

# Understanding Credit & Managing Student Loans



Developed by  
Virginia Bankers Association Education Foundation  
&  
VBA Emerging Bank Leaders

Prepared for  
VBA Bank Day Scholarship Program Participants



## TYPES OF FINANCIAL INSTITUTIONS

- Banks\*
- Credit Unions\*
- Savings & Loan Associations\*
- Savings Banks\*
- Brokerage Firms
- Pay-day Lenders
- Credit Card Companies
- Investment Banks

*\*Deposits Insured up to \$250,000*



## BEING “BANKED”

Advantages	Disadvantages
Access to Money	Limited Access to Credit
Convenience	No Insurance
Safe/Insured	Potential for Loss (Robbery, Fire, Etc.)



One of the disadvantages of being unbanked is limited access to credit. Often times customers who have not established credit or who have poor credit may turn to pay day loan services who charge very high fees for their services. Another consequence of not having a banking relationship is the lack of deposit insurance. If you have your money with a bank or credit union, you are guaranteed to get up to \$250,000 per person no matter what happens. If you keep your money at your house, if there is a fire or you are robbed, it is gone forever.

In summary, the key questions in deciding where to put your money are:

### Is it insured?

Is it accessible? (available for withdrawal when you need it)

Is it convenient? (on-line banking, debit card access, branch etc.)

## BASIC SERVICES PROVIDED BY FINANCIAL INSTITUTIONS

- **Checking Accounts** – Quick access to funds on demand
- **Savings Accounts** – Pays interest and not as easily accessible
- **Certificates of Deposit** – Pays interest with specific maturity or accessibility
- **Consumer Loans & Credit Cards** – Secured and unsecured method of purchasing consumable goods and paying for them over time



### Financial Institutions generally offer:

- **Checking Accounts** - an account held for the purpose of securely and quickly providing frequent access to funds on demand, accounts are also referred to as demand accounts or demand deposit accounts. They are meant neither for the purpose of earning interest nor for the purpose of savings, but for convenience of the business or personal client; hence they tend not to bear interest or if so, at a smaller rate than savings accounts. Instead, a customer can deposit or withdraw any amount of money any number of times, subject to availability of funds. Funds can be withdrawn either by writing a check or by using a debit card. (See slide 20 for more discussion of debit cards.)
- **Savings Accounts** – an account that pays interest but cannot be used directly as money (for example, by writing a check). These accounts let customers set aside a portion of their liquid assets while earning a monetary return. Interest rates on savings accounts vary according to balance requirements and transaction requirements, for example some accounts pay higher rates of interest but limit the number of transactions allowed before a fee is charged.
- **Certificates of Deposit** - similar to savings accounts in that they are insured and thus virtually risk-free; they are "money in the bank" (CDs are insured by the FDIC for banks or by the NCUSIF for credit unions). They are different from savings accounts in that the CD has a specific, fixed term (often three months, six months, or one to five years), and, usually, a fixed interest rate. It is intended that the CD be held until maturity, at which time the money may be withdrawn together with the accrued interest. This type of deposit represents an agreement between the financial institution and the customer that the financial institution will have the money for the specified amount of time. Therefore, if the customer chooses to redeem the CD before the maturity date, there is usually a penalty (in dollars).
- **Consumer Loans** – a wide range of loans which are either unsecured (use no collateral) or are secured for the purchase of consumable items such as a car, boat, manufactured home, line of

credit, recreational vehicle, etc. Consumer loans do not include mortgage loans (typically used for home purchases) or commercial loans (loans made to businesses for business purposes.)

## IS MY MONEY SAFE?

- **Banks, Savings Banks and Savings & Loan Association** – Federal Deposit Insurance Corporation (FDIC) – Up to \$250,000
- **Credit Unions** – National Credit Union Share Insurance Fund (NCUSIF) – Up to \$250,000



**Banks, credit unions and savings and loan companies are required to ensure deposits up to a certain level. There are two primary funds which cover all insured financial institutions.** In the fall of 2008, the insurance protection was increased to \$250,000 for all types of accounts through the end of 2009. Federal legislation then extended this increase through 2013. **All financial institutions that carry deposit insurance are required to pay premiums that the government maintains and uses to cover future losses. The premiums are based upon the amount of losses the insurance fund has and expects to have and is allocated to all institutions based upon the amount of deposits any one institution holds.**

**Credit Unions** are insured through The National Credit Union Administration (NCUA), an independent federal agency that charters and supervises federal credit unions and backed by the full faith and credit of the U.S. government. The NCUA operates the National Credit Union Share Insurance Fund (NCUSIF), insuring the savings of 80 million account holders in all federal credit unions and many state-chartered credit unions. NCUSIF provides coverage on deposits at federally insured credit unions.

**Banks** are insured through the Federal Deposit Insurance Corporation (FDIC). The FDIC provides deposit insurance, which guarantees the safety of deposits in member banks, currently up to \$250,000 per depositor per bank. The FDIC insures deposits at all banks. The FDIC also examines and supervises certain financial institutions for safety and soundness, performs certain consumer-protection functions, and manages banks in receiverships (failed banks).

