



**D**aryl has watched in fascination as his father unfolded his packet of credit cards. He has five oil company cards, six charge accounts at department stores, an American Express card, an ATM cash card, four MasterCards, and six VISA cards. Daryl thinks that carrying that many cards around must be a chore! How in the world can anyone manage to acquire so many cards, much less need them all? There must be a lot of checks to write each month when the bills come. Daryl carries only four cards: his driver's license, his school library card, a credit card for gasoline, and his ID card for the video rental store.

Once when Daryl asked his father about all the credit cards, he explained that his credit rating is excellent. He has lived in the same house for 8 years, he has been a high-salaried employee at the same business for 12 years, he has bought three different cars with installment

loans, making prompt payments every month, and he is 41 years old. Creditors are more than willing to give him credit because he has shown he is capable and consistent in making payments. Over a 4-year period, 12 different banks from around the country offered him credit cards. He took most of them up on their offers, realizing how easy it is to use the cards to buy much more than he could afford to pay for with cash. Now he makes the minimum payment each month to each bank and continues to use almost all the credit available to him on each card.

When Daryl watches his father writing all the checks each month, he is not sure carrying 23 credit cards is truly necessary. However, he would like to know how to get at least one general purpose card for himself. Since he has never had a bank card and probably does not even have a credit rating, he is wondering where to begin.

**OBJECTIVES:** In this lesson, we will help Daryl to:

- Determine an individual's credit rating, using the judgment of the creditor or a credit-scoring table.
- Learn how to get credit for the first time.

## HOW CREDIT IS GRANTED

A **credit rating** is an indication of a person's ability to secure goods, services, and money in return for the promise to pay. Daryl knows a favorable credit rating does not come automatically. His father's good rating has developed slowly over time. It has been nurtured, fostered, strengthened, and improved. A good credit rating is an asset of tremendous value to those who develop it over a long period, but it can easily be destroyed. A good credit rating is sensitive to abuse and usually continues only as long as it is justified. Daryl's father has so much credit now that were he to apply for more, he would probably be told he already has sufficient credit.

The decision to grant credit lies with the *judgment of the creditor*. The creditor considers the "three C's" of credit—capacity, character, and collateral.

**Capacity** Do you have the capacity to repay the loan? How long have you worked, and how much do you earn? Creditors will also ask about your expenses such as rent, mortgage, car payments, and so on.

**Character** Have you been responsible about meeting financial obligations in the past?

**Collateral** Are the creditors protected from loss if you fail to pay? Creditors want to know if you have a savings account or other assets (car, home, or other valuable assets) to offer as security for a loan.

Because of laws that prohibit discrimination, large credit-lending institutions have developed **credit-scoring systems** that can be considered more objective than personal judgment. Credit-scoring systems award points for various factors to determine credit worthiness. A scoring system is shown on page 293. The principles underlying a scoring system are as follows:

- In general, you are a better *credit risk* if you are older. People in their mid-30's often face unforeseen expenses due to divorce or other causes of financial stress. Consequently their credit rating points may be lower.
- You are considered more stable the longer you have lived in the same place, and your score will increase if you own your home rather than rent it. People with cars get more points than those without, and owners of newer cars generally earn more points than owners of older cars.



- The length of time you have held the same job is another factor that is considered. The kind of job you have, your income, and your amount of current debt also make a difference.
- It is favorable to have either a savings account or a checking account. If you have both, you score more points.
- If you have one or more credit cards in good standing, you will score higher than those who have none. Department store charge cards, travel and entertainment cards, and oil company cards usually rate somewhat lower than all-purpose bank cards.
- If you have borrowed recently at high interest from a finance company, you will probably lose several points. If you have applied and been turned down for credit more than once in the last 6 months, you may have difficulty getting new credit at all.

### Hypothetical Credit-Scoring Table

Fill out your credit profile by answering the nine questions below in Table 1. Circle the one response that applies to you, and then find your total score by adding up the points you got for each response. The points are found in the lower right-hand corner of each box. (For example: if you are 25 years old, you get 5 points.) Once you've totaled your score, look at Table 2 to find out how good a credit "bet" you may be.

