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Credit: An Introduction

Before making a purchase on credit, there are certain facts you should know – both in regard to your own financial position and about the types of credit available to you. This booklet will explain what choices you have when shopping for personal credit and will help you determine what amount of credit you can realistically afford. It will also provide a look at credit from the other end of the spectrum – what to do if you've taken on too much.

Credit can be a useful tool in your financial planning. But unfortunately it can also result in financial disaster if the use of it is not well planned and carefully thought through. The Credit Book will help you make well-informed decisions and will tell you how to spot and avoid potential problems.

The Smart Use of Credit

You want to use credit wisely. Here are some things to think about:

1. Do you really want or need the item, or are you in fact buying on impulse?

Because personal credit is available to most people in the form of a credit card, it is often too easy to buy something. When cash doesn't change hands, it can seem as if you aren't spending real dollars. Don't let the convenience of a credit card lure you into extravagant or foolish spending.

2. How can I make some important purchases or emergency expenditures and still put money away for the future?

You may be considering the purchase of investment savings such as GICs, RRSPs, Canada Savings Bonds and other investments that have good rates of return, but which may be difficult to cash out. You might be tempted to delay the purchase of good investments for fear of not having enough cash for emergencies or for important purchases. By using credit, you can maximize the return on your cash savings by putting them into high yield products, and then borrow when special expenses come up. Consider obtaining a line-of-credit and keep a good portion free for emergencies. Also, if you stagger the maturity dates of your investments, you can use maturing investments to make regular payments on your borrowings.

3. Are you thinking about how to invest in your RRSP?

Consider increasing the size of your contribution, by borrowing what your expected tax savings would be from the RRSP contribution.

If you will have a tax refund, this refund will cover what you borrowed. Even if you will not have a tax refund, by doing this, you will have taken a portion of what you would have paid in taxes, and put that into your own RRSP account.

4. If you wait until you have enough money saved to pay cash for the item, will the price increase substantially in the meantime?

Higher-priced purchases, such as major appliances and cars, tend to become considerably more expensive from year to year. Unless you are able to save quickly, it may well be to your advantage to take out a loan and buy the item sooner rather than later – provided that your budget can accommodate repayment of the loan out of current earnings.

5. If you are making a long-term credit commitment, how secure and how stable is your current financial situation?

For most people, a purchase such as a house is possible only by means of a mortgage loan. The buyer makes a long-term commitment to repay what is often a substantial amount each month toward the amount of the loan plus interest charges. In determining how much you can afford to pay each month, be sure you leave yourself some “breathing room”. You should still be able to set aside some savings for emergencies. If your employment situation should change and your monthly income is decreased, will you still be able to meet your monthly payments?

Using credit can be of benefit to you in many ways. But if a loan or credit repayment is not carefully budgeted, it can lead to financial strain, possibly even to the point where you are unable to make your payments.

Before using credit, you should determine how much you can realistically afford.

Credit: How Much is Enough?

There are several rules of thumb to express how much personal credit an individual can comfortably handle. A general rule of thumb, known as the Total Debt Service (TDS) ratio, says that no more than 40% of your monthly gross income should go towards mortgage loan payments, and any other monthly debt obligations. Realistically, how much credit you can afford depends on your own personal situation. If your current employment is not very secure, the amount of credit you will want to take on will be less than the recommended guidelines. Conversely, if you have no other obligations, such as a mortgage, and your source of income is reliable, you may want to take on more credit, depending on what your goals are.

In any case, you should borrow only enough money to make the purchase you have planned, rather than borrow as much as you can get.

Having credit obligations will deplete your monthly buying power. With costs of essential items and services on the increase, you'll want to be sure you will still have enough money left over each month to be able to pay all of your bills. And it's always a good idea to have some money set aside in case of an emergency. If you're only just meeting your monthly bills, an unexpected expense could mean a serious financial setback.

