Chapter Overview
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Consumers have three main sources from which to pay for goods and services in the marketplace: cash, bank accounts (including checking and savings), and credit. Everyone knows what cash is, and virtually all sellers accept it. Yet it is not always convenient to use cash as a method of payment in today’s global marketplace. Bank accounts and credit offer consumers convenient alternatives to paying cash for goods and services.

The largely electronic nature of bank accounts and credit sometimes presents more complex problems for consumers. When using a bank account or credit—unlike using cash—there is no physical reminder of how many dollars and cents you have in your pocket to spend. There are also special risks associated with these financial arrangements. This chapter will focus on the use of bank accounts and the payment devices associated with them as well as the use of credit to pay for goods and services.

Credit cards offer consumers a convenient alternative to cash.
The Basics About Bank Accounts

Checking and savings accounts are the most common types of bank accounts that people use to manage their money. Banks offer checking accounts to consumers as convenient places to deposit cash and checks for safekeeping from which the consumer can easily withdraw money to pay bills and to make purchases. To withdraw money, an account holder can write checks to vendors and creditors, withdraw cash directly from an automatic teller machine (ATM), or make purchases using debit cards. Many smart consumers also open savings accounts into which they deposit a certain amount of money each month. Although an account holder can link an ATM or debit card to a savings account, many believe it is better to limit access to savings accounts so that money will be available in case of an emergency. Smart consumers also use savings accounts as a way to save for a special purchase or vacation.

The key to maintaining a checking account is to record all deposits and withdrawals in the check register so that you do not spend more than what is in the account. Many banks offer overdraft protection, which can assure the account holder that checks written on and debits made from the account will be honored up to the limit of the overdraft protection. This service is like a line of credit and is typically offered only to customers with a good credit history and for a certain amount—up to $1,000, for example. Interest is charged, usually on a daily basis, until the line of credit is repaid.

Banks may offer different types of overdraft protection. Some types may be costly and may not guarantee that your overdraft will be paid. Ask your bank what service it offers, and find out all the associated costs and terms of the service.

Banks are required by law to provide account holders with periodic information regarding their accounts. For a checking account, this information often includes the checks you have written that have been paid, or copies of them, and a monthly statement. The statement details the status and activity on your account during that period, including all deposits and withdrawals. It is important that you review these statements to ensure that there has been no unauthorized activity on your
account. Many banks also allow online banking and you may be able to review your monthly transactions on the bank’s secure Web site.

If you encounter a problem with an electronic funds transfer (EFT) or debit card transaction on your monthly statement, the Electronic Fund Transfer Act provides you with protection, but only if the errors are of a computational nature, such as withdrawals of the wrong amount or unauthorized withdrawals. You must file a written complaint within 60 days of the date the statement was mailed. The bank must investigate the error within 10 business days, but if the bank credits the amount in dispute to your account during the investigation, it can take up to 45 days. If no error is found at the end of the investigation, the bank can take back the money it credited to you, provided that it sends you a written explanation. If you do not file a complaint within 60 days, you could lose the total amount of money in question.

**Banking Fees**

Banks usually charge fees for maintaining a checking account, so it is important for consumers to shop around for the best deal. Some accounts are free, and some carry a monthly service charge. Standard charges often include fees for ordering checks, for writing more checks than the maximum decided upon at the time you open the account, for failing to keep a minimum balance in the checking account throughout the month, and for “bouncing” checks because there was not enough money in the account. You may also be charged a small fee by your bank to use ATMs, usually for those it does not operate, as well as a “guest” fee by the bank that does. In some instances, if you are able to keep a certain amount of money in your account, most bank fees are waived and you may accrue interest on the funds in your account.
ATM and Debit Cards

Banks also offer their customers electronic funds transfer cards—more commonly known as automatic teller machine (ATM) cards—as an alternative to writing checks or having to go into a bank to withdraw money from an account. These embossed plastic cards look like a credit card but are connected to a bank account belonging to the card holder. They allow you to withdraw money from your bank account at an automatic teller machine using your personal identification number (PIN). ATM cards that also serve as debit cards allow you to make “point-of-sale” purchases for food, gasoline, clothing, or other items at stores. The amount of your purchase is instantly deducted from your bank account. For example, when you purchase gasoline using your ATM card, the amount of the purchase is transferred from your bank account to the gas station’s bank account.

