Participant Guide

FDIC
Money Smart

FDIC Financial Education Curriculum

Borrowing Basics

Revision Date: 03–2010

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Checking In

Welcome

Welcome to the *Borrowing Basics* module! Sooner or later, almost everyone needs to borrow money. When used wisely, credit can benefit you and your family. But first, there are some things you should know about the value of credit and its costs. This course will help you decide when and how to use credit.

Objectives

After completing this module, you will be able to:

- Define credit and loan
- Distinguish between secured and unsecured loans
- Identify three types of loans
- Identify the costs associated with getting a loan
- Identify the factors lenders use to make loan decisions
- Explain why installment loans cost less than rent-to-own services
- Explain why it is important to be wary of rent-to-own services, payday loans, and refund anticipation loans
- Describe how to guard against predatory lending practices

Participant Materials

This *Borrowing Basics* Participant Guide contains:

- Information and activities to help you learn the material
- Tools and instructions to complete the activities
- Checklists and tip sheets
- A glossary of the terms used in this module

Pre-Test

Test your knowledge about credit before you go through the course.

1. **What is *credit*?**
    a. Money you borrow and must pay back
    b. Free money that you do not have to pay back
    c. Money you have saved for emergencies
    d. The balance left on a gift card after you have used it to pay for something

2. **Select all that apply. Maintaining good credit is important because it:**
    a. Can help you graduate from college
    b. Allows you to carry more cash than usual
    c. Allows you to buy expensive items, like a car, house, or furniture, and pay over time
    d. Might cause your interest rates to be raised

3. **What is a *loan*?**
    a. A charge by a financial institution for maintaining or servicing your loan account
    b. Money you borrow but must also repay
    c. Something valuable that you own and can sell for cash
    d. The cost of borrowing money

4. **Which type of loan is used to pay for personal expenses for you and your family? Select all that apply.**
    a. Consumer installment loans
    b. Credit cards
    c. Home loans

5. **A loan for which of the following is most likely to be unsecured? Select all that apply.**
    a. Home
    b. Car
    c. Furniture
    d. Education (e.g., student loan)

6. **Which of the following replaces a loan on your home in order to get a better interest rate?**
    a. Home equity loan
    b. Home equity line of credit
    c. Home refinance loan
    d. Home purchase loan

7. What type of an interest rate changes periodically?

a. Fixed rate
b. Variable rate
c. Waning interest
d. Dual rate

8. What should you review and compare when shopping for a loan?

a. Annual percentage rate (APR)
b. Fees
c. Truth in Lending Disclosures
d. All of the above

9. What four factors do lenders generally use in their loan making decision?

a. Collateral, capacity, capital, and whether you purchase their credit protection insurance
b. Capital, character, overdraft protection, and collateral
c. Capacity, capital, collateral, and character
d. Character, collateral, capacity, and credit limit

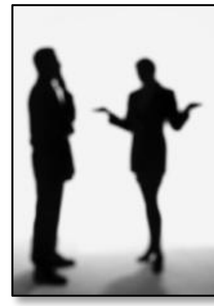
10. Getting credit is not cheap. However, which is usually the least expensive?

a. Rent-to-own services
b. Bank loan
c. Payday loan
d. Refund anticipation services

11. If someone offers you a loan, what can you do to make sure it is a good deal?

a. Check to make sure the loan provider is reputable
b. Shop around with several loan providers and compare all terms and conditions of an offered loan
c. Make sure you can afford the loan payments
d. All of the above

What Is Credit?



Credit is the ability to borrow money. When you borrow money on credit, you get a *loan*.

You make a promise to pay back the money you borrowed plus some extra. The extra amount is part of the cost of borrowing money. This cost is also called *interest*.

If you use credit carefully, it can be useful to you. Not being careful in the way you use credit can cause problems.

