Managing Your Resources

Chapter Outline

LESSON 1
Avoiding the Credit Trap

LESSON 2
Insurance for Protecting Your Resources

“There is no dignity quite so impressive, and no independence quite so important, as living within your means.”

Calvin Coolidge, 30th President of the United States
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If you would like to know the value of money, go and try to borrow some.”

Benjamin Franklin, scientist, author, politician, musician, postmaster, inventor, Founding Father of the US

What Is Credit?

The American economy is built on credit. Americans have $2.68 trillion in consumer credit, according to the US Department of the Treasury. If people didn’t use credit, they’d have to give up many of the things they now take for granted—a car, a home, a college education, a great vacation. Few people have $20,000 or so on hand to buy a new car. But they can’t get along without one. So they have to use credit to get the money.

Here’s a good math problem. What is 2.68 trillion divided by 300 million? That’s how much consumer credit each American has amassed on average. The answer will come later in the lesson.

Credit, or providing or lending money with the expectation of future repayment, enables you to postpone payment for something you buy. The creditor, usually a bank, credit union, or financing company that loans money, makes the purchase for you. You promise to pay the creditor back what you’ve borrowed within a certain time period, with interest.

How Credit Works

Once you’re 18, you may qualify to apply for a credit card and many other kinds of loans. This lesson is to help you prepare for that day. The more knowledge and information you have about credit, the better you’ll be prepared for the time when you have to manage money on a larger scale.
(As you may remember from Chapter 1, Lesson 1, interest is a charge on borrowed money.) An annual percentage rate (APR), is the yearly interest rate. Finance charge is another term for interest and APR. Credit may come through a direct loan; for example, the bank may loan you money to buy a car. Credit may also come through a credit card that you use to purchase goods and services. Suppose you need a loan of $15,000 to buy a new car. The money you borrow is called the principal. A direct loan will have a maturity date, which is the date by which you must repay the money you borrowed. You cannot wait until the maturity date to make payments on your loan. You must make monthly payments, which include both the principal and interest. Credit card loans have no maturity date. You simply pay a minimum amount each month on your credit card bill. If you don't pay the remaining balance of your bill each month, you'll also pay interest.

Some people think that it's never a good idea to buy things on credit. They don't like the idea of being in debt. However, virtually no one today can get along without borrowing money at some point. Furthermore, if you never borrow, you won't establish a credit rating, or an assessment of how trustworthy you are in paying your bills.

It's actually a good idea to get one or two credit cards—as long as you have an income from steady employment. However, do not overspend, and do make your payments on time. That way, you will establish a good credit rating. Then creditors will be more likely to give you a loan when you need one for a big purchase, such as a car or a house.

Good credit can help you reach your goals. In this lesson, you'll learn how using credit wisely can be an important part of managing your finances.
### A Credit Dictionary

**Account statement**—a summary of the activity in your credit card or other account. It includes how much you charged, borrowed, and paid during the past month, as well as updated information on the overall status of your account.

**Annual percentage rate (APR)**—the yearly interest rate you must pay for the use of the money loaned to you. If you have a $10,000 loan and the APR is 5 percent, you’ll pay $500 a year in interest.

**Annual fee**—a yearly fee that some credit card companies charge in addition to the interest charge.

**Bankruptcy**—a situation in which a court rules that a person is not able to pay his or her bills.

**Collateral**—possessions such as a home or car that a borrower pledges in return for a loan. If a borrower does not repay a loan, the lender has the right to take possession of an item used for collateral. You can also use the money in a savings account as collateral.

**Cosigner**—a person with a good credit rating who signs a loan note along with a borrower—the cosigner agrees to be responsible for repaying the loan if the borrower defaults.

**Credit bureau**—a public or private agency that gathers credit information on people—the information includes where, when, and how much you have borrowed and whether you made your payments on time.

**Credit history**—the record of a person’s use of credit, often compiled by a credit bureau.

**Credit rating**—a rating that a credit bureau gives you based on your history of borrowing and repaying money, your character, and your assets.

**Default**—failure to make a loan payment as scheduled.

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### Important Credit Terms

Credit is a complex subject. If you know the meanings of some basic terms, you will find it easier to understand. The “Credit Dictionary” in this lesson defines some of the words that come up most in discussions of credit. Perhaps you’ve heard some of them before. Others will probably be new. Most of the words on this list appear in bold text in this lesson. Check back to this list if necessary as you go through the lesson. Then keep the list handy and refer to it when you need it.