Banks also regularly issue debit cards, sometimes called “check cards,” to their customers as a convenient way to make purchases without the added costs associated with credit cards. Debit cards look like credit cards, complete with your name, the credit card company symbol, a unique 16-digit account number, and an expiration date. However, debit cards are not credit cards and do not have the same legal protections as credit cards. Debit cards may be used anywhere that major credit cards are accepted and are used to make purchases in the same way as a credit card. Instead of borrowing the money and paying interest on a balance, as you would on a line of credit, the amount of the purchase is deducted directly from your bank account, and the total amount you can spend is limited to your account balance. In some types of debit card transactions, you will be required to sign a receipt when making a purchase. In other types of debit card transactions, you may be asked to enter a special code or PIN. And in other instances, you may only have to swipe the card through a card reader. The amount of the purchase will be deducted from your bank account, usually fairly quickly.

Lost and Stolen Checkbooks and Bank Cards

Carrying a checkbook is safer than carrying cash because only the authorized signers on the account are allowed to use checks to withdraw funds from the account. If you lose a checkbook or it is stolen, you must notify your bank and ask them to cancel all of the checks in the book. This is called stop payment. By law, the bank may charge you a small fee to stop payment on a check, but it cannot charge you to stop payment on each of the checks in your checkbook if it is lost or stolen.

Although carrying bank cards is typically safer than carrying cash, there are significant risks to consumers if an ATM or debit card is stolen or lost. Because ATM cards often require the use of a PIN to access cash from an account, it is more difficult for someone to make unauthorized withdrawals using your card if you keep your PIN secret.
The Lost Wallet

Bridget went to the beach on a sunny Saturday afternoon, but didn’t notice that her wallet fell out of her beach bag. On Monday morning, she realized that her wallet was gone when she reached into her bag for bus fare. Worried that someone might be using her debit and credit cards, she looked up her checking account balance online, but no unauthorized purchases had been made using her debit card.

Unfortunately, when she called her credit card company, she discovered that $500 had already been charged to her account. Bridget was so upset about the unauthorized purchases on her credit card that she forgot to call her bank to notify them of the lost debit card.

Problem 25.1

a. For what amount, if any, is Bridget liable on her credit card?

b. Suppose Bridget goes to make an ATM withdrawal from her bank account on Thursday and finds that all of the money in her account—$755—is gone. What if she immediately notifies the bank about the problem? Would she have been better off if she had notified the bank on Monday when she discovered that her debit card was gone? Explain your answers.

c. Do you think a consumer’s liability should be different for lost credit cards than for lost debit cards? Why or why not?

d. Why might a bank agree to provide better protection to its customers than what is required by law?

On the other hand, a debit card can be used like a credit card and does not always require the use of a special code. Thus, anyone can use your debit card as they would a credit card and potentially drain all of the money out of your bank account.

With lost or stolen credit cards, your liability is limited to $50 regardless of when you discover the loss. By contrast, your liability for lost or stolen ATM or debit cards depends on how quickly you notify your bank. If you notify the bank within two business days of discovering that your ATM or debit card is lost or stolen, you cannot be charged more than $50. If you discover unauthorized use of your card and notify your bank within 60 calendar days of the date your statement was mailed, your liability is limited to $500. If, however, you fail to notify your bank within this 60-day period, your potential loss from a lost or stolen credit card is unlimited.

Although banks are prohibited from imposing greater liability on a consumer than what is provided for under the law, a bank may voluntarily provide greater protection by reducing a consumer’s potential loss in the event of a stolen ATM or debit card. Make certain you understand your bank’s rules regarding your potential liability for your ATM and debit cards. You should also read your monthly bank statement carefully to monitor your account for unauthorized activity. Many people also monitor their account activity through online banking.
An Introduction to Credit

Using credit means borrowing money or buying goods or services now in exchange for a promise to pay in the future. People who lend money or provide credit to others are called creditors. People who borrow money or buy on credit and delay paying for the goods or services are called debtors. Debtors usually pay creditors additional money over the amount borrowed for the privilege of using the credit. This additional money owed to the creditor is called the finance charge. It is based on the interest charged plus other fees.

The two general types of credit are unsecured and secured. Unsecured credit is credit extended in exchange for a promise to repay in the future. The consumer is not required to pledge property in order to obtain the credit. Most credit cards and store charge accounts are examples of unsecured credit.

Secured credit is credit for which the consumer must put up some property of value—called collateral—as protection in the event the debt is not repaid. A borrower who does not make the required payments is said to default on the loan. If a borrower defaults on a secured loan, the lender can take the collateral.

For example, a person who buys an automobile may be required by the lender (often a bank) to post the car as collateral until the debt is paid off. If the buyer defaults on the loan and fails to pay it off, the lender can repossess and sell the car, using the proceeds of this sale to pay off the debt.