**Savings and Loan Companies** used to be insured by the Federal Savings and Loan Insurance Corporation (FSLIC) until 1989, when the Financial Institutions Reform, Recovery and Enforcement Act abolished it in 1989 and transferred the responsibility for savings and loan deposit insurance to the FDIC (see Banks above).

**Other Options are Available....At a Price.**

The advantages of using check-cashing and pay day lenders, also called cash advances, are the quick access to money and the lack of a credit check. These advantages are far outweighed by the interest rates and fees that are charged for these services. Finance charges on payday loans are typically in the range of 15 to 30 percent of the amount for the two-week period, which translates to rates ranging from 390 percent to 780 percent when expressed as an annual percentage rate (APR).

## COMMON DEBT PROBLEMS

- Liens
- Foreclosures
- Garnishments
- Bankruptcy (Chapter 7 & 13)
- Repossessions
- Evictions
- Student loans



### Common Debt Problems to Avoid:

Aside from adding negative marks to a person's credit report, there are numerous other reasons to avoid debt problems. These include specific actions taken by finance companies and other creditors when the credit that they have extended to a person has not been handled properly. These actions include: liens, foreclosure, garnishment, repossessions, and evictions. Let's go over each action to learn what it means, and what you can do to ensure that it is something that you never have to face.

**1. Liens:** A lien is a legal claim against an item of property which is used to secure a loan and which must be paid when the property is sold. A lien can be placed on many different items; a house, a car, a motorcycle, a boat, or a piece of equipment. If a person falls behind on their debt payments to a creditor, that creditor may place a lien against the item of property. This lien will prevent that item from being sold until the debt is satisfied. This situation can be avoided by making debt payments on time and in full.

**2. Foreclosure:** Foreclosure is a situation in which a homeowner is unable to make debt payments on their mortgage loan, so the lender (creditor) can seize and sell the property as stipulated in the terms of the mortgage loan contract. Although most people claim to "own" their home, as long as there is a mortgage on the home, the mortgage lender holds the right to step in and force the sale of the house if payments are not made in a timely manner. To avoid having to ever face foreclosure and be forced to find another place to live, ensure that all mortgage loan payments are made on time, never buy more house than your budget permits, and maintain a level of savings adequate to cover mortgage payments in the event of unexpected job loss.



**3. Garnishment:** The term garnishment refers to a court-ordered method of debt collection in which a portion of a person's salary is paid to a creditor. Garnishment can become an ongoing issue faced by someone with debt problems. If a borrower does not make the scheduled debt payments, a creditor can take the issue to court and receive a judgment which will allow them to receive a portion of the borrower's paycheck. Imagine how frustrated you would be if someone took \$200 out of every one of your paychecks and there wasn't anything that you could do about it! By keeping your debt load within in check, and making all of your payments on time, you can avoid a garnishment of your paychecks.

**4. Repossessions:** The term repossession refers to the taking back of property by a lender from the borrower or buyer, usually due to default of debt payments. The lender repossesses the item in hopes that by re-selling it, they can pay back down the debt level on which the borrower defaulted. Most repossession occurs with automobiles, although lenders can also repossess boats, motorcycles, equipment, or rented furniture/ electronics. To avoid having your car repossessed in the middle of the night by your lender, make sure that the payments are made on time and are being sent to the correct address.

**5. Evictions:** To put out a tenant by legal process. Evictions, like foreclosures, can result in a borrower being forced to move out of their home. An eviction occurs when a landlord is not paid the rent that they are contractually due and through legal proceedings forces the tenant out of the space. As with all other debt problems that we have discussed, this can be avoided by making your monthly rent payments in a timely manner.

**6. Bankruptcy:** Bankruptcy is the legal process in which a person declares inability to pay debts. While the law provides for many different types of bankruptcy, most are either declared as Chapter 7 or Chapter 13.

Under Chapter 7, any available assets are liquidated and the proceeds are distributed to creditors.

Under Chapter 13, a declaration is made that the individual needs a temporary break from payments, but intends to pay off debt over a period of 3 to 5 years. Upon a court declaration of bankruptcy, a person surrenders assets to a court-appointed trustee, and is relieved from payment of previous debts.

Filing for bankruptcy may help you solve debt problems, but it is a serious step to take. A bankruptcy notation will stay on your credit report for ten years, which can affect your future ability to get credit, insurance or even a job.

In summary, debt problems can not only affect your credit report, but also your daily life. It is of paramount importance to ensure that you take the necessary steps to avoid the pitfalls that will increase your chances of facing any of the debt problems that we have discussed. Through use of a monthly budget and logging of debt payments, your chances of financial success are greatly increased.

## AVOIDING DEBT PROBLEMS

- Stick to a budget.
- Maintain a record keeping system.
- Consider early payoffs, where advantageous.
- Make sure to live within your means and only use debt that is within a level that your income can support.
- Make it your goal to eventually live debt free.



So far today we have learned about the advantages of being banked, the best means to build and maintain your personal credit, where to find credit, and the details of how credit cards work. With credit, however, usually comes debt.

