



02



Consumer Credit

 Teacher's Guide

Powerpoint and E-textbook

Learning Objectives

This chapter helps you:

-  Compare the different types of consumer credit
-  Explain the importance of maintaining a good personal credit record

Let's Get Started

Tony is a salesman and earns \$10,000 per month. He wants to buy a \$200,000 car, but he only has \$150,000 in savings.



To have enough money to purchase the car, he plans to apply for consumer credit. There are a few types of consumer credit for Tony to choose from.

| Type | Interest rate | Repayment period |
|----------------|------------------------|------------------|
| Personal loan | 15% | 1 year |
| Bank overdraft | 20% | Not fixed |
| Credit card | 30% for late repayment | Not fixed |

Discussion Questions

1. Which consumer credit should Tony choose? Express your opinion.
2. Have your parents had any experiences in applying for consumer credit?

Suggested Answers

1. Open-ended question. Teachers may point out that different types of consumer credit have different interest rates, repayment periods and other features.
2. Open-ended question.

Overview

In the 'Let's Get Started' section, Tony does not have enough money to do what he wants. Borrowing money may solve his problem. **Consumer credit**¹ is about individuals borrowing money.

There are a few types of consumer credit, such as instalment credit², bank overdraft³, and credit card⁴. This chapter discusses the benefits and problems of using consumer credit.

To apply for consumer credit successfully, consumers have to have good personal credit records⁵. The importance of maintaining a good personal credit record is also discussed in this chapter.

Activities

Ask students to think about when they will want to borrow money, and what types of things they want to borrow money for.



Fig 2.1 Consumer credit is common in our society.

2.1 What is consumer credit?

Consumer credit consists of the loans obtained by consumers for the consumption of goods and services. It includes bank overdrafts, credit cards, personal loans⁶, retail instalment loans, and student loans. However, if an investor borrows money to invest in the stock market, the amount borrowed is not considered consumer credit.

Consumer credit (e.g., credit cards) is often unsecured⁷. However, some types of consumer credit (e.g., mortgage and personal loans) require collateral⁸. Banks and finance companies⁹ are the typical lending institutions that provide consumer credit.

Learning Objective

Compare the different types of consumer credit

Note Card

Consumer credit consists of the loans obtained by consumers for the consumption of goods and services.

1. consumer credit 消費者信貸 2. instalment credit 分期付款信貸 3. bank overdraft 銀行透支 4. credit card 信用卡
5. credit record 信貸記錄 6. personal loan 私人貸款 7. unsecured 無抵押 8. collateral 抵押品
9. finance company 財務公司

A. Benefits of using consumer credit

- (i) Consumers can have the chance of **acquiring expensive items**, such as luxury jewellery, watches and air tickets, without enough cash on hand.
- (ii) Consumers **do not need to carry large amounts of cash**, hence there is less chance for theft and loss.
- (iii) Some consumer credit facilities may have the feature of 'points¹', which benefits consumers.

B. Problems of using consumer credit

- (i) **Consumer credit without collateral is often more expensive than credit with collateral in terms of interest payments** due to its nature of not requiring collateral.
- (ii) The extensive use of consumer credit **may lead to over borrowing** by consumers.

Teaching Notes

Consumer credit without collateral means consumers can get money easily. It increases the risk of over borrowing.

Quick Quiz

1. Consumer credit is often (*secured / unsecured*)*.
2. What does 'unsecured' mean?

*Underline the correct answers.

Suggested Answers

2. Unsecured means the lending institution does not require any collateral on the loans.

2.2 Classification of consumer credit

A. Classified by revolving and non-revolving

1. Revolving consumer credit

Revolving consumer credit² is a kind of credit that allows the consumer to draw credit as long as the total amount of credit is within a limit. The limit is set by the lending institution. The consumer can choose to pay the full amount of the loan or parts of the credit used at the end of a repayment period.

Revolving credit is also known as open-end credit. When the loan is fully repaid, the credit account remains open for the consumer to draw again. It is not closed unless the institution offering the credit or the consumer closes the account.

Note Card

Revolving consumer credit is a kind of credit that allows the consumer to draw credit as long as the total amount of credit is within a limit.