How Credit Works

Today, many stores and companies (including banks) issue credit cards and allow their customers to maintain charge accounts. Consumers can use credit cards to buy gasoline, go out to dinner, buy clothing, pay bills, and many other things. Some cards can also be used to obtain cash advances from banks and ATMs.

Credit cards are embossed with the account holder’s name and identification number. They entitle the holder to buy goods or services on credit. Some companies provide these cards free of charge, while others charge a yearly fee. Lenders charge interest on unpaid balances. Consumers are usually given a credit limit and can make

Some consumers use credit cards for everyday things such as food and gasoline, while others use credit cards for big-ticket items only. What is an annual percentage rate?
purchases costing up to that limit. If you exceed that limit, the creditor may or may not permit the charge to go through; even if they do, they may impose an over-limit fee. You should be aware of your credit limit and be sure to stay within that amount. Exceeding your limit could lead to a negative credit report or termination of your account.

Companies issuing credit cards send out monthly statements indicating how much you owe. Most credit card companies allow you to pay the balance over time by making a minimum monthly payment. You then pay interest on the unpaid portion of the bill. The interest rate can be as high as 30 percent or more on unpaid balances. Often, if you pay the entire amount on or before the due date indicated on the bill, there is no extra charge. However, some companies impose interest charges from the date of the transaction. A few require full payment of money owed each month. Some also charge a penalty if you do not pay the monthly minimum.

Companies use different methods to compute interest. However, you may be able to estimate the monthly interest charge by multiplying the balance owed by the monthly interest rate. For example, if the monthly rate is 1.5 percent, you will multiply by .015. Suppose you owe a balance of $500. The monthly interest charge will be about $7.50 ($500 × .015), and the total amount owed for the month will be approximately $507.50 ($500 + $7.50 interest). It is important to remember that different companies use various methods of calculating the balance on which interest is charged.

To more easily compare the rates charged by different companies, you can ask what annual percentage rate (APR) is charged. This rate is calculated the same way by all lenders. The APR is the percentage cost of credit on a yearly basis. Federal law requires creditors to give the APR when consumers ask about the cost of credit.

Choosing a Credit Card Wisely

When deciding which credit cards or charge accounts to maintain, you should find out the annual fee, if any; the percentage rate charged on money owed; and whether interest is charged from the date of the transaction or only on balances unpaid at the end of the billing period. Providers of credit compete with each other to get new customers. Some offer credit without a fee or at very low interest for a certain period of time. Be sure to find out what the interest rate will be after the introductory period. Some have agreements with airlines by which frequent-flyer miles can be earned and redeemed for airline tickets or other merchandise. Others provide cash rebates, insurance benefits, or the status of a particular card color (such as silver, gold, or platinum) which may carry additional benefits. Annual interest rates may vary by 10 percentage points or more, so it pays to shop very carefully for credit. Once you establish yourself as a creditworthy customer, you can try to negotiate a lower interest rate. Some companies may reduce their interest rate as a show of goodwill to their long-term customers.
Credit cards are in such wide use today that certain goods and services may be difficult to obtain without one. For example, some car rental companies will not rent to people without a major credit card. While credit cards are an important convenience for many consumers, others use their cards repeatedly to obtain “instant loans.” If they regularly make purchases with credit cards, they might then be unable to pay the balance on time. The interest rate on unpaid credit card balances is almost always higher than the interest on a bank loan, so using credit cards for this purpose is usually not a good idea.

Lost and Stolen Credit Cards

If your credit card is lost or stolen, you should report it immediately to the credit card company. For protection, any person with credit cards should keep a list of the following information for each card: (1) the name of the company issuing the card, (2) the account number on the card, and (3) the number to call if the card is lost or stolen. Some people recommend photocopying both sides of all credit cards and keeping these records in a safe place.

If your credit card is lost or stolen, you are not responsible for any unauthorized charges made after you have notified the issuer that the card is missing. Although federal law limits your liability for charges made before notification to $50 per card, many card issuers waive even this fee as a way of competing for business. If your card itself was not used but the thief obtained your credit card number and made unauthorized charges, you are not responsible for any of those charges.

Billing Errors

Billing errors can be a real problem. It takes time and energy to sort them out, and they can cost you money if you do not discover them right away. To avoid problems, check all sales slips, save receipts and canceled checks, and go over each monthly statement carefully.

