



Shopping for Consumer Credit

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Credit means buying now and paying later. Credit also means becoming indebted to someone for something. With credit you may use a product, a service or money and pay for it later. By so doing, you incur a debt that must be paid.

When you are in debt, you are charged an additional amount for the use of the product, the service or money before you pay for it.

Two terms are essential in understanding credit — **finance charge** and **annual percentage rate (APR)**.

The **finance charge** is the total of all costs that you must pay, directly or indirectly, for credit. The annual percentage rate is the relative cost of credit in percentage terms.

Lending institutions are required by the truth-in-lending law to give both the finance charge and the APR to the borrower in writing. Rates quoted orally might not be the same as rates quoted in writing. Insist on the proper rate quotation and disregard other rates that may be given.

The **annual percentage rate** will be the rate by which you can compare the cost of credit from one creditor or credit transaction to another.

The type of credit agreement, where you get the credit, and your credit rat-

ing are all factors that determine the amount you pay for consumer credit.

Types of consumer credit

■ **Charge accounts**, also known as regular 30-day accounts, are accounts that are due in full at a specified future date, usually 15 to 30 days from date of billing. Generally, there is no finance charge if payment is made within the specified period. An example of this type of credit is your monthly utility bill. This type of credit is also referred to as service credit, and often a deposit is required.

■ **Revolving credit accounts** differ from a regular charge account. The consumer is allowed to charge purchases up to a certain limit. A maximum limit per customer is established, and new purchases may be made as long as the balance remains below the maximum limit. Also, a monthly minimum payment of only a portion of the balance, usually five to 10 percent, is required, but any amount above that may be paid. The finance charge is usually calculated on the unpaid balance. However, you may be charged interest on the previous month's interest as well.

■ Credit cards

are of several types.

Single-use credit cards are issued by department stores and oil companies. This kind of credit card is issued for the convenience of the consumer and to promote brand or store loyalty.

It provides the easy credit features of the revolving charge account with the convenience of the regular 30-day charge. Most goods and services available from the issuing company can be charged on the card. If the bill is paid within the allowable period, usually 25 to 30 days from the date of the billing, there is no direct charge for using credit. After that period, however, a charge is made on the unpaid balance.

Travel and entertainment credit cards, such as American Express, Diners Club, and Carte Blanche, were originally designed for people who traveled a great deal and wanted to charge most expenses. An annual membership fee, usually beginning at \$40 a year, is paid for this card. There is usually no additional finance charge because the balance is paid in full each month. If for some reason a balance must be carried forward, a charge is made on the unpaid balance.

Bank credit cards are in wide use now. One bank, a group of banks, or an

independent credit card company may issue these cards. They offer the convenience and ease of credit features of the regular 30-day charge and the revolving charge account. Small cash loans called cash advances, as well as goods and services, may be charged to this account and repayment must be made just as for any other purchase.

Often there is a special charge for obtaining a cash advance in addition to the interest charged. Many cards are now charging interest from the day of purchase, assessing a minimum finance charge for each billing period when the card is used, and/or charging an annual fee.

A bank card also offers an extended payment supplement. This means you can borrow an amount over your regular credit limit for a specific item. This type of credit must have special approval from the card-issuing company and the cardholder must specify the repayment period prior to approval. All transactions related to a sale under the extended payment supplement are identified separately on the monthly statement.

Debit and ATM cards are very different from bank credit cards. A debit card is not a credit card. It is used like a credit card, but is not a credit card. The debit card is usually linked to your checking account, and it allows you to access your account at an ATM or at a retail store when you make a purchase. Don't confuse debit cards with credit cards. Debit cards may look like credit cards, but they act like checks. Once the debit card is used, the amount is immediately deducted from your checking or savings account and you are not able to pay for an item over a period of time. The debit card eliminates the need for carrying cash, but it does not extend credit. Debit cards may be used as guaranteed check cashing cards. In contrast, credit cards defer your pay-

ment until you are billed. It is possible for a card to be set up to serve as both a credit and debit card. In this case, you must specify to the cashier what type of transaction you would like made to your account — credit or debit.

