

How to Get and Keep Credit

Chapter Objectives

After completing this chapter, you will be able to:

▶ Section 26.1 Applying for Credit

- **Explain** how you can develop a credit history.
- **Name** five factors to think about when deciding which credit card to secure.
- **Define** the three factors that creditors consider when granting a person credit.

▶ Section 26.2 Maintaining Credit

- **Explain** one major difference between credit cards, installment loans, and mortgages.
- **Indicate** at least three ways to maintain a good credit rating.

Ask

STANDARD How to Get and Keep Credit: Inflation Risk & POOR'S

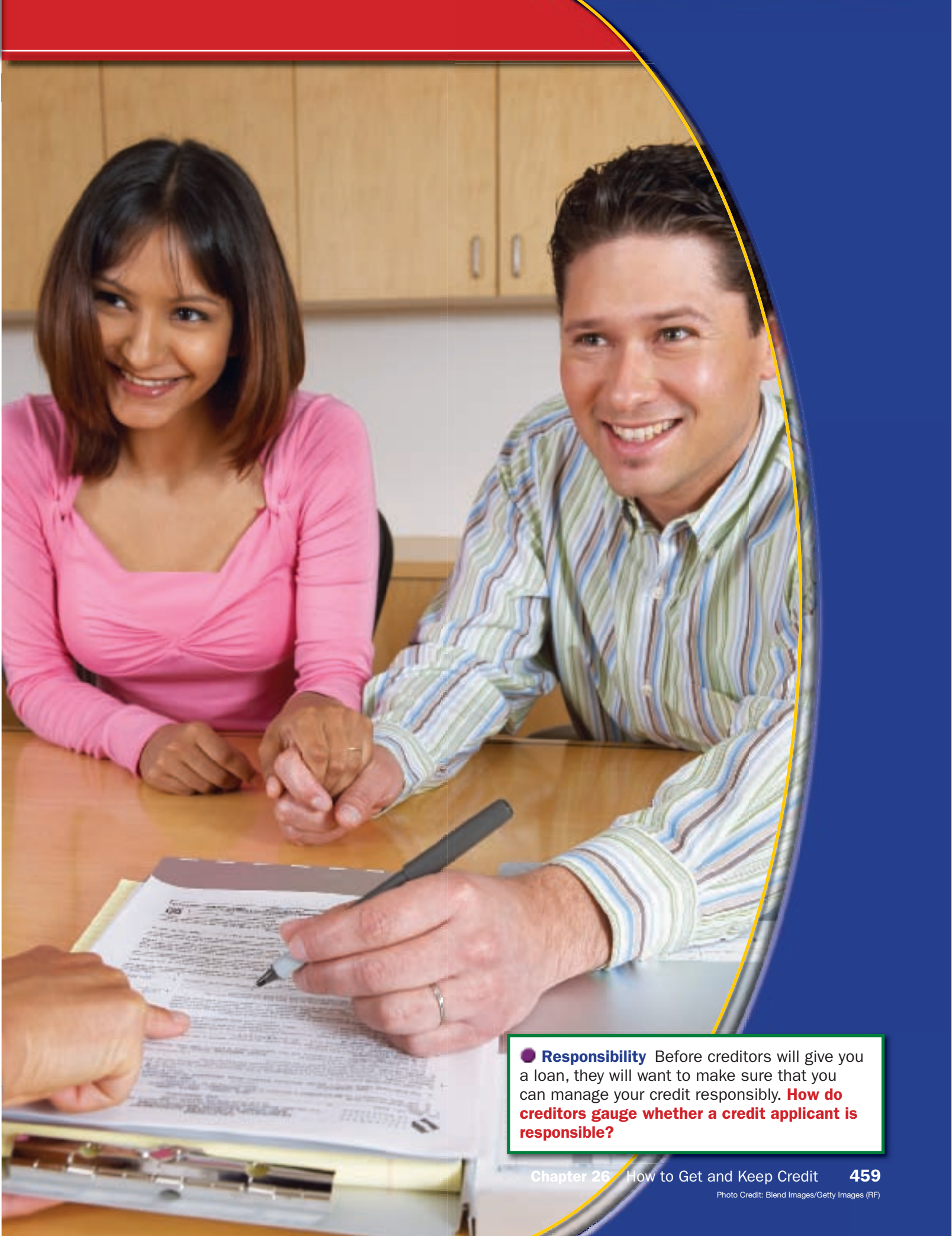
Q: How can I tell if a variable rate loan is right for me?