1. point 積分 2. revolving consumer credit 循環式消費者信貸

Revolving means that as long as the consumer is making satisfactory repayment to the institution the credit available will be adjusted back to the credit limit¹, less the outstanding² amount. Typical examples of revolving consumer credit are overdrafts and credit cards.

$$\text{Credit available} = \text{Credit limit} - \text{Outstanding amount}$$

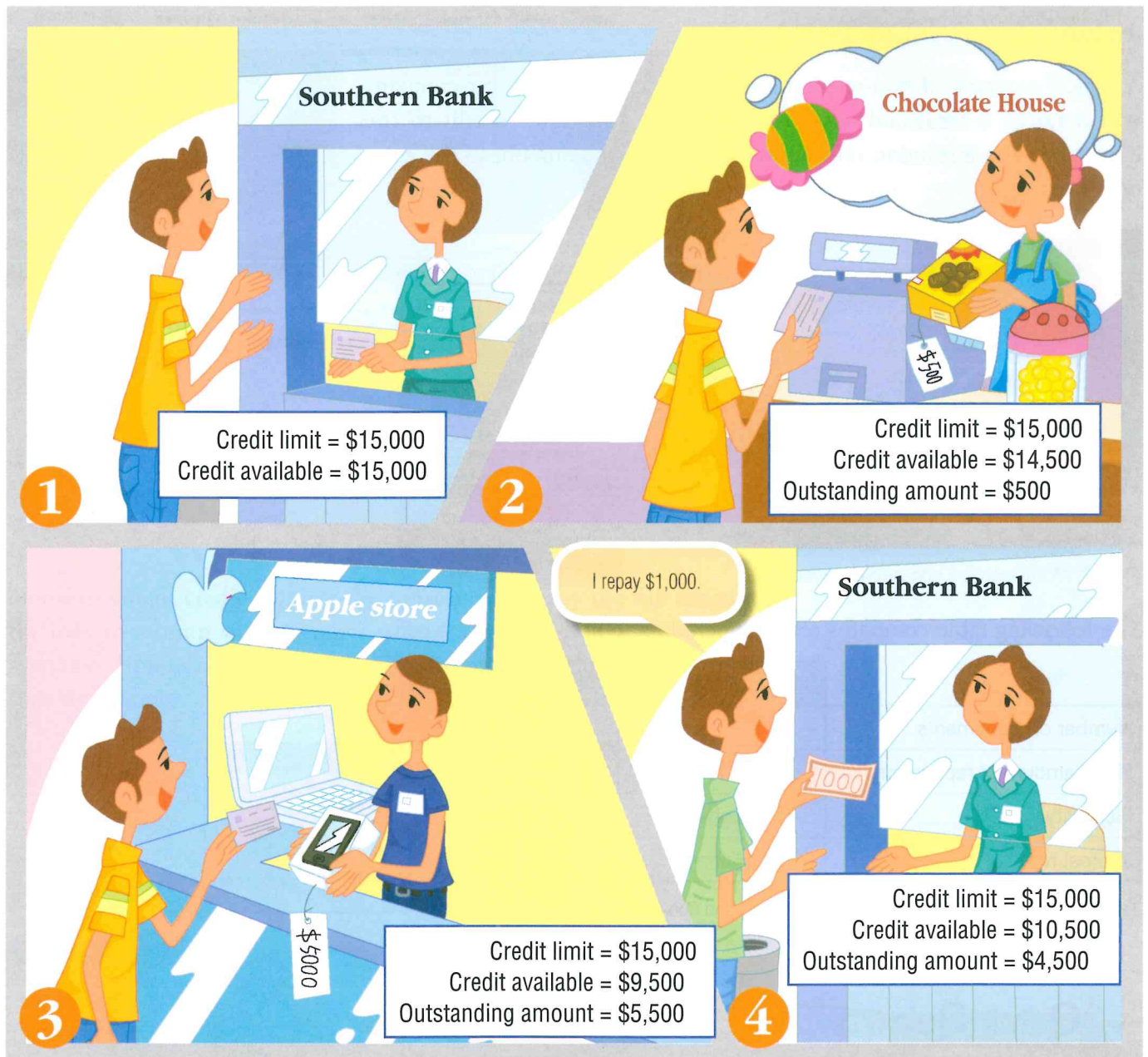


Fig 2.2 The process of a revolving consumer credit

Teaching Strategies

Teachers may list other examples of non-revolving consumer credit, such as tax loans and student loans.

