Managing Your Personal Finances

Understanding Financial Institutions and Credit

Video 2, Lesson 1— Banking Services of Financial Institutions

Learning Objectives

After viewing the program, students should be able to:

1. Describe the services that you expect from a financial institution and evaluate how you can maximize your relationship with your financial institution.
2. Analyze factors that affect selection and use of financial services.
3. Compare the types of financial institutions.
4. Compare the costs and benefits of various savings plans.
5. Identify the factors used to evaluate different savings plans.
6. Compare the costs and benefits of different types of checking accounts.
7. Describe the activities involved with using a checking account.

Video Synopsis

The video opens with a quick overview by Camille and Kelvin of the various types of financial institutions the consumer will deal with. These include commercial banks, state and federally chartered banks, credit unions, finance companies, and federal savings banks, formally known as savings and loans.

Then, we visit "Check Mates Café," where we meet a cook with a very practical view on keeping your checkbook balanced. Here we see how to compare checks, deposits, and bank charges listed on your statement with your check register at the end of the month. Kelvin follows up to remind us to be sure to check for fees such as ATM charges, check printing fees, and bank service charges that we would not normally list in the check register.

Finding the right financial institution to fit your needs is the subject of a discussion between Kelvin and Carmen Luna of Chase Manhattan Bank. She gives us good advice about choosing the right type of account for our money, evaluating the services provided by the financial institution, and why it is important to find a bank where you can feel comfortable and develop a good relationship. With the advent of electronic banking, the ability to contact and deal with your bank is critical, and Carmen suggests some ways to determine if a bank is right for you.

Review Questions

1. What are the major services of financial institutions?

There are more than 25,000 different banking institutions in the United States providing a wide variety of financial services. These institutions include commercial banks, federal banks, state-chartered banks, mutual savings banks, federal savings banks, and credit unions. Most financial institutions not only offer the traditional checking and savings accounts but also provide investment opportunities, make loans, and offer credit cards and business services. Many banks have extended the reach of their services well beyond the four walls of their buildings. Today a trip to the supermarket may be a trip to the bank as several banks have opened mini-branches inside retail centers. You will find automated teller machines (ATMs) almost anywhere you go. And, for the ultimate in banking convenience, you need go no farther than your own computer to access banking services online.

2. Name four types of financial institutions offering banking services.

Banks and credit unions provide most of the traditional services offered by banks. However, today you might find mortgage companies, investment brokers, and insurance companies offering full or partial banking services.

3. What factors should consumers consider when selecting a financial institution to meet their banking needs?

Factors such as location, types of accounts, and interest rates are the primary criteria for selection of a financial institution. However, an important consideration is the personal aspect of banking, and the relationship you establish with your financial institution. Additional attractions may include credit cards at favorable rates, certificates of deposit (CDs) and money market fund investments, and savings opportunities like club accounts. Today, the opportunity to use the Internet to bank electronically is also a consideration when choosing a bank.

4. What common difficulties do people have when reconciling their checking accounts?

Besides forgetting to enter checks and deposits in the check register, many people fail to account for ATM transactions and service charges. Common bank charges include checking account fees, fund transfer fees, cash advance charges, ATM transaction fees, and check printing charges. You should check your monthly statement thoroughly for these charges and reflect them in your register.

5. What types of accounts offer “instant access” to your money, and which do not?

Typically, checking and savings accounts, sometimes called demand deposit accounts, offer the most liquidity for your funds. This means that by merely writing a check, using an ATM, or visiting the bank, you can withdraw some or all of your money. Other accounts, such as interest-bearing CDs or money market accounts, may have a restriction on how often you can access the money deposited in them. A 60-day or 90-day CD means your money is tied up for the full duration of that period if you want to get the interest rate advertised. Early withdrawal of the original deposit might cause you to forfeit some or all of the interest you may have earned.

