

# Money Management II



## TYPES AND SOURCES OF CREDIT

## What We're Doing Today



- Closed-End vs. Open-End Credit
- Loans
  - ✦ Different sources for different uses
- Credit Cards
  - ✦ The basics and classifying the different types

## Closed-End Credit

- Closed-End credit refers to a one time loan that will be paid back over a specified period of time, in payments of equal amounts.
- An agreement, or contract, will outline the terms of the loan including:
  - × The number of payments
  - × Payment amount
  - × Total cost of credit

## Examples of Closed-End Credit

- Examples of items purchased with closed-end credit include houses, vehicles, furniture, and large appliances.
- The lender will hold the title, the legal document showing ownership of the item, until all payments have been made.

## Common Types of Closed-End Credit

- **Installment Sales Credit:** Used for the purchase of merchandise, typically requires a down payment with remaining balance of loan being paid in installments.
- **Installment Cash Credit:** Money borrowed for personal reasons, does not necessarily require a down payment, balance is paid in installments.
- **Single Lump-Sum Credit:** A loan that must be paid in full, by a specified day, typically within 30-90 days.

## Open-End Credit

- **Open-End Credit:** Credit as a loan with a certain limit on the amount of money you can borrow for a variety of goods and services.
- **Line of Credit:** The maximum amount of money a creditor will allow a credit user to borrow.
- **Examples of Open-End Credit:** Visa, Mastercard, American Express

## Open-End Credit Continued

- After your application for credit is approved, you typically can begin to make purchases as long as you do not exceed your line of credit.
- Payment amounts, dates, applicable charges, and all other pertinent information regarding your account will be determined by the terms of agreement.

## Sources of Consumer Credit

- Consumer credit has a variety of sources. In fact the number of sources are so staggering it can often be difficult for consumers to select the best option for their credit.
- Because of this, it is important to understand why you are in need of credit and how you intend to use it.
- Be a smart borrower and do your research!

## Sources of Consumer Credit

Credit Source	Type of Loan	Lending Policies
Commercial Banks	<ul style="list-style-type: none"> <li>• Single payment loan</li> <li>• Personal installment loans</li> <li>• Passbook loans</li> <li>• Check-credit loans</li> <li>• Credit card loans</li> <li>• Second mortgages</li> </ul>	<ul style="list-style-type: none"> <li>• Seek customers with established credit</li> <li>• Often require collateral</li> <li>• Prefer to deal in large loans</li> <li>• Determine repayment schedules according to the purpose of the loan</li> <li>• Vary credit rates according to the type of credit, time period, customer's credit history and the security offered</li> <li>• May require several days to process a new credit application</li> </ul>
Consumer Finance Companies	<ul style="list-style-type: none"> <li>• Personal installment loans</li> <li>• Second mortgages</li> </ul>	<ul style="list-style-type: none"> <li>• Often lend to consumers without established credit history</li> <li>• Often make unsecured loans</li> <li>• Often vary rates based on the size of the loan balance</li> <li>• Offer a variety of repayment schedules</li> <li>• Make a higher percentage of small loans than other lenders</li> <li>• Maximum loan size is limited by law</li> <li>• Process applications quickly, frequently on the same day the application is made</li> </ul>

## Sources of Consumer Credit

Credit Source	Type of Loan	Lending Policies
Credit Unions	<ul style="list-style-type: none"> <li>• Personal installment loans</li> <li>• Share draft-credit plans</li> <li>• Credit card loans</li> <li>• Second mortgages</li> </ul>	<ul style="list-style-type: none"> <li>• Lend to members only</li> <li>• Make unsecured loans</li> <li>• May require collateral or cosigner for a loan</li> <li>• May require payroll deductions to pay off loan</li> <li>• May submit large loan applications to a committee of members for approval</li> <li>• Offer a variety of repayment schedules</li> </ul>
Life Insurance Companies	<ul style="list-style-type: none"> <li>• Single-payment or partial payment loans</li> </ul>	<ul style="list-style-type: none"> <li>• Lend on cash value of life insurance policy</li> <li>• No date or penalty on repayment</li> <li>• Deduct amount owed from the value of the policy benefit if death or other maturity occurs before repayment</li> </ul>
Federal Savings Banks (Savings and Loan Associations)	<ul style="list-style-type: none"> <li>• Personal installment loans</li> <li>• Home improvement loans</li> <li>• Education loans</li> <li>• Savings account loans</li> <li>• Second mortgages</li> </ul>	<ul style="list-style-type: none"> <li>• Will lend to all creditworthy individuals</li> <li>• Often require collateral</li> <li>• Loan rates vary depending on size of loan, length of payment, and security involved</li> </ul>

## Sources of Consumer Credit

- Although most people immediately think of traditional commercial banks when loans come to mind, there are many other options in securing a loan, each with their own pros and cons.
- For inexpensive loans, you may consider parents, family, or friends. Often the interest will be very low, or non-existent. However, these loans can complicate relationships.

## Sources of Consumer Credit

- For medium-priced loans, those with moderate interest rates, consider commercial banks, savings and loan associations, and credit unions. Credit unions in particular can offer personalized service, and are more likely to work with customers who are late, or miss payments. However, in order to secure a loan from a credit union, you must be a member.

## Sources of Consumer Credit

- Although they are the easiest to obtain, expensive loans should be avoided whenever possible. Finance companies and retail stores that lend to consumers will often charge 12-25% interest rates.
- It is also possible to get cash advances from your credit card provider but these should be avoided as well. Typically interest rates are higher for these loans and interest will be charged from the first day the money is made available.

## Sources of Consumer Credit

- Home equity loans are based upon difference of the current market value of your home and the amount you still owe on the mortgage.
- An advantage of a home equity loan is the interest charged is tax deductible.
- Yet buyer beware! If you miss a payment on your home equity loan, the lender may take your home!
- For this reason home equity loans should only be used for major items such as education, home improvements, or medical bills.

## Credit Cards



- Credit cards are extremely popular. The average cardholder has more than nine credit cards!
- Cardholders who pay off their balances every month are known as convenience users.
- Cardholders who do not pay off their balances every month are known as borrowers.

## Credit Cards



- Many credit card companies offer a grace period, a time period during which no finance charges will be added to your account.
- A finance charge is the total dollar amount you pay to use credit.
- Generally, if the balance is paid in full prior to the due date, there will be no finance charge to pay.
- In fact, many credit card companies have stopped charging cardholders annual fees!
- The terms and conditions set by the lender determine many of the aforementioned factors.



## Almost/Kinda/Sorta Credit Cards

- Debit cards are not credit cards! They do not extend credit, rather they subtract money from the savings or checking account they are connected to.
- Cobranding is when credit card companies link their services with another business. This will often lead to rebates on particular items offered by the participating company.
- Smart cards are from the future! They come equipped with a computer chip and can store 500 times as much data as a normal credit card! Although not prevalent, they do have functional uses such as digitally storing a plane ticket and frequent flyer information.

## Wrap Up & Review

- Credit comes in two main varieties: Closed-End and Open-End.
- There are a HUGE number of sources for consumer credit!
- When seeking credit it is important to understand what you will be using the credit for and doing the appropriate research.