If you do encounter a billing error, the Fair Credit Billing Act provides you with a measure of protection. Billing errors include items not delivered, unauthorized charges, failure to properly list return credits or charges, and errors in computing the amount owed. Problems with the quality of a purchased item are not billing errors.
This law requires that if you complain *in writing* about your billing error within 60 days of the date your monthly statement that first showed the error was mailed, creditors must acknowledge and respond to your complaint within 90 days. Phone calls do not protect your rights under this act. The written complaint must include your name, address, account number, and the nature and amount of the error. You may withhold payment of the disputed amount pending the investigation; however, undisputed amounts must be paid as normally required. Until your complaint is settled, the law forbids the creditor from reporting the matter to a credit bureau.

If it is determined that the bill is correct, you may have to pay a finance charge on the unpaid amount in dispute. However, a creditor who does not follow the requirements of the law may not collect the first $50 of the disputed amount, even if the bill turns out to be accurate. A consumer can sue such a creditor for damages and can also recover attorney’s fees.

**When Should You Use Credit?**

To make an informed decision about a credit purchase, you must first answer this question: Is it worth having a car, television, vacation, or other item before you have saved enough money to pay the entire purchase price, even though you will pay more for it in the long run?

Most American families answer “yes” to this question. In fact, many households are seldom debt free. More than 75 percent of households carry some kind of debt. In 2006, more than 55 percent of credit card holders carried a balance, and for those families the average monthly unpaid balance was $2,200.

Extensive use of credit is here to stay, but consumers should know that credit purchases usually cost more than cash purchases. In addition, studies show that consumers who use credit spend more and buy more often. This is the reason many merchants offer “easy credit.” Furthermore, consumers who buy on credit risk losing their newly purchased products as well as their previous payments if they fail to make the remaining payments.

As a general rule, consumers who spend more than 20 percent of their take-home salary to pay off debts (excluding mortgages) are using too much credit. Consumers who skip payments to cover living expenses or who take out new loans to cover old loans are also using too much credit.
Examining the billing statement above and answering the following questions:

a. Who is the creditor? Who is the debtor?

b. What is the new balance? How did the creditor arrive at the new balance?

c. How much credit is available on this account? How did the creditor determine the available credit?

d. Assume the debtor had a store receipt from the camera shop for $77.67. Draft a letter to the creditor about this billing error.
Paying for College

With tuition rapidly increasing, more and more students and their families must borrow money to pay for college. By the time they graduate, almost 70 percent of students at four-year institutions will have some student loan debt. Average debt levels for graduating seniors with student loans more than doubled from 1995 to 2005, increasing from $9,250 to $19,200.

Student loans are often a young person’s first exposure to the world of credit and debt. Private or government-sponsored student loan programs can provide the only means for some students to attend college. Student loans, however, create debt that must be managed and paid back, just like a credit card bill or a car loan. Borrowers sometimes default on student loans just as they do on other commercial loans. Because borrowers who do not finish school are more likely to default on student loans than those who graduate, it is very important to decide how committed you are to attending and graduating from college before you borrow money. In deciding whether and how much to borrow for school, you should carefully consider the following:

• What is the total cost for tuition, fees, and books?
• How much additional will living expenses cost? Will you be living at home, on campus, or in an apartment? Alone or with roommates? How will you pay for your meals?
• Are there other sources of income that will help pay your expenses? Can your parents contribute part of the cost? Will you have a job during the school year? Do you have any money in savings? How much can you save from working over the summer?
• Are full or partial scholarships available?
• On what time schedule will your loans become due after you finish school?

Some student loan programs are quite borrower-friendly. Various loan programs exist, including those where either a parent or the student is the borrower. Others allow the student to be the primary borrower, but require a co-borrower as added assurance that the loan will be paid back. A co-borrower is someone who promises to pay the debt in the event the student defaults on the loan. Many banks and universities offer private loans for education expenses.
Students should carefully pursue all government-supported loan options before considering private loans because government-supported loan programs typically have lower interest rates. In addition, government-supported loans may have other desirable options. For example, repayment of student loans can be deferred while you are in school, and many lenders offer grace periods, forbearance periods (if you encounter a difficult financial situation during the repayment period), consolidation programs, and graduated payment programs that allow your payments to start out low and increase as your income increases.

You can get more information about student loan programs from any college or university, as well as online from private lenders, loan servicing companies, and the federal government. The following government Web sites are a good starting place to learn about student loan programs:

- Visit FAFSA (Free Application for Federal Student Aid) online at www.fafsa.ed.gov.
- The U.S. Department of Education also provides online information at www.ed.gov/finaid.

You may also want to use an Internet search engine to find the Web sites for colleges and universities, private lenders, and loan servicing companies.