1.								2.																					
1.	age?	under 25 12	25-29 5	30-34 0	35-39 1	40-44 18	45-49 22	50 or over 31	<p>A lender using this scoring table selects a cutoff point from a table like this, which gauges how likely applicants are to repay loans.</p> <table border="1"> <thead> <tr> <th>Total Score</th> <th>Probability of Repayment</th> </tr> </thead> <tbody> <tr><td>90</td><td>89 in 100</td></tr> <tr><td>95</td><td>91 in 100</td></tr> <tr><td>100</td><td>92 in 100</td></tr> <tr><td>105</td><td>93 in 100</td></tr> <tr><td>110</td><td>94 in 100</td></tr> <tr><td>115</td><td>95 in 100</td></tr> <tr><td>120</td><td>95.5 in 100</td></tr> <tr><td>125</td><td>96 in 100</td></tr> <tr><td>130</td><td>96.25 in 100</td></tr> </tbody> </table>	Total Score	Probability of Repayment	90	89 in 100	95	91 in 100	100	92 in 100	105	93 in 100	110	94 in 100	115	95 in 100	120	95.5 in 100	125	96 in 100	130	96.25 in 100
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2.	time at address?	less than 1 yr. 9	1 yr. 0	2-3 yrs. 5	4-5 yrs. 0	6-9 yrs. 5	10 yrs. or more 21																						
3.	age of auto?	none 0	0-1 yrs. 12	2 yrs. 16	3-4 yrs. 13	5-7 yrs. 3	8 yrs. or more 0																						
4.	monthly auto payment?	none 18	less than \$125 6	\$126-\$150 1	\$151-\$199 4	\$200 or more 0																							
5.	housing cost?	less than \$274 0	\$275-\$399 10	\$400 or more 12	owns clear 12	lives with relatives 24																							
6.	checking and savings accounts	both 15	checking only 2	savings only 2	neither 0																								
7.	finance company reference	yes 0	no 15																										
8.	major credit cards?	none 0	1 5	2 or more 15																									
9.	ratio of debt to income?	no debts 41	1%-5% 16	6%-15% 20	16% or over 0																								

Source: Federal Reserve Board. Developed by Fair, Isaac, and Co., Inc. Modified to update.

Daryl would like to know how to obtain *first-time credit*. Credit is easy to get if you have had it before. But what about getting credit for the first time?

Below are some suggestions for Daryl to help him establish a good credit reputation. He can do the following:

- Open a charge account at a retail store where his parents have an account.
- Establish checking and savings accounts at the local bank.
- Get one of his parents to **cosign** a small loan. By cosigning, Daryl's father promises to pay if Daryl does not. When Daryl repays on time, he establishes a good credit record.
- Join a credit union.
- Be a responsible employee. Creditors generally ask for length of employment at a job and for personal references.

As Daryl begins to establish his own credit rating, he will be careful not to abuse it. He will treat it as the valuable asset that it is, and continue to strengthen it as time goes on.

### ASK YOURSELF

1. What are the "3 Cs" that creditors use to judge a person's acceptability for credit?
2. How does a lending institution determine the credit worthiness of an applicant?
3. How might you establish a good credit reputation?

## ALGEBRA REVIEW

When you take a test in school, you often receive a score. Mrs. Esposito assigned the following point values to each question on her mathematics test:

- Questions 1–9: 5 points each
- Questions 10–13: 7 points each
- Questions 14–15: 11 points each
- Bonus Question: 10 points

**Determine each test score.**

1. Sally missed Questions 2 and 12, but answered the others correctly. She also answered the bonus question correctly.
2. Tom missed Questions 13 and 14, but answered the others correctly. He received no bonus points.
3. Janet missed Questions 5, 6, 11, but answered the others correctly. She received no bonus points.
- 4.–6. If Mrs. Esposito assigns grades as follows, determine each student's grade on the test.
  - 90+ → A
  - 80–89 → B
  - 70–79 → C
  - 65–69 → D
  - 0–64 → F
7. Write a general formula for calculating a test score.

## SHARPEN YOUR SKILLS

### SKILL 1

**EXAMPLE 1** Daryl wonders how his father qualifies for so many credit cards. He knows the following facts about his father.

1. He is 41 years old.
2. He has lived at his current address for 8 years.
3. His current car is 2 years old.
4. He has no monthly car payment.
5. His housing cost is \$482 per month.
6. He has a checking account and a savings account.
7. He has not been referred to a finance company.
8. He has 23 major credit cards.
9. His ratio of debt to income is 20%.

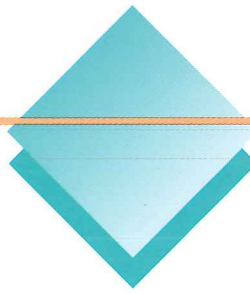
**QUESTION** How would a potential creditor rate his credit worthiness? According to the credit-scoring system, what is the probability that he will repay a loan?