You have probably heard the term “good credit.” Having good credit means that you make your loan payments on time to repay the money you owe. If you have a good credit record, it will be easier to borrow money in the future. However, if you have problems using credit responsibly, it will be harder to borrow money in the future.

Why Is Credit Important?

Credit is important because it:

- Can be useful in times of emergencies
- Is more convenient than carrying large amounts of cash
- Allows you to make a large purchase, such as a car or house, and pay for it over time
- Can affect your ability to obtain employment, housing, and insurance based on how you manage it

Collateral

Collateral is security you provide the lender. Example: You pledge an asset you own, such as your home, to the lender with the agreement that it will be used as repayment if you cannot repay the loan.

A *guarantee* is a form of collateral. Example: Cosigning is a form of guaranteeing a loan; if a person with no credit history asks another person to cosign a loan, the cosigner is equally responsible and has to repay if the borrower defaults.

In a *secured loan* the borrower offers collateral for the loan. Example: Collateral is given up to the lender if the loan is not paid back. Home equity loans and home equity lines of credit are examples.

An *unsecured loan* is not backed by collateral. Example: Credit cards are often unsecured loans, although some are secured. Other examples include personal and student loans.

An *asset* is something valuable that you own like a car, savings and investment accounts, and property such as your home.

Types of Loans

Consumer Installment Loans

A *consumer installment loan* is used to pay for personal expenses for you and your family. Examples are:

- Auto loans, whereby the automobile you are purchasing is used as collateral for the loan
- Unsecured loans for short-term needs, such as buying a computer

Credit Cards

Credit cards give you the ongoing ability to borrow money for household, family, and other personal expenses.

Having a credit card allows you to buy things without actually having the money right away. Remember that if you are not careful in spending, you can get into big trouble—you could be burdened with debt. You need to be sure you are able to make the minimum monthly payment on your credit card bill.

Home Loans

There are three main types of home loans.

Home purchase loans are made for the purpose of buying a house. These loans are secured by the house you are buying.

A *home refinancing loan* is a loan that replaces an existing home loan by paying it in full and replacing it with a new home loan. A *cash-out refinance loan* allows you to borrow more money than owed on the loan to be replaced. Reasons homeowners might want to refinance their home loan include getting:

- A lower interest rate
- Money for home repairs
- Money for other personal needs

Home equity loans allow you to borrow money that is secured by your home. *Equity* is the value of the home minus the debt or what you owe on the home loan:

Value of Home	$250,000
Minus debt	-200,000
Equity	**$50,000**

If you already have a home mortgage, such as the original home purchase loan, the home equity loan would be a second mortgage also secured by your home. A lender may allow you to borrow up to a certain percentage of your home's value, generally up to 80 percent. These loans can be used for any reason.

Activity 1: Which Loan Is Best?

This exercise gives you an opportunity to practice identifying the type of loan best suited for particular items. Read the description of the purchase to be made. Fill in the blank with the most appropriate loan type for that purchase.

Types of Loans

Consumer installment loan

Credit card

Home loan (purchase, refinance, or equity)

Which type or types of loans would be best to…

…finance a college education?

____

… make small purchases in a department store, such as a $50 household appliance?

____

… make home improvements?

____

… consolidate two or more loans?

____

… buy a $500 refrigerator?

____

The Cost of Credit

Fees

Fees are charged by financial institutions for activities such as reviewing your loan application and servicing the account. A credit card company might charge you an *annual maintenance fee* of $30, a *service fee* when you get a cash advance, or a *penalty fee* for charging over your credit limit. A lender might charge a $30 *late fee* when you do not pay your bill on time.

Interest

Interest is the amount of money a financial institution charges for allowing you to use its money.

The interest rate can be either fixed or variable:

- *Fixed rates* stay the same throughout the term of the loan, except in the case of credit cards, where the rate may be changed if the bank gives you required notice.
- *Variable rates* might change during the loan term. The loan agreement will show the details of the rate changes.