**Problem 25.3**

a. What are the advantages of taking out student loans rather than using credit cards to pay for college expenses?

b. How might a person determine whether it is worth incurring debt in order to attend college?

**The Cost of Credit**

As mentioned earlier, you should shop for credit just as you would shop for other products and services—by comparing costs and the terms of the agreement. The cost of credit includes interest and other finance charges. Because there are different methods for calculating interest rates, always ask for the APR. This number is calculated the same way by all lenders, so you can use it to compare rates from various lenders.
Interest Rates

Each state sets limits on the amount of interest that can be charged for various types of credit. Charging any amount above the legal limit is called **usury**. Lenders who charge interest rates above the legal maximum may be liable for both civil and criminal penalties. There is no general federal usury law.

Interest rate ceilings, or limits, vary from state to state. Generally, however, loans from banks or finance companies carry interest rates from 10 to 30 percent per year. Department stores often charge about 1.5 percent per month, or about 18 percent per year, but these rates can vary widely depending on the lender and the economic conditions at the time. Most store charge cards are now issued by banks. Interest rates on installment contracts for consumer goods, such as new cars or furniture, also vary widely.

Many credit card companies now offer **variable interest rates** to consumers. With a variable rate, the amount of interest the card holder is charged changes slightly from time to time. The rate is computed based on conditions in the economy and can go up or down with the changing economy.

Typical variable interest rates for new credit card holders range widely, often from 10 to 30 percent or more. Although some cards may offer 0 percent or another very low rate, these are usually introductory terms. Find out when these introductory rates expire and what the interest rate will be after that. These rates may be lowered over time if your credit is good, but the rates can also go up if your bank thinks you are a credit risk.

Borrowers should carefully review the information provided by the lender to determine how often the interest rate can change and how much it can change at each adjustment, as well as over the entire term of the loan. When the rate changes, your minimum required payments may also change. While your payments may start out low, they could increase over time if the interest rate also increases. It is important to note that if you are late with one payment on one credit card, which may cause your interest rate on that card to increase, other credit card companies may find out about this through a credit reporting bureau and increase your interest rate on your other accounts too.

**Problem 25.4**

Think of an item you would like to have now but could purchase only by using credit and paying later.

a. Name at least two institutions where you could shop for the credit you need to buy the item you want.

b. What interest and other fees might each creditor charge?

c. How would you determine which lender to use?
Other Charges

In addition to the interest paid on a credit purchase, other charges may be added to the basic price. Some of these additional services are offered as options by credit card companies, while others are unavoidable costs of having credit. These costs include:

- **Credit property insurance**—Insures the purchased item against theft or damage.
- **Credit life/disability insurance**—Guarantees payment of some or all of the balance due if the buyer should die or become disabled during the term of the contract.
- **Service charge**—Covers the seller’s cost of bookkeeping, billing, and so on.
- **Penalty charge**—May include court costs, repossession expenses, and attorney’s fees. In addition, many credit card companies charge a late payment penalty fee and increase your interest rate if you fail to make timely payments.

For Your Information . . .

**Students and Credit Cards**

More students have credit cards than ever before. Companies aggressively market credit cards to college students, often setting up booths on campuses and offering free gifts just for applying. They may also mail preapproved application forms to students and offer discounts on items of interest, such as cell phones and music downloads.

While students may plan to destroy the cards, they sometimes keep them, accumulating multiple cards and high credit limits. Initially attractive interest rates may often last for only a limited time. While having one credit card may be useful, carrying many cards can be an invitation to trouble.

Students can quickly accumulate debt by:

- paying only the minimum due on each card,
- paying off one credit card debt by using another credit card (and never lowering the total amount owed), and
- failing to exercise restraint.

With most college students already taking out student loans, additional credit card debt can put students in a deep financial hole.

Failure to make timely payments can also contribute to a negative credit rating, which can limit future financial choices. For example, some employers will not hire or some landlords may not rent to someone with a bad credit history.
Costly Credit Arrangements

Consumers may fall prey to loan sharking. Loan sharks are people who lend money at high, often usurious (illegal) rates of interest. They promise “easy credit” and appeal to people who have problems obtaining and keeping good credit. Usurious loans are illegal under state laws. There are, however, a variety of legal but costly credit arrangements that consumers should also avoid.

Some credit agreements call for balloon payments. In such agreements, the last payment is much larger than the monthly payments. Consumers may find it difficult to make the final payment, so carefully consider any agreement that calls for a large final payment. If you cannot make this payment, you may have to return the item to the seller even though you have made all the other required payments.