To determine how much credit you can comfortably use, you should first establish a saving and spending plan. Suggestions for doing this are set out in *The Budget Book* (available at your credit union). To begin, you should decide what your financial goals are – short, medium and long-term. Then calculate your average monthly income and expenses. The form on the following page will serve as a guide. You can adapt the expense categories listed to suit your own particular needs. (To arrive at a monthly average, total your income and expenses for the year and divide by 12.)

The difference between the income amount and the amount allocated to minimum monthly savings and expenses is discretionary income. This is the amount of money available to you for saving, spending or making payment on a loan or credit card. Discretionary income defines how much new credit you can afford to take on. If you are already making debt repayments – which will be included in your expense summary – you may not be in a position to use additional credit until your existing obligations are repaid. Remember too, that in order to reach certain financial goals, you will have

to assign some portion of your discretionary income to savings. This will be over and above the money you set aside as “minimum monthly savings”, which constitute your contingency fund or reserve in case of emergency.

Your Saving and Spending Plan

AVERAGE MONTHLY INCOME after taxes and payroll deductions	\$
LESS:	
Rent / Mortgage Payments	\$
Loan, Conditional Sales Contract, and Lease Payments	\$
Condo Fees	\$
Property Taxes	\$
Utilities	\$
Home, Auto, Personal Insurance	\$
Medical / Dental	\$
Daycare / Dependent Support	\$
Groceries	\$
Clothing	\$
Transportation (gas, public transit, etc.)	\$
Household Maintenance	\$
Hobbies / Entertainment	\$
Vacation / Holiday Savings	\$
Professional Associations / Union Dues	\$
Other	\$
Monthly Discretionary Income Available for New Credit Payments	\$

Types of Credit

As a consumer with a regular income, you have a variety of credit options available to you. Your cost of borrowing money will be affected by the type of credit you choose to use. The interest rate, the method by which interest is calculated, the frequency of payments – all of these factors will determine how much you will pay to borrow money. The type of credit you choose to use will be affected by what your needs and goals are and the purchase you are making.

The following summary can help you to make an appropriate choice.

Consumer Loans

Consumer loans, also known as personal loans, are used to finance a variety of purchases – almost any major acquisition except the purchase of a home. (Home buying is typically financed through a mortgage loan, discussed later.) You may apply for a consumer loan, for example, to pay for a stove, a car, a boat, new clothes, a vacation or an addition to your home.

Borrowing Against Your Home Equity

This alternative allows home owners to borrow against the equity in their home, usually to finance additions or major renovations to the property. The equity in your home equals the value of the home, less what you owe on your home. Home equity loans may be used for other purposes, depending on the lender's available programs.

Home equity loans normally have two payment options, fixed payments and line-of-credit. Fixed payment loans can be structured as a term loan (see page 7) or amortized over a longer period like a regular mortgage payment. Lines of credit operate like credit card or personal lines of credit, but they are secured by your home – a valuable tool for the responsible borrower. The advantage of doing this is that you can often obtain a lower interest rate because your line is secured by a valuable asset – your home. The disadvantage is that if interest rates rise before a mortgage is paid in full, you may find yourself with an unmanageable, over-extended mortgage.

Personal Installment Loans

A term loan usually has a maturity of one to five years with repayment in the form of regular monthly payments of equal amounts. Payments are usually made each month. Some financial institutions are willing to arrange bi-weekly or even weekly payments. The payment amount can be set to fit within your budget, since payment can be lowered by extending the term of the loan. Some financial institutions provide automatic life insurance on term loans. This guarantees that, in the event of death, the borrower's family will not be burdened with having to repay the loan. Also, some financial institutions will allow you to repay all or part of the loan at any time without charging an interest penalty.