### Positive and Negative Aspects of Using Credit

Credit has one big advantage: You can buy something you need, even if you don’t have the money right now. There are also other advantages to using credit. For example, using a credit card makes day-to-day purchases more convenient. You don’t have to carry a lot of cash with you. Credit can be useful in emergencies, also. Using credit has many disadvantages, however. If you borrow too much money, you may have difficulty making your payments. Having credit can tempt you to make impulse purchases that you cannot afford.

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CHAPTER 2  Managing Your Resources
Lesson 1

Delinquent—an account for which payment is overdue
Down payment—an initial cash sum that a buyer must pay in order to make a credit purchase or get a loan, usually a small percentage of the total amount of the purchase
Finance charge—a charge for using credit—another term for APR or interest
Grace period—the time during which you can pay a credit card bill on new purchases without being charged interest
Installment—a partial payment of a loan, usually paid monthly
Interest—the cost of borrowing money, expressed as a percentage—you earn interest when you invest your money in a savings account; you pay interest when you borrow money
Maturity date—the date by which you must repay your loan
Minimum payment—the smallest amount you must pay in any given month in order to keep your credit account in good standing—usually a great deal less than the total amount you have charged on your account
Periodic rate—the monthly interest rate on a credit card—for example, the periodic rate on a credit card with an 18 percent APR is 18 divided by 12, for a periodic rate of 1.5 percent
Principal—the amount of the money borrowed—payment of the principal is usually spread out over the term of the loan
Variable rate—an interest rate that changes over time

Here is the answer to the earlier math problem on how much consumer credit debt Americans have acquired. By using 300 million as the base population estimate, and $2.68 trillion as the total amount of consumer credit spread among the population, every American has about $8,933 in acquired credit debt, on average.

Young adults, especially those who have borrowed to finance a college education, may be in worse shape. Many young people accumulate considerable debt by the time they graduate from college. The average new college graduate today has more than $25,000 in debts, including credit cards, student loans, and other debts, such as car loans.

Because they have big debts and are always struggling to get by financially, many people make only the minimum payment—the smallest amount due to the lender to keep your credit in good standing—on their credit cards each month. They’re always hoping that they’ll be able to pay off their balance when they get more money. This frequently does not work—the accumulating interest fees catch many people by surprise. Their debt grows each month instead of decreasing and can quickly become difficult to manage. Almost 1.5 million people in the United States file for bankruptcy each year. Bankruptcy is a situation in which a court rules that a person is not able to pay his or her bills. A primary reason for these bankruptcies is that the individuals obtain more credit than they can repay.

Lesson 1  Avoiding the Credit Trap
Sources of Credit

Credit is available from a variety of sources. Some of the most common sources are store charge accounts, credit cards, charge cards, installment loans, and layaway plans.

Charge Account or Retail Account

These accounts let you buy goods or services at a specific store on credit. For example, a charge account from Sears allows you to charge purchases, but nowhere else. In return for your promise to pay in full by a later date, the store lets you pay in monthly payments, or installments. The store will charge interest on the amount that you have not yet paid. If you fail to pay on time, the store may charge you a late fee.

Credit Card

You can use a credit card to pay for goods or services at any business establishment that accepts the card. The credit card has a code number that tells the issuing company who you are and where to send your bill. If you pay your entire bill at the end of the month, you may not have to pay interest. If you pay your bill in monthly installments, you will be charged interest.

With credit cards, you may be able to get a cash advance, or borrowed cash, through the card. If you get a cash advance, you will usually have to pay a higher interest rate than if you bought something with your credit card. Thus, it’s a good idea to avoid taking cash advances. In addition to interest, the credit card company may charge you an annual fee, a yearly fee that some companies charge in addition to the interest charge.

Charge Card

A charge card looks like a credit card, but it is quite different. If you buy something with a charge card, you must pay the entire balance very quickly, usually within 30 days or less.

A credit card gives a consumer more flexibility on purchases, but should be used in a responsible manner.

Courtesy of Media Bakery13/Shutterstock
Installment Loan

People usually use installment loans when they need to make a single expensive purchase, such as a car or a home. You may use the item, but the lender holds ownership until you repay the loan. Installment loans may require you to make a down payment or pledge collateral, possessions (such as a home, car, or savings) that a borrower pledges in return for a loan. (Often the collateral will be the item you are taking out the loan to buy.) You will make fixed payments over a set period. The interest rate may be lower than that of other kinds of credit.