Truth in Lending Disclosures

The *Federal Truth in Lending Act* requires banks to state charges in a clear and uniform manner so consumers can easily compare the actual cost of borrowing.

Lenders are required to disclose:

- The amount financed
- APR
- Finance charges
- Total payment

Activity 2: Borrowing Money Responsibly

The purpose of this exercise is to give you practice making decisions on when credit is appropriate for purchasing certain items. Read each question carefully. Then answer the questions. Be prepared to support your answer.

Should you use credit to pay overdue bills?

____

____

Should you use credit to make a purchase even if you could pay cash?

____

____

Should you use credit if you really wanted something but could not afford the monthly payment?

____

____

The True Cost of Alternative Financial Services

Getting credit is not cheap. However, getting a bank loan is usually less expensive than the following alternatives.

Rent-to-Own Services

Rent-to-own services let you use an item for a period of time by making monthly or weekly payments. If you want to purchase the item, your rental payments will be partly credited toward the purchase price. The store will set up a plan for you to rent the item until you pay enough to own it. If you choose not to purchase the item, you would simply be renting the item to be returned at the end of the rental period.

The store is the legal owner of the item until you make the final payment. If you miss a payment, the store can take the item back. If this happens you will not own the item, and you will not get your money back.

Rent-to-own agreements are technically not loans, so no interest is charged. However, the difference between the cash price (if you were to buy the item outright that day) and your total payment (the total of your rental payments over time) is like the interest you pay on a loan. Generally, using rent-to-own services is more expensive—sometimes much more expensive—than getting a consumer installment loan to buy the item.

Payday Loans

Payday loans are short-term loans (usually up to two weeks). You write a post-dated check and receive cash that day. The loan service cashes the check on your payday to pay the loan in full. You can also go into the loan office and pay your loan with cash, at which point the lender returns your uncashed check to you.

You must be careful of payday loans. They are usually made to people who need money right away and plan to pay it back with their next paycheck. However, payday loans can be much more costly than they appear at first glance. If you do not have the money to pay the loan within the agreed-upon time period, the lender will renew the loan and charge you additional fees. This will increase the total amount you owe.

Refund Anticipation Loans

Refund anticipation loans are short-term loans secured by your income tax refund. Although the business preparing your income tax return will give you the money, you are actually receiving a loan from a bank or finance company. You may not realize how much this loan is really costing you because you do not have to pay any fees associated with obtaining a refund anticipation loan at the time you receive the money.

When you electronically file (e-file) your tax return and request direct deposit, your refund is often deposited in your bank account within two weeks. Sometimes refund anticipation loans take just as long, yet cost you substantially more money.

Many organizations host Volunteer Income Tax Assistance (VITA) sites. VITA is an Internal Revenue Service (IRS)-coordinated program that provides free income tax assistance and e-filing. Income eligibility restrictions may apply. Contact the IRS for a location near you.

When You Need Money Fast

Many people have turned to alternative financial service providers such as pawnshops, car title lenders (for a loan secured by the borrower's car), and payday lenders (for unsecured loans that borrowers promise to repay out of their next paycheck or regular income payment). While many nonbank lenders advertise quick and easy cash, their services tend to come at a steep price and can trap you in a cycle of debt. Here are some tips for finding emergency cash at affordable prices.

