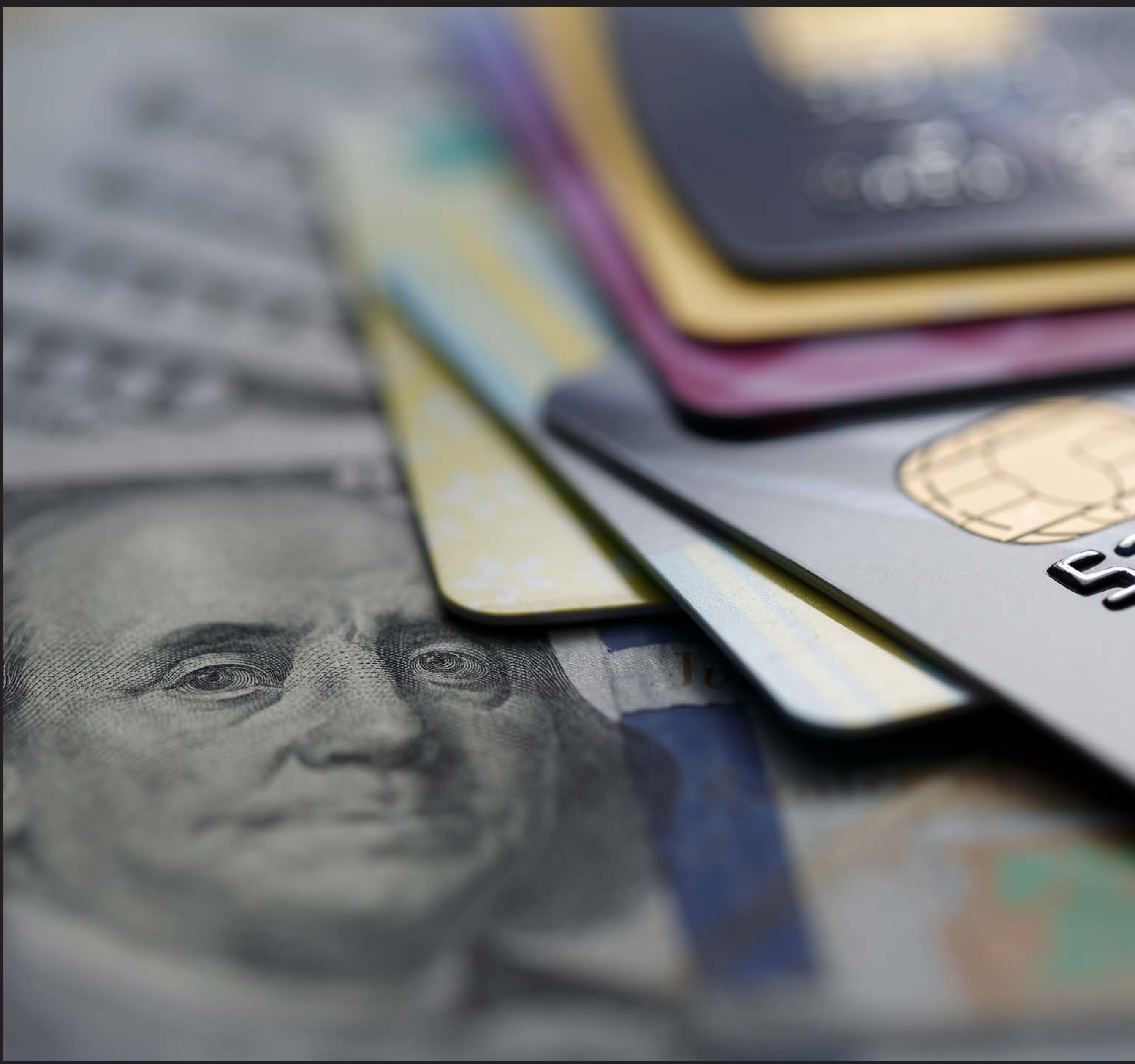
MONEY SMART

MODULE 7: Borrowing Basics

PARTICIPANT GUIDE



FDIC

MONEY SMART for Adults

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The Federal Deposit Insurance Corporation is an independent agency created by the Congress to maintain stability and public confidence in the nation's financial system. One way we do that is by providing free, non-biased financial education materials, including this Participant Guide. For more information about our family of Money Smart products, visit **www.fdic.gov/moneysmart**.