A: When you take out a loan or use a credit card, your interest rate will be either fixed or variable. With fixed rate plans, the interest rate does not change throughout the period of the debt. Interest rates change with variable rate plans, which may use such indices as the prime rate, the one-, three-, or six-month Treasury Bill rate, or the Federal Reserve discount rate to determine the rate to use. While a fixed rate may be a couple of percentage points higher than a variable rate at a given time, you have the advantage of knowing what the rate will be. Variable rates increase or decrease your finance charges. Fixed rates can be changed by the lender, on future purchases made on credit cards, for example, although the Truth in Lending Act requires the lender to provide 15 days' notice before changing the rate.

Mathematics You are trying to decide between a credit card that has an APR (annual percentage rate) of 18% and no annual fee, and a card that has an APR of 14% and an annual fee of \$20. What would your average monthly balance need to be for the second plan to cost less in fees and interest?

CONCEPT

Using Variables to Solve an Inequality A variable is a placeholder for an unknown value. Write an inequality inputting all of the values that you know and using a variable, such as x , to fill in for the value that you are trying to find.



● **Responsibility** Before creditors will give you a loan, they will want to make sure that you can manage your credit responsibly. **How do creditors gauge whether a credit applicant is responsible?**

Applying for Credit

Reading Guide

Before You Read

Consider what you know about using credit and how you might use a credit card.

Read to Learn

- Explain how you can develop a credit history.
- Name five factors to think about when deciding which credit card to secure.
- Define the three factors that creditors consider when granting a person credit.

The Main Idea

Developing a credit history is important. The first step will be choosing a credit card and applying for it. Before deciding to issue credit to a consumer, a creditor looks at the applicant's capacity, character, and capital.

Key Concepts

- Developing a Credit History
- Selecting a Credit Card
- Applying for a Credit Card

Vocabulary

Key Terms

annual percentage rate (APR)
 cash advance
 cosigner
 grace period
 credit limit

Academic Vocabulary

You will find these words in your reading and on your tests. Make sure you know their meanings.

impact submit
 anticipation minimum

Graphic Organizer

In a figure like the one below, list and describe the three Cs of credit.



The Three Cs of Credit



Go to the *Introduction to Business* Online Learning Center through glencoe.com for a printable graphic organizer.

Academic Standards

English Language Arts

NCTE 1 Read texts to acquire new information

NCTE 9 Develop an understanding of diversity in language use across cultures

Mathematics

Number and Operations Understand meanings of operations and how they relate to one another

Developing a Credit History

Credit can have a major **impact** on a consumer's life. If a consumer uses credit responsibly, it can make life easier in a number of ways. If the consumer uses credit irresponsibly, his or her ability to make future purchases will be harmed. To develop a credit history, you will need to apply for credit, be approved for it, use it, and then make payments to the creditor.

How do you prove to others that you can handle credit responsibly? First, develop a credit history. Most people start by getting a credit card in their own name (if they are 18 years of age or older) or getting one with an adult family member. Before getting a credit card, though, it is important to understand how credit cards work.

As You Read

Think about ways you might use credit in the future.

Selecting a Credit Card

There are several things to consider when choosing a credit card. The five main factors to consider are the interest rate, extra fees, whether the interest rate will change, whether a cosigner is needed, and whether there is a grace period. Some other questions to ask are:

- What will the cost of credit be?
- Who will accept the card?
- What is the credit limit?
- Will I be able to use the card to get cash?

