

APPENDIX: WORDS TO KNOW

A

Adjustable Rate Mortgage (ARM): A mortgage loan where the interest rate changes over time. ARMs usually offer lower interest rates at the start, but they also involve the risk of rates rising in the future which can mean higher payments or increasing balances. In comparison, a *fixed rate mortgage* usually offers a higher rate, but payments generally stay the same for the length of the loan. ARMs sometimes have caps that limit how much the interest rate can rise or fall with each change or over the life of the loan.

Annual Fee: A charge sometimes required by credit card companies for use of an account. Annual fees range from \$10 to \$200 a year or more and are most common with rewards cards or cards for subprime borrowers.

Annual Percentage Rate (APR): The interest rate being charged on a debt, expressed as a yearly rate. Credit cards often have several different APRs—one for purchases, one for cash advances and one for balance transfers. Lenders also may increase the APR if a payment is late. (See Default Rate.)

Asset: Personal assets are things owned by a person that have cash value—meaning they can be resold. Common assets include homes, cars, boats, savings and investments, but not clothing or furniture.

Authorized User: Anyone who uses your credit cards or credit accounts with your actual or implied permission. For example, an authorized user can be someone who has a credit card from your account with their name on it. An authorized user is not legally responsible for the debt but may be reported to the credit bureaus.

B

Balance Transfer: The process of moving all or part of the outstanding balance on one account to another account. Credit card companies often offer special rates for balance transfers.

Bankruptcy: A proceeding that legally releases a person from repaying a portion or all debts owed. One form of bankruptcy involves setting up a repayment plan; another involves selling or transferring your assets to pay your debts. Bankruptcy damages your credit for 7–10 years or more and should only be considered as a last resort if you cannot repay your debts.

C

Charge-Off: When a creditor or lender “writes off” the balance of a delinquent debt on its books because the creditor or lender no

longer reasonably expects the debt to be repaid. A charge-off is also known as a “bad debt.” Charge-off records can remain on your credit report for up to 7 years or more and can harm your credit score. Just because a debt is charged-off doesn’t mean that you cannot be asked to re-pay the debt. Your promise to repay continues, even if the company doubts you will keep your promise. A charged-off debt can be sold to a debt buyer for further collection.

Closing Costs: Certain costs that have to be paid when a property is sold. Closing costs include lender title and escrow fees and usually range from 1%–5% of the purchase price. Closing costs often have to be paid in cash, though they can sometimes be included in the loan balance. They can be paid by the buyer or seller or split between the two.

Collateral: An asset or property used as security against a loan. If the loan isn’t paid, the lender can legally take the asset away from the borrower.

Collections: A lender may choose to collect a delinquent loan itself or hire a collection agency to collect on its behalf, or even sell a debt to a debt buyer to recover on amounts owed. Credit card debts, medical bills, cell phone bills, utility charges, library fees and video store fees are often sold to debt buyers. Collections records can remain on your credit report for up to 7 years or more from the beginning of final delinquency.

Co-Signer: An additional person who signs a loan document and takes equal responsibility for the debt. Borrowers may want to use a co-signer if their credit or financial situation is not good enough to qualify for a loan on their own. Co-signers must be very careful because they are legally responsible for the debt and the shared account will appear on the co-signer’s credit report too. Having a co-signer is only helpful if the co-signer’s credit or financial standing is better than the primary borrower.

Credit Bureaus: Also known as credit reporting agencies, these companies collect information from creditors and lenders about consumer financial behavior. This data is then provided to businesses that want to evaluate how risky it would be to lend money to a potential borrower. There are three national credit bureaus—**Equifax, Experian and TransUnion**—and many smaller local and regional bureaus. FICO is not a credit bureau. Instead it is a company that develops credit scoring formulas based on the information in credit reports.

Credit Counseling: A service that can help consumers repay their debts and get into good financial health. Many of these agencies offer helpful and affordable services. *Consumers should be aware that there are also credit counseling agencies that are expensive, ineffective and even damaging to the client’s credit. Consumers should carefully review the company’s reputation and services before signing up.* To find a legitimate credit counseling agency, go to www.nfcc.org or call 1-800-388-2227.

Credit History: Another term for the information on your cred-



it report. Your credit history is a record of how you have repaid your credit obligations in the past.

Credit Limit: The total amount that a company will allow you to charge to a credit card or credit line. If you spend more than your credit limit, you may be charged an “overlimit fee”. It’s a good idea to keep all of your credit card balances below 35% of your credit limits.

Credit Report: A record of an individual’s financial behavior, kept by credit bureaus and provided to businesses when they want to evaluate potential borrowers, employees, tenants or insurance purchasers. Credit reports include records on: consumer name, current and former addresses, employment, credit and loan histories, inquiries, collection records, and public records such as bankruptcy filings and tax liens.

