



Innovation, Science and
Economic Development Canada

Office of the Superintendent
of Bankruptcy Canada

Innovation, Sciences et
Développement économique Canada

Bureau du surintendant
des faillites Canada

INSOLVENCY COUNSELLING PROGRAM

Responsible Use of Credit Module



Canada

Responsible Use of Credit Module

Welcome to the responsible use of credit module

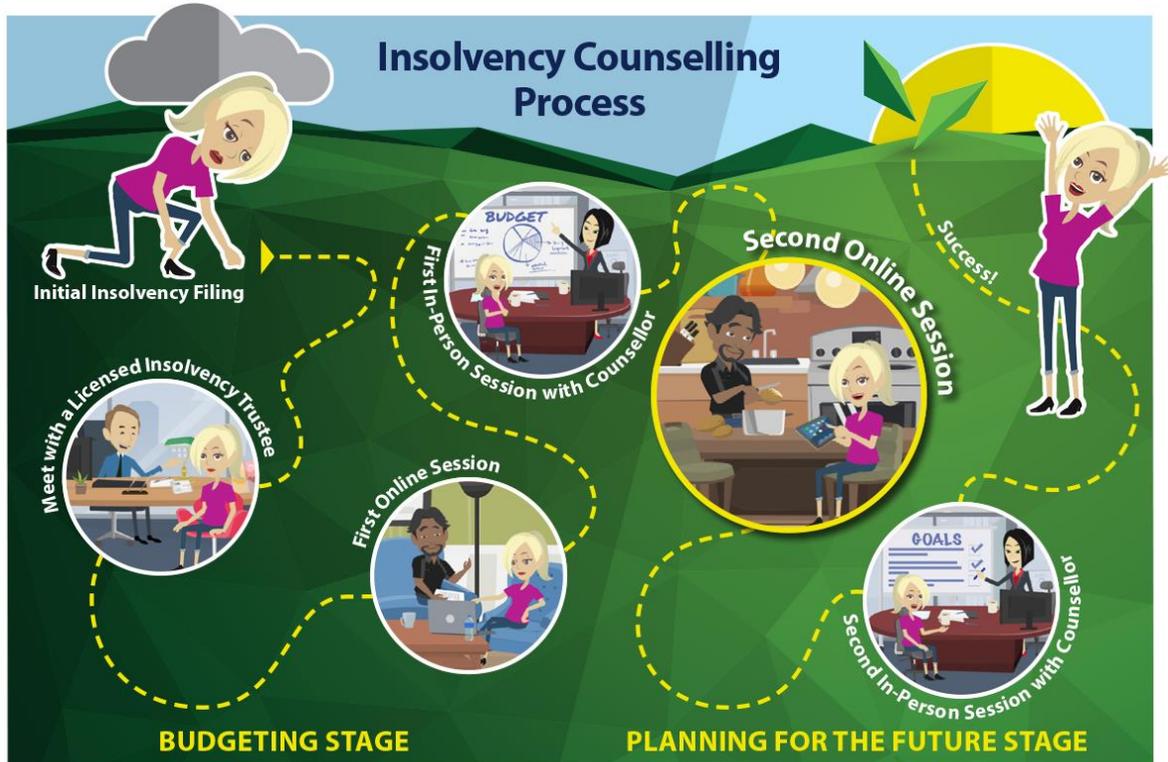
When completing the modules:

- sit in a quiet place;
- take your time, move at your own pace and take regular breaks; and,
- write down any questions you may have and bring them with you to your in person counselling session.

① Although the modules are presented in a certain order, it is important to remember that everyone is different, so your BIA Insolvency Counsellor can adjust your counselling to suit your needs. This may include changing the order of the online modules.

Responsible use of credit overview

The insolvency counselling process



Congratulations, you are almost finished the online insolvency counselling modules (unless your BIA Insolvency Counsellor has customized your counselling and rearranged the order of the online modules to better suit your needs).

Now that you are nearing the end of your insolvency, the modules in the planning for the future stage will help prepare you for post-insolvency success by giving you the tools you need to help you stay on track.

Many financial goals, such as getting an education or making a large purchase, often require the use of credit. Using credit will let you achieve certain financial goals. Using it responsibly lets you remain in control.

Many people file for insolvency due to the overuse of credit. The objective of this module is to learn about credit and how to use it responsibly. You will learn what questions to ask yourself before using credit and you will get a better understanding of your rights and responsibilities as a borrower.



If you have questions, write them down and bring them to your in-person counselling session.

Factors of borrowing

Important factors of borrowing money

Credit is a tool, just like a hammer is a tool. These tools are neither good nor bad. They can help you in achieving objectives if used properly. However, there may be negative consequences if credit is not used responsibly.