The Cost of Credit

Credit cards allow people to purchase goods and services without using cash. They enable consumers to make major purchases that might otherwise take years of saving. They also provide security during emergencies. Consumers usually need a credit card to rent a car or to place a reservation for a hotel room. However, for all of their conveniences, credit cards come with a cost.

Interest Rates To gauge the cost of credit, first look at the annual percentage rate. The **annual percentage rate (APR)** determines the cost of credit on a yearly basis. For example, an APR of 18 percent means that for every \$100 you owe, you pay \$18 per year ($\$100 \times .18$) or \$1.50 per month. It is important to note if the interest rate will change on a credit card. In many cases, a credit card might offer a low introductory rate such as 3 percent. After a few months, the rate could jump to 20 percent.

International Business

International Monetary Fund

The International Monetary Fund (IMF) is an organization of 184 nations that monitors the global financial system. In the 1930s, a majority of industrial countries began trying to defend their economies with tougher restrictions on imports. Some countries abolished foreign imports entirely, while others devalued their currency in an attempt to defend their economies. These practices eventually proved detrimental to the economies they were trying to protect, and their demise showed the need for a global financial monitoring organization.

Examples of Languages Across Cultures

Q: In Finnish, how do you say: "How do you say _____?"

A: **Kuinka sanotaan** (pronounced: Koo-ink-ä sä-nō-tään)

Find out more about the IMF and how it was founded. What are the purposes of the IMF, and how have they changed since its creation?

As You Read

Think about how the cost of credit can increase when low introductory rates offered for credit cards rise considerably.

Fees Credit card companies charge different fees for different services. Some charge an annual fee. There is usually a fee for a cash advance. A **cash advance** is a loan given in cash by a credit card company in **anticipation** of the borrower's being able to repay it. A late- or missed-payment fee is charged when a payment is missed or is not made on time. Another fee is charged if the card holder is over the credit limit.

Reading Check

Explain What is the best way to gauge the cost of credit?

Other Considerations

There are other matters to consider before you will be able to get a credit card. One is that you may need a cosigner. A **cosigner** is someone who agrees to be responsible for a debt if the main applicant does not repay it. Another thing to consider is whether there is a grace period for payments. A **grace period** is an amount of time allowed to repay a debt without having to pay interest charges. There is also a grace period to make a late payment before a penalty is charged.

BusinessWeek Reader and Case Study

Personal Finance for Freshmen

College students need money smarts if they want to succeed after graduation. Increasingly, schools are offering assistance.

Undergrads who believe GPAs and test scores determine whether they can go to graduate school should consider another number: their credit score. Some law and medical schools encourage—and a few actually require—admitted students to submit their credit score to help the school decide if applicants have the means and commitment to complete the degree. Georgetown Law School urges students with severe credit issues to defer for a year while getting their finances in order. “The decisions they make today have a cumulative impact on practicing law,” says Ruth Lammert-Reeves, Georgetown's assistant dean for financial aid. According to Lammert-Reeves, bar examiners in states such as California and New York take an applicant's observance of fiduciary responsibility into consideration. The Medical College of Wisconsin even reserves the right to deny

admittance if a student doesn't provide a clean credit report.

Such actions may seem harsh, but institutions say they want to ensure that financial ignorance doesn't jeopardize a student's graduate education or career aspirations.



CASE STUDY Go to the *Introduction to Business* Online Learning Center through glencoe.com for the *BusinessWeek* Reader Case Study.

Active Learning

Consider ways the three Cs of credit apply to your life—and to your academic plans. First, develop a spreadsheet that applies each facet of creditworthiness to your personal needs and experiences. Next, create a row that applies each facet of creditworthiness to your future goals, and fill that row with the steps you will need to take to meet your goals in life.