Credit Score: A score that reflects how good your credit history is. It is used by creditors to quickly understand how risky a borrower you are. Credit scores are calculated using complex mathematical formulas that may look at your most current payment history, debts, credit history, inquiries and other factors from your credit report. FICO scores usually range from 300-850, with 680 or higher generally considered to be “good” credit scores. There are thousands of slightly different credit scoring formulas (including FICO, Beacon and Empirca scores) used by bankers, lenders, creditors, insurers and retailers. Each score can vary somewhat in how it evaluates your credit data.

D
Debt: An amount of money owed to another person, company or other organization.

Debt Consolidation: A process of combining debts into one loan or repayment plan. Debt consolidation can be done on your own, or with a financial institution or credit counseling service. (See Credit Counseling Service) Student loans are often consolidated in order to secure a lower interest rate.

Debt-to-Available-Credit Ratio (or Debt-to-Credit): The amount of money you owe compared to the total amount of credit you have available, though all credit cards and credit lines. This ratio measures how much of your available credit you are using. The higher your debt to available credit ratio, the more risky you appear to potential lenders.

Default: Generally any “breach” or failure to comply with the terms of a loan contract. Default is often specifically defined,

although many creditors may not consider you “really” in default until after you have made late (delinquent) or no payments several times. Defaults are a serious negative item on a credit report and can trigger interest rate increases, a reduction in your credit line or even cancellation and acceleration (when the creditor requires a borrower to pay the entire amount due immediately) of your account.

Default Rate: A higher interest rate that may be imposed on an account after it is in default. Credit card issuers have to disclose the default rate before you sign up for the card.

Delinquency: A term used for late payment or lack of payment on a loan, debt or credit card account. Accounts are usually referred to as 30, 60, 90 or 120 days delinquent because most lenders have monthly payment cycles. Delinquencies remain on your credit report for up to 7 years or more and can be damaging to your credit score.

Down Payment: The amount of money that is paid toward the purchase price upfront. A down payment reduces the size of the loan needed to make a purchase. For example, if you pay a \$4,000 down payment on a \$20,000 car, you only need to take out a loan for \$16,000.

E
Equifax: One of the three major national credit bureaus (also known as credit reporting agencies) that collects and provides consumer financial records.

Experian: One of the three major national credit bureaus (also known as credit reporting agencies) that collects and provides consumer financial records.

F
FCRA, or Fair Credit Reporting Act: A federal law that regulates credit reporting agencies and users of credit reports. Among other things, the FCRA protects access to the information in your credit report. Under the FCRA, the three major national credit bureaus are required to disclose your credit report to you for free once every 12 months, or if you’ve been denied an application based on information in the report, upon request.

FICO Score: A specific credit score developed by the Fair Isaac Corporation. The FICO score is the most common credit score used by bankers, lenders, creditors, insurers and retailers.

Finance Charge: For federal disclosure purposes, the total cost



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of using credit. In addition to periodic interest charges, the finance charge may include other fees and charges, such as pre-paid interest, credit insurance required for the loan and cash-advance fees.

Fixed Rate: A periodic interest rate for a credit card or loan that does not “move” or automatically change with changes in other standard interest rates. A fixed rate may, however, be increased through a change-in-terms notice or, after default, by the application of a default rate. “Fixed” means “not moving.”

Fixed Rate Mortgage: A mortgage loan with a fixed rate. FRMs typically have longer terms (15-30 years) and higher interest rates than adjustable rate mortgages but generally do not involve the risk of changing interest rates or increasing payments that adjustable rate mortgages do.

Foreclosure: When a lender legally takes away an asset (such as a home or car that has been given as collateral for a loan) because the borrower isn't paying back the loan according to its terms. Foreclosure is a legal process to claim ownership of the collateral property and often involves a forced sale of the property, with the proceeds going toward paying off the debt. If the asset is not valuable enough to cover the debt owed, a “deficiency” (remaining balance) may remain. You can sometimes avoid losing an asset to foreclosure by catching up on missed payments and related fees and charges (called “redemption”).

G

Grace Period: This refers to a period of time, often about 25 days, during which you can pay for new purchases on your credit card bill without incurring a finance charge. With most credit card accounts, the grace period applies only if you pay your balance in full each month. It usually does not apply if you carry a balance forward or in the case of cash advances. If your account has no grace period, finance charges can be charged on a transaction as soon as it is made.

Gross Income: Your total income (wages), before taxes, Social Security deductions, insurance and other payments.



H

Home Equity: The part of a home's value that the mortgage borrower owns outright. This is the difference between the fair market

value of the home and the principal balances of all mortgage loans for which the home is collateral.

Household Income: The total income of all members of a household. This is an important measure used by lenders evaluating applications for joint credit, or in a few states, individual credit.

I

Inquiry: An item on your credit report that shows that someone with a “permissible purpose” under FCRA regulations has requested a copy of your credit report data. Often inquiries are listed when you are applying for a credit card or other loan. Too many inquiries can damage your credit because it may appear you are desperate for money.