Layaway Plan

When you buy something on layaway, the store holds it until you have paid for it in full. You must usually make a down payment and then make regular payments according to a contract. The store may add a service charge. If you fail to pay on time, the store may no longer hold the item for you.

How Credit Works

How does all this work? Say you have a credit card with an APR of 18 percent. You want to buy a $650 iPad.® When you make the purchase, you hand your credit card to the store clerk. The clerk contacts the credit card company (usually by swiping your card into a computer reader) to make sure you have sufficient credit to cover the purchase. He or she then checks your signature and the card expiration date, and sells you the item. The store charges $650, plus any sales tax, to your account.

When you receive your credit card account statement the following month, you make the minimum monthly payment. Suppose that minimum is 10 percent of the balance. In that case, you’d pay $65 within the specified time. This would leave you with a balance of $585.

So far, so good. However, it’s at this point that many people get into trouble. That’s because for each month that you do not pay your entire balance, the company adds interest to the remaining balance. Thus, once you make your initial $65 minimum monthly payment, you will be charged an APR of 18 percent on your remaining balance. As long as you didn’t pay off your total debt, your interest would continue to accumulate. If you continued to charge additional items on your card and pay only the minimum amount required, your interest and principal would continue to grow each month. If you have several credit cards and pay only the minimum monthly balance on each, your interest will really add up, overwhelming your ability to pay.
To see what effect interest can have on your financial situation and what difference the interest rate can make, look at Figure 2.1. It shows what happens with a $10,000 loan at various interest rates. If you borrow money at an 8 percent rate, your interest, or finance charge, will be $800 during a year. However, if you borrow at an 18 percent APR—the standard interest rate for credit cards today—the charge will be $1,800. If you don’t make any payments for four years, you will owe $7,200 just in interest. Most people are responsible, and they make monthly payments. But again, they often make only the minimum monthly payments. That means that their debt will quickly grow.
Using Credit Responsibly

Using credit wisely is an essential part of managing your finances. You should use it within the limits of your resources and your overall financial plan. Here are some tips for managing your credit:

- **Pay all your bills on time**—Remember that you will be able to get credit only as long as your **credit history**, or record of paying your bills, is good.

- **Don’t think of a credit card as extra cash**—When you use your card, think of it as borrowing money. Before charging a purchase, ask yourself, “If I had to pay cash, would I still buy it?”

- **Never borrow more than your budget shows you can pay back**—Never get into the position of having to borrow money to pay credit debts.

- **Always pay your other regular monthly bills, such as rent, utility, and telephone on time**—Try to pay more than your monthly minimum on your credit card bills. Whenever possible, avoid paying high finance charges by paying off your balance each month.

- **Limit yourself to no more than two credit cards**—Make sure that one card has the lowest interest rate available. Use this card for purchases or services that you plan to pay for over a period of time, if that’s really necessary. If the other card has a higher interest rate, pay the full balance on it each month.

Remember, pay yourself first. Get into a savings habit so that you rarely need the support of credit.

Credit and Credit Card Options

When you’re looking for credit, you need to be a smart shopper, just as when you buy groceries, clothing, or anything else. You need to comparison shop.

Say you’re like most people and don’t pay the balance of your credit card bill each month. If so, you should look at either the annual interest rate or the **periodic rate**, or **monthly rate**, the card issuer uses to calculate your finance charge (Figure 2.2).

**LESSON 1** Avoiding the Credit Trap
### INTEREST RATES AND INTEREST CHARGES

<table>
<thead>
<tr>
<th>Description</th>
<th>APRs</th>
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<tbody>
<tr>
<td><strong>Annual Percentage Rate (APR) for Purchases</strong></td>
<td>8.99%, 10.99%, or 12.99% introductory APR for one year, based on your creditworthiness. After that, your APR will be 14.99%. This APR will vary with the market based on the Prime Rate.</td>
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<tr>
<td><strong>APR for Balance Transfers</strong></td>
<td>15.99% This APR will vary with the market based on the Prime Rate.</td>
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<tr>
<td><strong>APR for Cash Advances</strong></td>
<td>21.99% This APR will vary with the market based on the Prime Rate.</td>
</tr>
<tr>
<td><strong>Penalty APR and When It Applies</strong></td>
<td>28.99% This APR may be applied to your account if you: 1) Make a late payment; 2) Go over your credit limit; 3) Make a payment that is returned; or 4) Do any of the above on another account that you have with us. <strong>How Long Will the Penalty APR Apply?</strong>: If your APRs are increased for any of these reasons, the Penalty APR will apply until you make six consecutive minimum payments when due.</td>
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</tbody>
</table>

#### How to Avoid Paying Interest on Purchases
Your due date is at least 25 days after the close of each billing cycle. We will not charge you any interest on purchases if you pay your entire balance by the due date each month.