In this section you will learn about some of the important factors that you, as a potential borrower, should consider so that you can use credit as an effective tool. One of the most important factors to consider is the cost of borrowing money.

Cost of borrowing

The two main components to consider when determining the cost of borrowing money are the principal amount and the interest.

Principal amount is the original amount borrowed or the amount that remains unpaid.

Interest is the additional amount owed to the lender based on the outstanding balance.

Borrowing money allows you to get what you want today, but at an additional cost. When borrowing money, people are able to make a purchase today by “renting” someone else’s money. The expense of renting this borrowed money is called interest. An important question to ask is whether the cost (interest) of borrowing someone else’s money is worth the benefit of making the purchase today instead of at a later date.

If you make a purchase now using a loan, then this will cost you the purchase price plus interest. However, if you make the same purchase at a later date using your savings, then you will only have to pay the purchase price. Therefore, the overall purchase will cost you less if you make the purchase with your savings at a later date.

For example, financing a \$20,000 car could cost approximately \$4,000 in interest only. This means the total cost of the \$20,000 car would be \$24,000. (8% interest, 5 year amortization.)

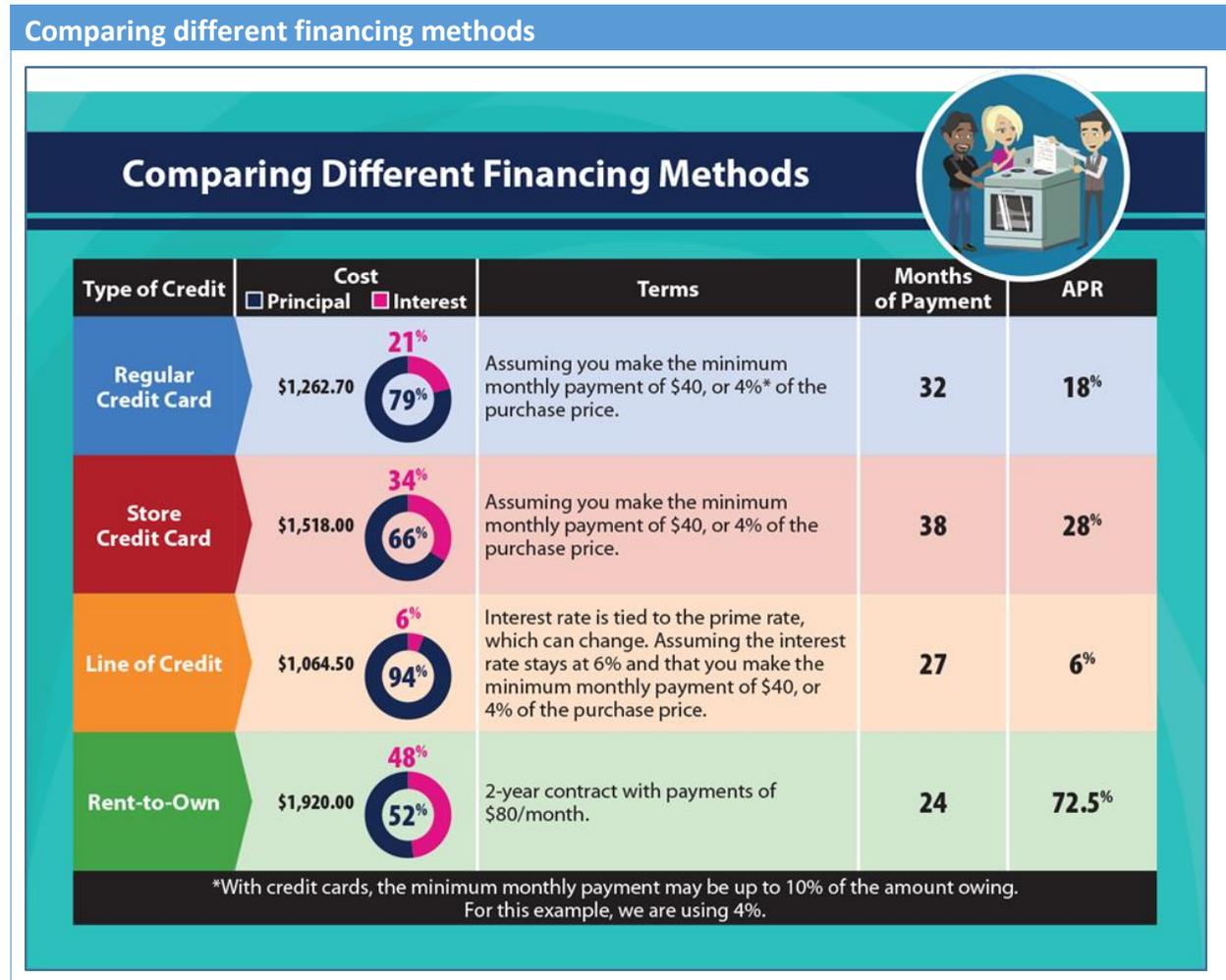
Comparing the costs of borrowing of different types of credit products

Let’s assume that you have made the decision to purchase something now and pay the additional borrowing cost. Interest often makes up a large part of the total purchase cost.