Demand Loans and Bridging Loans

This type of loan is usually granted to people who have established a solid relationship with the credit union, bank or trust company they are dealing with, and who have the security (in the form of savings, investments, real estate or other assets) to assure settlement of the debt. Demand loans are usually short-term in nature, and the conditions of repayment are flexible. The borrower can make partial payments on the loan, or pay off the full amount, at any time. The lender, however, also can demand payment in full at any time.

Interest on the balance outstanding is paid monthly. The interest rate charged is usually tied to the prime lending rate, and therefore can fluctuate. Interest at "prime plus" is the best interest rate that a financial institution will offer to a consumer.

Home Mortgages

A mortgage is a long-term credit commitment. In fact, it is probably the largest personal financial transaction you will make in your lifetime. The life of a mortgage can range from a few months up to 35 years. You can usually borrow up to 80% of the appraised value of the house (or more than 80% if insured through Canada Mortgage and Housing Corporation, Genworth Financial or AIG United Guaranty). Repayment of a mortgage is usually made in regular monthly installments for the life of the mortgage, although some financial institutions will allow you to make weekly, bi-weekly or lump sum payments without any interest penalties. These options are worth

exploring because they can save you a lot of money in interest charges over the life of your mortgage. Interest rates are usually set for a specific time, from a few months to several years, and are renegotiated at the end of each term. However, the variable rate method is usually the least costly over the long term in spite of the risk of rate increases. Interest is usually calculated on a semi-annual basis, but monthly calculations are common as well.

(NOTE: For more detailed information on home mortgages, ask your credit union for a free copy of *Facts About Mortgages*, another helpful consumer information booklet.)

Second mortgages are available, but usually at higher interest rates than first mortgages. If payments are not being made, the second lender has rights to the property, only after the lender holding the first mortgage is paid in full. A second mortgage can become a serious strain on a homeowner if it is not properly budgeted for.

Credit Cards

Credit cards are issued by financial institutions, oil companies, airlines and special agencies (such as American Express or Diner's Club). Credit cards issued by financial institutions can be used to purchase goods and services, and for cash advances. Terms of payment vary. With some credit cards, interest is charged on purchases only after a grace period (usually 21 to 30 days); however, for cash advances, interest charges begin at the time the advance is made. On most credit cards, the interest rate charged is usually considerably higher than the current rate on consumer loans. Some cards require the full amount owing for the billing period to be paid upon receipt of the bill.

If only a partial payment is made, some credit cards will charge interest on the total amount owing up to the date of the partial payment and interest on the remaining balance after the partial payment is made. Therefore you lose your grace period if you don't pay in full. Many financial institutions have introduced user fees, in the form of a monthly or annual charge for the card.

Charge Accounts

A charge account is an arrangement made between a retailer and a customer. The retailer will decide, on the basis of your credit rating, whether credit will be extended. A pre-authorized limit is set and you can make purchases on credit up to that amount. Retailers' charge accounts can be either a 30-day account, requiring payment in full within 30 days, or a revolving account, where either payments can be made in full or partial payments can be made over a period of time. Another option that is sometimes available is an installment or layaway plan, where equal payments including interest are made for a certain number of weeks or months.

Lines of Credit

A line-of-credit is a one-time-approved ongoing loan that allows you to borrow up to a pre-arranged limit by simply writing a cheque.

You only pay interest on the exact amount you borrow and only for the number of days you've used it, at rates usually substantially below retail credit cards.

It's ready cash when you really need it – travel emergencies, car repairs and to take advantage of savings on specialty priced one-time bargains. It can help you to pay your credit cards in full on the payment due date to avoid higher interest charges or to purchase an RRSP. The credit union line-of-credit is your protection at any time against overdrawing your account or having returned cheques because of inadequate funds.

Conditional Sales Contracts

A conditional sales contract is an agreement between a consumer and a dealer which includes details of a proposed sale and purchase, and the terms of the credit. Conditional sales contracts are usually available through car dealers, furniture and appliance stores. The conditional sales contract may be assigned or sold to a financial institution, thereby transferring the seller's financing obligations and responsibilities under the conditional sales contract to the financial institution.