**Minimum Interest Charge**
If you are charged interest, the charge will be no less than $1.50.

**For Credit Card Tips from the Federal Reserve Board**
To learn more about factors to consider when applying for or using a credit card, visit the website of the Federal Reserve Board at [http://www.federalreserve.gov/creditcard](http://www.federalreserve.gov/creditcard).

### FEES

<table>
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<tr>
<th>Description</th>
<th>Fee</th>
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<tr>
<td><strong>Set-up and Maintenance Fees</strong></td>
<td>NOTICE: Some of these set-up and maintenance fees will be assessed before you begin using your card and will reduce the amount of credit you initially have available. For example, if you are assigned the minimum credit limit of $250, your initial available credit will be only about $209 (or about $204 if you choose to have an additional card).</td>
</tr>
<tr>
<td><strong>• Annual Fee</strong></td>
<td>$20</td>
</tr>
<tr>
<td><strong>• Account Set-up Fee</strong></td>
<td>$20 (one-time fee)</td>
</tr>
<tr>
<td><strong>• Participation Fee</strong></td>
<td>$12 annually ($1 per month)</td>
</tr>
<tr>
<td><strong>• Additional Card Fee</strong></td>
<td>$5 annually (if applicable)</td>
</tr>
<tr>
<td><strong>Transaction Fees</strong></td>
<td>Either 5% or 3% of the amount of each transfer, whichever is greater (maximum fee: $100). Either 5% or 3% of the amount of each transfer, whichever is greater. 2% of each transaction in U.S. dollars.</td>
</tr>
<tr>
<td><strong>• Balance Transfer</strong></td>
<td></td>
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<tr>
<td><strong>• Cash Advance</strong></td>
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<tr>
<td><strong>• Foreign Transaction</strong></td>
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<tr>
<td><strong>Penalty Fees</strong></td>
<td></td>
</tr>
<tr>
<td><strong>• Late Payment</strong></td>
<td>$29 if balance is less than or equal to $1,000; $35 if balance is more than $1,000</td>
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<tr>
<td><strong>• Over-the-Credit Limit</strong></td>
<td>$29</td>
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<tr>
<td><strong>• Returned Payment</strong></td>
<td>$35</td>
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**How We Will Calculate Your Balance:** We use a method called “average daily balance (including new purchases).”

**Loss of Introductory APR:** We may end your introductory APR and apply the Penalty APR if you become more than 60 days late in paying your bill.

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**FIGURE 2.2**

Sample Credit Card Disclosure Box
Source: [www.federalreserve.gov](http://www.federalreserve.gov)
That rate is fixed. Some credit card companies offer a variable rate, an interest rate that changes over time. It starts low, but the company can then raise it after you’ve had the card for a while. Variable rates can also go down, although this does not happen often with credit cards.

Are you a person who pays off your bills each month? Then the credit card that has no annual fee and offers a grace period, the time during which you can pay a credit card bill on new purchases without being charged interest, is good for you. Other questions to ask when shopping for credit include the following:

- Which kind of credit is appropriate for your purchase? Should you put the item on a credit card or take out a loan, which would usually have a lower interest rate?
- What kind of maturity period do you want? A longer maturity means smaller monthly bills. A shorter period costs less interest. Which plan best fits your budget? Is there a penalty if you pay off the loan before the maturity date?
- Do you have to pledge collateral? What collateral do you have?
- Does one credit card have a higher annual fee than another?

**Applying for a Credit Card**

You must be 18 years old to get a credit card. In most cases, in order to get credit, you must show that you have steady employment; a checking or savings account; a history of paying your bills on time; an income that exceeds your budgeted expenses; and a permanent residence.