### Is all debt bad?

Contrary to what the headlines often read, debt in and of itself is not all bad. There are things most Americans wouldn't be able to do without borrowing: Buy a house, a car, get a college education. That's how you can tell the difference between good debt and bad debt. Good debt is debt that actually gets you somewhere. It's the mortgage that puts a roof (one you can actually afford, mind you) over your head, the car loan that gets you back and forth to work, the student loan that helps fund the college education that increases your lifetime earning potential by \$1 million.

A person's income is the main determinate of how much debt they can manage. There are many people that fall into the trap of taking on more debt than their income will support, or using debt to finance purchases that shouldn't be made on credit. Many people also fail to hold enough money in savings to cover their debt payment in the event of unexpected job loss.

Aside from mortgage, auto, and student loan debt, the easiest strategy for dealing with debt is to simply avoid it - stick to your budget and pay off any credit card bills immediately. ***Remember, if you can eat it, drink it or wear it, it probably should not be paid for on a credit card.***

### Managing Debt

The problem with debt is that it rarely happens all at once - little by little your credit card balance increases until one day you discover it will take months or even years to pay it all off. If left unchecked, all cases of

chronic debt have the same result - your credit rating is ruined and banks, credit card companies, and other lenders deny you credit. Once this happens, get ready to be called at dinnertime by collection agents, and attempts to finance a car or home in the future - even if you have paid the debt - may be refused.

Now that you understand the gravity of this situation, we have good news; following some simple strategies can help everyone to keep their credit healthy and avoid debt problems.

**1. Stick to a budget.** Write down a budget that includes all of your monthly take home pay (salary minus taxes) as well as other income (e.g. investment income, alimony) and all expenses. Include savings for retirement and unexpected expenses. Ensure that the income number is larger than the expense number. If it isn't, you are living beyond your means and need to reduce your expenses. Once you have a budget that works, stick to it!

**2. Maintain a record keeping system:** Keep a log of when bills are due and when they are paid. Use this log in conjunction with your budget to ensure that all debt payments are made on time, thereby avoiding late payment penalties and protecting your credit report standing. Maintain a check register of your checking account to insure you have sufficient funds to cover upcoming expenses and to avoid fees.

**3. Consider early payoffs, where advantageous:** If your income goes up, seek to increase the size of payments on your existing debt as well. By doing so, you will pay off your debt faster and reduce the amount of interest paid to the lender, putting more money back into your pocket. The less debt that you have, the less likely you are to face problems created by debt. Check with your lender to make sure there is not a penalty for paying off your loan early. While rare, there are some lenders who charge a fee to the borrower for paying off a loan prior to the scheduled payoff date.



# UNDERSTANDING CREDIT

THE IMPORTANCE OF UNDERSTANDING YOUR CREDIT SCORE



## MEASURING YOUR CREDIT

### 4 Types of Information Make Up Your Individual Credit Report

<i>Personal Information:</i>	Name, address, SS#, DOB & employment information
<i>Accounts:</i>	Credit accounts that report on you
<i>Inquiries:</i>	Lenders and others who check your credit report
<i>Negative Items:</i>	Delinquency information and public records (bankruptcy, tax liens, judgments, etc.)



## Establishing a Good Rating

Your personal credit report consists of four types of information. From this information, the credit bureaus calculate your credit score.

The four types of information within your credit report include:

### **1. Personal Information**

Your name, address, Social Security number, date of birth and employment information is used to identify you. These factors are not used in calculating your credit score. Updates to this information come from information you supply to lenders.

### **2. Accounts**

These are your credit accounts. Most lenders report on each account you have established with them. They generally report the type of account (credit card, auto loan, mortgage, etc.), the date you opened the account, your credit limit or loan amount, the account balance and your payment history.

### **3. Inquires**

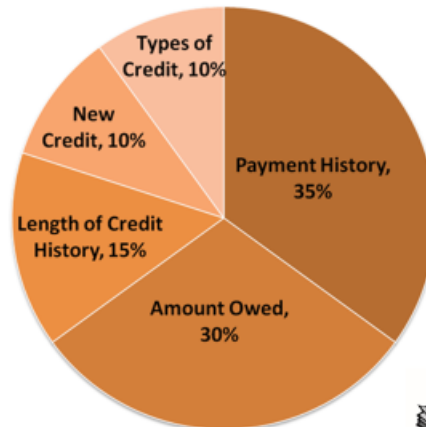
When you apply for a loan, you authorize your lender to ask for a copy of your credit report. This is how inquiries appear on your credit report. The inquiries section contains a list of lenders who accessed your credit report within the last two years. The report you see lists “voluntary” inquiries, spurred by your own requests for credit, and may also list “involuntary” inquiries, such as when lenders order your report before making you a preapproved credit offer in the mail. See page 15 for more information on inquiries.

### **4. Negative Items**

Lenders report delinquency information when you have missed a payment. Credit reporting agencies also collect information on overdue debt from collection agencies, and public record information from state and county courts. Public record information includes: bankruptcies, foreclosures, tax liens, garnishments, legal suits and judgments.

## CREDIT SCORE MAKE UP

Credit Score = A Number That Summarizes Your Credit Risk



When lenders order your credit report, they can also buy a credit score that is based on the information in the report. That credit score is calculated by a mathematical equation that evaluates many types of information from your credit report at that agency. By comparing this information to the patterns in hundreds of thousands of past credit reports, the credit score estimates your level of future credit risk.