Security for Loans

In some cases, depending on the amount you want to borrow and your credit rating, your signature will be enough to secure a loan. However, in most cases, a lender will want something tangible as security that the loan will be repaid, such as real estate, stocks, bonds, or durable goods. When the loan is secured, the lender will be more willing to lend the money and the interest rate will likely be less. The risk of loss to the lender is decreased by having the right to the secured property in the event that the borrower defaults on payments. Two types of security are: personal property security (chattel mortgage) and a collateral mortgage.

Personal Property Security

Personal Property is tangible and moveable property. If you provide property for security on a loan (such as a car or boat), you will be required to sign a promissory note and a personal property security agreement. (Sometimes this is referred to as a chattel mortgage.) This security gives the lender the right to take possession of the property if you are unable to make regular payments. When you sign a personal property security agreement, you are agreeing to the following conditions:

- You must make the payments you agreed to as defined on the loan document itself.
- No other liens can be placed on the property you have given as security.
- The property must not be sold without the permission of the lender.
- The property you give as security must not be taken out of the province in which you reside for an extended period of time without notifying the lender.

Collateral Real Estate Mortgage

A collateral mortgage uses the equity you have built up in real property (such as your home) as security. Equity is the difference between the value of a property and the amount that you owe on the property. This difference, your equity, can be used as security for a loan.

When you offer your assets as security, it is important to remember that, in the event that you are unable to meet your payments, the lender has the right to your property. You must therefore be certain that you can meet all of your financial commitments.

Sources of Credit

There are many financial institutions and other organizations that provide credit to consumers. Along with comparing the rates and conditions on loans that are available to you, you will want to decide if the credit union, bank, trust company or other lender is one that you will want to deal with on an ongoing basis. Developing a relationship with one financial institution offers several advantages, particularly when you need to use its credit services. For example, you can build up your credit record with the loans department or manager. Once you are known to be a creditworthy borrower, you should find that it is easier to obtain additional credit when you require it (always assuming, of course, that your financial situation justifies your request for a new loan). In addition, a loans officer or manager who knows your circumstances and your goals can often offer valuable advice and assistance with your personal financial planning.

Credit Unions

Credit unions are co-operative financial institutions, offering a full range of financial services, including various forms of consumer credit. Credit unions differ from other financial institutions in that their “customers” are also members of the organization – the people who own and control it. As co-operatives, credit unions operate on democratic principles.

Every member has a vote and all votes are equal, regardless of the number of shares or the size of deposits an individual may hold in the credit union. Members exercise their voting control by attending meetings, in particular the annual meeting, where they elect a board of directors from the membership body to represent their needs and priorities. The board of directors works with the management group to set policies and develop credit union services. This operating structure enables credit unions to be both flexible and responsive in meeting members’ financial service requirements.

Flexibility in lending means personal loans tailored to meet your needs and within your budget. Most credit unions have funds available for many credit needs – personal loans, lines of credit, mortgages.

There are many advantages to borrowing money at a credit union:

-
- The borrowers are given the option to purchase insurance (life, disability, etc.) on their loan. In the event of death, the borrower's family will not be burdened with having to repay the loan.
 - A credit union's surplus may be returned to its members in the form of an interest refund.
 - At some credit unions, loan payments can be made through an automatic payroll deduction.

(Services may vary from one credit union to another. Check with your local credit union for details.)

Chartered Banks

Like credit unions, banks offer many personal credit services, covering a wide range of personal borrowing needs. Lending rates and conditions vary from one institution to another.

Trust Companies

Trust companies also offer a variety of loans, including mortgages and personal loans that can be repaid on a term or a demand basis.

Life Insurance Companies

If you have a whole life insurance policy and premiums have been paid regularly for two or more years, you may be eligible to borrow up to 95% of the policy's cash surrender value at relatively low interest rates. If you die before the loan is repaid, the balance and any interest due will be deducted from the amount the insurance company would normally pay your beneficiary.