You must fill out an application from the store or bank offering the card. Be honest on the application. The company has its requirements for a reason. If you are tempted not to be fully honest about your income or expenses, you probably cannot afford credit at this time.

Once you’ve applied, the company has 30 days to respond to your application. If the company does not approve your application, it must tell you why.
If your application is accepted, the company will ask you to sign a credit agreement. Read this very carefully. The Truth in Lending Act, a federal law, requires that any company issuing the credit card disclose the following information to you:

- Annual fee if applicable
- Annual percentage rate (APR) for purchases
- Other APRs (balance transfer, cash advances, default APRs)
- Grace period
- Finance calculation method
- Other transaction fees (balance transfers, late payments, exceeding credit limit fee, cash advances)

All credit card companies use the same format, making comparison shopping for credit cards easy. Although the disclosure box contains the basic terms of the credit card, there are other terms that you should look for in the fine print. For example,

- **Universal default clause**—If you are reported late by another creditor, your APR can be increased even if you are paying your bills on time with that creditor.
- **Dispute resolutions, binding arbitrations**—Disputes are settled by an independent third party body instead of a judge or court. The arbitrator’s decision is final and cannot be disputed or appealed. There are two types of arbitrations—voluntary and mandatory. In mandatory arbitration, a consumer waives the right to sue and must use an arbitrator instead to resolve disputes. In voluntary arbitration, the consumer and company may mutually agree to allow a third party to intervene.

### Questions to Ask Yourself When Applying for a Credit Card

When it comes time to apply for a credit card for the first time, ask yourself these 10 questions:

1. Do I really need to establish this account? What will I use it for?
2. Can I qualify for credit?
3. What is the interest rate?
4. Are there additional fees?
5. What percentage is the monthly minimum payment, and when is it due?
6. Can I afford to make the monthly payments?
7. What will happen if I don’t make the payments on time?
8. Are there any nontangible costs if I use credit? That is, can I sleep at night, or will I worry about my debts?
9. Given my current earnings and other regular expenses, what is the maximum credit card debt that I can handle?
10. All things considered, is using a credit card worth it?
• "Double Billing Cycles"—You are charged interest on your current billing cycle and the previous one. As such, even though you may have paid your previous balance in full, you are still charged interest on it.

• "Fees"—Read your contract for other fees you may incur. For example, some credit card companies charge a fee for not updating your account every year.

Do not sign the agreement until you fully understand it. If you need help, ask the lending officer to explain what you want to know. Ask that person to confirm how much is due each payment, how long the grace period is, and what happens if you default, or fail to pay your bill on time. In short, know what you are getting into. If the creditor has not filled out all the blanks on the form, do not sign until the company has filled out all the information.

**How the Creditor Evaluates Your Application**

Credit institutions use various guidelines to determine who qualifies for credit. Most lenders look at three things. These are sometimes referred to as the "three Cs of credit."

• "Character"—Are you reliable? Do you pay your bills on time? The application form may ask you for references or the names of other creditors.

• "Capacity"—Is your income enough to pay the debt? Do you have a job? Do you have other debts? Is it likely you can continue to earn your present salary, or even more, in the future? If you don’t hold a job and have no regular income, you’ll probably have a hard time obtaining credit.

• "Collateral"—Do you have enough assets? What do you own that has value and that you could use to repay the debt? A car? A savings account? Another word for collateral is security. A loan that does not require collateral is called an **unsecured loan**.

**Building Your Credit History**

The "three Cs" sound good, but what if you’re just starting out? What if you don’t have collateral or sufficient capacity? There are many ways to start building good credit. Most banks are willing to work with small loans. A good practice is to borrow a small amount of money from a bank and pay it back quickly.

The best collateral you could probably use for your first loan is your savings account. For example, if you had $750 saved, you could borrow $675 for a sofa and pledge your $750 savings against the loan as collateral. Be sure to make regular payments on your loan and be on time. When you pay off the loan, you have started a good credit history.

Another way to establish credit is to apply for a credit card or charge account at a local business or bank. Charge a few items that you would normally buy with cash, and pay the bill in full when it is due.

**LESSON 1** Avoiding the Credit Trap
A third alternative is to have someone cosign your loan. The cosigner, a person with a good credit rating who signs a loan note along with a borrower, should be a relative or other responsible adult who has a good credit history and the ability to pay. If you are unable to make payments on the loan, the person who cosigned is responsible for paying the debt.