2. Non-revolving consumer credit

Non-revolving consumer credit¹ is a kind of credit that allows the consumer to draw credit limited to a particular amount. The consumer has to repay the loan in a fixed number of payments, including the loan principal and the interest. The repayment period varies. It can be several months, or it can be as long as several years.

Non-revolving consumer credit is also known as closed-end credit. When the loan is fully repaid, the credit is closed.

A typical example of non-revolving credit is a car loan. The car company will arrange a financial institution to offer consumer credit to the consumer. The institution offering the loan limits the amount to the price of the car.

Note Card

Non-revolving consumer credit is a kind of credit that allows the consumer to draw credit limited to a particular amount.



Fig 2.3 A car loan is a non-revolving credit.

The following table compares revolving credit and non-revolving credit.

| | Revolving credit | Non-revolving credit |
|---------------------------|------------------|----------------------|
| Number of repayments | Not fixed | Fixed |
| Fixed amount of repayment | No | Yes |
| Flexibility | Higher | Lower |
| Interest rate | Higher | Lower |

Table 2.1 Comparison between revolving credit and non-revolving credit

Quick Quiz

- A bank offers a revolving consumer credit account to Tony. The credit limit is \$15,000. Tony purchases a mobile phone of \$5,000 on credit. Now the credit available is \$10,000.
- What does 'revolving' mean?

Suggested Answers

- Revolving means that as long as the consumer is making satisfactory repayment to the institution, the credit available will be adjusted back to the credit limit less the outstanding amount.

1. Non-revolving consumer credit 非循環式消費者信貸

Before obtaining credit, consumers should always study the repayment details carefully, and consider whether they can repay on time.

B. Classified by instalment and non-instalment

Instalment credit allows the consumer to obtain credit for consumption with periodic repayment of the loan. The repayment period varies. It can be several months or several years. Instalment credit is usually due in a long period of time.

Note Card

Instalment credit allows the consumer to obtain credit for consumption with periodic repayment of the loan.

Non-instalment credit requires the consumer to repay the full amount of the loan in a lump sum.

The figure shows two screenshots of bank websites. The top screenshot is from Standard Chartered, displaying a 'Standard Chartered Personal Instalment Loan' page with an 'Apply Now' button. The bottom screenshot is from Bank of China (香港), showing a 'BOC Express Cash Instalment Loan' page with details on features and terms.

Fig 2.4 Banks provide instalment credit to customer.

Non-instalment credit requires the consumer to repay the full amount of the loan in a lump sum. In other words, there is no periodic repayment schedule. Non-instalment credit is usually due in a short period of time, such as a month.

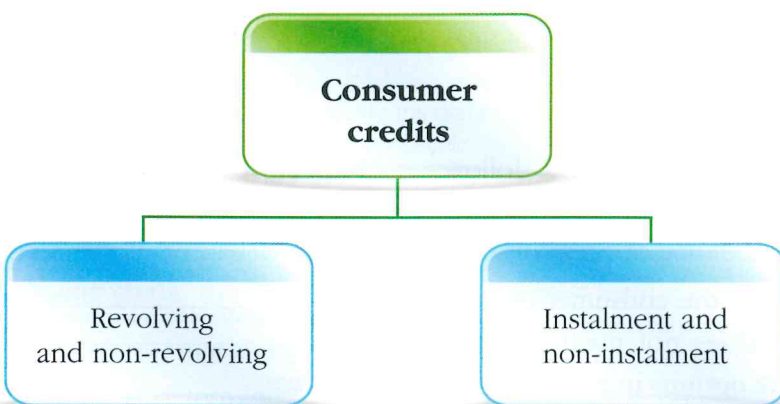


Fig 2.5 Classification of consumer credits

2.3 Examples of consumer credit

A. Instalment loan

There are many kinds of consumer credit that are **'instalment' in nature**. These kinds of consumer credit have the feature of **a fixed payment schedule of both the principal and interest**. They are **not revolving** credit. In Hong Kong, consumer credit is provided mainly by banks and finance companies, which are under the *Money Lenders Ordinance*¹.