Mortgage Loan Companies

These companies specialize in both personal and business loan services, with emphasis in residential mortgages.

Payday Loan Companies

A payday loan is a short-term loan that you promise to pay back from your next paycheck. A payday loan is a very expensive way to borrow money. Payday loans are offered by privately owned payday loan companies and by most cheque cashing outlets. In most provinces, these companies are not regulated by the government.

Overdraft Protection

As a more cost-effective alternative to a payday loan, check with your credit union into a possibility of getting an overdraft protection on your chequing account. This will permit you to withdraw from your chequing account, and allow it to go into a negative balance to a specified limit. Subsequent deposits will clear the overdraft.

Applying for a Loan

When you are making a purchase that will require financing, it is just as important to shop for the best interest rates and conditions on a loan as it is to comparison shop for your purchase. As mentioned earlier, there are many different financial organizations with many types of credit available to you. Shop around for the lowest interest rate and most favourable repayment options. If your credit rating is good and your request is reasonable, you can borrow money from any lender. Remember you are a paying customer, purchasing the use of the lender's money. The lender will be making a profit by lending you money.

Although credit is a privilege not to be abused, the decision to borrow money is yours alone and you can afford to take the time to ensure you get the best deal. When comparison shopping, keep a checklist of points to consider. Record what each financial institution will be prepared to offer you. You will then have a factual basis for deciding which option suits your needs and circumstances.

Get Organized

Before you visit a financial institution to inquire about obtaining a loan, first make a thorough assessment of your current financial situation. Determine, in advance, how much money you will need to borrow and how much you can afford to pay each month. It would be a good idea to have a statement of income to verify your employment and your monthly salary.

Following is a list of all of the financial information that you should take with you when applying for a loan (see page 14). Having this information readily available will make the application process run smoothly. It will also be helpful to have your spending plan with you, so that you and the credit officer can negotiate a reasonable monthly payment.

Information You'll Need to Apply for a Loan

1. Assets:	
Cash on Hand / Downpayment	\$
Savings	\$
Investments	\$
Cash Value of Life Insurance	\$
Home	\$
Other Property	\$
Vehicle(s)	\$
Business or Farm Assets (if any)	\$
Personal Effects	\$
Other	\$
TOTAL ASSETS	\$
2. Liabilities:	
	Payment Amount Frequency
Personal Loans (balance owing)	\$
Credit Cards (balance owing)	\$
Charge Accounts (balance owing)	\$
Home Mortgage (balance owing)	\$
Unpaid Bills	\$
Business or Farm Liabilities (if any)	\$
Other	\$
TOTAL LIABILITIES	\$
3. Your Net Worth: (Assets minus liabilities)	
TOTAL ASSETS	\$
TOTAL LIABILITIES	\$
NET WORTH	\$

Ask the Right Questions

When meeting with the lender, ask questions about the loan to be sure that you understand exactly what will be required of you. Some of the questions you should remember to ask are listed below. Make a checklist and compare responses from each lender you meet with.

- What will the annual interest rate be?
- Will the interest rate be fixed for the life of the loan, or will it be variable (subject to change with changes to the prime lending rate)?
- What will the monthly payment amount be?
- How many payments will you be required to make?
- Are bi-weekly or weekly payment options available?
- On what date will the loan be paid in full?
- What will the actual cost of borrowing money be, in dollars and cents?
- Will the loan be insured?
- Are there any fees for processing the loan or for insurance?
- Can extra payments be made at any time without paying an interest penalty? Can the loan be paid out early without interest penalty?
- Will any collateral or other security be required to guarantee the loan?

Asking these and similar questions will give you a clear understanding of the loan before you commit yourself to it. When comparing one loan with another, be aware that the most important factor to consider is how many dollars you will actually have to pay for the use of the lender's money.