A Promise Made
Americans buy a lot of things with credit cards. **What promises are made when making a credit purchase?**

Applying for a Credit Card

To secure a credit card, a consumer has to fill out an application form and **submit** it to the credit card company. The form asks for information about where the applicant lives and works, and what other credit the applicant has received. It also asks questions about an applicant's income and savings.

Creditworthiness: The Three Cs

Before creditors give a consumer a charge or credit account, they want to make sure the consumer is worth the risk. They consider the applicant's capacity, character, and capital, commonly referred to as the "three Cs of credit."

Reading Check **Identify** What are the three Cs of credit?

Capacity is the applicant's ability to repay the loan. To determine an applicant's capacity to pay, creditors will verify the applicant's employment and income. If the applicant already has a lot of debt in relation to his or her level of income, lenders will be less willing to extend more credit. An applicant's *character* shows whether he or she has proven to be trustworthy in repaying debts. They will ask for credit references or check with credit bureaus, businesses that provide information about consumers' creditworthiness to companies or banks. They may ask for personal or professional references, and they may check to see if the applicant has a criminal record. An applicant's *capital* is the amount of money the applicant has beyond his or her debts. It includes savings and investments. Creditors want to know if an applicant has capital that can be used as collateral.



Credit Ratings A credit rating, or credit score, is a measure of a person's ability and willingness to pay debts on time. These ratings come from Fair Isaac Corporation (FICO). The company's FICO scores, which measure credit risk, are the most widely used credit scores in the world. *Why do you think credit issuers rely on FICO scores?*

● As You Read

Think about the capital you have that would qualify you for a loan. What are some of your assets?

Credit Limits

Creditors also consider capacity, character, and capital when determining the amount of a card holder's credit limit. A **credit limit** is the maximum amount a card holder can charge on a credit card. If a person pays his or her bills on time, most creditors will raise the person's credit limit.

Making the Minimum Payment

Credit card companies usually send card holders a monthly statement of their charges, the balance they owe, and the minimum amount due. If a consumer owes \$2,000 on a credit card, he or she might have a minimum payment of \$50 to make each month. Many people make the **minimum** payment due each month. However, consumers who pay more than the minimum amount will pay less in interest and will pay off their debt more quickly. When a consumer signs a credit card application, the application is a legal contract. The minimum payment is in the contract. If the consumer does not make at least the minimum payment, the consumer is not meeting his or her legal obligation.

Section 26.1

● After You Read



Review Key Concepts

1. How can a consumer develop a credit history?
2. What is an annual percentage rate? Why is it important?
3. What are the three Cs of credit?

Academic Skills

4. **Mathematics** Mary Ellen bought some furniture on credit. Her total came to \$1,036.29 and she qualified for interest-free financing. She made a down payment of \$36.29 and agreed to pay \$50 twice a month until the \$1,000 balance was paid. As an alternative option, the store sent her a payment book. She could choose to use the 24 monthly payment coupons and pay the amount of \$49.92. What are the differences in the two payment options?

CONCEPT **Interest Rate** To determine the rate of interest given a sequence of payments, add up the payments, subtract the principal, and divide the difference by the principal.



For math help, go to the Math Appendix.



Go to the *Introduction to Business* Online Learning Center through glencoe.com to check your answers.

Maintaining Credit

Reading Guide

Before You Read

Think about the ways that you could use credit wisely.

Read to Learn

- Explain one major difference between credit cards, installment loans, and mortgages.
- Indicate at least three ways to maintain a good credit rating.

The Main Idea

There are several similarities between credit cards, installment loans, and mortgages. There are also differences. Keeping a good credit rating is important if the consumer is interested in getting loans at a reasonable cost.

Key Concepts

- Understanding Loans and Mortgages
- Keeping a Healthy Credit Record

Vocabulary

Key Terms

variable rate	secured loan
fixed rate	unsecured loan
down payment	garnishment of wages
principal	repossess
finance charge	

Academic Vocabulary

You will find these words in your reading and on your tests. Make sure you know their meanings.

similar
portion

maintain
obtain

Graphic Organizer

In a table like the one below, name and give examples of the five factors that affect your credit score.