In order for a credit score to be calculated on your credit report, the report must contain enough information—and enough recent information—on which to base a score. Generally, that means you must have at least one account that has been open for six months or longer, and at least one account that has been reported to the credit reporting agency within the last six months.

Credit scores provide a reliable guide to future risk based solely on credit report data. Credit scores have a 300–850® score range. The higher the score, the lower the risk. But no score indicates whether a specific individual will be a “good” or “bad” borrower. And while many lenders use credit scores to help them make lending decisions, each lender has its own strategy, including the level of risk it finds acceptable for a given credit product. There is no single “cutoff score” used by all lenders.

To ensure that you create and maintain a good credit report and score, you must pay attention to the five areas that the credit agencies consider when calculating your credit. Remember, your credit history is your responsibility. These areas are:

### 1. Payment History; *what is your track record?*

*Approximately 35% of your credit score is based on this category.*

The first thing any lender would want to know is whether you have paid past credit counts on time. This is also one of the most important factors in a credit score. Late payments are not an automatic “scorekiller.” An overall good credit picture can outweigh one or two instances of, say, late credit card payments. But having no late payments in your credit report doesn’t mean you will get a “perfect score.” Some 60%–65% of credit reports show no late payments at all. Your payment history is just one piece of information used in calculating your credit score.

Your credit score takes into account:

**-Payment information on many types of accounts.**

These will include credit cards (such as Visa, MasterCard, American Express and Discover), retail accounts (credit from stores where you do business, such as department store credit cards), installment loans (loans where you make regular payments, such as car loans), finance company accounts and mortgage loans.

**-Public record and collection items—reports of events such as bankruptcies, foreclosures, suits, wage attachments, liens and judgments.**

These are considered quite serious, although older items and items with small amounts will count less than more recent items or those with larger amounts. Bankruptcies will stay on your credit report for 7–10 years, depending on the type.

**-Details on late or missed payments (“delinquencies”) and public record and collection items.**

The credit score considers how late they were, how much was owed, how recently they occurred and how many there are. A 60-day late payment is not as significant as a 90-day late payment, in and of itself. But recency and frequency count, too. A 60-day late payment made just a month ago will affect a score more than a 90-day late payment from five years ago.

**-How many accounts show no late payments.**

A good track record (paying on time) on most of your credit accounts will increase your credit score.

**2. Amounts Owed; *How much is too much?***

*Approximately 30% of your credit score is based on this category.*

Having credit accounts and owing money on them does not necessarily mean you are a high risk borrower with a low credit score. However, when a high percentage of a person's available credit has already been used, this can indicate that a person is overextended, and is more likely to make some payments late or not at all. Part of the science of scoring is determining how much is too much for a given credit profile.

Your credit score takes into account:

**-The amount owed on all accounts.**

Note that even if you pay off your credit cards in full every month, your credit report may show a balance on those cards. The total balance on your last statement is generally the amount that will show in your credit report.

**-The amount owed on all accounts, and on different types of accounts.**

In addition to the overall amount you owe, your credit score considers the amount you owe on specific types of accounts, such as credit cards and installment loans.

**-Whether you are showing a balance on certain types of accounts.**

In some cases, having a very small balance without missing a payment shows that you have managed credit responsibly, and may be slightly better than carrying no balance at all. On the other hand, closing unused credit accounts that show zero balances and that are in good standing will not raise your credit score.

**-How many accounts have balances.**

A large number can indicate higher risk of over-extension.

**-How much of the total credit line is being used on credit cards and other “revolving credit” accounts.**

Someone closer to “maxing out” on many credit cards may have trouble making payments in the future.

**-How much of installment loan accounts are still owed, compared with the original loan amounts.**

For example, if you borrowed \$10,000 to buy a car and you have paid back \$2,000, you owe (with interest) more than 80% of the original loan. Paying down installment loans is a good sign that you are able and willing to manage and repay debt.

**3. Length of Credit History; *How established is yours?***

*Approximately 15% of your credit score is based on this category.*

In general, a longer credit history will increase your credit score. However, even people who have not been using credit long may get high credit scores, depending on how the rest of the credit report looks.

Your credit score takes into account:

**-How long your credit accounts have been established, in general.**

Your credit score considers the age of your oldest account, the age of your newest account and an average age of all your accounts, i.e.:

**-How long specific credit accounts have been established.**

**-How long it has been since you used certain accounts.**

**4. New Credit; *Are you taking on more debt?***

*Approximately 10% of your credit score is based on this category.*

People tend to have more credit today and to shop for credit—via the internet and other channels—more frequently than ever. Credit scores reflect this reality. However, research shows that opening several credit accounts in a short period of time does represent greater risk—especially for people who do not have a long established credit history. Multiple credit requests also represent greater credit risk. However, credit scores do a good job of distinguishing between a search for many new credit accounts and rate shopping for the best mortgage or auto loan.

Your credit score takes into account:

**-How many new accounts you have.**

Your credit score looks at how many new accounts you have by type of account (for example, how many newly opened credit cards you have). It also may look at how many of your accounts are new accounts.

