive your bill. It is up to you to know your credit limit and how much available credit you have left.