Topic 6: Borrowing Products

Learning outcomes:

- outline the key features of the financial services products for borrowing;
- identify the key features of the costs of borrowing; and
- begin to evaluate lifelong financial planning, by understanding that people's borrowing needs change as they pass through the various life stages.

Borrowing:

When choosing how to borrow money, people need to consider:

- what they can afford to repay;
- the costs and risks of different borrowing methods;
- how long they need to borrow for; and
- how they apply for and manage the debt.

Overdrafts:

- Authorised overdraft usage fee: a fixed one-off fee such as £10 and / or a fee per day up to a maximum amount in the statement period, such as £1 per day up to a maximum of £20 per month. Having an authorised overdraft for a month with a provider that charges these fees would incur a maximum charge of £30 plus the EAR on the amount borrowed.
- Unauthorised overdraft usage fee: a fixed, one-off fee such as £20 and / or a fee per day up to a maximum in the statement period, such as £5 per day up to a maximum of £100 per month. Having an unauthorised overdraft for one month with a provider that charged these fees would incur a maximum charge of £120 plus the EAR on the amount borrowed.
- Unpaid transaction fee: providers can return transactions such as cheques, standing orders and direct debits to the payee's bank unpaid and charge a fee per item – for example, £8 per item up to a maximum of £40 per day.
- Paid transaction fee: providers must honour certain transactions, such as debit card payments, even though the account has insufficient funds to cover them. Again, an example would be a fee of £8 per item, up to a maximum of £40 per day.

Key terms:

APR	Annual percentage rate – the total cost of borrowing over one year, including the interest charged and any fees.
ATM	Automated teller machine, also known as a cash machine.
Bank rate	The interest rate that the Bank of England uses when it lends money to other banks. Financial services providers take account of the Bank rate when they decide how to set interest rates on their own products.
Basic bank account	A current account that allows people to store their money as an electronic balance and make payments by direct debit, standing order, prepaid cash card or by withdrawing cash. There is no debit card, cheque book or overdraft facility on this type of account.
Balance transfer	Moving the balance (total amount owed) on a card from one card provider to another.
Borrowing money	Also know as 'taking credit' or 'consumer credit'.
Card verification value (CVV)	Three numbers on the back of a credit or debit card. These are a security measure designed to prevent fraudulent use of the card by someone other than the cardholder.
Cashback card	A type of card that gives back to the cardholder a percentage of the value of transactions made with the card, in the form of cash.
Charge card	A credit card that must be repaid in full every month.
Cheque	A written instruction to the provider (eg the bank or building society) to pay a specified amount to a specified person or organisation.
Consumer credit	This is another term used for borrowing. It is important to understand that 'taking credit' or 'buying on credit' refers to borrowing. However, a credit into a bank account means paying money in.
Cost of borrowing	Also called 'cost of credit'. This is the total amount that the borrower will be charged including interest and any fees. For personal loans and credit card borrowing the cost over a 12-month period must be quoted – the annual percentage rate (APR).
Credit agreement	The formal agreement between a provider and a borrower setting out the amount borrowed, the interest charged, the arrangements for repayment and any other terms and conditions.
Credit card	A card that allows the holder to make purchases face to face, online or over the phone, and to withdraw cash from an ATM. Unlike a debit card, where the money is taken from the holder's own account, transactions are paid by the card provider. The card holder repays the amount owed to the provider either in one payment or in instalments. The provider charges interest on cash withdrawals from the time the withdrawal is made and on purchases after a certain period.
Credit history	A record of money borrowed and repaid by an individual. These records are held by credit reference agencies and providers will check the individual's credit history when a prospective customer applies for a borrowing product.
Credit union	A mutual organisation (that is, owned by its members) that provides a range of financial products to members, eg savings accounts and personal loans. Members of a credit union must share a common bond, eg all work for the same employer or all work in the same district.
Current account	A bank or building society account where people can store their money in the form of an electronic balance and withdraw it to make payments.
Debit card	A card that can be used to withdraw cash, to make face-to-face transactions in, for example, shops, and to make payments online or over the phone.
Direct credit	An electronic payment into an account, for example a salary or benefit payment.
Direct debit	An electronic payment out of an account. The amount and frequency of a direct debit payment can vary.
EAR	Equivalent annual rate – the cost of borrowing using an overdraft. The EAR includes only the interest rate, as fees are listed separately.
Interest	Money either paid to an account holder by the provider, or charged to the account holder by the provider. Interest is paid on savings accounts and some current accounts and charged on borrowing, eg an overdraft. Each provider decides the rate of interest it will pay or charge, depending on the type of account and, in some cases, the credit history of the individual account holder.
Interest rate	The amount, expressed as a percentage, that a financial services provider or pays to a saver, or charges a borrower when it lends money.
Mortgage	A loan taken out to pay for a property, usually over a long term such as 25 years.
Overdraft	A facility that allows an account holder to withdraw more money than they actually have in their account.
Payday loan	A loan designed to be taken out for only a very short period, which charges a very high APR.
Payment allocation	The order in which a card provider uses money paid into an account to pay off the amount outstanding.
Personal loan	A product that allows someone to borrow a fixed amount over a fixed period at a fixed rate of interest.
Standing order	An electronic payment out of an account. Standing orders are used to make regular payments of the same amount.
Store card	A card issued by a retailer that the holder can use to make purchases within that store or group of stores. As with a credit card, the amount owing is paid off at a later date, either in one payment or in instalments, and interest is charged on the amount owed.

Avoiding costs:

- They could sign up for an alert service from their bank that sends a text message when the account balance is below a set amount or a large transaction has been received for payment.
- They could check their account balance regularly – online, for example, or at an ATM, or by using a mobile banking app.
- They could agree a small overdraft.
- They could choose a basic bank account as their current account; these accounts do not have an overdraft facility and so it is not possible to go overdrawn.