**-How long it has been since you opened a new account.**

Your credit score may consider this information for specific types of accounts.



**-How many recent requests for credit you have made, as indicated by inquiries to the credit reporting agencies.**

Inquiries remain on your credit report for two years, although credit scores only consider inquiries from the last 12 months. credit scores have been carefully designed to count only those inquiries that truly impact credit risk.

**-Length of time since credit report inquiries were made by lenders.**

**Whether you have a good recent credit history, following past payment problems.**

Re-establishing credit and making payments on time after a period of late payment behavior will help to raise a credit score over time.

### **5.Types of Credit in Use; Is it a “healthy” mix?**

*Approximately 10% of your credit score is based on this category.*

The score will consider your mix of credit cards, retail accounts, installment loans, finance company accounts and mortgage loans. It is not necessary to have one of each, and it is not a good idea to open credit accounts you don't intend to use. The credit mix usually won't be a key factor in determining your credit score—but it will be more important if your credit report does not have a lot of other information on which to base a score.

Your credit score takes into account:

**-What kinds of credit accounts you have.**

Do you have experience with both revolving and installment type accounts, or has your credit experience been limited to only one type?

**-How many of each.**

Your credit score also looks at the total number of accounts you have. For different credit profiles, how many is too many will vary depending on your overall credit picture.

## CONSEQUENCES OF A POOR CREDIT RATING

- Difficult to qualify for credit cards, loans, mortgages
- Increase in auto insurance rates
- Higher rates of interest when borrowing
- May be declined a cell phone account
- Can stay on your record a long time (judgments, bankruptcy)
- May not be able to open a deposit account
- May be declined to lease an apartment
- Could prohibit you from receiving a job offer



## CHECK YOUR CREDIT ANNUALLY!

[www.annualcreditreport.com](http://www.annualcreditreport.com)

Annual Credit Report  
P. O. Box 105281  
Atlanta, GA 30348-5281  
1 877 FACT ACT (1 877 322 8228)



### Correcting Errors on a Credit Report

*Because lenders check your CREDIT® scores, it makes sense to see how lenders see you.*

It's easy to check your own credit scores online; although in most cases there will be a charge to obtain the credit score. An important time to check your credit score is six months or so before you plan to make a major purchase, such as a car or home. This will give you time to verify the information on your credit report, correct errors if there are any, and take actions to improve your credit score if necessary. In general, any time you are applying for credit, taking out a new loan or changing your credit mix is a good time to check your credit score.

Regardless of having a specific reason or not, you should review your credit report from each credit reporting agency at least once a year. You have the right to obtain one free copy of your credit report a year from each of the three major credit reporting agencies. For more information, contact the

Annual Credit Report  
Request Service at:  
P.O. Box 105281  
Atlanta, GA 30348-5281  
1 877 FACT ACT (1 877 322 8228)  
[www.annualcreditreport.com](http://www.annualcreditreport.com)

If you discover an error on your report, using the contact information on slide #11, contact the credit agency with documentation supporting the error. Law states that the credit reporting agency must investigate and respond to you within 30 days.

In addition, if you are in the process of applying for a loan, immediately notify your lender of any incorrect information in your report.

## CREDIT REPORTING AGENCIES

TransUnion

www.transunion.com

(800) 888 4213

Equifax

www.equifax.com

(800) 685 1111

Experian

www.experian.com

(888) 397 3742

*Note: There are many other websites that advertise "free" credit reports, but free comes only with the purchase of a credit monitoring service.*



Statistics show that 70 percent of credit reports contain serious errors that might cause consumers to be denied credit cards, car loans and even mortgages. The good news is that the Fair Credit Reporting Act requires credit-reporting agencies to fix these mistakes. But it takes your diligence to make sure it happens.

**[www.annualcreditreport.com](http://www.annualcreditreport.com) works in conjunction with the US government and the three recognized credit agencies to provide a full report, less credit scores. For a fee, the credit score can be included with the report.**

## SOURCES OF FINANCING/CREDIT

- Rent-to-Own
- Installment Plans/Layaway
- Retail Stores
- Banks & Credit Unions
- Finance Companies
- Pawn Shops
- Loans – Secured and Unsecured
- Private Individuals
- Auto Dealerships/ Manufacturers
- Payday Lender



- *Rent-to-Own* – a process by which a customer purchases an item and agrees to pay a monthly rent. When a sum equal to the original full price plus interest has been paid in equal installments, the buyer may then exercise an option to buy the goods at a predetermined price (usually a nominal sum) or return the goods to the owner.
- *Installment Plan* – Also called rent-to-own, is when a customer purchases an item and agrees to pay a monthly payment. When a sum equal to the original full price plus interest has been paid in equal installments, the buyer may then exercise an option to buy the goods at a predetermined price (usually a nominal sum) or return the goods to the owner.
- *Layaway* - is a way to purchase an item without paying the entire cost at once. However, rather than taking the item home and then repaying the debt on a regular schedule, the layaway customer does not receive the item until it is completely paid for. There is sometimes a fee associated, since the seller must "lay" the item "away" in storage until the payments are completed. When the transaction is not completed, item is returned to stock, and customer money returned.
- *Secured and unsecured loans* –
  - *Secured loan* - is a loan in which the borrower pledges some asset (e.g. a car or property) as collateral for the loan, which then becomes a **secured debt** owed to the creditor who gives the loan. The debt is thus secured against the collateral — in the event that the borrower defaults, the creditor takes possession of the asset used as collateral and may sell it to satisfy the debt by regaining the amount originally lent to the borrower, for example, repossession of a vehicle.
  - *Unsecured loan* - is a loan that is not backed by collateral. Also known as a *signature loan* or *personal loan*. Unsecured loans are based solely upon the borrower's credit rating. As a result, they are often much more difficult to get than a secured loan, which also factors in the borrower's income. An unsecured loan is considered much cheaper and carries less risk to the borrower. However, when an **unsecured loan** is granted, it does not necessarily have to be