Classroom Activities

1. Have students visit a local bank or credit union and ask about the types of accounts they offer and make a list of the benefits, or restrictions, of each account. Have students report their findings to the class.
2. Have students use their check register and monthly bank statement, or that of a friend or relative, to practice reconciling the statement. Remind them to pay particular attention to services charges and fees. As an alternative, ask a banking representative to visit the classroom and go through the process step by step.

Managing Your Personal Finances
Understanding Financial Institutions and Credit
Video 2, Lesson 2— Introduction to Consumer Credit

Learning Objectives

After viewing the video, students should be able to:

1. Define consumer credit and analyze its advantages and disadvantages.
2. Differentiate among various types of credit.
3. Identify the steps you can take to avoid and correct credit mistakes.
4. Explain the differences among credit cards, debit cards, and charge cards.
5. Describe the various types of credit cards available and determine which type is best for you.

Video Synopsis

To start off, we meet Claire, who is about to get a rude surprise. Her credit card bill has arrived, and she must face the charges she ran up on a recent shopping spree. In a flashback, we see how easy it was for her to take advantage of her credit card to purchase merchandise that was on sale…whether she needed it or not! We see that she has carelessly put herself in the position to pay off a large debt, which may take her a long time and cost her a great deal in interest.

Camille and Kelvin then review some of the “dos” and “don’ts” of credit, reminding us that credit is a loan that must be paid back … at interest. It is NOT free money. In Camille’s interview with Jim Frannea of Consumer Credit Counseling Services, we learn about open-end and closed-end credit, and about the importance of maintaining a good credit rating. He reminds us that we should only pay for items with credit if it is an emergency, or if it is a large item like a car or a home, and not practical to pay cash. Camille and Kelvin then review the concepts of closed-end and open-end credit, and annual percentage rate, or APR. Finally, Victor Velez explains the basic differences between debit cards, credit cards, and charge cards, and the costs of using each.

Review Questions

1. What is consumer credit?

Credit is an arrangement to receive cash, goods, or services now and pay for these items over some time period. Lenders may extend credit for a purchase or an investment based on your ability to repay that loan and the costs of carrying that loan (interest) in the future. Credit is not free money. In addition to repaying the amount you borrowed, you must also pay an additional expense in the form of interest for as long as any balance remains.

2. Why is credit so often abused by individuals today?

In today's society, consumer credit is available almost everywhere. We are encouraged to use credit to purchase everything from groceries to automobiles. Yet most consumers have a limited understanding of consumer credit and the pros and cons of using it. Everyone is vulnerable to this type of impulse buying. In fact, retailers do anything they can to tempt you to give in to your impulses. Our society is built on an inherent belief that material things will make you happier, or healthier, or better, or at least superior to those who do not own as much "stuff" as you do. Often we feel that our own self-worth is dependent upon our material possessions. Our vulnerability in these areas makes it very easy to overspend and abuse credit in our society.

3. What is the difference between closed-end and open-end credit?

Closed-end credit is usually used for a specific purpose and involves a specified amount of money. This is the common type of financing used when purchasing a home, an automobile, or a major appliance. A home equity loan or a business loan would also be closed-end credit. Open-end credit, on the other hand, is more flexible. It is the extension of credit commonly associated with credit card companies such as Visa, MasterCard, or Discover. With a credit card, money can be loaned at any time for any amount up to that card's limit, and for almost any purpose. This loan can be repaid within the flexible repayment schedule of the company. Credit cards do have a spending limit, the maximum amount of credit that will be extended to you. Up to that limit, however, the amount you borrow is open-ended.

4. Can you describe the types of credit cards and how they differ?

Open-ended credit cards generally fall into three classifications: standard credit cards, debit (or ATM) cards, and charge (or travel and entertainment) cards. Balances on credit and some charge cards will be assessed at an annual percentage rate, or APR. The APR will include not only the interest charged on balances but also any other fees the company charges you for the privilege of using their card. Debit cards are more like checks than credit cards. If you pay for a purchase with a debit card, your checking account will automatically be debited shortly after the purchase. However, if you overdraw your checking account, sometimes the debit card becomes quite similar to a credit card. Before you select a credit card, evaluate which one will offer the services you need with the lowest APR.