An acceleration clause permits the creditor to accelerate the loan, making all future payments due immediately in the event a consumer misses a single payment. Many auto sales finance agreements have acceleration clauses. If you miss a payment, you may suddenly owe the creditor the entire amount of the loan. Many cars are repossessed by lenders for this reason.

You should also beware of bill consolidation, or combining all your debts into a single one. Lenders sometimes claim you can wipe out all your bills by making one “easy” monthly payment to them, which they will distribute to your creditors. However, the consolidation loan may require payments over a longer period of time and at a higher rate of interest. Some lenders also charge a substantial fee for these loans. They may subtract the fee from your monthly payment to them before paying off your creditors, so you wind up falling deeper in debt.

Credit unions may offer the best terms to borrowers who want to consolidate debts, as they may lend you an amount sufficient to pay off all your bills. Then the credit union becomes your only creditor. Depending on your creditworthiness, they may also offer you a better interest rate than other lenders.

Truth in Lending

To prevent credit abuses, Congress passed the Truth in Lending Act in 1968. This law requires creditors to give you certain basic information about the cost of buying on credit. The creditor must tell you—in writing and before you sign a contract—the finance charge and the APR. The finance charge is the total amount you pay to use the credit, including interest charges and any other fees. The APR is the percentage cost of credit on a yearly basis. The law also requires creditors to give you information about variable-rate loans (for which your payments may increase over time).

Additionally, the law requires that consumers be given a copy of the disclosure form containing the credit information and be told the rules and charges for any late payments. Violators can be subject to both civil and criminal penalties, and consumers who sue creditors under this act may recover damages, court costs, and attorney’s fees.
The 50/50 Credit Plan

Linda wants to buy a new washing machine. The sales clerk at The Washer Mart tells Linda, “This washing machine is a good buy—only $500. But don’t worry if you don’t have the cash. I can arrange easy credit for you; only $50 down and $50 a month for 12 months. Just sign here.” Linda signs the paperwork and pays $50. The washing machine is delivered to Linda’s house the next day.

Problem 25.5

a. What is the total price Linda will pay for this washing machine under the contract? How much of this is interest? What is the annual interest rate? Is this a fair price? Explain.

b. What might happen if Linda misses a payment to The Washer Mart?

c. Would it be better for Linda to buy the washing machine on her credit card, which charges monthly interest of 1.5 percent (18 percent annually)?

What Lenders Want to Know

Any store, bank, or credit card company that lends money or extends credit wants to know that the money will be repaid. Before making a loan, the lender will want to know several things:

- Is the consumer a reliable person? For example, a person who moves or changes jobs frequently might not be considered reliable.
- Does the consumer have a long-term steady income?
- Does the consumer have a high enough income to pay for the items to be purchased?
- Does the consumer have a good record in paying off other loans?

Lenders are in business to make money; thus, it is understandable that they would ask questions such as these. However, lenders have sometimes unfairly denied credit and loans for reasons such as the applicant’s race, gender, or source of income. A federal law, the Equal Credit Opportunity Act, protects consumers against credit discrimination based on sex, marital status, race, color, religion, national origin, age, or source of income. The Federal Trade Commission (FTC) handles credit discrimination complaints against finance companies, retail stores, oil companies, and travel and entertainment credit card companies. Bank regulatory agencies, such as
the Federal Reserve Board, the Comptroller of the Currency, and others handle complaints against banks and bank credit cards. If you think you have been discriminated against, you can complain to one of these agencies or sue the creditor in court.

Many states also have their own laws that forbid credit discrimination. Complaints should be directed to the state or local consumer affairs office or human rights commission.

**What If You Are Denied Credit?**

If you ever apply for credit, the lender or creditor will evaluate your application according to certain standards. They may investigate you personally or pay a credit bureau to check your credit record. Many do both. Credit bureaus operate nationwide and often share financial and personal information about consumers. The Internet has increased the amount of information about consumers that is available to lenders and creditors. Information in a credit bureau’s files can be a key factor in determining whether you can get loans, credit cards, or other forms of credit in the future.

If a credit report indicates that you are a high credit risk, the creditor will probably deny credit or offer credit on less favorable terms. Also, if you are trying to get credit for the first time and have no credit record at all, the lender may deny credit. Sometimes lenders deny credit or a loan based solely on information in the application, without taking the time to order a credit report.

**Problem 25.6**

You are a loan officer at a local bank. Each of the following people is seeking a loan. Based on the information provided, evaluate each applicant and make a decision regarding each loan request. Explain your reasons.