- **Borrow From Yourself**
  The best way to avoid a cash crunch is to put money into an emergency savings account that you can use to pay for unforeseen expenses. You might even link this savings account to your checking account to protect yourself if you were to ever overdraw your checking account. Experts say this emergency savings account should equal about three to six months of living expenses to get you through a difficult period without having to take out a loan or borrow from retirement savings. If saving money seems impossible to you, consider making small, simple changes in your habits or banking practices. Possibilities include having your paycheck directly deposited into your checking account with a portion automatically placed into an emergency account.
- **Comparison Shopping**
  If you do need to borrow money, it pays to comparison shop. When comparison shopping for loans, look at both total dollar costs and the APR. Payday lenders, for example, typically charge about $15 for every $100 borrowed. So, on a $500 loan for two weeks, you would pay $75 in interest. That might not sound like a lot of money to pay for a small loan, but it translates to a whopping 391 percent APR! If you renew or roll over the $500 loan for another two weeks, you would pay an additional $75 in fees. At that rate, in just 14 weeks, you will owe more in fees ($525) than the original loan!
- **Emergency Cash Options from Banks**
  Many banks offer reasonably priced, small loans that enable you to borrow money and repay the money (plus interest) later. One example is a line of credit, which you can use to borrow money for a short period of time. It is best to work with your bank to set up an account in advance instead of waiting until you are in a rush to get cash. As with any other loan, you will be told the APR before signing a formal agreement.

  If you need cash quickly, be cautious of using fee-based overdraft programs to deliberately overdraw your account. The costs can quickly add up depending on the number of transactions covered. To learn more, read the interagency brochure, "Protecting Yourself from Overdraft and Bounced-Check Fees" available online at www.federalreserve.gov/pubs/bounce/default.htm.

Ultimately, it is a good idea to open and build up a savings fund to cover unexpected expenses. That way, you can borrow from yourself and avoid paying interest and fees.

How Credit Decisions Are Made

When you apply for credit, the lender will review the Four Cs to decide whether you are a good credit risk, or in other words, whether you are likely to pay back the loan. These are the Four Cs:

- *Capacity* refers to your present and future ability to meet your payments
- *Capital* refers to the value of your assets and your net worth
- *Character* refers to how you have paid your bills or debts in the past
- *Collateral* refers to property or assets offered to secure the loan

Free Annual Credit Report

You can obtain free annual credit reports by doing one of the following:

- Submit a request online at www.annualcreditreport.com
- Call toll-free: **1-877-322-8228**
- Complete the Annual Credit Report Request Form from www.annualcreditreport.com or www.ftc.gov/credit and mail it to:

Annual Credit Report Request Service
P. O. Box 105281
Atlanta, GA 30348-5281

Questions to Ask Before Applying for a Loan

Here are some important questions you need to ask yourself before applying for credit:

- Do I need this?
- Do I need this now?
- Can I wait until I have cash to pay for it?
- Can I get credit?
- What is the total cost of the credit, including fees?
  - Can I afford the monthly payments?
  - What is the APR?

Tips for Managing Your Credit

Once you have decided you want to get a loan and have been approved, you need to keep these tips in mind to use the money you have borrowed wisely.

- Try to pay off your entire bill (for credit cards or other lines of credit) each month. If you cannot, paying more than the minimum balance due will reduce finance charges and total interest paid.
- Pay on time to avoid late fees and to protect your credit history. If you cannot pay on time, call your creditor immediately to explain the situation. The creditor may waive the late fees or be willing to make other payment arrangements.
- Check your monthly statements regularly to verify that they are accurate. Call your creditor right away if you suspect or identify any errors.

- Ignore offers creditors may send you to reduce or skip payments. You will still be charged finance charges during this period.
- Think about the cost difference if you purchase your item with cash versus if you purchase your item with credit.

Guard Against Predatory Lending Practices

The best ways to guard against being involved in a predatory loan transaction is to be a good consumer by:

- Dealing with reputable loan providers
- Shopping around with several loan providers *of your choice* to obtain the best terms
- Reading and understanding all terms and conditions of an offered loan or asking questions until you are sure you understand
- Ensuring you can afford and make payments according to the loan terms

Post-Test

Now that you have gone through the course, see what you have learned.