A typical example of this form of consumer credit is specialised personal loans, such as car loans and tax loans. For example, a car loan is provided to the consumer for the purpose of purchasing a car, while a tax loan is provided to the consumer for the payment of tax.

Activities

Ask students to think about what kinds of goods can be bought with instalment credit in their daily lives. For example, mobile phones, televisions and courses.



Mortgage loan*

A mortgage loan² is a type of instalment credit, and is very common in Hong Kong.

In Hong Kong, the property price is very high. Most citizens cannot pay the full amount of expenses when they purchase flats. They apply for mortgage loans from banks.

When a consumer pays a part of the expense, he can obtain a flat. Then he will repay the rest of the expense according to a fixed schedule.



Fig 2.6 Most Hong Kong citizens use mortgage loans to buy a flat.

* This section is for reference only. 'Mortgage loan' is beyond the curriculum requirement.

1. Advantages of using instalment loan

- (i) **Fixed repayment schedule** makes it easy for the consumer to follow. The schedule can be set to fit the repayment ability of the consumer. A repayment period can be several years in the case of car loans.
- (ii) **Periodic repayment amount can be lowered** if the consumer chooses to prolong³ the repayment period. This does not mean a lower amount of interest payment, but rather **more options in managing the cash flow**.
- (iii) Instalment loans are relatively **easy and fast to obtain**, hence saving the consumer's time and effort.

Note Card

Advantages of using instalment loan:

- Fixed repayment schedule
- Periodic repayment amount can be lowered
- Easy and fast to obtain

Disadvantages of using instalment loan:

- Fixed rate loan
- Fixed terms

1. *Money Lenders Ordinance* 《放債人條例》 2. mortgage loan 按揭貸款 3. prolong 延長

2. Disadvantages of using instalment loan

- (i) If the loan is a **fixed rate loan**, the interest rate will not change. For example, when the market interest rate is lower than the fixed rate, the interest rate paid by the client may be higher.
- (ii) The terms¹ of instalment loans are **fixed once the negotiation is done**. The client needs prior approval and consent from the financial institution before any changes to the instalment loan agreement can be made.

B. Bank overdrafts

A bank overdraft is also a form of consumer credit in the sense that **the financial institution grants the client the right to draw money from a bank account, even though the account does not have enough money**.

One common application of an overdraft is in the current account². The drawer may issue cheques in amounts that exceed the balance in the current account. By having the overdraft facility, the drawer can prevent cheques from being dishonoured³.



Fig 2.7 By having the overdraft facility, the drawer may issue cheques in amounts that exceed the balance in the current account.

A credit limit will be established between the bank and the client, and the client can draw credit any time up to the limit granted. Of course, in drawing credit, the client needs to pay interest for the loan.

Overdraft facilities are provided by banks. The amount of a possible overdraft is determined by the credit limit and the unused portion of the credit. Therefore, an **overdraft is always revolving in nature**.