5. What is the benefit of having good credit?

A poor history of using credit can hurt in many ways. If you want to get new lines of credit, a bad history can stop you instantly. If you want to buy a home, or even rent a nice apartment, a check of your credit history is standard. Many employers also check on a job candidate's credit worthiness as an indication of the person's level of responsibility. In many ways, it pays to maintain a good and responsible pattern of credit use.

Classroom Activities

1. Have students list the criteria they would use to determine if a credit card offers a good deal on open-end credit. Factors should include advertised interest rate, APR, annual fees, grace period, late fees, and cancellation policy.

2. Have students locate a bank or credit union Web site that has an interest calculator. Using the calculator, have them determine the cost of a $1,000 loan for a period of three years. Then, using the same methods, have them determine the earnings in a savings account or CD from that same institution, for the same amount over the same three-year period. What is the difference? What could they do with that money? This is the opportunity cost of the use of credit versus savings or investment.

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Video 2, Lesson 3— Choosing Sources of Consumer Credit

Learning Objectives

After viewing the video, students should be able to:

1. Analyze the major sources of consumer credit.
2. Understand charges associated with obtaining and using credit.
3. Understand the five “Cs” of credit and how they are applied.
4. Know how to obtain and review a credit report.

Video Synopsis

As the video opens, we meet Eddie and Kellie. He has rushed over to her apartment because he can’t wait to “break in” his new Platinum credit card. Kellie asks him if there are any fees associated with the card, and if he knows the annual percentage rate (APR). His enthusiasm ebbs as he is forced to admit he didn’t check those things out. For the moment, they decide to pass on the big date and order pizza instead.

In their introduction, Camille and Kelvin talk about the best ways to determine a source of credit by determining the associated charges and the APR. They also show us how to calculate the cost of a loan. The message is: avoid using credit to buy unnecessary items, and pay cash whenever possible, except for possibly a home or a new car.

Back with Kellie and Eddie, we learn that she has been doing research on where to get a loan. She tells Eddie about the various sources that she has found to borrow money, and the advantages and disadvantages of each. These include banks, credit unions, and finance companies.

Getting a loan is dependent on your creditworthiness, and in the next segment we meet the Hernandez family and Mr. Hicks. Both parties need loans and have gone to their respective bankers, where they learn about the five “Cs” of credit. These are character, capacity, capital, collateral, and conditions. In the end, we see how these criteria affect whether or not they will get the loan. Returning to Eddie and Kellie, we learn that he is ready to do a little critical thinking about how best to select and use his credit options.

Review Questions

1. What are the major sources of consumer credit?

Most commercial banks offer many types of loans and loan options, such as automobile loans, credit cards, and home mortgages. The cost of credit from these lenders is usually relatively low because they take few risks and have conservative lending practices. Commercial banks may also be rather slow at processing your loan application.

Consumer finance companies may be able to approve your loan in less time. In fact, they can often get your loan approved in one day. They may extend credit to applicants without an established credit history, or even with a poor credit rating. Because they take more risks, you will pay for the lender's risk-taking with higher rates and/or higher fees.

Credit unions are another source of consumer loans. They usually offer credit cards, personal installment loans, and even mortgages. Additionally, their cost of credit is usually relatively low compared to other lending institutions. However, you cannot get a loan from a credit union unless you are a member. To become a member, you must belong to some group of people with a "common" bond. Teachers, government employees, or employees of some corporations are typical groups that have formed credit unions.

Finally, federal savings banks, previously called savings and loan associations, offer most of the same types of loans as commercial banks. They prefer to lend to individuals with good credit ratings, and they usually secure their loans with collateral, such as a savings account balance or real estate. The cost of credit for a loan from a federal savings bank is usually very affordable.