The challenge is that there are various ways to calculate interest and the cost of borrowing can vary significantly depending on the method used. The annual percentage rate (APR) is designed to provide a common measure for comparing the interest rates of different loan products.

The APR is a standard way of expressing the interest. It can help you compare rates from one loan to another because it is calculated using standardized rules.

For example, suppose your oven breaks down and you need to buy a new one. The new oven costs \$1,000 at your local department store. You are considering different options, including a credit card, a store credit card, a line of credit from your bank, a rent-to-own contract, or using your emergency fund.



The best option is almost always to use your savings to pay for an unexpected expense such as this one. If you don't have enough savings to cover the cost of the oven, then the next best option in this case is to pay for it using a line of credit. However, it is important to note that a line of credit is not always the least expensive loan option. There are many situations in which other types of credit might actually be less expensive and/or less risky than a line of credit. You should always explore options specific to your situation. Above all, consider all of the factors, such as what the total cost of the purchase will be.

Ask the lender about the fees and interest you will pay before you sign a loan agreement.

To understand the cost of a loan, make sure that you ask:

- What is the total cost of the loan including interest? This will help you determine whether buying now versus later is worth the additional borrowing cost.
- What is the APR on the loan? This will help you choose between various borrowing options.

Remember that there may be other fees, charges and conditions associated with borrowing money, on top of the interest. Before deciding to borrow, make sure you understand all of the terms and conditions of the loan.



If you have questions, write them down and bring them to your in-person counselling session.

Payday loans

Payday loans are short-term loans, approximately 14 days in length. A payday loan is typically a small-dollar loan of up to \$1,500. These loans are offered by a non-traditional financial service provider.

The cost of a payday loan is typically based on a set dollar amount per \$100 borrowed. For instance, let's assume that a \$100 payday loan costs approximately \$18. If someone borrows \$100 from a payday loan and repays it in 2 weeks, this borrower will need to pay \$18 on the \$100. If the borrower continues to do this for an entire year, that is 26 payday loans. The original \$100 loan will cost \$468, and therefore the APR of this payday loan is 468%. Also, borrowers who are unable to repay their loans in full and on time may have to pay additional fees. When comparing the APR of payday loans to the APR of the financing products listed in the infographic above, payday loans are generally the most expensive financing option.

Consider your other options before resorting to payday loans:

- use your emergency savings fund
- negotiate with your creditors and discuss alternate payment arrangements
- get a loan from your family or friends
- cash in your vacation days at work
- ask your employer for a pay advance
- obtain a line of credit

Be aware of payday loans. Payday loans typically have very high interest rates and charge costly fees so it is important that you understand all of the loan terms. Payday loan interest rates and fees vary by province. Before taking a payday loan, consider all other options.

Auto financing

Auto financing is another type of credit that many people need to consider. Buying a car is typically the second biggest purchase after a house and it often requires borrowing money.

The length of the loan and the amount of the payments are other important factors to consider when borrowing money to buy a car. These considerations are particularly important when buying something that will go down in value, such as an automobile.



If you have questions, write them down and bring them to your in-person counselling session.

Factors that lenders consider before extending credit

Important factors that lenders consider before extending credit

Earlier in this module you reviewed the factors that you should consider when borrowing money. Borrowing money entails a relationship between you and the lender. It is important for you, as a potential borrower, to learn about the factors that lenders consider when making loan decisions.

Gaining the lender's trust

Much of a lender's willingness to lend money is based on the level of confidence that they will be repaid. Lenders may consider your credit score as a major factor when deciding to lend you money. Credit scores are for the benefit of lenders. Your credit score is based on:

- whether you make your payments on time;
- how much of your available credit you've used;
- how long you've had credit;
- the different types of credit products you have; and,
- how many enquiries (or hits) are on your credit file.

It is important to understand that the way you use credit will always be reflected on your credit rating. Responsible use of credit is key to being able to borrow.

Lenders get your credit score from credit reporting agencies. These agencies collect information from lenders on the way that you use credit and then share this information.

Lenders may also consider other factors before lending you money. For example, your bank may be more likely to lend you money if you have a long-standing relationship with them.

How insolvency affects your credit rating

Your insolvency will affect your credit rating. The table below details certain insolvency timelines (for specifics, it is best to check directly with credit reporting agencies and/or provincial authorities).

