

Chapter 2: Credit

Credit allows you to buy a product and use it while you pay for it. You have to establish a **credit rating** before a bank will lend you money. If you do not have a good credit rating, it will be difficult to borrow money.

Types of credit

Generally, there are two types of credit:

Credit cards are offered by credit card companies, department stores and other financial institutions. The interest rates vary from 6% to 29%.

Sometimes you will also have to pay a fee once a year known as an **annual fee**. You will receive a monthly bill. You are required to pay a minimum fee by a certain date. If you do not pay the entire bill you will have to pay interest fees.

Mortgages and loans are used for larger purchases such as a house or a car. You pay back the amount borrowed on a monthly or bi-monthly basis. Sometimes you have to put up **collateral** to prove that you will repay the money. If you do not pay back the money, you will **default** on your loan. The **lender** can sell what you gave as collateral to help pay back the loan. Often, if you do not have any collateral, you can use the item you are buying as collateral. For example, if you want to borrow money to buy a car, you can use the car as collateral. The bank will own the car until you finish paying back the loan.

Before you sign any loan agreement, it is important to know the total cost of your loan when it is paid back. This should include all interest, charges, and monthly payments. If you don't see

Credit rating: a history of how well you pay back the money you owe.

Credit is good because:

- you can buy something while it is on sale
- you can pay for an unexpected expense
- you can make a major purchase such as a car or house
- you can track how much you spend each month.

Credit can be dangerous because:

- it is easier to buy something you did not plan for or buy for something you do not need
- if you do not pay what you owe quickly, a sale item may cost more because you will pay interest charges.
- it is easy to forget to keep track of what you spend until the bill comes
- it is like cash and should be treated with the same care.

Collateral: something you agree to give the lender if you do not pay back the loan.

Default: is when you cannot pay back your loan.

Lender: is the person or place from which you borrow money.

this amount on your agreement, ask the lender before you sign it.

How do I get a credit card?

Different companies charge different interest rates for their credit cards. Some charge **annual fees**. Industry Canada, a part of the federal government, publishes the different interest rates and fees charged by major credit card companies. Generally, department stores credit cards have higher interest rates than bank credit cards.

You have to fill out an **application form** to apply for a credit card. The form will ask for your name, address, type of job you have and how much money you make. The reason they need this information is to see if you have the ability to pay back what you borrow.

What happens if my application is accepted?

If your application is accepted, the credit card will be sent to you. Read the cardholder agreement carefully. It explains the rules for using the credit card. Make sure you keep a record of your account number and the phone number of the credit card company. This helps in case your card is lost or stolen. Keep this information hidden in a safe place.

Monthly statements

Check your **monthly statement** carefully each month. Make sure you recognize all the items for which you are charged. If you find a mistake, report it immediately by phoning the credit card company. Be prepared. Have your credit card number with you when you call the company.

Annual fee: this is a fee paid once a year to the credit card company.

Monthly statement: a report that shows the purchases you have made on your credit card in the last month.

Due date: this is the last date you can pay your bill without a penalty.

The bill tells you:

- how much money you owe
- the **due date**
- the minimum payment required
- the interest charge
- where each purchase was made
- how much you spent on each purchase

Credit history: a record of the money you have borrowed in the past.

Co-signer: someone who is required to pay the loan if the borrower does not pay it.

Registered letter: the person who receives the letter must sign a form to prove they received it. A registered letter has a guaranteed delivery.

Photocopy your cards or keep a record of your account numbers in case you lose your cards.

Always cut up your old credit cards!

What if my application is rejected?

If you are refused credit, ask why. Ask the credit card company what you can do to fix the situation. If you do not have much of a **credit history**, start by opening a savings account and make regular deposits. Make sure you pay any debts on time.

If you have been refused credit because you do not have a good credit rating, you may have to get someone to co-sign for you. If you do not pay back your loan the **co-signer** will have to pay back what you owe.

What if I want to cancel my credit card?

If you do not want your credit card anymore, you can cancel it. You must pay any money owing on it first. There are a few ways to cancel your card. You can phone the credit card company to cancel your card, however, this does not give you any proof that you have cancelled.

You can send a **registered letter** to the credit card company. Tell you want to cancel your card. You have to go to the post office to register a letter. There is a small charge to do this. A registered letter lets you know that the letter reaches its destination. Keep a copy of the letter as proof that you have cancelled the card.

You can also go to the bank branch or store to cancel your card. If you do not cancel the account, it will remain open, even if you are not using it. Once your card has been cancelled, make sure to cut it into small pieces.

Protect Your Credit Cards

Remember: Always protect your credit card information. Occasionally banks may call you to ask questions about your credit card or other

See **Chapter 7: Protect Yourself**, for more tips on how to protect your credit card information.

Alternative Financial Institutions: these companies are not banks, but they offer some of the services banks offer, such as cheque cashing and small, short-term loans. Businesses like Money Mart and Paymax are alternative financial institutions.

Small, short-term loans: these are often called "payday loans." These loans cannot be larger than 30% of your pay cheque. The alternative financial institution will give you this loan before your payday. You must pay the loan back on your payday. The interest on these loans is often very high. Also, you may be charged extra fees in addition to the interest.

services. Be careful with these types of phone calls. The caller may pretend to be a bank employee in order to obtain your personal information.

Do not give your credit card number or expiry date to anyone who phones you. If someone phones you and asks for credit card information over the phone, hang up and contact the police.

It is okay to give information over the phone **if you call the bank** yourself.

Alternative Financial Institutions

Some people use alternative financial institutions if they:

- need money quickly
- don't have a bank account
- can't cash a cheque at a bank.

Sometimes consumers choose these companies if they have poor credit history, would not be able to get a loan at a bank, or don't live near a bank.

These companies do not have the same rules as banks. They may charge much more than a bank to cash your cheque. Interest on short-term loans is often extremely high (59% annually).

Before you cash your cheque at an alternative financial institution, make sure you know how much it will cost.

Before taking a loan from another alternative financial institution, find out if you can get the same loan from a bank. Ask the alternative financial institution these questions:

- what is your annual interest rate?

- how much will I have paid when the loan is paid back, including all fees and interest?
- what will happen if I don't pay back the loan on time?

Ask the bank the same questions. Then compare the answers. It is important to know what you are agreeing to, and what other choices you have.