Contents

Welcome

Welcome to the FDIC's Money Smart for Adults!

This is the Participant Guide for **Module 7: Borrowing Basics.** Use it during and after training. Mark it up, write in it, take notes—it is yours to keep.

Module Purpose

This module covers options for borrowing money and what they cost.

This module also:

- Discusses how to borrow money
- Covers borrowing when someone helps you manage your money

Section 1: Ways to Borrow Money and What It Costs

We will discuss different types of loans and the costs of borrowing.

Key Takeaway

Be sure you can afford the payments before getting a loan. Also, know how much it will cost and what will happen if you can't pay.

What Borrowing Means

When you borrow, a lender provides you money and you have to pay it back – usually with interest.

Credit = The Ability to Borrow Money

Debt = Money You Owe a Person or Business

Types of Loans

An **installment loan** is usually repaid in equal payments for a specific period of time, usually several years.

A **revolving loan** allows you to make unlimited purchases up to a pre-approved dollar limit. Your payments will vary based on how much you have borrowed.

There are other ways to purchase items, which are typically not loans. For example:

- **Rent-to-own services** let you use an item for a period of time by making monthly or weekly payments. If you want to purchase the item, your rental payments will be partly credited toward the purchase price.
- **Buying on layaway** involves putting down a deposit — usually a percentage of the purchase price — and paying the balance (which usually includes fees) over time. You take the merchandise only when you have paid in full. Be sure you understand the refund policy.

Secured and Unsecured Loans

Secured loans require collateral. You pledge collateral to support repayment of the loan.

Collateral is an asset you own, such as your house, vehicle or cash. If you cannot repay the loan as agreed, the lender can take your collateral and use it to get some or all of their money back.

Unsecured loans are made based only on your promise to repay the money you borrow. They do not use collateral.

The Cost of Borrowing

The amount you repay on a loan will generally be greater than the amount you borrowed.

Amount you repay on loan > Amount you borrowed

Principal	Amount of money you borrow
Interest	Amount of money a financial institution charges for allowing you to use its money—expressed as a percentage
Fees	May be charged by financial institutions for certain activities, such as reviewing your loan application and servicing the account
Prepayment	Early repayment of all or part of a loan—when you shop around for a loan, find out if a fee could be charged for prepayment (called a prepayment penalty)

Try It: Exploring Borrowing Options

Read the scenario and answer the questions.

Scenario: Binh Explores Her Options for Buying New Furniture

Raising children has been tough on Binh's living room furniture. And, because of challenges finding and keeping steady employment, she hasn't had enough income to replace it. But now that she has more income from a steady job, she can finally start buying some nicer things for her home.

Earlier this week, she saw a living room set for sale that she really liked. It cost $2,500 which is more than the $1,500 she has saved for new furniture at this point.

Yesterday Binh explored some options for buying the furniture and learned:

- **She could get a 36-month unsecured installment loan for $1,000 from her local bank.** When she adds up the loan amount with interest, plus the $1,500 she pays from her savings, she realizes she will pay a total of $2,636 for the furniture. And, she would be in debt for three years, making payments of about $32.00 each month.
- **She could keep her savings for an emergency and instead buy the furniture using her credit card.** Her credit limit is high enough. If she takes this option, she estimates that she will pay at least $3,000 for the furniture. That includes the interest she'll pay to the credit card company since she won't be paying off the balance right away. Her credit card payments would be about $83.00 each month for three years.
- **She could purchase the furniture on layaway.** The store tells her that purchasing the furniture this way would mean paying $2,750 for the furniture. But she won't get to bring home the furniture until she's paid $229.00 each month for 12 months.
- **She could use a rent-to-own option.** The same living room set is available for delivery tomorrow from a local store. When she adds up the payments and fees for their rent-to-own option, she learns that she will pay $3,500 for the furniture. She estimates that she'll be paying $292.00 each month for 12 months if she chooses this option.

Try It: Exploring Borrowing Options *continued*

Which options allow Binh to get the furniture today (or as soon as it can be delivered)?