1. **If you buy something on credit, you must pay back the amount you borrowed:**
   a. All at once
   b. Plus interest
   c. According to the credit terms
   d. b and c

2. **A loan is the amount of money a financial institution charges for letting you use its money.**
   a. True
   b. False

3. **The three main types of loans are:**
   a. Consumer installment loans
   b. Credit cards
   c. Home loans
   d. All of the above

4. **What is used as collateral for a home loan?**
   a. The home
   b. The furniture or furnishings
   c. Personal assets (e.g., a car)
   d. All of the above

5. **Which of the following is an example of a secured loan?**
   a. Home loans and home equity loans
   b. Most credit cards
   c. Personal loans
   d. Student loans

6. **Which type of interest rate can change during the loan term?**
   a. Fixed interest rate
   b. Variable interest rate

7. **Which of the following must be included in the Truth in Lending Disclosure? Select all that apply.**
   a. Amount financed
   b. APR
   c. Finance charge
   d. Total payments

8. **Lenders will review the Four Cs to determine whether you are a good credit risk. Which of the following refers to property or assets offered to secure the loan?**
    a. Capacity
    b. Collateral
    c. Capital
    d. Character

9. **What can you do to guard against predatory lending practices? Select all that apply.**
    a. Deal with reputable loan providers
    b. Read and understand all terms and conditions of an offered loan
    c. Accept offered credit before you know whether you can afford it
    d. Accept the first loan offer you receive or the first one that sounds reasonable

10. **You must be careful of rent-to-own services, payday loans, and refund anticipation loans because they often cost more than an installment loan.**
    a. True
    b. False

11. **Why is credit important?**
    a. It allows you to make a large purchase, such as a car or house and pay for it over time
    b. It can be useful in times of emergencies
    c. It is more convenient and safer than carrying large amounts of cash
    d. All of the above

Glossary

Annual Percentage Rate (APR): The cost of your loan expressed as a yearly percentage rate.

Credit: The ability to borrow money.

Collateral: The security you provide the lender.

Consumer Installment Loan: A loan used to pay for personal expenses for you and your family over a set term or period of time.

Credit Cards: Plastic cards with magnetic strips on the back. The front displays your account number, name, and bank name. With a credit card, you can buy goods or services and pay for them over time, receiving a bill each month. Credit cards give you the ongoing ability to borrow money for household, family, and other personal expenses.

Fees: The amounts charged by financial institutions for activities such as reviewing your loan application and servicing the account.

Fixed Rate: The interest rate stays the same throughout the term of the loan, except in the case of credit cards, where the rate may be changed.

Guarantee: A form of collateral. It occurs when someone you know agrees to be responsible for any money that you owe the lender but have not paid.

Home Equity Loan: A loan that allows a homeowner to borrow money that is secured by their home.

Home Purchase Loan: A loan for the purpose of buying a house. This loan is secured by the house you are buying.

Home Refinancing Loan: A loan process by which an existing home loan is paid off and replaced with a new loan.

Interest: The amount of money a financial institution charges for letting you use its money.

Loan: Money borrowed on credit.

Payday Loan: A short-term loan. The loan service cashes the check on your payday, at which time your loan is paid in full.

Penalty APR: The terms of your credit card agreement may provide that the creditor will permanently increase the interest rate on your credit card by a large amount if you do not pay your credit card bill on time, or if you exceed your credit limit.

Predatory Lending: Use of certain marketing tactics in making loans, such as abusive collection tactics and loan terms that deceive borrowers into thinking they are receiving better loan terms than they really are.

Refund Anticipation Loans: Short-term loans secured by your income tax refund.

Rent-to-Own Service: A service that lets you use an item for a period of time by making monthly or weekly payments. You can opt to purchase the item(s) you are renting as well, but it is usually much more expensive than purchasing the item (s) outright.

Unsecured Loan: A loan not backed by collateral. Credit cards are often unsecured loans, although some are secured by a bank account.

Variable rate: An interest rate that may change during the loan term.