Interest Rate: A measure of the cost of credit, expressed as a percent, and typically imposed on a periodic basis. Sometimes prepaid finance charges or other fees are included with a periodic interest rate in the calculation of an APR.

Interest: The money a borrower pays for the ability to borrow from a lender or creditor. Interest is typically calculated as a percentage of the money borrowed and is paid over a specified time periods or “term.” Interest can be collected in a lump sum or charged to a loan over a period of time.



Interest-Only Loan:

A type of loan or option on a mortgage loan where the initial repayments only cover the interest that accumulates on the loan balance. The principal loan balance (total amount owed) does not decrease with the payments of interest only. After the initial “interest only” term (1-5 years), payments may increase so the principal will be repaid.

L

Late Payment: The failure to make a required loan or debt payment on or before the time agreed. A partial payment may be considered late if it does not match the required minimum payment amount. Late payments may be reported and can harm your credit score for up to 7 years (sometimes longer).

Lender (or Creditor): The individual or financial institution that makes a loan or who purchases the debt.

Loan Origination Fee: A fee charged by a lender for underwriting a loan, usually a mortgage. The fee often is expressed in “points”; a point is 1% of the principal amount of the loan.

Loan Processing Fee (or Application Fee): A fee charged by a lender for accepting a loan application, often a mortgage, and gathering the supporting paperwork such as an appraisal or credit report.

M

Market Value: The top dollar that would be paid for a house, vehicle or other property.

Minimum Payment: The least amount of money that you must pay on a loan. Failure to pay the minimum could result in late payment fees or a default rate.

MSRP: The “Manufacturer’s Suggested Retail Price” on an item such as an automobile, which shows the manufacturer’s recommended selling price for an item and each of its options or components. This is often just a starting price for negotiation—you may not have to pay this price.

N

Net Income: Also called “take-home pay,” this is the amount of income that you actually receive from your paycheck, after taxes, insurance and other payments.

P

Point: A unit for measuring fees related to a loan; a point equals 1% of a mortgage loan’s principal amount. Some lenders charge “origination points” to cover the expense of making a loan. Some borrowers pay “discount points” to reduce the loan’s periodic interest rate.

Prime rate: The interest rate a commercial bank charges to its best or “prime” customers, usually large businesses. The variable rates charged to consumers on credit cards. For example, the APR on a credit card account may be based on the prime rate plus a certain fixed percentage (or “margin”). So, if the APR on your card is “prime plus 18%”, then when the prime rate is 7%, your APR will be 25%. If the prime goes up by 1% (to 8%), which it may, then your APR may increase by the same amount as the prime rate increase (by 1% in our example to 26%). credit card issuers and other lenders typically use the prime rate published in [The Wall Street Journal](#).

Principal: The amount of money borrowed with a loan or owed on a debt, usually excluding interest and fees.

R

Refinance: The process of paying off an old loan with a new loan. Borrowers usually choose to refinance a mortgage or other loan to get better loan terms such as a lower periodic interest rate or lower monthly payments, or to receive cash for their equity.

Revolving Account: A loan or account that allows you to borrow, pay down and re-borrow money over an indefinite period of time, also known as “open-end” credit (as distinct from “closed-end” or “installment” credit under an installment loan where there is a definite term of repayment). Under a revolving account, when you pay down the outstanding balance of your account, you have more credit available to make purchases. Credit card and home equity loans are examples of revolving accounts.



S

Secured Debt: A loan that requires a piece of property (such as a house or car) or other asset (such as a deposit account or stock) to be used as collateral. This collateral provides security for the lender since the property can be seized and sold if you don’t repay the debt.

Subprime Borrower: A borrower who does not meet the minimum qualifications for standard (so called “prime”) credit and loan offers. Usually a subprime borrower has poor credit (such as a FICO credit score under 650) because of late payments, accounts in collection or adverse public records (such as bankruptcy or collection suits). Subprime borrowers may qualify for loans and credit, but usually at a higher interest rate or with special terms and higher fees.

T, U, V

Term: With respect to loans, the length of the loan period. With respect to a loan contract, a particular benefit, condition or obligation to which a borrower or lender has agreed.

Title: A legal document that shows the ownership of property (like a car or house).

TransUnion: One of the three major national credit bureaus (also known as credit reporting agencies) that collects and provides consumer financial records.

Unsecured Debt: A loan for which there is no collateral. Most credit card accounts are unsecured debt.

Variable Rate: A type of periodic interest rate tied directly to the movement of some other rate or “index”. A variable rate is typically made up of an index (the moving rate) and a “margin” or “spread” (a fixed percentage over the index). For example, a variable rate might involve the prime rate (the index) plus 15% (the margin) and would change from time to time (increase or decrease) as the prime rate changes. The frequency of changes may vary. Some variable rates can change as frequently as monthly, while others may change only yearly. A variable rate may be subject to a rate maximum (“ceiling”) or rate minimum (“floor”), or both. The prime rate and London Interbank Offered Rate (“LIBOR”) are commonly used as indices.