Some cards, those with Visa or MasterCard, can be used to withdraw money from automatic teller machines (ATMs). Beware of fees eating up your money if you use your ATM card frequently for small withdrawals. If you get cash at an ATM machine that is not part of your financial institution's network, the fees could be as much as \$8 per transaction.

■ **Installment credit**

may be described as buying on time, financing through a retail store or the easy payment plan. The installment sale is a familiar type of credit that offers many variations. It is generally used for major purchases, but may also be used in the purchase of smaller items.

An installment sale involves a contractual agreement in which a down payment or trade-in is usually made and a predetermined amount is paid periodically until the entire debt is satisfied. The finance charge is added to the price of the merchandise and included as a portion of the subsequent payments. Rates vary widely, depending on the seller, the merchandise purchased and the debtor's credit rating.

Contracts vary from sale to sale and the customer should read and understand all terms of the contract before signing.

■ **Cash loans**

may be obtained from a variety of sources with an even wider variety of finance charges. They may be repayable in regular installments or by a single payment made for the loan, plus the finance charge, at the end of the time period. The lending agency,

the credit rating of the debtor, the purpose of the loan and the collateral available are determining factors in the total finance charge. All forms of loans (student, car, mortgage, etc.) are types of consumer credit.

Sources of consumer credit

Banks

Banks lend money for a variety of reasons. Some small loans may be made on the debtor's signature only (unsecured), while large loans usually require some collateral (secured).

Most **consumer bank loans** are repaid on the installment basis, much like an installment sales plan. The annual percentage rate compares favorably with other sources, but standards for qualifying for a loan may be higher than those of other creditors.

Many banks also offer an **automatic overdraft or advance** to their checking account customers. To use this feature, the customer must qualify in advance for such a loan and a ceiling is placed on the amount a customer may borrow. To activate such a loan, all the customer has to do is write a check for more than the amount that is in the checking account. Repayment is made either through regular installments or from the next deposit into the account.

Savings and loan associations

Savings and loan associations also offer a variety of consumer lending options. In addition to the **traditional cash loans** secured by the borrower's savings account, savings and loans offer **credit cards, overdrafts, interest-bearing checking accounts, and other types of consumer credit**.

The annual percentage rate and qualification standards for a loan are comparable to those at commercial banks.

Credit unions

Credit unions make consumer loans from money deposited by members. In addition to **consumer loans**, some credit unions are now in the **mortgage** market. Loans from credit unions are often the lowest cost loans available to persons who are members.

Many credit unions offer **share draft accounts** that operate much like a checking account. Those credit unions that offer this account also offer **automatic overdrafts or advances** much the same as commercial banks and savings and loans.

Consumer finance companies

Consumer finance (small loan) companies specialize in **small cash loans** to all income and occupation groups. The borrower need not have as high a credit rating as is usually demanded by other institutions, although most loans are made on signature only. Because of this added risk, finance charges are usually higher than most other lending agencies. Debts are repaid in monthly installments, which include the finance charge. The debtor may be required to purchase credit life or disability insurance payable to the loan company, which increases the cost of the loan.

Life insurance companies

The **cash surrender value** of a whole-life insurance policy has been one of the least expensive sources of loans available. The policyholder is allowed to borrow against a policy's cash value. The interest rate on such a loan is stated in the policy.

This type of loan does not require a credit check. However, the amount still owed on the loan is deducted from the face value of the policy if the insured dies before repaying the loan.

No demand for payment is made, so it is easy to ignore the loan and not return the policy to its full face value,

thus decreasing the amount of coverage of the policy.

The cash surrender value of a whole-life policy is the savings that has been built up within the policy because the insured pays premiums that are larger than the amount needed to provide the insurance protection.

Policy values and premiums are based, in part, on the assumption that the cash value is invested by the company. When the insured borrows from the cash value, he becomes the investment outlet for those funds, and thus must pay interest on the loan.