**a.** Erika is the mother of four children. Her only income consists of public assistance payments of $1,020 per month and $100 per month from the pension of her deceased husband. She wishes to buy a new oven and refrigerator that cost a total of $1,100. She lives in a public housing development where her rent and other household expenses average about $950 a month.

**b.** Jerry is a carpenter seeking work wherever he can find it. Depending on the weather and other factors, he is subject to seasonal unemployment. He currently brings home about $1,200 per month but has no money in the bank. His monthly expenses include car and insurance payments of $350, minimum credit card payments of $50, and rent of $500. He would like to borrow $7,500 to buy a motorcycle.

**c.** Barbara, 20, is in her second year of college. She has excellent grades and plans to attend medical school after graduation. Until recently, her parents paid her bills, but she is now on her own. She is seeking $4,000 for her college tuition and expenses. She has never borrowed money before, but she plans to repay all loans after finishing medical school.
The Equal Credit Opportunity Act requires that creditors and lenders tell consumers why they were turned down. The reasons given must be specific. For example, “applicant does not meet our standards” is not specific enough. On the other hand, “insufficient income” is a specific reason. It tells you how your circumstances must change to qualify for credit.

Another federal law protects you from inaccurate credit bureau reporting. The Fair Credit Reporting Act requires creditors who deny credit based on information received from a credit bureau to tell you that fact. The creditor must also give you the name and address of the credit bureau that supplied the consumer report.

Under a law passed by Congress in 2003—the Fair and Accurate Credit Transactions (FACT) Act—every consumer is entitled to a free annual credit report from each of the three national credit bureaus. The reports can be obtained online at www.annualcreditreport.com or by calling 1-877-322-8228. For a small fee, consumers can also obtain their credit scores.

If you discover false, misleading, incomplete, or out-of-date information in your file, you can request in writing that the credit bureau recheck its information and correct the errors. The credit bureau is required by law to make such corrections. If the credit bureau does not cooperate in correcting your credit file, you may complain to the FTC or your state attorney general, or you can sue the credit bureau in court. If after reinvestigating the information the bureau still believes that it is correct, you have the right to have your version of the dispute inserted in the file. If the information being reported about you is accurate, the credit bureau can report it for seven years. After this period of time, the information is removed from the file.

Default and Collection Practices

Consumers who use credit sometimes have difficulty making all their payments. Problems can arise because the consumer is too deeply in debt or because of unexpected unemployment, family illness, or a variety of other reasons. A consumer who does not pay a debt is said to be in default.

What a Consumer Can Do in Case of Default

If you have problems paying your bills, you should consider the following options:

- Reassess your financial lifestyle to determine how the problem arose. If you are not already on a budget, consider starting one.
- Notify each creditor of the problem and ask to have the term of debt extended (resulting in smaller monthly payments) or to have the amount of the debt reduced or refinanced. Keep in mind that refinancing over a longer period usually results in increased finance charges.
• Contact a consumer credit counseling service or a family service agency that offers free or low-cost financial counseling to those in need.
• Seek financial assistance from friends or relatives to reduce the debt to a manageable level.

**Bankruptcy**  If taking the steps listed above does not resolve your problem, you may have to declare bankruptcy. This is a procedure through which a person places assets under the control of a federal court in order to be relieved of debt. Many people are surprised to learn that the majority of civil cases filed in federal courts are bankruptcies. In 2007, 1.1 million consumers filed for bankruptcy in the United States.

Under Chapter 13 of the federal bankruptcy law, a wage earner can make an arrangement, supervised by a federal court, to pay off some or all of what is owed to creditors over an extended period of time. A more severe form of bankruptcy is called a Chapter 7 bankruptcy. Under Chapter 7, the federal court takes control of most of the debtor’s assets (some states allow the debtor to keep certain items), sells them, and pays off as much debt as possible. Generally, the money received from the sale of the assets is not enough to fully pay all creditors.

A declaration of bankruptcy has serious long-term consequences for the debtor. Records of personal bankruptcy remain in credit reports for 10 years. Even after that time, it may be very difficult to obtain credit or borrow money. In addition, some debts are not wiped out through bankruptcy. Taxes, alimony, child support, and student loans must still be repaid.

**Creditor Collection Practices**

Creditors have many ways of collecting money from consumers who are unwilling or unable to pay their debts. It is understandable that creditors take action to recover money or property owed them. However, in the past, some bill collectors engaged in unsavory practices. As a result, some debtors suffered family problems, lost their jobs, and had their privacy invaded.