Factors Affecting Your Credit Score	Example



Go to the *Introduction to Business* Online Learning Center through glencoe.com for a printable graphic organizer.

Academic Standards

English Language Arts

NCTE 1 Read texts to acquire new information

NCTE 6 Apply knowledge of language structure and conventions to discuss texts

NCTE 12 Use language to accomplish individual purposes

Science

Content Standard F Students should develop understanding of science and technology in local, national, and global challenges

● As You Read

Think about what it would be like to own a home.

Understanding Loans and Mortgages

Many of the principles of owning and using a credit card also apply to other types of credit. Loans and mortgages are **similar** to credit cards. They also allow consumers to borrow money that will be paid back with interest. Their requirements are similar to those of a credit card. However, there are some differences between credit cards and other forms of credit.

How Installment Loans and Mortgages Work

A *loan* is money lent by one party to another at interest. Most loans require collateral and are paid back in installments. Similarly, a *mortgage* is a loan agreement secured by property. This property is usually the item that the mortgage is for, such as a home. Installment loans and mortgages are written for a specific period of time. Many installment loans on appliances are written for three years. Installment loans for cars are often for five years. Mortgages are generally written for 15, 20, or 30 years.

With installment loans and mortgages, the interest rate is the same for the period of the loan except when the loan has a variable rate. A **variable rate** is an interest rate that fluctuates or changes over the life of the loan. A change in the rate causes changes in either the payments or the length of the term of the loan. With a **fixed rate**, the interest rate always remains the same.

● **Dream Home** Mr. and Mrs. Morgan are going to take out a loan to buy land and build their dream home. **What type of loan should they pursue?**



Online Security

Identity theft is used by criminals for stealing goods and services. In the past, identity theft wasn't a big concern, mainly because it was easy to protect against it. To guard against the theft of important "identity" factors online, be careful about the Web sites you use. Never click on links in e-mails that are sent to you by individuals who are "phishing" for secret identity information and passwords. Furthermore, it is wise to look for the SSL (secure socket layer) protection certificate symbol—signified by an "s" after the familiar "http" header on a URL—before you give out any personal data. This caution is particularly important when any aspect of your identity or financial history is at stake.

WebQuest

Go to the *Introduction to Business* Online Learning Center through glencoe.com for links to Web sites where you can research the technology protecting the security of people's identities. Look for information on how consumers can protect themselves as well as what businesses can do.

When purchasing an appliance, automobile, or home with an installment or mortgage loan, the applicant usually has to make a down payment. A **down payment** is a **portion** of the total cost that is paid when a product or service is purchased. The **principal** is the amount of borrowed money that is still owed and on which interest is based. On a *simple interest* loan, interest is based on the original principal alone.

According to the Truth in Lending Law, the lender must provide the borrower with the APR and all the finance charges of the loan. The **finance charge** is the total amount it costs the borrower to have the lender finance the loan. It includes the interest and any other charges, such as the application fee.

Secured and Unsecured Loans

When you receive an installment loan or mortgage, you must sign a written agreement to repay the loan within a certain period of time. If the loan is backed by collateral, it is called a **secured loan**. A loan that is not backed by collateral is called an **unsecured loan**. Because of the increased risk, the interest rate of an unsecured loan is often higher than that of a secured loan. A loan on a car or boat is secured. Mortgages are secured. Credit card debt is unsecured.