### SOLUTION

	Points	
1.	18	Use the credit-scoring table to find his credit score.
2.	5	
3.	16	
4.	18	
5.	12	
6.	15	
7.	15	
8.	15	
9.	0	
Score:	114	

Look in part 2 of the credit-scoring table to find the probability that Daryl's father will repay his loan. Since 114 is not listed, use the lower score of 110. The probability that he will repay a loan is 94 in 100, or 94%.

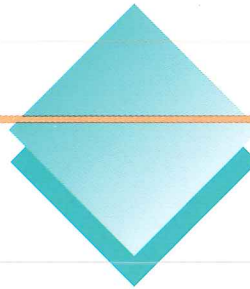




## TRY YOUR SKILLS

Use the credit-scoring table to find Brooke's credit score for each item.

1. She is 28 years old.
2. She has lived at her current address for 1 year.
3. Her current car is 4 years old.
4. She has no car payment.
5. She lives with relatives.
6. She has a checking account and a savings account.
7. She has not been referred to a finance company.
8. She has no major credit cards.
9. She has no debts.
10. What is Brooke's total score?
11. What is the probability that Brooke will repay a loan?



## EXERCISE YOUR SKILLS

1. Why is it important to establish a favorable credit rating?
2. If you were a lender, what is the minimum score on the credit-scoring table that you would accept on an applicant? Why?
3. It has been said that a person's credit rating is one of his or her most valuable assets. Do you agree or disagree? Why?

Use the credit-scoring table on page 293 to determine the credit score for each head of household described below. Then determine the probability that the person will repay a loan.

### 4. Family 1

- Age of the head of the household—35
- Lived at the current address—4 years
- Age of current car—3 years
- Monthly car payment—\$165
- Housing cost—\$650
- Has a checking account and a savings account.
- Has not been referred to a finance company.
- Has 7 major credit cards.
- The ratio of debt to income is 12%.

KEY TERMS
collateral cosign credit rating credit-scoring systems

**5. Family 2**

Age of the head of the household—48  
Lived at the current address—12 years  
Age of current car—5 years  
Monthly car payment—\$0.00  
Housing cost—\$385  
Has a checking account and a savings account.  
Has not been referred to a finance company.  
Has 6 major credit cards.  
The ratio of debt to income is 19%.

**6. Family 3**

Age of the head of the household—26  
Lived at the current address—2 years  
Age of current car—1 year  
Monthly car payment—\$364  
Housing cost—\$741  
Has a checking account but not a savings account.  
Has not been referred to a finance company.  
Has 12 major credit cards.  
The ratio of debt to income is 24%.

**7. Family 4**

Age of the head of the household—43  
Lived at the current address—16 years  
Age of current car—1 year  
Monthly car payment—\$0.00  
Housing cost—\$640  
Has a checking account and a savings account.  
Has not been referred to a finance company.  
Has 3 major credit cards.  
The ratio of debt to income is 8%.

**8. Family 5**

Age of the head of the household—32  
Lived at the current address—3 years  
Age of current car—1 year  
Monthly car payment—\$237  
Housing cost—\$853  
Has a checking account but not a savings account.  
Has been referred to a finance company.  
Has 12 major credit cards.  
The ratio of debt to income is 32%.

**9. Family 6**

Age of the head of the household—52  
Lived at the current address—22 years  
Age of current car—3 year  
Monthly car payment—\$0.00  
Housing cost—\$332  
Has a checking account and a savings account.  
Has not been referred to a finance company.  
Has 8 major credit cards.  
The ratio of debt to income is 4%.

**10. Family 7**

Age of the head of the household—34  
Lived at the current address—6 months  
Age of current car—8 year  
Monthly car payment—\$0.00  
Housing cost—\$213  
Has a checking account but not a savings account.  
Has not been referred to a finance company.  
Has 2 major credit cards.  
The ratio of debt to income is 8%.

**11. Family 8**

Age of the head of the household—23  
Lived at the current address—17 years  
Age of current car—1 year  
Monthly car payment—\$233  
Housing cost—\$150  
Has a checking account and a savings account.  
Has not been referred to a finance company.  
Has 1 major credit card.  
The ratio of debt to income is 3%.

**MIXED REVIEW**

1. If you borrow \$1350.00 for 4 years at 12% to buy furniture, what is the deferred payment price of the furniture?
2. The fixed costs in Nicolette's business are \$300 per week. The variable costs are \$4.50 per item. What is the total cost if she produces 120 items in one week?
3. You have \$778.22 in your checking account and you write a check for \$105.89. Show how you would enter this check in your check register.
4. Determine the interest for 9 months if the starting principal is \$5525, the annual rate is 5%, and the interest is compounded quarterly.
5. You earn \$18,600 per year plus 12% of your salary in fringe benefits. Find your yearly earnings, including benefits.