Teaching Strategies

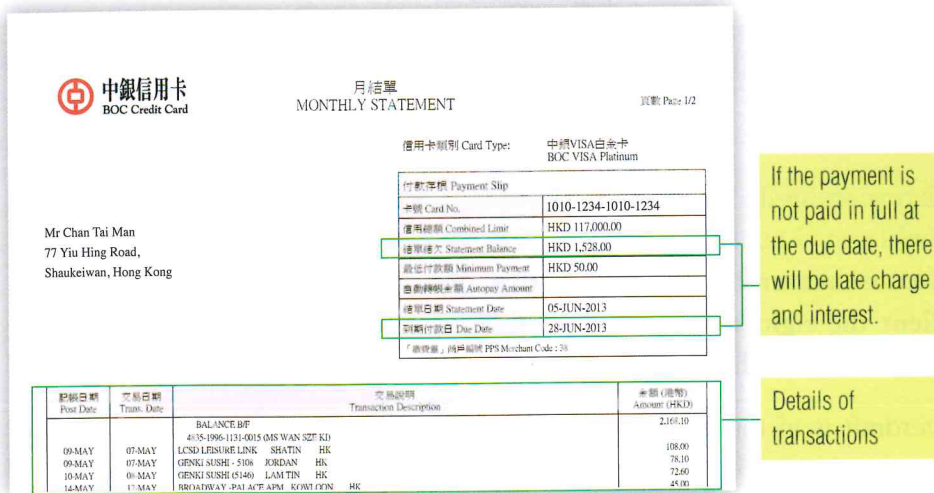
Teachers may list a few reasons for cheques to be dishonoured:

- The account does not have enough money to settle the cheque and the account does not have an overdraft facility.
- The signature on the cheque is incorrect or missing.
- There is no date on the cheque.
- The amount in figures differs from the amount in words.
- The cheque is stale (over six months).

1. term 條款 2. current account 往來存款帳戶 3. dishonour 拒付

C. Credit cards

A credit card allows the consumer to make purchases on credit, and the amount of credit available is determined by the amount of credit granted and the outstanding amount.



Teaching Notes

Some consumers use credit cards to make purchases, but they only settle the minimum payment every month. This usually happens because they purchase things they cannot afford. As a result, the interest payments as well as the loan amount become greater and greater over time. Since credit cards have very high interest rates, the total balance due can balloon rapidly.

Fig 2.8 The statement lists the details of transactions and payment due date.

At the end of a billing cycle, the cardholder will receive a statement from the card issuing institution. The statement will list the details of the transactions, such as the dates of the transactions, names of the merchants and transaction amounts. One important piece of information, of course, is the payment due date. **Since a credit card is revolving credit, any credit used will be charged interest if the payment is not paid in full at the payment due date.**

The major credit card operators in Hong Kong and over the world are VISA and MasterCard. These operators are not the issuers of credit cards, but payment channels.

The credit card was introduced in Hong Kong many years ago, and this form of credit became popularised in the 1980s. At the end of the first quarter of 2013, there were around 16.3 million credit cards in Hong Kong.

Teaching Notes

Some shops do not accept credit cards. The reasons are as follows:

- Shops cannot receive money immediately which affects their cash flow.
- Credit card companies charge a service fee.
- The shops want to avoid fake cards.



Fig 2.9 Each person holds an average of 2.3 credit cards in Hong Kong.

1. Types of credit cards

(a) Standard credit cards

This is the most common type of credit card. The credit available will be reduced if the consumer makes a purchase, and the credit available will increase again if the consumer makes a repayment. A typical standard credit card will also impose a minimum payment that the cardholder must pay by the due date.

(b) Premium credit cards

When compared with standard credit cards, **premium credit cards offer more benefits and services to cardholders**, such as cash rebate¹, reward points, discounts in making purchases at designated retailers, lounge services at airports and priority in banking services.

Examples of premium credit cards include Gold and Platinum cards. **Premium cards are targeted towards consumers who have higher incomes and better credit histories.**

(c) Affinity credit cards

An institution may offer an affinity credit card² to its members so as to demonstrate a certain 'affinity' with that institution.

Affinity credit cards are jointly issued by two institutions. One is a financial institution, such as banks and financial companies. The other is a non-financial institution, such as retailers, shopping malls, airlines and universities.