based on a credit score. For example, if your friend lends you money without any collateral, meaning something of worth that can be repossessed if the loan isn't repaid, then your credit score has zero to do with it, but rather the value of your friendship is at stake. Therefore the real meaning of an unsecured loan is that it is not backed by any object of value and is lent to you based on your good name. For financial institutional purposes, they may want to look at your credit score because it is strictly a business transaction, therefore your good name may be associated with your historical payment history on prior debt, reflecting in your credit score.

## WHICH FINANCING METHOD IS RIGHT FOR YOU?

- What are you looking to accomplish?  
(lowest interest rate)
- Is there a certain time by which you need the item?  
(paid for by end of year)
- How much can you afford to spend and when?  
(no down payment required)



## THE OPPORTUNITY COST OF CREDIT

**IS**

the decreased future purchasing power

(giving up what could be bought in the future with the money  
that must be repaid)



### OPPORTUNITY COST

Should I go to work today? Should I go to college after high school? Should the government spend money on a new weapon system? These are decisions that are made everyday; however, what is the cost of our decisions? What is the cost of going to work, or the decision not to go to work? What is the cost of college, or not to go to college? Finally what is the cost of buying that weapon system, or the cost of not buying that weapon? In economics it is called **opportunity cost**.

**Opportunity cost** is the cost we pay when we give up something to get something else. There can be many alternatives that we give up to get something else, but the opportunity cost of a decision is the most desirable alternative we give up to get what we want.



## UNDERSTANDING HOW A FICO CREDIT SCORE IS DETERMINED



Link to video:

<https://www.stlouisfed.org/education/continuing-feducation-video-series/episode-1-understanding-how-a-fico-credit-score-is-determined>

[https://www.youtube.com/watch?v=Hf4BqvN5f\\_E&t=64s](https://www.youtube.com/watch?v=Hf4BqvN5f_E&t=64s)



## CREDIT CARDS

THEIR FEATURES AND IMPACT ON PERSONAL FINANCIAL PLANNING



# Credit Cards

## CREDIT CARDS

Using a “credit” card is a form of “credit.” “Credit” is a deferred payment or loan purchase – the word is related to “credible,” meaning belief or confidence in something. *For example, credit is confidence in a buyer's likelihood of repaying a loan.*

The cost of using a credit card comes in the form of **annual fees** and **interest**.

- An annual fee is a charge by a credit card issuer for use of the card and their services. Annual fees vary, but can range from \$25 to \$100.
- Interest is the price you pay for the use of borrowed money.



Interest on a credit card is different than interest on most loans in one very important way: it's what's called compounded interest, as opposed to simple interest.

In order to define an interest rate fully, and enable one to compare it with other interest rates, the interest rate *and* the compounding frequency must be disclosed. Since most people prefer to think of rates as a yearly percentage, the government requires financial institutions to disclose the equivalent yearly compounded interest rate on deposits or advances. This **disclosure statement** is mailed to each cardholder by the credit card issuer. For instance the yearly rate for the loan in the above example is approximately 12.68%. This equivalent yearly rate is referred to as an **annual percentage rate** (APR). When a fee is charged up front to obtain a loan, the APR usually counts that cost as well as the compound interest in converting to the equivalent rate. More simply put, the APR is another name for the annual total cost of credit.

Credit cards are issued with **credit limits**. A credit limit is the maximum amount a credit card issuer will allow a cardholder to borrow.

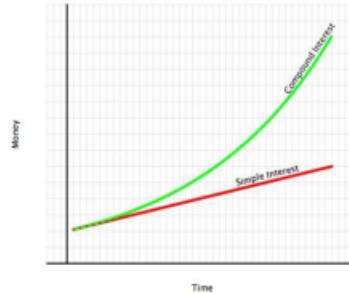
Credit card issuers charge **penalty fees** for late payments and for making purchases that exceed your approved credit limit.

## COMPOUNDED INTEREST VS. SIMPLE INTEREST

**Compounded interest** arises when interest is added to the principal, so that from that moment on, the interest that has been added *also itself* earns interest. This addition of interest to the principal is called *compounding*.

**Simple interest** is not added to the principal (i.e., it is not compounded).

*For example, a loan with \$100 initial principal and 1% interest per month would have a balance of \$101 at the end of the first month, \$102.01 at the end of the second month, and so on. In this example, interest is compounded monthly.*



## DEBIT CARDS VS. CREDIT CARDS



A debit card (or check card) is not a form of credit. Debit cards are directly linked to the money in your bank accounts. When using your debit card (even if you select credit), you are not deferring (or putting off) payment.