For Further Information

Federal Deposit Insurance Corporation (FDIC)
www.fdic.gov/consumer
Division of Supervision & Consumer Protection
2345 Grand Boulevard, Suite 1200
Kansas City, Missouri 64108
1-877-ASK-FDIC (275-3342)
Email: consumeralerts@fdic.gov

Visit the FDIC's website for additional information and resources on consumer issues. For example, every issue of the quarterly *FDIC Consumer News* provides practical hints and guidance on how to become a smarter, safer user of financial services. Also, the FDIC's Consumer Response Center is responsible for:

- Investigating all types of consumer complaints about FDIC-supervised institutions
- Responding to consumer inquiries about consumer laws and regulations and banking practices

U.S. Financial Literacy and Education Commission
www.mymoney.gov
1-888-My-Money (696-6639)
MyMoney.gov is the U.S. Government's website dedicated to teaching all Americans about financial education. Whether you are planning to buy a home, balance your checkbook, or invest in your 401k, the resources on MyMoney.gov can help you. Throughout the site, you will find important information from federal agencies.

Federal Trade Commission
www.ftc.gov/credit
1-877-FTC-HELP (382-4357)
The Federal Trade Commission (FTC) website offers practical information on a variety of consumer topics, including privacy, credit, and identity theft. The FTC also provides guidance and information on how to select a credit counselor.

What Do You Know? – Borrowing Basics

Instructor: ____ Date: ____________________

This form will allow you and the instructors to see what you know about credit both before and after the training. Read each statement below. Please circle the number that shows how much you agree with each statement.

	Before the Training				After the Training			
I can:	Strongly Disagree	Disagree	Agree	Strongly Agree	Strongly Disagree	Disagree	Agree	Strongly Agree
1. Define credit and loan	1	2	3	4	1	2	3	4
2. Distinguish between secured and unsecured loans	1	2	3	4	1	2	3	4
3. Identify three types of loans	1	2	3	4	1	2	3	4
4. Identify the costs associated with getting a loan	1	2	3	4	1	2	3	4
5. Identify the factors lenders use to make loan decisions	1	2	3	4	1	2	3	4
6. Explain why installment loans cost less than rent-to-own services	1	2	3	4	1	2	3	4
7. Explain why it is important to be wary of rent-to-own services, payday loans, and refund anticipation loans	1	2	3	4	1	2	3	4
8. Describe how to guard against predatory lending practices	1	2	3	4	1	2	3	4

Evaluation Form

This evaluation will enable you to assess your observations of the *Borrowing Basics* module. Please indicate the degree to which you agree with each statement by circling the appropriate number.

Statement	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
1. Overall, I felt the module was: [ ] Excellent [ ] Very Good [ ] Good [ ] Fair [ ] Poor					
2. I achieved the training objectives.	1	2	3	4	5
3. The instructions were clear and easy to follow.	1	2	3	4	5
4. The overheads were clear.	1	2	3	4	5
5. The overheads enhanced my learning.	1	2	3	4	5
6. The time allocation was correct for this module.	1	2	3	4	5
7. The module included sufficient examples and exercises so that I will be able to apply these new skills.	1	2	3	4	5
8. The instructor was knowledgeable and well-prepared.	1	2	3	4	5
9. The worksheets are valuable.	1	2	3	4	5
10. I will use the worksheets again.	1	2	3	4	5
11. The participants had ample opportunity to exchange experiences and ideas.	1	2	3	4	5

	None				Advanced
12. My knowledge/skill level of the subject matter before taking the module.	1	2	3	4	5
13. My knowledge/skill level of the subject matter upon completion of the module.	1	2	3	4	5

14. Name of Instructor: Instructor Rating: Please use the response scale and circle the appropriate number.	**Response Scale:** **5 Excellent** **4 Very Good** **3 Good** **2 Fair** **1 Poor**

Objectives were clear & attainable	1	2	3	4	5
Made the subject understandable	1	2	3	4	5
Encouraged questions	1	2	3	4	5
Had technical knowledge	1	2	3	4	5

What was the most useful part of the training?

What was the least useful part of the training and how could it be improved?