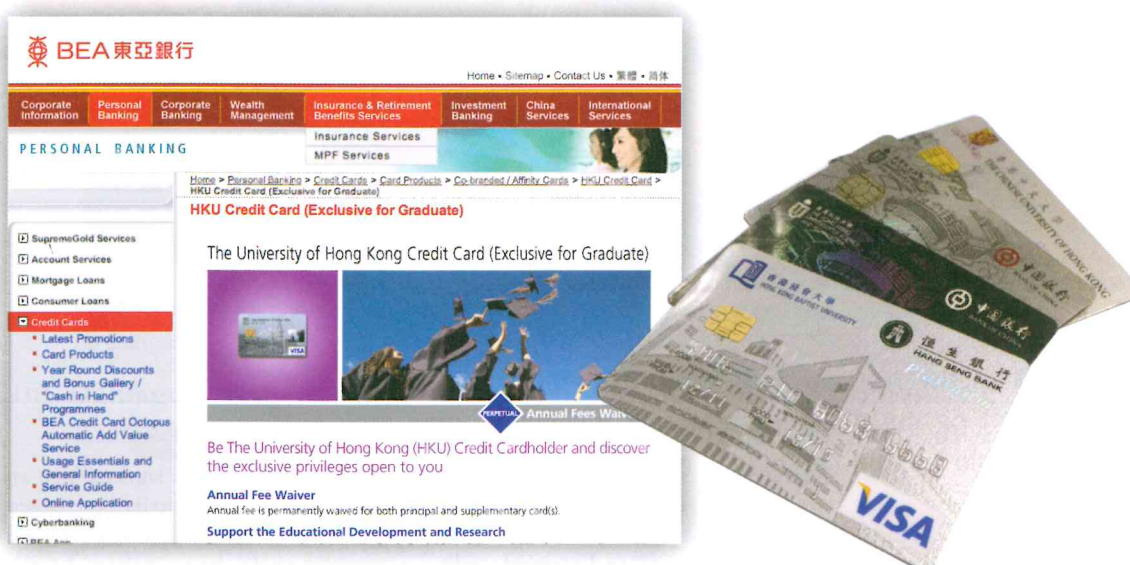


Fig 2.10 Universities jointly offer affinity credit cards with financial institutions.

1. cash rebate 現金回贈 2. affinity credit card 聯營卡

Some of the affinity credit cards have a limited purpose. This means **they can only be used at specific retail outlets**, such as gas stations. The terms and conditions of the limited purpose cards vary, and are subject to mutual agreement between the retailer and the cardholder.

Activities

Ask students to discuss the advantages and disadvantages of using credit cards.

2. Advantages of using credit cards

- (i) **Convenience and safety:** Using a credit card is more convenient because the cardholder does not need to carry large amounts of cash. This is convenient and safe. Some modern purchase channels like the Internet, mail orders, and TV shopping require a credit card for transactions.



Fig 2.11 Using credit cards means that consumers do not need to carry lots of cash.

- (ii) **Payment flexibility:** With the option of minimum payment, the cardholder can decide on paying the full amount or the minimum payment. It is more flexible for the cardholder to manage his cash flow.
- (iii) **Worldwide acceptance and currency translation:** Credit cards are accepted globally, and this also eliminates the problem of exchanging different currencies into cash.

DSE Reminder

Refer to HKDSE Exam 2013 paper 1B Q.1(a). The question asks students to explain the benefits for customers of using credit cards.

Note Card

Advantages of using credit cards:

- Convenience and safety
- Payment flexibility
- Worldwide acceptance and currency translation

Disadvantages of using credit cards:

- High interest cost
- Damaged credit rating
- Credit card abuse

Teaching Strategies

Teachers may remind students that an additional fee will usually be charged when credit cards are accepted globally.

According to census data, the average monthly credit card consumption increased from \$5,530 (2009) to \$7,070 (2013).

FINANCE

DAILY NEWS

5 September 2013

Credit card consumption has grown

An official from China Construction Bank (Asia) claims that credit card consumption has grown in recent years. That bank has issued around 700,000 credit cards now, and more credit cards are expected to be issued in the coming year.

Overseas credit card transactions is one of the reasons for the greater number of credit cards. Nowadays, credit cards have become a common transaction tool around the world. The official claims the volume of overseas transactions increased by more than 10% last year. China Construction Bank (Asia) will offer more benefits for overseas transactions. The aim is to attract more credit card users.

Fig 2.12 Overseas transaction increases credit card consumption.

3. Disadvantages of using credit cards

- (i) **High interest cost:** If the cardholder does not repay the full amount of credit on time, interest will be charged. Since credit cards are an unsecured form of financing, the interest rate charged is much higher than other forms of financing.