Think about the pros and cons of having a credit card. Be sure you understand the terms of your agreement with a card issuer and always use your card wisely.





# STUDENT LOANS

MAKING INFORMED FINANCIAL DECISIONS ABOUT PAYING FOR COLLEGE



## HOW MUCH WILL COLLEGE COST?

- Costs vary widely!
- Remember, it's not just tuition and fees. Housing, meals, books, supplies, personal and transportation expenses must be considered when calculating total cost.
- According to the College Board, the average cost of tuition and fees for the 2017–2018 school year was **\$34,740** at private colleges, **\$9,970** for state residents at public colleges, and **\$25,620** for out-of-state residents attending public universities.



## COLLEGE COST CALCULATORS

- College Cost Projector: [FinAid.org](http://FinAid.org)
- Budget Calculator: [StudentAid.gov](http://StudentAid.gov)



*According to the Project on Student Debt, 69% of graduating college seniors in 2013 had student loans – with an average amount owed of \$28,400. The figure was up 2% from 2012.*





## WHAT FINANCIAL AID IS AVAILABLE?

- StudentAid.gov is a great starting point
  - This division of the US Department of Education is the largest supplier of student financial aid in the nation.
  - Provides grants, loans and work-student funds for college OR career school.



## FREE APPLICATION FOR FEDERAL STUDENT AID (FAFSA)

- Completing the FAFSA is the first step toward receiving federal student financial aid. It's also the basis for state and school financial aid.
  - Available after January 1 at [fafsa.ed.gov](https://fafsa.ed.gov)
  - FAFSA must be filled out for every school year
- When you fill out your FAFSA, you will also create a Federal Student Aid Identification (FSA ID), used to:
  - get into the Federal Student Aid system
  - fill out your FAFSA form
  - legally sign your student aid documents



## STUDENT AID REPORT (SAR)

- After you submit your FAFSA, you will receive a Student Aid Report (SAR)
  - Includes basic information about your eligibility for federal student aid
  - Information can be requested by your college to assess need for school-based resources



## TYPES OF FINANCIAL AID

- There are four basic types of financial aid available for college:
  - Grants (free money)
  - Scholarships (free money)
  - Federal Work-Study employment opportunities (money you earn and can use to help pay college costs)
  - Loans (money you have to pay back—with interest).
- Federal funding includes Pell Grants, Stafford loans (subsidized and unsubsidized) and Parent PLUS loans.
  - Each option requires a completed FAFSA.



## GRANTS/SCHOLARSHIPS

- Grants and scholarships should be your first choice:
  - They are free money.- you don't have to pay them back.
- Other sources of grants/scholarships:
  - the financial aid office at a college or career school
  - a high school or [TRIO](#) counselor
  - the U.S. Department of Labor's [free scholarship search tool](#)
  - [federal agencies](#)
  - your [state](#)
  - your library
  - foundations, religious or community organizations, local businesses, or civic groups
  - organizations related to your field of interest, like professional associations
  - ethnicity-based organizations
  - your employer or your parents' employers



## FEDERAL WORK STUDY

- Need-based grant that requires you to work part-time while you're in school.
- You are only paid for the hours you work.



## STUDENT LOANS

- Student loans fall into two categories: federal loans and private loans.
- **Federal loans** include:
  - Direct Loans, where the U.S. Department of Education is the lender;
  - Federal Family Education Loans (FFEL), where private lenders make loans backed by the federal government;
  - Federal Perkins Loans, low-interest federal student loans for undergraduate and graduate students with exceptional financial need; and
  - PLUS loans, federal loans that graduate or professional students and parents of dependent undergraduate students can use to help pay for college or career school.
- **Private loans**, sometimes called “alternative loans,” are offered by private lenders, like banks, and do not include the benefits and protections that come with federal loans.



## MANAGING STUDENT LOAN DEBT – FEDERAL LOANS

### ■ Federal Loans

- If you have federal loans, the Department of Education has free programs that could help, including:
- income-driven repayment plans — your monthly payment is based on how much money you make
- deferment and forbearance — you can postpone making payments, if there's a good reason you can't repay right away, though interest might cause what you owe to increase
- loan forgiveness or loan discharge — in some circumstances, you don't have to repay some or all of your loans. You might qualify if, for instance, you work for a government or not-for-profit organization, if you become disabled, or if your school closed or committed fraud. Also, under certain income-driven repayment plans, any balance that remains after 20 or 25 years of payments is forgiven. In some cases, you may owe income taxes on the forgiven or discharged amount.





## MANAGING STUDENT LOAN DEBT – PRIVATE LOANS

- **Private Loans**

- With private student loans, you typically have fewer repayment options, especially when it comes to loan forgiveness or cancellation.
- To explore your options, contact your loan servicer directly.
- If you don't know who your private student loan servicer is, look at a recent billing statement.