Which option does not allow Binh to get the furniture today?

Which option results in Binh paying the most money for the furniture?

Which option results in Binh paying the least money for the furniture?

Some months, Binh finds that money is tight. She has just enough income to cover her expenses. Which options would help Binh manage in months when her cash flow is a challenge?

What else could Binh consider?

Truth in Lending / Comparing Offers

The federal Truth in Lending Act or TILA requires lenders to give prospective borrowers a written disclosure (called a TILA disclosure) that states the loan terms in a clear and uniform manner. You receive the TILA before you sign for the loan.

Part of a Sample TILA Disclosure for an Installment Loan

ANNUAL PERCENTAGE RATE	**FINANCE CHARGE**	Amount Financed	Total of Payments
The cost of your credit as a yearly rate.	**The dollar amount the credit will cost you.**	The amount of credit provided to you or on your behalf.	The amount you will have paid after you have made all payments as scheduled.
12.00 %	**$ 600.00**	$ 5,000.00	$ 5,600.00

The disclosure you will receive for a mortgage (home loan) or some student loans will look different.

Use the TILA disclosures, in particular the Annual Percentage Rates, to compare loan options.

Visit **consumerfinance.gov** and search for “compare loans” to find tools to help you compare loans.

You can also seek help from a housing counseling agency approved by the U.S. Department of Housing and Urban Development (HUD) or a credit counseling organization.

Remember the Key Takeaway

Be sure you can afford the payments before getting a loan. Also, know how much it will cost and what will happen if you can’t pay it back.

Section 2: Preparing to Apply for a Loan

We will discuss how to borrow money and how lenders decide whether to loan money.

Key Takeaway

Considering what lenders look for when deciding to loan money helps prepare you to apply for a loan.

Factors Lenders May Use in Their Decisions

Each lender will have its own method for determining whether you are a good credit risk.

You can take notes from the discussion here.

Your credit or character: How you have paid your bills or debts

Your capacity: Your present and future ability to meet your payments

Your capital: The value of your assets and your net worth

Net Worth = Your Assets – Your Liabilities

Your collateral (for secured loans only): The assets that secure the loan

Conditions of the loan: Depends on type of loan

Try It: Getting Ready to Borrow

Read the scenario and answer the questions.

Scenario: Shandra Gets Ready to Borrow
Shandra is thinking about modifying her van so her father can more easily ride in it. Currently, she hires wheelchair-accessible taxis to meet his transportation needs.

She borrowed money eight years ago to buy a car. At the same time, she applied for and began using a credit card. Unfortunately, she had money trouble a year later. The car was repossessed and she missed payments on her credit card several times.

Shandra worked hard to stabilize her finances. She finally finished paying off the credit card debt and canceled the card. For four years, she has not had debt of any kind while she saved money. She purchased her used van in cash.

Shandra has been in the same job now for two years and plans to stay there. Income from that job covers living expenses for Shandra.

She would like to modify her van soon, but she could wait if she needed to. She can pay for part of the costs to modify the van using cash she has saved for that purpose. If her preliminary research into financing options is accurate, she thinks she can afford to make the payments on a loan to finance the rest of the van modifications.

Shandra promised herself she would save some money every time she received income. And she's been doing that. Her emergency fund in a savings account can now cover her current living expenses for about one week. She's proud of how much she's saved so far.

The questions are on the next page.

Try It: Getting Ready to Borrow *continued*

Question	Capacity	Capital	Credit/Character
What will reflect positively on Shandra?			
What will reflect negatively on Shandra?			
What can Shandra do to improve her chances of being approved for the loan?			

Apply It: Getting Myself Ready to Borrow

To get yourself ready to borrow, pretend you are a lender. Would you approve you for a loan? Complete this worksheet to see how a lender might evaluate your creditworthiness now. Then think about what you can do to improve that evaluation before applying for a loan. Also, think about how you will manage a loan if your application is approved.

Question	Capacity	Capital	Credit / Character	Collateral (for secured loans only)
What will reflect positively on me?				
What will reflect negatively on me?				
What can I do to become a stronger applicant?				