Fig 2.13 If the cardholder does not repay the full amount of credit on time, interest will be charged.

- (ii) **Damaged credit rating:** Since credit cards are easy to obtain, cardholders often are not aware that the misuse of credit cards can damage their credit rating. When there is a late payment, it will be counted against them and recorded.
- (iii) **Credit card abuse:** Paying the minimum payment of the credit outstanding seems to be a relatively easy way of repayment. However, this will actually get cardholders into more debt than they can handle. In the worst cases, the cardholders may even end up filing for bankruptcy.

Exam Drill

- Which of the following about credit card is not correct?
 - Cardholders can pay part of the payment on the due date.
 - Credit cards have credit limits.
 - If a cardholder's retail purchase exceeds his credit limit, the card issuing institution would apply a high interest rate as a punishment.
 - Eligible cardholders in Hong Kong only can have one credit card.
- What are the advantages and disadvantages of using credit cards?

D

Suggested Answers

- Advantages of using credit cards:
 - Convenience and safety
 - Payment flexibility
 - Worldwide acceptance and currency translation
 Disadvantages of using credit cards:
 - High interest cost
 - Damaged credit rating
 - Credit card abuse

2.4 Personal credit records

A **credit record** is a record of the credit history of a consumer. The record contains information about the consumer's previous borrowing and repaying, as well as important information such as late payments and bankruptcy.

When making lending decisions, financial institutions will determine if the borrower is a good customer. The decision to lend is based on the borrower's **credit worthiness**¹, which means **the ability of an individual to repay the debt**.

A. Credit score and credit rating

A credit score² or credit rating³ is a composite measure of the credit worthiness of the credit applicant.

The **credit score** measures the borrower's credit worthiness by using a **numerical value**, while the **credit rating** represents the ability of an individual to repay the debt by using a **rating**. Before deciding to grant a loan, financial institutions would consider the applicant's credit score or credit rating.

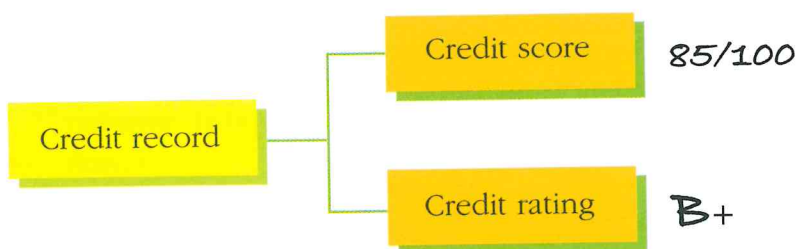


Fig 2.14 Both credit score and credit rating are measures of credit worthiness.

Learning Objective

Explain the importance of maintaining a good personal credit record

Note Card

A **credit record** is a record of the credit history of a consumer.

B. Factors affecting credit worthiness

In order to reach a decision, the financial institution will measure the credit worthiness based on various factors. Although different financial institutions may have different approaches in calculating the credit score, they still use the same major factors that affect credit worthiness.

- (i) **Applicant's financial situation:** Important consideration will be given to the amount of assets and liabilities the applicant has. If an applicant has a larger amount of assets and a smaller amount of liabilities, the credit score or credit rating will be higher.
- (ii) **Applicant's occupation:** A more stable career and longer employment history will enable the financial institution to have a better picture about the earning power, hence ability of repayment, of the applicant.



Fig 2.15 Since civil servants have more stable income, they may enjoy lower interest rates.

- (iii) **Past payment record:** If an applicant repays bills on time and has a good payment record, he has a higher credit score or credit rating.

Conversely, if an applicant has a default record, he has a low credit score or credit rating. Therefore, a bad past payment record will damage the credit worthiness of the applicant.

Quick Quiz

5. What is a personal credit record?
6. How does a higher amount of liabilities affect one's credit worthiness?

Note Card

Factors affecting credit worthiness:

- (i) Applicant's financial situation
- (ii) Applicant's occupation
- (iii) Past payment record

Suggested Answers

5. A personal credit record is a record of the credit history of a consumer.
6. More liabilities would lower one's credit worthiness, because it means the ability of an individual to repay the debt is lower.

