

Advantages & Disadvantages to Using Credit

Advantages to Using Credit

- Able to buy needed items now
- Don't have to carry cash
- Creates a record of purchases
- More convenient than writing cheques
- Consolidates bills into one payment
- Emergencies

Disadvantages to Using Credit

- Interest (higher cost of items)
- May require additional fees
- Financial difficulties may arise if one loses track of how much has been spent each month
- Increased impulse buying may occur

The Three Cs: How Financial Institutions Choose Qualifying Borrowers

Character—Will you repay the debt? From your credit history, does it look like you possess the honesty and reliability to pay credit debts?

- Have you used credit before?
- Do you pay your bills on time?
- Do you have a good credit report?
- Can you provide character references?
- How long have you lived at your present address?
- How long have you been at your present job?

Capital—What if you don't repay the debt? Do you have any valuable assets such as real estate, savings, or investments that could be used to repay credit debts if income is unavailable?

- What property do you own that can secure the loan?
- Do you have a savings account?
- Do you have investments to use as collateral?

Capacity—Can you repay the debt? Have you been working regularly in an occupation that is likely to provide enough income to support your credit use?

- Do you have a steady job? What is your salary?
- How many other loan payments do you have?
- What are your current living expenses? What are your current debts?
- How many dependents do you have?

Types of Credit

Single-payment credit

Items and services are paid for in a single payment, within a given time period, after the purchase. Interest is usually not charged. Examples: utility companies, medical services, most retail services.

Installment credit

Merchandise and services are paid for in two or more regularly scheduled payments of a set amount. Interest is included. A repayment plan is drawn up in the form of a conditional sales contract based upon fulfilling a number of conditions of the contract. Examples: some retail businesses, such as car and appliance dealers;

Consumer loans

Money may also be loaned for a special purpose, with the consumer agreeing to repay the debt in regularly scheduled payments. Examples: financial institutions.

Revolving credit

Many items can be bought using this plan as long as the total amount does not go over the credit user's assigned dollar limit. Repayment is made at regular time intervals for any amount at or above the minimum required amount. Interest is charged on the remaining balance. Example: credit cards issued by financial institutions and retail stores.

How Much Can You Afford? *The 20-10 Guideline*

Never borrow more than 20% of your yearly net income (not including housing debt such as rent or mortgage payments). Example:

If you earn \$3,000 a month after taxes, then your net income in one year is: $12 \times \$3,000 = \$36,000$

Calculate 20% of your annual net income to find your safe debt load: $\$36,000 \times 20\% = \$7,200$

So, you should never have more than \$7,200 of debt outstanding.

Monthly payments shouldn't exceed 10% of your monthly net income. Example:

If your take-home pay is \$3,000 a month: $\$3,000 \times 10\% = \300

Your total monthly debt payments shouldn't be more than \$300 per month.

Practice: Should They Use Credit?

Directions Read each of the following scenarios and determine the largest amount of debt each person can safely carry. Write your answers in the blanks provided.

1. \$ David has a monthly net income of \$1,360. His fixed monthly expense is a student loan payment of \$116. David would like to buy a new television set using a credit card. What is the largest monthly payment David can afford and still be within a safe debt load?
2. \$ Francine and Pierre have a combined monthly net income of \$2,700. Their fixed monthly expenses include \$220 for Francine's student loan payment and \$82 for the stereo they bought last month. Francine and Pierre would like to buy a new car. How much can they currently afford for monthly car payments and still maintain a safe debt load?
3. Yes or No? Miyoshi has a monthly net income of \$1,625. Her fixed monthly expenses include \$68 for the furniture she bought last month and a car payment of \$167. Are Miyoshi's expenses within a safe debt load?

Building Credit

In order to establish a strong credit history, you can:

- Establish a steady work record.
- Pay all bills promptly.
- Open a chequing account and don't bounce cheques.
- Open a savings account and make regular deposits.
- Apply for a local store credit card and make regular monthly payments.
- Apply for a small loan using your savings account as collateral.
- Get a co-signer on a loan and pay back the loan as agreed.