These practices prompted Congress to pass the *Fair Debt Collection Practices Act* in 1978. This act protects consumers from abusive and unfair collection practices by third-party debt collectors but does not apply to creditors collecting their own bills. Under the act, the debt collector’s communications are limited to reasonable times and places. False or misleading statements, as well as acts of harassment or abuse, are strictly prohibited.
**Calls and Letters** If you receive unfair, deceptive, or harassing phone calls or letters from a debt collector, you should report the collection practice to the FTC or to your local consumer protection agency. You can stop a debt collector from contacting you by writing a letter telling him or her to stop. After receiving your letter, the debt collector must not contact you again except to say that there will be no further contact or to tell you that the debt collector or creditor intends to take some specific action. Remember that sending this letter does not make the debt go away. You could still be sued by the debt collector or the original creditor.

**Repossession** As mentioned earlier, consumers sometimes post collateral when they take out a loan or sign credit sales contracts. The creditor can usually **repossess**, or take back, the collateral if the borrower defaults on the loan or obligation. Most states do not permit creditors to repossess collateral if doing so would involve violence or disturbing the peace. Usually the creditor will hire a repossession company to take back the collateral. This may happen late at night to reduce the chance of violence.

After repossessing the collateral, the creditor can sell it and then apply the proceeds of the sale to the amount owed. Debtors are also charged for any costs incurred in the repossession and sale. After the sale, the debtor is entitled to get back any amount received by the seller that is in excess of the amount owed (plus expenses). However, if the sale brings in less than the amount owed (plus expenses), the creditor can still demand that the debtor pay the difference.

**Court Action** Creditors may sue debtors in court for the exact amount owed on the debt. At times, the trouble and expense of suing in court make creditors avoid this method. However, creditors often sue debtors in small claims court. You will learn more about small claims court later in Chapter 27.

Just because you are sued does not mean the creditor is entitled to collect the disputed amount. Consumers may have legitimate defenses, such as the fact that the goods were defective. For this reason, *if you ever receive a summons to go to court, don’t ignore it.* If you cannot appear in court on the date set in the summons, contact the court clerk in advance to arrange for a postponement of the trial. In addition, contact a lawyer immediately. If you are unable to afford one, you may call the local legal services or legal aid office.

The main thing to avoid when being sued is a **default judgment.** This is a judgment entered for the plaintiff (creditor) against the defendant (debtor). Most default judgments occur simply
The Missed Payment

Orlando buys a used car from Top Value Cars for $5,000 and signs a contract agreeing to monthly payments for three years. After paying $3,000, he misses two payments because of unexpected medical bills.

Top Value needs to determine which debt collection method to use. Read each option and consider whether the action is legal and fair to Orlando. What arguments could creditors make in support of each option? What arguments could debtors make against them?

Problem 25.7

a. Top Value could hire someone to repossess the car. If Top Value takes this route, incurring expenses of $300, and is able to sell the car for $2,000, will Orlando get any money back? Will he still owe money to Top Value even though he no longer has the car?

b. Top Value has previously contracted with a collection agency that has an impressive record of getting consumers to pay their debts. The collector sends a letter every day to both the consumer’s home and place of business demanding payment and threatens to contact the consumer’s employer about the debt. The collector also calls the debtor at home and at work, leaving messages every hour, beginning at 6 A.M. until 11 P.M. Is this contact reasonable, or does it amount to harassment? Would it be any different if one of Top Value’s employees conducted the debt collection activities? Is it proper for a debt collector or a creditor to threaten to contact a debtor’s employer?

c. Top Value could file a suit in small claims court against Orlando to sue him for the unpaid amount on the contract. Is this a reasonable first step in the collection process? Is there something else the creditor could do before resorting to a court action?

because the defendant fails to show up in court. If the debtor fails to show up, a default judgment could be entered for the creditor even if the debtor had a good reason for failing to make a required payment.

Garnishment and Attachment  A creditor who wins a judgment against a consumer may still have trouble collecting if the consumer does not pay voluntarily. It was once common practice to put people in prison for not paying their debts. This is no longer allowed, except in some cases of failure to pay court-ordered child support.

One solution creditors use is to get a court order that forces the debtor’s employer to withhold part of the debtor’s wages and pay it directly to the creditor. This is called garnishment. The federal Wage Garnishment Act limits the amount that can be garnished to 25 percent of the debtor’s take-home pay (pay after taxes and Social Security deductions). The act also prohibits employers from firing employees who have their wages garnished for a single debt. State laws may further limit and sometimes completely prohibit garnishment.

Creditors can also get possession of a debtor’s money or property by attachment. This is a court order that forces a bank to pay the creditor out of a consumer’s bank account or that allows the court to seize the consumer’s property and sell it to satisfy the debt.