For details on the company TransUnion, students may refer to its website: <http://www.transunion.hk/>

C. Personal Credit Reference in Hong Kong

The agencies that collect credit information are often known as credit reference agencies¹ (CRAs) or credit bureaus. **TransUnion² in Hong Kong is the first and only consumer credit reference agency in Hong Kong.** The company maintains records on nearly 5 million consumers. Apart from providing information to financial institutions, the company also entertains requests from individuals on their own credit history, credit score and credit rating for a fee.

Since credit information is sensitive in nature, the company has to follow the *Code of Practice on Consumer Credit Data*³ issued by the Office of the Privacy Commissioner for Personal Data, Hong Kong⁴.



Fig 2.16 TransUnion was the first centralised database providing credit information.

D. Importance of maintaining a good personal credit record

1. Ensure the chance to get a loan

A good personal credit record means people can get a loan when they need it. Financial institutions are not willing to make loans to people who have a bad personal credit record because it is risky.

2. Avoid being charged higher interest rates

A person who has a good personal credit record is generally charged a lower interest rate when he applies for a loan.

Conversely, since it is risky for a financial institution to make a loan to a person with a poor personal credit record, the institution will charge a higher interest rate to compensate for the risk.

3. Maintain a good personal resume

A good personal credit record is part of maintaining a good personal resume for individuals.

A bad personal credit record may have a negative effect on a person's personal resume. It may even damage a person's career. For example, some careers may ask applicants to provide their personal credit record. A person with a bad personal credit record is not suitable for handling some financial or accounting duties which are sensitive.

DSE Reminder

Refer to HKDSE Exam 2013 paper 1B Q.1(b). The question asks students to explain why credit card companies are more willing to issue credit cards to applicant with good personal records.

1. credit reference agency 信貸資料機構 2. TransUnion 環聯
3. *Code of Practice on Consumer Credit Data* 《個人信貸資料實務守則》
4. Office of the Privacy Commissioner for Personal Data, Hong Kong 香港個人資料私隱專員公署

 **Activities**

Ask students to discuss how to maintain a good personal credit record.

E. How to maintain a good personal credit record

Maintaining a good personal credit record is important in the successful application of loans. The following are useful advice:

- (i) **Use credit responsibly:** Consumer credit is provided to facilitate consumers' purchase decisions; however, consumers may make many impulse¹ purchases and apply for consumer credit blindly². Therefore, consumers should use credit responsibly, and not apply for credit if not necessary.
- (ii) **Maintain a good habit of financial discipline:** Consumers do not use credit responsibly if they lack financial discipline. Financial discipline refers to a good record of maintaining a spending budget, and constant evaluation of budgeted against actual spending.
- (iii) **Avoid applying for too many credit cards:** Since a credit card is an unsecured credit, cardholders are seen to hold liabilities. If an individual holds many credit cards, credit reference agencies (CRAs) may lower his credit worthiness.
- (iv) **Repay on time:** Consumers should pay all bills on time. This not only cuts down the interest paid to financial institutions, but also maintains credit worthiness at a good level.

→ Case in Focus 2.1

Why do we need to maintain a good personal credit record?

Mr Yan's car broke down last week. Mr Yan needs \$10,000 to fix it. Therefore, he went to a bank and applied for a loan.

However, the bank rejected his application. The reason is Mr Yan's poor personal credit record. The bank found that Mr Yan did not repay a loan of \$200,000 on time two years ago.

As a result, Mr Yan is forced to pay a very high interest rate to get a loan from another bank.

Let's think

1. Apart from a personal loan, which other kinds of consumer credit could Mr Yan choose? Name two of them.
2. Why is the bank not willing to make a loan to someone who has a bad personal credit record?
3. According to the case above, why do we need to maintain a good personal credit record?

Suggested Answers

1. Credit card and bank overdraft.
2. It is risky for the bank to make a loan to someone who has a bad personal credit record.
3. We can ensure the chance to get a loan, and avoid being charged higher interest rates.

1. impulse 衝動的
2. blindly 盲目地