Apply It: Getting Myself Ready to Borrow *continued*

What can I do to improve my credit?

How will I make payments on a loan if I'm approved?

For example, will I have payments automatically taken out of my account or will I remember to write a check and mail it in each month?

How will I monitor the loan?

For example, will I receive paper statements or monitor my payments and balance online? Or both?

Co-Borrowing and Cosigning

Co-borrowing is taking out a loan jointly with one or more other people.

- Each co-borrower is responsible for repaying the debt. The payment history appears on the credit reports of each of the co-borrowers.
- Before you co-borrow, have a clear agreement with the other co-borrowers about how much of the loan payment you will each pay and other responsibilities.

Cosigning is different from co-borrowing. The loan proceeds go to the borrower and not to you as the cosigner. When you cosign, you promise to pay the debt if the borrower does not.

Apply It: My Tip Sheet for Considering Cosigning Someone Else's Loan

Review this tip sheet if you are considering cosigning someone's loan.

Questions to Ask Yourself before Cosigning

- **Can I afford to pay the loan?**
  Consider the worst-case scenario—the borrower does not make the payments and you have to make them and possibly also pay late fees and collection costs.

- **Will cosigning affect my ability to get the credit I need?**
  When you cosign, the debt appears on your credit report. If this debt is ever in default, that fact may become part of your credit history and affect your credit scores.

  Also, if you want to get other credit, lenders may consider the cosigned loan as one of your debts when they are determining your capacity to take on new debts.

- **Do I understand exactly how much money I might be obligated to repay?**
  Ask the lender to calculate the amount you might owe. You also may be able to negotiate specific terms of your obligation.

  For example, you may want to limit your liability to the principal on the loan. If you do—before you cosign—ask the lender to include a statement in the contract. The statement could say: "The cosigner will be responsible only for the principal balance on this loan at the time of default." While that is better for you, it could mean the lender will not approve the borrower for the loan.

Apply It: My Tip Sheet for Considering Cosigning Someone Else's Loan *continued*

- **Do I understand what I might lose?**
  If—in addition to cosigning—you offer items you own as collateral for the loan, understand that you may lose those items. Before you pledge property to secure the loan, like your car, furniture or jewelry, consider the risk. If the borrower defaults and you cannot pay the debt, you could lose that property.

Ways to Protect Yourself as a Cosigner

- **Get notified.**
  Ask the lender to notify you if the borrower misses a payment or the terms on the loan change. Get the lender's agreement to do that in writing, before you cosign. That will give you time to deal with the problem or make payments without having to repay the entire amount immediately. The lender is not required to notify you of these events, so you need to ask.

- **Get copies.**
  Make sure you get copies of all important papers, like the loan contract and the Truth in Lending Disclosure. These documents may be useful if there's a dispute. The lender may not be required to give you these papers so you may have to get copies from the borrower.

Check with your state attorney general's office for rights that cosigners may have in your state. You can also search on "loan cosigner" at **www.usa.gov**.

Remember the Key Takeaway

Considering what lenders look for when deciding to loan money helps prepare you to apply for a loan.

Section 3: Borrowing When Someone Helps You Manage Your Money

We will discuss borrowing money when someone helps you manage your money.

Key Takeaway

Even if someone helps you manage your money, understand the terms of a loan before you commit to it.

Responsibilities of the Person Helping You

When someone helps you with your finances, they must:

- Act in your best interest
- Manage your money and property carefully
- Keep your money and property separate from theirs
- Keep good records
- Include you in decision-making to the extent possible

You can find guides specifically for people who help other people with their money by visiting **consumerfinance.gov** and searching for "someone else's money."

What to Discuss

You may want to talk about these questions with the person who helps you with your finances as well as another trusted advisor. It's okay if the people helping you with your money also help you answer these questions. You don't need to know all of the answers already yourself.

- Why do you need to borrow money?
- Do you have enough money to repay the loan?

- How you will make payments on the loan?
- Will borrowing money affect any of your sources of income?
- What is the best borrowing option for your needs?