Still another way to start credit would be to purchase something on the installment plan. Many stores, such as furniture stores, encourage first-time credit for such purchases.

**How Credit Bureaus Function**

Once you borrow money and pay it back on time, the credit bureau, a public or private agency that gathers credit information on people, will have a record of your credit history. That’s a good beginning, because other companies will then be more likely to give you credit.

Your credit report shows every time you apply for credit, your payment history, late fees that are assessed if you miss a payment, and other notations about your accounts. Out of this comes a credit score, a rating that helps lenders decide whether and/or how much credit to approve to a borrower. Your credit score gives a lender an idea of how creditworthy you may be.

**Using a Credit Bureau**

If a company turns you down for a loan or a credit card, you will want to find out why. Under federal law, you are entitled to a free report if a company takes adverse action against you, such as denying your application for credit, insurance, or employment, and you ask for your report within 60 days of receiving notice of the action. The notice will give you the name, address, and phone number of the consumer reporting company.

If you find errors on your credit report, write the credit bureau giving proof of the error. The credit bureau will then correct your report. It will send the corrected information to any company that requested your credit report in the previous six months.

There are three main credit bureaus in the United States: TransUnion, Experian, and Equifax. Each bureau covers a different region of the country, but since credit card and other companies have offices nationwide, you will likely deal with all three at some point in your life. You can find out more at the companies’ websites. It’s good practice to check your credit rating every year or so, even if you don’t have any problems.
Avoiding Credit Card Fraud

Credit card fraud is a growing problem. It's all too easy for dishonest people to find ways to use your credit for their own purchases. They can do this by stealing your card, of course. But people who engage in fraud have more tricks up their sleeves.

Preventing Misuse of Your Credit Card

Follow these steps to reduce your risk of credit card fraud:

- **Always sign a new credit card as soon as you receive it**—When you buy something, the salesperson will compare the signature on the back of the card with your signature at the bottom of the receipt for your purchase.
- **Save your receipts from credit card purchases**—Compare them with the charge amounts on each month’s account statement.
- **Never give out a credit card number to someone who has called you on the phone**—Give out your number only if you have made the call and you’re sure you’re dealing with a reputable company.
- **If you’re purchasing on the Internet make sure you’re using a secure site**—Look for the little lock on your browser’s status bar.
- **Destroy any preapproved credit offers you receive in the mail**—A dishonest person might pull the blank application from your trash and apply for the card in your name.
- **Destroy any old or canceled credit cards**—Dishonest practices have made even canceled credit cards susceptible to misuse.

Saving your purchase receipts and adding up your credit card purchases will help you manage your spending.

Courtesy of Andrey Popov/Shutterstock
If Your Credit Card is Stolen

What if your card or card number is stolen and a thief runs up charges? Federal law protects you. It states that credit card holders who are victims of theft or fraud are not responsible for more than $50 if they report the theft promptly.

Keep a record of all your account numbers and the phone numbers for any credit card or charge card companies you deal with. If you lose your card, if someone steals it, or if someone uses your credit card number fraudulently, contact the company immediately.

You have the option to buy credit card insurance protection, but it’s expensive for a young person. Often, credit card companies offer it by making exaggerated claims about the protections that are offered. The Federal Trade Commission says that if you follow your credit card company’s procedures for disputing charges you haven’t authorized, or lose a credit card and report it promptly, your liability for unauthorized charges is limited to $50. We will cover how to protect your personal and financial information in more detail in Chapter 2, Lesson 2, “Insurance for Protecting Your Resources.”

The Consequences of Deficit Spending

If you make a habit of deficit spending, or spending more than you earn, sooner or later you'll wind up in a credit crunch. This inability to make all your payments can strain more than your wallet. Money worries can bring stress and low morale, hurt family and social life, and cause poor performance at your job or in school. The minute you think you’re getting into trouble, take the following steps:

- Stop borrowing—Leave your credit cards at home. Carry only enough money to get through the day.
- Cut expenses both big and small—Limit trips to snack machines. Clip coupons for shopping, but only for items you really need. Borrow CDs or books at the library instead of buying them. Make do with what you have instead of buying something new.
- Talk to creditors—Explain your problem. They may be willing to work out an easier payment schedule for you.

Cutting your spending and borrowing can help you work your way out of a credit crunch.

