



# Department of Commerce

Division of Financial Institutions

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## Overview of Consumer Credit

“Credit” represents your reputation as a borrower. It tells banks, lenders, and merchants how likely you are to repay a loan. Earning credit is contingent upon information found in your borrowing history. That information comes from your credit reports.

### Tips to Managing Your Credit

- ▶ Only borrow and spend what you can afford. Try to pay credit card bills in full each month. Paying only the minimum payment will dramatically extend the length of your debt.
- ▶ Pay bills as soon as they arrive. Late payments on one account can result in a lower credit score. A lower credit score can result in higher rates on other accounts, including insurance.
- ▶ Check your credit report regularly for accuracy and dispute inaccurate information immediately.



### Two Types of Credit: Secured & Unsecured

**Secured debt** is backed by an item of equal or greater value, such as a house or car. This item is called collateral. A mortgage is a secured debt that uses a house and/or property as collateral. If a borrower fails to make his or her mortgage payments, the lender may take possession of the house through a foreclosure action.

**Unsecured debt** is any form of borrowing that is not secured by an asset. With an unsecured debt, a consumer obtains assets on credit in exchange for a promise to repay the creditor. Credit cards and most student loans are forms of unsecured debt.

### What Types of Credit Options are Available?

#### **Retail Installment Sales Agreement or Contract (RISA)**

When purchasing retail goods, many people are offered RISAs. When entering into a RISA, consumers should pay attention to the contract’s terms. If an introductory interest-free period ends and there is a remaining balance, the lender could add the finance charge they would have collected over the "interest-free" period.

#### **Revolving Charge Accounts**

Most credit cards are revolving charge accounts. These accounts allow flexibility by offering a credit line that can be accessed when needed and by allowing a flexible period of time to pay off expenditures.

#### **Signature Loans**

Signature loans are small loans, usually under \$1,000, that extend over a short duration and do not involve collateral. In Ohio, payday loans are included in this category.

#### **Pawn Loans**

Pawn loans are made in exchange for personal property that is held by the lender until repayment is made. If the borrower does not pay the loan with interest within two months, the pawnbroker takes ownership of the property. This typically does not affect the borrower's credit record.

## **Secured Loans**

A typical secured loan has a life of more than 90 days and is collateralized by personal property. If a borrower defaults on a secured loan, the lender may take the collateralized property. These loans may be offered by banks, credit unions, or some consumer finance companies.

## **Home Equity Loans**

Consumers seeking to consolidate debt or pay large expenses like college education or major home improvements might take out a home equity loan. Home equity loans are collateralized by the consumer's home which is pledged in case of default. These are larger loans with lengthy repayment periods and often low interest rates. These loans can take two forms — either the refinance of the primary mortgage combined with a cash payment to the borrower or new junior lien that includes cash payment to the borrower.

## **An Explanation of Interest**

Interest is the finance charge paid by a borrower to a lender for the use of their money. Interest is often stated in more than one way:

**Simple interest** is interest charged on the principal amount borrowed only. Most mortgages are simple interest loans.

**Compound interest** is charged on the principal amount as well as the interest accrued during the term of the loan. Compound interest is more expensive because interest is charged on interest. Many credit cards charge compound interest.

**Annual percentage rate (APR)** is the rate charged for borrowing shown as a single percentage number. APR represents the yearly cost of funds over the term of a loan and is typically higher than the interest rate of the loan. The APR includes any fees or additional costs associated with the transaction typically charged at closing. APR is also used to evaluate the cost of a mortgage.

## **Who Decides a Consumer's Credit Rating?**

A record is kept by the three major credit bureaus (Equifax, Experian and TransUnion) that includes a consumer's name, address, Social Security number, payment history, previous credit amounts, employer, income, court judgments, and bankruptcy filings. Incorrect information can be removed by disputing the information to the credit bureau. If you have been denied credit or believe you are a victim of fraud, you are entitled to a free report. You can request a copy of your credit report from the credit bureaus by visiting <https://www.annualcreditreport.com> or calling 877-322-8228.

## **What if I Don't Repay My Obligation?**

A creditor can use reasonable means to collect a debt. This may include reporting nonpayment on your credit record, turning your debt over to a collection agency, taking possession or repossession of collateral, obtaining a judgment, or a court decision directing payment. Each of these actions can be reported on a credit record.

Collectors cannot lawfully use or threaten violence or other criminal means to harm you, your property or your reputation; use obscene or profane language; publicize your debt; place repetitive, harassing telephone calls; or make anonymous phone calls.