Rent-to-own businesses

Rent-to-own businesses advertise **no-obligation rentals** of items used in the home. Furniture, major appliances, televisions and other electronic goods are some of the items typically offered. Rent-to-own deals look good to people because of the advertised low payments. However, looking at the overall cost of the item (the total of the rental payments), it is not uncommon for the total to be 200 to 500 percent of what the item would cost in any retail store. While interest is not charged, the inflated cost of the item makes it an expensive way to purchase anything.

Sometimes the appeal of rent-to own is the fact that the businesses do not make credit checks. This speeds up the process of obtaining household items. It is important to stop and think about whether the speed and convenience is worth paying an inflated price for the item.

Payday loans businesses

Businesses offering **payday loans** (also known as paycheck loans) have opened their doors across Missouri in the past decade. The process of obtaining a payday loan is fairly easy. In most cases you have to provide evidence that you are employed, usually by

showing your pay-stub. You must have valid identification and a local checking account. To obtain a loan, you write a check that is post-dated for after your payday. Loan amounts with any lender may not exceed \$500. The check you write will be larger than the amount of cash you receive as a loan. The amount you actually receive is the loan, and the extra amount is the interest and fees. The business holds your check until your payday and then deposits it unless you renew the loan by paying any interest and fees due and agreeing to an additional fee. Upon the first renewal, and each additional renewal, you must pay off at least 5 percent of the original principal amount. No loan can be renewed more than six times. Loans must be for a term of at least 14 days but not more than 31 days. Lenders may charge any interest rate and fees, but the total amount of interest and fees cannot exceed 75 percent for any single loan and all renewals. All interest and fees must be used to calculate an Annual Percentage Rate (APR). The APR on a payday loan is very high, and this type of borrowing can become a very costly habit.

Title loans are a way to borrow money against the value of any vehicle with a title (car, truck, motorcycle, boat, trailer, motor home, etc.). You can only get a title loan if you own your vehicle free and clear. What the lender will loan to you is based on the value of your vehicle. In a title loan transaction, you can keep your vehicle while the lender keeps the title as security for repayment of the loan. The lender can charge any interest rate they choose. Fees may include a loan origination fee of 5 percent, with a maximum of \$50, late fees and insufficient funds fees. Non-payment of the loan may result in the loss of your vehicle or other tilted

property. Because you are risking an important asset, make sure you read and understand the entire title loan application/contract before taking out a title loan.

Tax refund loans can be another credit alternative at certain times of the year. An income tax refund loan is provided through a commercial tax preparation office. A tax professional prepares your return for a fee of \$25-\$60, files the return for another fee (usually around \$25), and then can extend a loan in the amount of the return (less a loan fee of \$30-\$60 or a percentage of your refund). You receive a loan check immediately or in the mail a few days later, depending on the company. The loan is paid back when the refund check from the IRS is actually received.

Pawnbrokers are an alternative source for securing a loan. They hold your property and lend you a small portion of its value. If you repay the loan and the interest on time, you get your property back. If you don't, the pawn-

broker will sell it, although an extension can be arranged, for an additional fee. Pawnbrokers charge higher interest rates than other lenders; however you don't have to apply or wait for approval.

Friends and relatives are sometimes a loan source; however, such loans frequently result in friction between the parties involved. No generalizations can be made as to usual interest rate. These loans, if used, should be entered into with a contract that clearly states all terms of the agreement; signed by the parties involved.

Unlicensed lenders, commonly known as loan sharks, operate outside the law. The finance charge made by these illegal lenders is frequently more than 1,000 percent per year. This type of loan should never be considered.

Helpful Web sites

University of Missouri Outreach and Extension:
missourifamilies.org

University of Missouri Outreach and Extension publications:
<http://muextension.missouri.edu/explore/hesguide/>

Federal Consumer Information Center:
<http://www.pueblo.gsa.gov>

Federal Trade Commission:
<http://www.ftc.gov>

National Foundation for Credit Counseling:
<http://www.nfcc.org>

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Information you can use from the MU Extension Web site:

<http://muextension.missouri.edu/>



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