✓ Reading Check

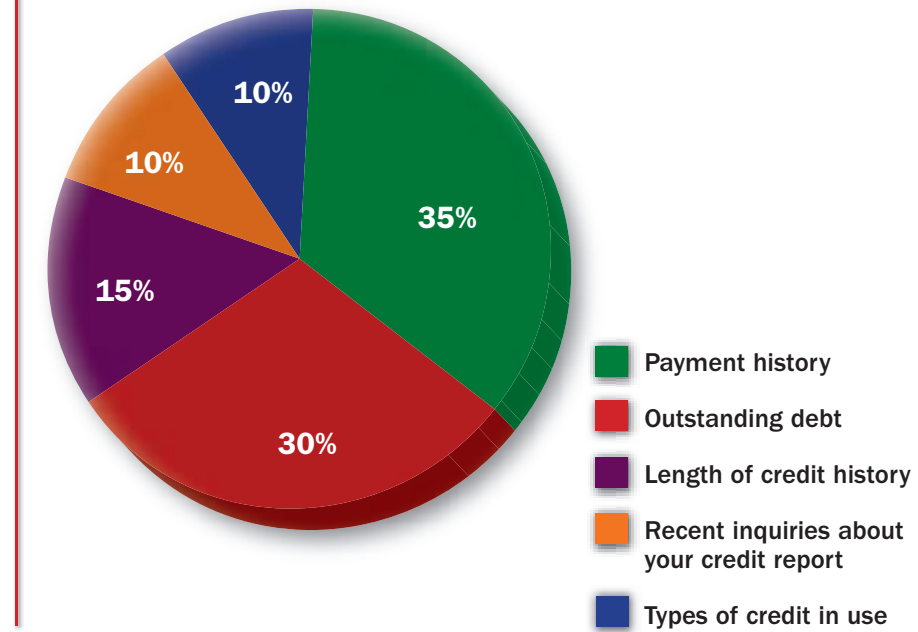
Contrast What is the difference between a secured loan and an unsecured loan?

● As You Read

Think about the impact a down payment can have on debt. Why would you want to offer a down payment on an item such as a car or a house?

Credit Score Credit bureaus take several factors into consideration when assigning your credit score. **Which of these factors do you think is most important? Why?**

Figure 26.1 Factors That Affect Your Credit Score



Keeping a Healthy Credit Record

Someday you might want to get a loan for a major expense, such as a house or business. You also might want to increase your credit limit or apply for a credit card. To continue using credit or to get new credit, you need to **maintain** a good credit rating or score. To get the best credit rating, you need to pay your bills on time. If not, your credit rating will decrease, which will make it more difficult to **obtain** additional credit. Consumers with low credit ratings are usually given higher interest rates and more restrictions. **Figure 26.1** shows the factors credit bureaus consider when determining credit scores.



Reading Check

Analyze Is it possible to get credit if you have a bad credit rating?

Staying Within Your Income Limits

You need to know the amount of credit you can afford to have. Experts say consumers should not use more than 20 percent of their income for credit payments. Suppose your first full-time job pays \$2,000 a month. After taxes, you bring home \$1,500. You have two monthly loan payments—\$120 for a student loan and \$160 for a car payment. You want to buy a new entertainment system that would cost you \$50 a month for three years. Can you afford it? No. Twenty percent of your income is \$300. Your total payments each month would be \$330, which is 22 percent of your take-home pay.

Signs of Credit Trouble

Here are some signs of credit problems.

- You cannot make monthly loan payments and minimum monthly payments on your credit cards.
- You receive second and third payment-due notices from creditors.
- You get calls from bill collectors.
- Your wages are being garnished. Credit card companies can obtain a court order to take all or part of a debtor's pay-check if he or she stops making payments. This is called **garnishment of wages**.
- The creditor takes back the item you purchased on credit. If that item was offered as collateral and you stopped making payments for it, the creditor has the legal right to **repossess** or take back the item.

There are a number of procedures you can follow to help you get out of financial trouble. Those procedures are discussed in Chapter 27.

Section 26.2

● After You Read

Review Key Concepts

1. Which type of loan usually carries a lower interest rate—a secured or an unsecured loan? Why?
2. What is the maximum percentage of your income that you should allocate to credit payments?
3. What is garnishment of wages?