The Application

When completing a loan application, the lender will ask you several questions about yourself and your financial situation to assess whether or not you qualify for the amount of money you want to borrow. Your credit history will be considered. The lender will also want to see the information you can provide – your spending plan, statement of earnings, list of credit card numbers and accounts. Having all of this information at hand will speed up the application process and will demonstrate that you have thought seriously about your decision to borrow.

You may be asked some questions that you feel are too personal, such as questions on how many children you have and your spouse's income. If this kind of information will have an impact on whether the lender is able to grant you the loan (for example, if your ability to repay the loan depends on your spouse's contribution to household income), then questions such as these are quite legitimate. But if you feel that the questions being asked are discriminatory in nature, ask the lender why the information is needed. Be aware of your rights as a borrower and, if you feel you are being discriminated against, contact the government consumer agency or department in your province.

When applying for a loan, it is up to you to disclose all the facts. If you don't present all the facts or you present them in a misleading way, you will seriously damage or destroy your relationship with the lender. A credit arrangement is based on trust and honesty on the part of both the borrower and the lender. You should keep in mind, as well, that if your current financial situation does not satisfy the lender's requirements, it may not be in your own best interest to take on additional debt at this time.

On the following pages is a sample of a loan application. Become familiar with it; read it over to be sure you have all the answers to the questions being asked.

Before you sign a loan application, review it carefully to be sure that all of the information about the loan is documented just as you had understood it to be. Make certain that all of the blanks on the application either are filled in or have a stroke running through them. Once you are satisfied that the loan application outlines terms and conditions that you agree with and can adhere to, sign it.

Note that on the sample application, you grant the lender the right to check all of the information you have provided and to conduct a complete credit check.

Sample Loan Application Form

Name In Full (first middle last): _____
Birthdate: _____ Marital Status: _____ No. of Dependents: _____
Social Insurance Number: _____
Home Phone No.: _____ Business Phone No.: _____
Address: _____
City: _____ Province: _____ Postal Code: _____
Name of Employer: _____
Address: _____ Phone No.: _____
How Long: _____ Position: _____ Salary: \$ _____
Name of Employer: _____
Address: _____ Phone No.: _____
How Long: _____ Position: _____ Salary: \$ _____
Spouse's Name: _____ Birthdate: _____
Social Insurance Number: _____
Employer: _____
Phone No.: _____ How Long: _____ Salary: \$ _____
Position: _____

Are you presently dealing with a credit union/bank/trust company? If yes,

Name: _____
Address: _____
Account No.: _____ Type: _____

LOAN INFORMATION

References:
Name: _____ Address: _____ Phone No.: _____
Name: _____ Address: _____ Phone No.: _____

Loan Particulars

Amount Required	\$
Current Loan Balance (if refinancing)	\$
Registration Fee	\$
Total Amount Required	\$

Terms: _____ Frequency: _____ Percentage: _____

Payment Schedule

Repayment Amount	\$
To Loan	\$
To Shares	\$
To Deposits	\$

To Be Repaid Over: _____ Years _____ Months

First Payment Due: _____

Purpose of Loan

Purchase Vehicle	\$
Serial No.:	
Purchase Land for a Residence	\$
Legal Description:	
Street Address:	
Other	\$

Assets

Cash on Hand / Downpayment	\$
Savings	\$
Investments	\$
Cash Value of Life Insurance	\$
Home	\$
Other Property	\$
Vehicle(s)	\$
Business or Farm Assets (if any)	\$
Personal Effects	\$
Other	\$
TOTAL ASSETS	\$

Liabilities

Outstanding Balance Monthly Payment

Personal Loans (balance owing)	\$	\$
Credit Cards (balance owing)	\$	\$
Charge Accounts (balance owing)	\$	\$
Unpaid Bills	\$	\$
Business or Farm Liabilities (if any)	\$	\$
Other	\$	\$
TOTAL LIABILITIES	\$	\$