2. What is the difference between the stated interest rate and the annual percentage rate (APR)?

The APR takes into account all the fees, expenses, and relative costs of that loan and presents it in an annual percentage form. Knowing this information is important. Although some lenders may promote themselves as having the lowest interest rates, the fees they charge for those loans may be the highest ones around. Thus, the total cost of credit, as evaluated by the APR, for this "low interest" loan may be much higher than for a comparable loan with a higher rate of interest, but much lower fees. The APR levels the playing field for borrowers. It allows the consumer to compare one loan with another, even though the two lenders may have a completely different pricing structure.

3. What are the five "Cs" of credit? Can you explain what each one means?

When you apply for credit, the lender will usually evaluate your creditworthiness, or ability to repay the loan, using the five Cs of credit: character, capacity, capital, collateral, and conditions. Character is the basis on which a creditor will evaluate whether you are someone who has demonstrated dedication to repay past loans. Capacity is the measurement of whether or not you have sufficient income to make the required repayment. Capital is the term for evaluating whether you have enough savings to cover the debt repayment. Collateral is the term for some asset you would agree to give the lender if you default on the loan. The likelihood that you will have a secure income that will not change before the loan comes due would be called conditions. The weight lenders give to these five Cs will vary. Since some will place more importance on one of these five areas than on others, it is as important to shop around for a loan as it is to shop around for goods and services.

4. Why do consumers typically overextend their indebtedness?

If indebtedness were a disease, it would be labeled an epidemic. However, since credit is so readily available, credit abuse can often continue for a long period of time. The abuse of credit may be the result of emotional problems, spending money to punish a spouse or friend, expectations of instant comfort, trying to keep up with the Joneses, overindulgence of children, lack of communication among family members, and the high cost of the finance charges. All of these reasons are simply expressions of a lack of understanding about the consequences connected with carrying large debit balances. Whatever the cause, overindebtedness will always take a tremendous emotional toll.

5. Name two good rules to follow when considering a purchase on credit.

Rule #1: Avoid using credit to purchase items that are not a necessity.

Rule #2: Do not use credit when you can afford to pay cash for an item.

An exception to these rules might be if you are in an emergency situation and haven't got any cash, or for the purchase of big ticket items like cars or a home. If you do use your credit card or charge account to purchase an item, pay your bill in full *before* the grace period expires.

Classroom Activity

1. Using the Internet, have students research the interest rates associated with various types of loans or credit accounts. Have them compare the stated interest rates with the APR figures advertised.
2. Using an interest rate calculator, have students determine the total cost of a loan over its term. For example, calculating a home loan at 7% for 30 years will reveal that the total interest paid during the term of the loan may be as much as twice the purchase price of the home. Calculating the interest paid for a car or other large item might also reveal a large percentage of interest compared to the purchase price. Show students the difference between *paying* the interest and *accruing* interest by saving for that item.

Managing Your Personal Finances
Understanding Financial Institutions and Credit
Video 2, Lesson 4— Credit Problems

Learning Objectives

After viewing the video, students should be able to:

1. Develop a plan to manage and repay debts.
2. Assess the choices available before declaring bankruptcy.
3. Discuss the methods available to reestablish a good credit rating.
4. State the warning signs of credit problems.
5. Discuss the ramifications of loan defaults, repossessions, bad credit, and bankruptcy.

Video Synopsis

Credit is the key to a glamorous lifestyle, if you believe the ads. Yet unwise use of credit can destroy the best of financial plans. In the opening segment, Camille and Kelvin present the “Top Ten” signs of looming credit problems. Can you relate to any of these?

Next, we meet some real people, and see how not everyone uses credit wisely. And when credit problems loom, a good option to avoid the debt collector, or potential bankruptcy, is to access a credit counseling service. In this segment we see how credit counseling services work, and learn why consumers get into serious credit trouble and what that does to family and other relationships.