Credit bureaus

- Equifax (1-800-465-7166)
- Trans Union
- Local credit bureaus affiliated with these major companies

Personal Credit Files

Every day, Canadians purchase goods and services using credit. The decision to extend credit to you, the buyer, is made by the seller—commonly referred to as the “credit grantor.” Most often, this decision involves reviewing your personal credit file, which is obtained from a credit-reporting agency such as Equifax. The agency is a clearing house for credit information. Credit grantors provide the agency with factual information about your credit history.

The reporting agency then assembles this information into your personal file. In return, credit grantors can access your files before granting credit to you and/or to identify you for security purposes. Only you and credit grantors can alter your personal file.

How long is information kept on my credit file?

- Inquiries made by credit grantors are retained for a minimum of three years.
- Credit history and banking information is retained for six years.
- Bankruptcies are retained for six years from the date of discharge (for first bankruptcy).
- Judgments, foreclosures, and garnishments are retained for six years from the date filed.
- Credit counselling, consumer proposals to creditors, Orderly Payment of Debt (OPD), voluntary deposit information is retained for three years from the date settled.
- Collections are retained for six years from the date of last activity.
- Secured loans are retained for six years from the date filed.

What is an inquiry?

Account inquiries are carried out by credit grantors when you apply for credit and by organizations based on their client lists before making a promotional offering.

Why was I denied credit?

Credit reporting agencies neither grant nor deny any application for credit. They simply provide a factual account of your credit history to credit grantors. Each credit-granting organization reviews this information and makes an independent decision based on its own individual criteria. If there is inaccurate information on your file, contact a credit-reporting agency so that the necessary amendments can be made.

Why is something I have paid off still in my credit file?

The fact that you have paid an account on time, or did not pay as agreed, is of interest to any potential credit grantor because it reflects your ability to pay your bills. A credit file shows past and present transactions.

What can be done if I suspect I am a victim of identity fraud?

If you have lost or had your personal identification stolen, or an institution has contacted you regarding suspected fraud activity, please call your credit-reporting agency. A statement should be added to your file to alert credit grantors that you may be a victim of fraud activity.

Practice: Credit Basics

List five things you can do to build a credit history.

- 1.
- 2.
- 3.
- 4.
- 5.

When a prospective creditor evaluates a credit application, they look for the three Cs: Character, Capital, and Capacity. For each of the following statements, write the answer that corresponds to each statement's specific characteristic.

a) Character

b) Capital

c) Capacity

- | | |
|---|---|
| <ol style="list-style-type: none"> 6. Do you have a savings account? 7. Have you used credit before? 8. How long have you lived at your present address? | <ol style="list-style-type: none"> 9. Do you have a steady job? 10. Do you pay your bills on time? 11. What are your current debts and your current living expenses? |
|---|---|

List the four major categories of information that appear on a credit report.

- 12.
- 13.
- 14.
- 15.

In the space provided, write the answer of the type of credit each statement represents.

a) Single payment credit

b) Installment credit

c) Revolving credit

16. Monthly payment on a car loan
17. Monthly telephone bill
18. Monthly heating bill
19. Using a credit card to buy a new jacket from a department store and then paying the charge off over several months
20. Using a major credit card to buy a pair of shoes and then paying the total amount of the credit card balance within a month

For each of the following statements, write a T in the space provided if the statement is true, and F in the space provided if the statement is false.

21. It is legal for a creditor to deny an applicant credit based on marital status or age.
22. If you are denied credit, the creditor is not legally obligated to explain why.
23. When creditors evaluate your income, they can't legally refuse to consider income from public assistance in the same manner as other income.
24. If you are refused credit because of a credit report, upon request from you, the lender must give you the name and address of the credit bureau that issued the report.
25. Your credit report is available to anyone, regardless of the reason.
26. A debt collector has the right to contact you at any time of day or night.
27. To be within a safe debt load, your total credit should not exceed 50% of your net pay after subtracting rent.

28. What should you do if you find there is inaccurate information on your credit report?

29. Generally, how long can a consumer reporting agency report unfavourable information?

30. How long can bankruptcy information be reported by a consumer reporting agency?