Your Monthly Budget

AVERAGE MONTHLY INCOME after taxes and payroll deductions	\$
LESS:	
Rent / Mortgage Payments	\$
Loan, Conditional Sales Contract, and Lease Payments	\$
Condo Fees	\$
Property Taxes	\$
Utilities	\$
Home, Auto, Personal Insurance	\$
Medical / Dental	\$
Daycare / Dependent Support	\$
Groceries	\$
Clothing	\$
Transportation (gas, public transit, etc.)	\$
Household Maintenance	\$
Hobbies / Entertainment	\$
Vacation / Holiday Savings	\$
Professional Associations / Union Dues	\$
Other	\$

Monthly Discretionary Income Available for New Credit Payments

SECURITY OFFERED	TOTALS
Shares	\$
Deposits	\$
Other Investments	\$
Vehicle	\$

Year: _____ Make: _____

Model: _____

Wholesale Value: \$ _____

Auto Insurance Agent: _____

Address: _____

Collision Coverage: \$ _____

Expiry Date: _____

Policy No.: _____

The statements herein are made for the purpose of obtaining this loan and are correct to the best of my knowledge and belief. I hereby authorize you to confirm all particulars divulged and consent to any credit inquiries you deem necessary now and at any future date. This includes such information required as to confirm registration and encumbrances against any vehicles registered to me at any motor vehicle branch in Canada or the United States of America.

Signature of Applicant: _____

Signature of Co-applicant/Guarantor: _____

Witnessed by: _____ Date: _____

How a Loan is Approved

Once you have applied for a loan, the lender will require a certain amount of time, usually no more than three working days, to review the information you have provided, to run a “credit check” and, with this information, determine your credit-worthiness. A credit check informs the lender of your past performance in meeting your financial obligations. As one step in the process of conducting a credit check, the lender will contact the local credit bureau. The credit bureau is an organization that receives information from its members (financial institutions, retailers, other lenders) and from public records on consumers who have used credit services. Along with a history of how you have handled debts in the past, the credit bureau retains other records such as your employment and salary level. The credit bureau is governed by the province in which it operates, and therefore the kind of information kept on file may vary from province to province. As a consumer, you have the right to know what information is on your file with the credit bureau. It’s a good idea to check it periodically to be sure that this information is correct. (E.g. Visit the Equifax Canada website www.equifax.com/home/en_ca or TransUnion Canada website www.transunion.ca for your personal accurate information). Both sites offer immediate access via online service for a fee, as well as an option of receiving a credit report file free of charge via Canada Post.

If you have never had a loan, charge account or credit card, you will not be on file at the credit bureau. This makes it difficult for a lender to assess your credit-worthiness, since no history or “track record” is available. People who expect to borrow in the years ahead, to finance major purchases such as a car or a house, should consider taking out a small loan for some other worthwhile purpose before the need for a larger credit financing arises.

Repaying the loan on schedule will establish the necessary credit rating. Your credit history is certainly an important factor for a lender to consider. But along with that, a lender will usually make some judgements about you as a person.

Do you manage your chequing account well? Do you have some savings put away? These are all indicators of some sense of financial management. The lender will also, of course, consider your ability to repay the debt. Collateral or security on the loan will be a consideration as well. If you can offer good security, the risk is reduced or eliminated for the lender. Taking all of these factors into consideration, the lender can then make a sound decision about lending money to you.

If, for some reason, the lender decides not to lend money to you, treat it as a learning experience. Find out why the loan was not approved. If it is because your total debt ratio is already too high and the lender feels that one more monthly payment will cause you to reach your breaking point, then accept this as wise advice. Reassess your situation and, perhaps, wait until you have reduced some of your current debts before taking on more.