Academic Skills

4. **English Language Arts** The word *debt* comes from the Latin word *debitum* meaning “something owed.” Research and describe the origin of the word *credit* and list some related words.
5. **English Language Arts** Imagine that you have decided to attend a special summer camp related to one of your interests (for example, music, sports, government, or debating). The camp experience promises to be very valuable to you, but it will cost \$1,000 for the two-week program. Write an e-mail to your teacher explaining whether this would be a good use of credit.



Go to the *Introduction to Business* Online Learning Center through glencoe.com to check your answers.

Chapter 26 Review and Activities

Section 26.1 Summary

Applying for Credit It is important to develop a credit history. Most people do this by applying for a credit card, being approved for it, using it to make purchases, and making payments on time. When looking for a credit card, there are many factors to consider, such as the APR, fees, and the grace period. When deciding whether an applicant should be granted credit, the creditor looks at the individual's capacity, character, and capital. After being approved for credit, the consumer is given a credit limit. The consumer must repay a minimum amount each month. It is wise to pay more than the minimum payment, though.

Section 26.2 Summary

Maintaining Credit There are several similarities and differences between credit cards, installment loans, and mortgages. Installment loans and mortgages are secured. Unlike unsecured loans, secured loans are backed by collateral and usually offer lower interest rates. Credit cards are unsecured. Installment loans and mortgages last for a fixed number of years. A fixed-rate loan requires the same payment each month. The interest rate on a variable-rate loan can be raised. To maintain a good credit rating, consumers must avoid using more credit than they can afford. They must also make payments on time.

Vocabulary Review

1. On a sheet of paper, use each of these key terms and academic vocabulary terms in a sentence.

Key Terms

annual percentage rate (APR)	down payment
cash advance	principal
cosigner	finance charge
grace period	secured loan
credit limit	unsecured loan
variable rate	garnishment of wages
fixed rate	repossess

Academic Vocabulary

impact	similar
anticipation	portion
submit	maintain
minimum	obtain

Review Key Concepts

2. Explain how you can develop a credit history.
3. Name five factors to think about when deciding which credit card to secure.
4. Define the three factors that creditors consider when granting a person credit.
5. Explain one major difference between credit cards, installment loans, and mortgages.
6. Indicate at least three ways to maintain a good credit rating.

Critical Thinking

7. When someone uses credit to buy a product or service, is he or she actually paying for the item?
8. Why would most credit card companies encourage consumers to make the minimum payment on a credit card balance instead of paying the full amount owed?
9. When you cosign on a loan, you agree to take responsibility for a debt if the primary credit applicant fails to pay it. Would you be willing to cosign a loan for a friend or family member? Why or why not?
10. A credit limit is a maximum amount of credit a lender will extend. Why do companies set credit limits on credit cards?
11. Do you think a debt should be repaid as soon as possible? Why or why not?
12. When is it possible to use a credit card and avoid paying interest?
13. Do you think most creditors want to repossess an item, such as a car, when the debtor cannot pay for it?
14. What criteria do you believe are most important in choosing a credit card? Explain your answer.

Write About It

15. Most credit card applications ask applicants to indicate the amount of time they have spent at their present residence and job. In two or more paragraphs indicate why you think companies want this information.
16. Many people who have a poor credit rating have a hard time getting a loan, an apartment, and a job. Is this fair or unfair? Write a brief essay discussing your opinions.
17. Some people use multipurpose credit cards for most of their everyday purchases. In at least two paragraphs, discuss why you think people use credit cards instead of cash or checks.
18. When people and companies do not pay their debts, businesses raise the prices of their goods and services. Write a brief e-mail to your teacher indicating whether that is fair. If you feel that is unfair, explain how would you change the practice.
19. For a fee, a credit bureau will provide potential creditors with a consumer's credit report. Use the Internet to find out more about the firms that provide credit scores. Then write a one-page report on your findings.

Technology Applications

Online Mortgage Calculators

20. Find the current annual interest rate offered on a 30-year fixed-rate mortgage for \$100,000. Then use an online mortgage calculator to figure the amount of a monthly payment and the total amount of interest that will be paid over 30 years.