Camille then talks with Maxine Sweet of Experian, who explains how to keep your credit report from depicting inaccurate information, and why the so-called credit repair agencies can’t do anything you can’t do—for free! She details how to get a copy of your credit report, and how you go about correcting wrong information that might be on it. Finally, Camille and Kelvin remind viewers that the best time to start to fix credit problems is before they occur, or by contacting a credit counseling service to get help in setting up a budget to get you out of debt.

Review Questions

1. What are most frequent reasons for indebtedness?

Common reasons for indebtedness include emergencies like a sudden illness or accident or the loss of a job. Indebtedness can also result from a lifestyle of overspending, or by ignoring the signs of impending credit problems. People who follow a budget, put money in savings, and pay off their bills at the end of the month usually avoid the traps that cause credit problems to develop.

2. What are common danger signals of potential debt problems?

The ten most common signs of credit problems are:

1. If you lost your job today, you would be in immediate financial difficulty.
2. You put off doctor visits because you just can't afford to pay for them.
3. You have to dip into your savings to pay for routine expenses such as utility bills or groceries.
4. You don't know exactly how much you owe because you are afraid if you add it all up; the balance will shock you.
5. Because your credit card balances are so high, you can barely afford to make the minimum monthly payment.
6. You argue with your spouse about which bills you need to pay.
7. You have to borrow money from friends or family just to make ends meet.
8. Instead of making your payment within thirty days, you sometimes wait sixty or ninety days before sending it in.
9. All your credit cards are at or near their credit limit.
10. You are being threatened with legal action, such as repossession of your car or cancellation of credit cards.

If any of these warning signs sound familiar to you, it is probably just a matter of time before things take a turn for the worse. That means you may be hearing from a debt collector.

3. What is the Consumer Credit Counseling Service (CCCS) and what services do they provide?

This nonprofit organization is affiliated with the National Foundation for Consumer Credit (NFCC). Local branches of the CCCS provide debt-counseling services for families and individuals with serious financial problems. It is not a charity, a lending institution, or a governmental or legal agency. CCCS provides confidential counseling to people who are having problems managing their money. CCCS has a debt management plan that is endorsed and supported by creditors nationwide. This plan allows people to address their financial problems and to avoid bankruptcy. You must have a plan to confront the problem when you are having financial difficulties. If you have a plan, there is hope.

4. What is a credit report and why is it important?

Credit reports are compiled by agencies that provide credit reporting services to major retailers and financial institutions throughout the world. These agencies maintain computer databases on credit transactions and make that information available to potential lenders or to others who have a financial interest in your credit history. Any missed payments will remain on your credit report for seven years. Bankruptcies can be reported for up to ten years. Open accounts, that is credit accounts that you are currently maintaining, can remain on your report indefinitely. Maintaining a positive credit history can be important when it's time to buy a home or a car, or even when applying for a job or an apartment.

5. How can you remove negative information from a credit report?

If you have information on your credit report that is incorrect, you should contact the credit bureau itself. Anything those so-called credit repair companies can legally do, you can also do yourself—for free. The credit bureaus make it easy for consumers by providing toll-free phone numbers for that purpose. However, if your credit report shows missed or late payments, they are not going to go away. The best thing you can do is to begin building a positive payment history. If you are paying each month on time, you are building a positive credit history that will be more meaningful to lenders than some problems in the past. Making sure that your credit report is accurate could help you avoid some frustrating or embarrassing situations.

Classroom Activities

1. Contact the local office of Consumer Credit Counseling Services and arrange for a guest speaker for your class. This is one of the services they gladly provide to high schools and community groups.
2. Hold a classroom discussion about the ten common signs of credit problems. Ask students how many of them are experiencing any of these signs, or are close to it. Discuss what they might do to correct the situation.