How insolvency affects your credit rating



How Insolvency Affects Your Credit Rating

| Type of Information | Length of Time Information is Kept on the Credit Report | Start Date |
|-----------------------|-----------------------------------------------------------------------|-----------------------------------------------|
| Consumer Proposals | • 3 years | • Typically once the proposal is paid in full |
| Bankruptcy | • 6 to 10 years depending on the province and credit reporting agency | • Generally from the date of discharge |
| Multiple Bankruptcies | • 14 years | • Usually from the date of discharge |

Check your credit report on an annual basis to make sure there are no errors.

- [Ordering your credit report and score](#)

The only way to repair your damaged credit history is to practise responsible financial habits moving forward. Lenders will recognize this and, in time, you will see it reflected in an improved credit score. Rebuilding your credit score after your insolvency takes time, so do not give up or get discouraged!

Some lenders may be willing to give you credit immediately after your discharge or completed proposal. However, that usually comes at a high interest rate, which could put you in danger of being unable to manage debts again. Also beware of any promises to remove negative information from your credit record sooner than would otherwise be possible. By law, this cannot be done.



You can discuss additional options to repair your credit rating at your in-person counselling session with your counsellor. If you have questions, write them down and bring them to your in-person counselling session.

Managing your use of credit

If you have already reviewed the spending habits module, then you may remember learning that people tend to spend more money when using credit than when using cash. Many consumers are even willing to pay more for the same product when using credit instead of cash.

Consider the following points on how to avoid overspending through the use of credit:

- use your budget and let your financial goals guide your spending decisions;
- consider your current balance, not your credit limit;
- remember that you have to pay it back with interest; and,
- only use your credit card for things you would have purchased anyway (for example, your fixed monthly expenses, which are essential).

Managing your debt

Sometimes, despite your best efforts, you may find yourself taking on more debt than you can handle. The first step in solving your financial problems is to take control before they get out of hand.

Here are some tips for managing your debt post-insolvency:

Setup automatic payments

Consider setting up automatic payments through your bank or credit union. This will allow you to have your bills automatically paid when they are due and when you know you will have the money available in your account.

Use savings to pay off balances

Remember that the purpose of your emergency fund is for unforeseeable periodic expenses. If you find yourself with more debt than you can handle, using your emergency fund may be a solution.

Selling an asset

Consider selling items that also have other costs associated with them. For instance, selling a vehicle will provide money for paying down your debts, and may also cut down on other costs, such as gas and insurance.

Pay the debt with the highest interest rate first

If you carry a balance on your credit card, this is likely the debt with the highest interest rate. Use cash or a debit card for purchases while you are paying your credit card to avoid taking on more debt.

Switch to less expensive credit cards

There are many factors to consider when determining which credit card works best for you. The key considerations when choosing a credit card are the annual interest rate,

the fees, and the benefits and rewards. Look around for a credit card with a lower interest rate or fewer fees.

Talk to trusted financial professionals

These may include your bank representative or a financial planner. With their help, you will be able to identify your current debt situation, figure out your needs, make a budget, and pay off the debt.

Remember, credit is a tool and it is neither good nor bad. When credit is used responsibly, it can be very effective for achieving financial goals. However, if it is not used responsibly, there are negative consequences. Remember to be cautious when using credit to reduce your risk of overspending and to avoid future debt troubles!



If you have questions, write them down and bring them to your in-person counselling session.



Check your learning: responsible use of credit module

Select the correct answer for each of the questions below.

1. All financial goals require the use of credit.

- a. True
- b. False

2. A line of credit will always have the lowest interest rate when compared to other types of credit.

- a. True
- b. False

3. Which of the following statements about credit is false?

- a. Your payment history with one lender will be made available to other lenders.
- b. Your insolvency will affect your credit rating.
- c. Lenders rely on your credit rating when making loan decisions.
- d. Credit repair companies can remove negative information from your record sooner than otherwise possible

4. Which of the following is the most important factor that lenders use to make loan decisions?

- a. Your track record of timely repayments
- b. Your personality
- c. If you have more than one credit card
- d. If you have borrowed from them before

5. Which of the following statements about credit is false?

- a. Insurance companies always review your credit record.
- b. The credit bureau determines who will receive credit.
- c. Employers can review your credit record.
- d. You can receive a free copy of your credit report.

6. Longer-term car loans are always better because your monthly payments will be less than shorter-term car loans.

- a. True
- b. False

7. The APR on a loan always includes all of the additional costs and fees outside of the principal amount.

- a. True
- b. False

Answers
1. (b) 2. (b) 3. (d) 4. (a) 5. (b) 6. (b) 7. (b) 8. (b)

Congratulations

✓ You have now completed the responsible use of credit module!



If you have questions, write them down and bring them to your in-person counselling session.