## LOAN CONSOLIDATION

- Consolidating your student loans means combining multiple loans into one loan.
- Typically, people consolidate their loans to simplify monthly payments or get new repayment terms.
- When you consolidate your loans, you get a brand new loan with new terms.
- If all of your education loans have **fixed interest rates**, it may not matter when you consolidate.
- If some or all of your loans have **variable interest rates**, when you consolidate into a fixed loan may affect the interest rate of your loan.



### Federal Loans

[Consolidating federal loans with the federal government](#) is free. There are companies that may offer to help you consolidate your federal loans with the federal government, for a fee, but you don't have to pay for this service. Consolidating with the federal government is a process you can do on your own, at no cost.

When you consolidate your federal student loans, you get a Direct Consolidation Loan, which has a fixed interest rate for the life of the loan. The fixed rate is the weighted average of the interest rates on the loans being consolidated.

You should make sure that it makes sense to consolidate your loans. Consolidating a low-interest Perkins loan may not be in your favor. Perkins loan borrowers have unique deferment and cancellation rights that may be lost when consolidating.

**Consolidation has important pros and cons to consider, especially since once your loans are combined into a Direct Consolidation Loan, they cannot be separated.**

### Reasons to consolidate loans

If you currently have federal student loans that are with different loan servicers, consolidation can greatly simplify loan repayment by giving you a single loan with just one monthly bill.

Consolidation can lower your monthly payment by giving you a longer period of time (up to 30 years) to repay your loans.

If you consolidate your federal student loans, you might get access to additional income-driven repayment plan options and [Public Service Loan Forgiveness](#). (However, this is not true of Direct Loans, which are from the William D. Ford Federal Direct Loan Program.)

You'll be able to switch any variable-rate loans you have to a fixed interest rate.

### **Reasons not to consolidate loans**

Because consolidation usually increases the period of time you to have to repay your loans, you might make more payments and pay more in interest than you would if you don't consolidate.

Consolidation also may cause you to lose borrower benefits associated with your current loans.

If you're paying your current loans under an income-driven repayment plan, or if you've made qualifying payments toward Public Service Loan Forgiveness, consolidating your current loans will cause you to lose credit for any payments made toward [income-driven repayment plan](#) forgiveness or Public Service Loan Forgiveness.

If you are having problems making your monthly payment but are concerned about the impact of loan consolidation, you might want to consider [deferment or forbearance](#) as options for short-term payment relief, or consider switching to an income-driven repayment plan.

### **Private Loans**

Private loans have to be consolidated with a private lender. There might be a cost when you consolidate but avoid companies that tell you to pay upfront. Make sure you understand all the conditions of your consolidated loan before you agree to consolidate.

Some debt relief companies and lenders offer to consolidate federal and private loans together into one new loan to lower your monthly payments or interest rate. Don't do it. Consolidating private and federal loans turns it into a private loan, which means you will lose the federal repayment benefits and protections of your federal loans, such as deferment and forbearance, income-based repayment plans, and loan forgiveness.

Before you consolidate your loans, find out what it could mean for your specific situation. If you have private loans, talk to your loan servicer. For federal loans, call the Department of Education's Loan Consolidation Information Call Center at 1-800-557-7392. Take your time to determine whether consolidating is right for you.

## IMPORTANT THINGS TO REMEMBER

- Payment schedule for multiyear loans typically lasts 10 or more years.
- As long as student loan debts are paid on time, they are a record of responsible debt management.
- Default or mismanaged debt is likely to have a severe impact on your credit score.
- Student loans are NOT dischargeable through bankruptcy.



## AVOIDING STUDENT LOAN DEBT RELIEF SCAMS



Link to video:

<https://www.consumer.ftc.gov/articles/1028-student-loans#signs>

<https://www.youtube.com/watch?v=7TjSI4Q6ztQ>

## SIGNS OF STUDENT LOAN DEBT RELIEF SCAMS

- REMEMBER: there's nothing a student loan debt relief company can do for you that you can't do yourself for FREE
- Never pay an up-front fee.
- Only scammers promise fast loan forgiveness.
- A Department of Education seal doesn't mean it's legit.
- Don't be rushed into a bad decision.
- Don't give away your FSA ID.



Tips take from: <https://www.consumer.ftc.gov/articles/1028-student-loans#signs>

**Never pay an up-front fee.** It's illegal for companies to charge you before they help you. If you pay up front to reduce or get rid of your student loan debt, you might not get any help — or your money back.

**Only scammers promise fast loan forgiveness.** Before they know the details of your situation, scammers might say they can quickly get rid of your loans through a loan forgiveness program — programs most people won't qualify for. Or they might say they will wipe out your loans by disputing them. But they can't do either.

**A Department of Education seal doesn't mean it's legit.** Scammers use official-looking names, seals and logos, and tell you they have special access to certain repayment plans, new federal loan consolidations, or loan forgiveness programs. They don't. If you have federal loans, go to the Department of Education directly at [StudentAid.gov](https://studentaid.gov).

**Don't be rushed into a bad decision.** To get you to act fast, scammers tell you that you could miss qualifying for repayment plans, loan consolidation, or loan forgiveness programs if you don't sign up right away. Take your time and check it out.

**Don't give away your FSA ID.** Some scammers claim they need your FSA ID to help you, but don't share your FSA ID with anyone. Dishonest people could use that information to get into your account and take control of your personal information.