If your loan wasn’t approved because of lack of security, you might want to consider having a relative or very close friend cosign the loan for you. A cosigner agrees to take on all the responsibility of the loan, with its existing terms and conditions, in the event that the borrower is unable to meet the monthly payments. Co-signing a loan is not to be taken lightly. Being responsible to make the payments on the loan in the case of default by the borrower, a cosigner will want to be very certain that the borrower is capable of handling the payments for the duration of the loan and is an honest, trustworthy person. An error of judgement could prove very expensive!

Your Responsibilities

When you agree to borrow money from a lender, you enter into a legal and binding contract. It is your responsibility to ensure that you fully understand the agreement you are signing and all the terms and conditions that are included. Your signature is the final step that tells the lender that you agree to meet your obligation by repaying the loan amount according to schedule as outlined in the contract and all the terms and conditions.

If at some point during the life of your loan you are unable to meet your monthly payment, contact the creditor immediately, before the payment is actually due. Don't wait until the due date has passed and the creditor calls you. Most creditors are willing to make alternative arrangements if your situation has changed and it becomes difficult for you to meet your payments. If it's a one-time occurrence, your creditor may give you a grace period, allowing you some time to get your financial affairs in order. Or the creditor may extend the term of the loan, spreading equal payments of a smaller dollar amount over a longer period of time. This will give you more room to breathe each month, reducing the stress that financial burdens can cause. Contacting your creditor at the first sign of difficulty will demonstrate your good faith, your intention to honour the agreement. And the creditor will then be predisposed to accommodate you and, if necessary, to adjust the terms of the loan to suit your altered circumstances.

Not taking these steps can have drastic consequences. Since a loan is a legal obligation, if you fail to meet the terms of the agreement, your creditor has the right to take court action against you and thereby recover the balance of the debt. For example, if the loan is secured by a personal property security (chattel mortgage), the creditor is entitled to take possession of the property that you have signed over as security. The creditor can then sell the property and apply the proceeds against the outstanding balance of the loan. If there is no personal property security on the loan, or if you did not pledge any assets as security, the creditor can obtain a court order that will grant access to other goods that you own, which similarly can be sold to compensate for the default.

In the event that your spouse or some other person co-signed your loan application, the creditor will usually transfer the demand for payment to that person. If you were the sole signatory, your creditor may resort – again by court order – to garnisheeing your wages. This means that the money you

owe to the creditor will be paid directly by your employer until the full amount of the debt is repaid, your earnings will no longer pass through your hands.

As explained earlier, you can probably avert these consequences if you notify your creditors of the fact that you cannot make the required payments. If your financial difficulties are serious and you cannot resolve them yourself, you should consider credit counselling, either through your lending institution or through an independent agency.

In either case, all your current creditors should be consulted and informed of your plans to repay what you owe them. Typically a scheme is worked out for consolidating your debts, spreading your obligations over a longer period, and allocating regular payments to each creditor. Where the borrower is clearly acting in good faith, creditors often agree to such arrangements.

Failing such a solution, as a last resort you can declare personal bankruptcy. Bankruptcy will release you from most, if not all, of your debts. But the price you have to pay for this freedom from debts is very high. All of your non-exempt assets may be sold by a bankruptcy trustee. Other than money to cover the trustee's fees, the proceeds from the sale will be distributed to your creditors. It will take several years and much effort on your part to restore your credit rating. Bankruptcy is a very drastic step, and may cause you and your family a great deal of hardship.

Access to credit on reasonable terms is so readily available, and it is so valuable to the realization of personal and family goals, that it is simply foolish to abuse it. All that is required is some basic financial planning, self-education about the cost of credit, and a responsible attitude to the borrower's legal obligations. With these tools, you can make consumer credit work for you.

Remember, used wisely, credit can be a useful tool in your financial planning, helping you to achieve your personal goals.

Other booklets available for consumer information include:

The Budget Book, *Planning for Your Retirement*, and *Facts About Mortgages*. Ask for copies at your Credit Union.



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