If You Decide to Borrow Money

- It is important to understand the terms of the loan before you commit to it. You should know:
  - How much money you are borrowing
  - How much money you have to pay back in total
  - How much money you have to pay each month
  - When the payments are due
  - Other important information
- You can get help considering the terms of the loan and completing the application.
  - A lender cannot disqualify you because you need this help.
- The lender will decide if you are a good credit risk, just as they would any other potential borrower.
  - The lender will not consider the creditworthiness of the person helping you unless that person is a cosigner or a co-borrower.

After you borrow money, you can ask for help from the person who helped you get the loan or a trusted advisor. For example, you can ask for help:

- Remembering to make payments on time
- Keeping good records
- Setting up automatic payments and reminders
- Managing any other aspects of the loan

Remember the Key Takeaway

Even if someone helps you manage your money, understand the terms of a loan before you commit to it.

Module Closing

Remember the Key Takeaways

Section	Key Takeaway
1: Ways to Borrow Money and What It Costs	Be sure you can afford the payments before getting a loan. Also, know how much it will cost and what will happen if you can't pay it back.
2: Preparing to Apply for a Loan	Considering what lenders look for when deciding to loan money helps prepare you to apply for a loan.
3: Borrowing When Someone Helps You Manage Your Money	Even if someone helps you manage your money, understand the terms of a loan before you commit to it.

Take Action

You are more likely to take action if you commit to **taking action now.** One way to commit is to think about what you plan to do because of what you learned today. Then write it down.

What will I do?

How will I do it?

Will I share my plans with anyone? If so, who?

Where to Get More Information or Help

The Bureau of Consumer Financial Protection offers numerous tools to help consumers who are thinking about borrowing money wisely. Visit **consumerfinance.gov** and search for "borrowing money."

The Federal Trade Commission has information about a range of related topics, including scams to watch out for and consumer protections at **www.consumer.ftc.gov/topics/credit-and-loans**.

If you have a question about a banking product, ask a customer service representative at the financial institution for help.

If you have a concern, explain to the customer service representative what happened and what you would like them to do to correct the situation. If that does not help, consider contacting the federal regulator for that financial institution.

To find out who regulates the financial institution, call the FDIC toll-free at 1-877-ASK-FDIC (1-877-275-3342) or visit **www.fdic.gov/consumers/assistance/filecomplaint.html**.

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Pre-Training Survey

Your instructor may ask you to complete this pre-training survey before the training begins.

Please answer these questions:

1. You can increase your chances of being approved for a loan by improving which of these? Choose all that apply:
   a. Your capacity
   b. Your capital gains
   c. Your credit/character
   d. Your creditors
   e. All of the above

2. Most loans are set up the same, so it is not important to shop around.	True	False
3. Federal Truth in Lending Act or TILA disclosures can help you compare loan options from different lenders.	True	False
4. If someone helps you manage your money, you are not eligible to borrow money.	True	False

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Post-Training Survey

Your instructor may ask you to complete this post-training survey after the training ends.

Please answer these questions:

1. You can increase your chances of being approved for a loan by improving which of these? Choose all that apply:
   a. Your capacity
   b. Your capital gains
   c. Your credit/character
   d. Your creditors
   e. All of the above

2. Most loans are set up the same, so it is not important to shop around.	True	False
3. Federal Truth in Lending Act or TILA disclosures can help you compare loan options from different lenders.	True	False
4. If someone helps you manage your money, you are not eligible to borrow money.	True	False

About the Training
Check the box that best describes your agreement or disagreement with each of these statements.

	Completely agree	Somewhat agree	Somewhat disagree	Completely disagree
5. I would recommend this training to others.				
6. I plan to apply what was discussed in this training to my life.				
7. The instructor used engaging training activities that kept me interested.				
8. The instructor was knowledgeable and well prepared.				
9. The Participant Guide is clear and helpful.				

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Visit the FDIC's website at **www.fdic.gov/education** for more information and resources on banking-related issues. For example, FDIC Consumer News provides practical hints and guidance on how to become a smarter, safer user of financial services. Also, the FDIC's Consumer Response Center is responsible for:

- Investigating all types of consumer complaints about FDIC-supervised institutions
- Responding to consumer inquiries about consumer laws and regulations and banking practices

You can also call the FDIC for information and assistance at 877-ASK-FDIC (877-275-3342).

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