Courtesy of Orange Line Media/Shutterstock
Bankruptcy

This is the last resort when you get too deeply in debt. The reason it is a last resort is that it stays on your credit record for up to 10 years and affects your ability to seek credit for any reason. Here are the types of bankruptcy actions:

**Chapter 7** allows you to erase most of your debt, but to qualify, you must be unemployed or on a very low income, and you must go to financial counseling.

**Chapter 13** allows you to set a plan to repay debts over five years or less, but a court will oversee the process.

**A few important notes:**
- Congress changed the bankruptcy law in 2005 to make Chapter 7 bankruptcy more difficult to declare.
- Bankruptcy does not erase certain kinds of debt, such as school loans or penalties and fines because of a crime you may have committed.
- The “clean slate” is given only to people who have serious unforeseen and unavoidable misfortune that bankruptcy helps in rebuilding their lives.

*Source: NEFE High School Financial Planning Program Student Guide, p.55*

• **Learn from your mistakes**—Did an emergency throw you off course? Was your budget unrealistic? In both cases, you probably need to revise your budget, as discussed in the previous lesson. But if your problems result from spending money irresponsibly, you need to get serious about your financial future.

**The Importance of a Financial Plan**

It’s up to you to make sure your credit decisions fit your financial plan. The key question to ask yourself is: How will buying something through credit affect my future? By making proper decisions, you can keep a lid on your credit. This will increase the amount of money you have available now and enable you to buy the things you need.

Figure 2.3 shows a good example of how to manage credit. Stephanie Spratt has had to make the same decisions regarding credit that you will have to make soon. Note how she first set out in words her goals for managing credit. Then she figured out how much money ($1,100) she had left each month after paying basic bills. She explained to herself why this $1,100 could be used for credit card purchases, if necessary. Finally, she decided to make a real effort to reduce her debt. She decided that any extra money she gets will go first to paying back credit card bills. She wants to reduce her debt. This is because credit cards charge a higher rate of interest than she would earn by putting that money into savings account.

**LESSON 1** Avoiding the Credit Trap
CHAPTER 2  Managing Your Resources

GOALS FOR MANAGING CREDIT

1. Spend on my credit card only what I can pay back in the same month.
2. Avoid large expenses on my credit card.

ANALYSIS

Monthly income $2,500  
Monthly expenses (paid by check) $1,400  
Total Money Available $1,100  

<table>
<thead>
<tr>
<th>Sources of Assets</th>
<th>Balance</th>
<th>Interest Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$100</td>
<td>0.0%</td>
</tr>
<tr>
<td>Checking Account Balance</td>
<td>$800</td>
<td>0.0%</td>
</tr>
<tr>
<td>Money Market Fund</td>
<td>$400</td>
<td>3.0%</td>
</tr>
<tr>
<td>30-day CD</td>
<td>$1,200</td>
<td>4.3%</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Sources of Debt</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit Card Balance</td>
<td>$600</td>
<td>20.0%</td>
</tr>
</tbody>
</table>

DECISIONS

Credit limit: With $1,100 available after taxes on my income and regular monthly expenses, I can spend up to $1,000 and no more on my credit card to be able to pay it off the following month. If my income goes up, I can continue to spend up to $100 below my total money available each month after expenses, as long as I continue to pay off the credit card fully.

Credit balances: My interest rates on savings accounts are much lower than my interest payments on my credit card, so I will always pay off my credit card, even if I have to withdraw money from my savings to do so. But if that happens, I’ll reconsider my highest spending limit on my credit card each month to avoid dipping into savings.

How Credit Management Fits with Stephanie Spratt’s Financial Plan

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Lesson 1 Review

Using complete sentences, answer the following questions on a sheet of paper.

1. List three positive benefits and three possible negative results of using credit.

2. Name three sources of credit and describe the differences between each.

3. Explain why a credit card is different from a direct loan in terms of interest rates and in how they are “paid off.”

4. What are three ways you can start to build a credit history?

5. What are three ways that your identity could be stolen? Give an explanation of how you can prevent it from happening.

6. What are the main consequences of deficit spending?

7. Develop and explain a three-point method you might employ to reduce deficit spending.

APPLYING CREDIT SKILLS

8. Study the sample credit card disclosure box in Figure 2.2. Read it and analyze its terms. What is the interest rate? Are there other fees? Is there a grace period? What is the penalty rate? Get used to reading and understanding such information in credit card agreements. You will read many over your lifetime.