Business Ethics

Credit Applications

21. Suppose you have a job that pays you \$15,000 a year. You receive a credit application in the mail stating that you have been pre-approved for \$3,000 in credit, but that you must make at least \$18,000 a year to receive the card. What should you do?

Chapter 26 Review and Activities

Applying Academics to Business

English Language Arts

22. Rewrite the following sentence using correct punctuation and capitalization.

before you apply to first national bank for a loan figure out the costs to make sure you can afford it

Mathematics

23. Your credit card has a limit of \$3,000. You have charged goods totaling $\frac{2}{3}$ that amount. Your yearly APR is 12%. What is the finance charge one month?

CONCEPT **Finance Charges** The monthly finance charge rate is $\frac{1}{12}$ the annual rate.

English Language Arts

24. Write two or three sentences from this chapter that explain a cause-and-effect relationship. Then write two or three cause-and-effect sentences of your own about a different topic.

Mathematics

25. Total expenses for a year at college will be \$9,000. You plan to pay \$2,600 from your savings and finance the rest at a 5% simple interest. If you make 12 equal payments in one year, how much is each?

CONCEPT **Problem Solving** Computing the answer to some problems takes several steps.

Active Learning

Study Credit Habits

26. Choose a current article on the debt levels of college students, or interview someone at a local college or bank who is an expert on this topic. Find out the average debt load of college students, reasons for their debt, and how the students deal with it. Write a report of your findings. Then form groups and discuss your reports in class.

Business in the Real World

Credit Counselors

27. Research the career of a credit counselor. Find out what the job entails, the skills and formal education credit counselors should have, and the salary range for an entry-level counselor. Investigate the certification offered by the National Foundation for Credit Counseling. Write a one-page paper on your findings.

Real LIFE skills

LEARNING ABOUT LOAN APPLICANTS

28. Interview a loan officer at a bank regarding what he or she looks for in a credit applicant and why the loan officer looks for those qualities. Ask for the primary reasons people are not approved for a loan and the percent of loans that are not repaid. What action does the bank usually take when a loan is not repaid? Report your findings in writing or orally to the class.

COOL Business CAREERS

FIND YOUR DREAM JOB

29. Go to the *Introduction to Business* Online Learning Center through glencoe.com for a link to the Occupational Outlook Handbook Web site. Click on the “OOH Search/A-Z Index” link and enter the job category “credit authorizers, checkers, and clerks.” Then write a one-page report about these types of occupations. Conclude your report with a list of things you could do now to prepare yourself to pursue the occupation.

Role Play

APPLYING FOR A CREDIT CARD

30. **Situation** You would like to apply for a credit card to use for most of your purchases. You must consider the different credit card options that are available.

Activity Research different types of credit cards from at least three financial institutions. Then present your creditworthiness to the institution you feel best suits your financial needs.

Evaluation You will be evaluated on how well you meet the following performance indicators:

- Demonstrate an understanding of the three Cs of credit.
- Evaluate the credit requirements of the financial institution that best suits your needs.
- Discuss the importance of maintaining a good credit score.
- Project your voice and use correct grammar.
- Answer questions about credit.

Standardized Test Practice

Directions Choose the letter of the best answer. Write the letter for the answer on a separate piece of paper.

1. A person’s “safe debt load” is often defined as $\frac{1}{3}$ of a person’s after-tax income less expenses. If Devon’s after-tax income is \$23,930, and his expenses are \$4,800 for housing, \$4,900 for food, \$1,280 for transportation, and \$950 for clothes, what is Devon’s safe debt load?
- A \$3,000
B \$4,000
C \$6,000
D \$12,000



TEST-TAKING TIP If you do not know the answer to a question, make a note and move to the next question. Come back to it later, after you have answered the rest of the questions.



READING Go to the *Introduction to Business* Online Learning Center through glencoe.com for a list of outside reading suggestions.