Teacher's Guide

Lesson Seven

Understanding Credit

Practical Money Skills

websites for understanding credit

The following websites can provide students and others with current information, assistance, and data related to this lesson. Web addresses ending in "com" are commercial; ".org" are nonprofit; and ".gov" are government.

CardTrak: Comparison of Costs & Features	**cardtrak.com**
Credit Law Information	**ftc.gov** **federalreserve.gov**
Credit Report Information	**equifax.com** **experian.com** **transunion.com**
Current Loan & Credit Card Rates	**bankrate.com**
Debt Counselors of America	**dca.org**
National Foundation for Consumer Credit	**nfcc.org**
RAM Research	**ramresearch.com**

overview

"Buy now, pay later."

In today's world, using credit is part of our everyday lives. From making online purchases to reserving a concert ticket, credit cards are a necessary convenience. Using credit wisely is critical to building a solid credit history and maintaining sound finances.

Lesson 7 begins by defining credit and its advantages and disadvantages. Next, the lesson teaches students what it means to be creditworthy and how to establish a good credit record. Using provided guidelines, students practice making calculations to determine safe personal debt loads.

High school students may already be looking forward to owning their first credit card. This lesson lists the various types of credit cards as well as costs and features of different cards. Finally, it gives students an opportunity to analyze a credit card statement.

Suggested teaching strategies, teaching notes, activities, slides, and short quizzes are linked to student objectives. Additional ideas to help students practice and generalize skills related to understanding credit in real-life situations are included at the end of the lesson.

student performance goal:

- The student will increase his/her awareness and understanding of what credit is, how to establish it, and the responsibilities of using credit.

lesson objectives: the student will...

7-1 recognize advantages, disadvantages, and responsibilities of using credit.

7-2 identify ways to establish credit history.

7-3 use math skills to determine a safe debt load.

7-4 compare features and costs of various credit cards.

7-5 identify critical actions to take when in financial trouble.

7-1 The student will recognize advantages, disadvantages, and responsibilities of using credit.

discussion

should you use credit? how do you use credit wisely?

slide 7-1a

slide 7-1b

slide 7-1c

- Define "credit." Explain to students that they probably use credit, even if they don't own a credit card (e.g. borrowing lunch money from a friend). Credit may be in the form of credit cards, store credits, installment plans, car loans, or home mortgages.
- Outline and discuss the advantages and disadvantages of using credit. (slides 7-1a and 7-1b)
- Stress that because using credit is so convenient, it is easy to overspend. Talk about impulse buying. Ask students if they ever made a quick purchase that they later regretted.
- Remind students that they must always repay what they borrow. Explain that making small monthly payments on a credit card means it will take longer for them to repay debts. They will pay increased interest costs as well.
- Outline and discuss the responsibilities of using credit. (slide 7-1c)

terms you should know

credit — borrowing on the promise to repay at a later date. Credit is a loan. A credit customer has time to pay the money back, usually for a fee or with interest.

debt — money that is owed to a lender.

impulse buying — purchasing items in an unplanned, spur-of-the-moment manner.

advantages of credit

slide 7-1a

- Buying needed or wanted goods and services using anticipated future income
- Not having to carry cash
- Having a record of purchases
- More convenient than writing checks for each purchase
- Consolidating bills

disadvantages of credit

- Interest payments
- Credit cards can be lost or stolen
- Membership fees
- Increased chance of overspending
- Financial troubles if card is not managed properly

slide 7-1b

your responsibilities

1. Not to run up more debt than you can comfortably repay
2. To read and understand the credit contract
3. To pay debts promptly
4. To notify the credit company immediately if you cannot meet payments
5. To notify the creditor immediately if your credit card is lost or stolen
6. To never give your card number over the phone unless you have initiated the call or you are certain of the caller's identity

slide 7-1c

lesson 7 quiz: credit knowledge

quiz 7-1

7-2 The student will identify ways to establish credit history.

how do you establish a credit history?

- Explain that banks and businesses give credit only if they expect that their customers will pay off their loans. Define the terms associated with credit worthiness. Talk about the "five C's" that determine the likelihood that an individual will pay back a loan. (slides 7-2a, 7-2b and 7-2c)

- Stress that for students to obtain credit for the first time, they must demonstrate that they are responsible individuals. Discuss the ways that students can begin to build a credit history. (slide 7-2d)

- Talk to students about credit bureaus and their role in documenting past uses and misuses of credit. Stress the importance of maintaining a clean credit history in order for them to meet future financial goals.

- As a class, have students examine a sample credit report and identify categories of information the document covers: employment data, payment history, inquiries and public record information. (slide 7-2e) Using the sample document, ask students to determine how many times the customer made late payments or filed for bankruptcy.

- Explain that potential creditors look for the "five C's," based on an applicant's work history and how well he/she managed credit in the past. Tell students that they have a legal right to check their credit ratings. They are entitled to one free copy of their credit report every 12 months from each of the three nationwide credit-reporting companies. If they find a mistake in their credit histories, they can contact the credit bureau to have the incorrect information changed.

discussion

slides 7-2a, 7-2b, 7-3c

slide 7-2d

slide 7-2e

terms you should know

asset — anything owned that has monetary value.

capacity — the borrower's ability to pay, based on income.

capital — funds invested in a bank, property, or business.

collateral — anything that a borrower promises to give a lender if the borrower does not repay a loan.

conditions — any conditions that may affect a borrower's ability to repay.

dependents — people who rely upon a wage earner's income for financial support (the wage earner's spouse and/or children).

credit worthiness

slide 7-2a, 7-2b, 7-2c

1. Character
2. Capital
3. Capacity
4. Collateral
5. Conditions

credit bureau — An agency that checks credit information and keeps a complete file on people who apply for and use credit. A credit bureau furnishes credit reports on request. Consumers have a right to inspect their own credit report.

credit rating — A financial institution's evaluation of whether a person is suitable to receive credit. Credit ratings are based on an individual's character, capacity to repay, and capital.

a credit report

slide 7-2e

- **Identification and employment data**
- **Payment history** — includes timeliness of payments
- **Inquiries** — companies that have requested your credit file
- **Public record information** — liens, bankruptcy, etc.

lesson 7 quiz: establishing a credit history

quiz 7-2

7-3 The student will use math skills to determine a safe debt load.

slide 7-3a, 7-3b

student activity 7-3

what is a safe debt load?

- Define the term "debt load." Use slide 7-3a to illustrate that debt is like carrying a load or weight. Discuss the idea that determining how much is "safe" to carry is based on the individual. Explain the importance of determining a personal safe debt load, based on income and expenditures, before borrowing money.
- Demonstrate use of the "20-10 rule" using slide 7-3b. Review the definition of "net income."
- Have students determine safe debt loads for several consumers based on various incomes and fixed expenses. (activity 7-3) If necessary, complete the questions as a group, writing their calculations on the chalkboard or slide. Review the formula frequently.

terms you should know

safe debt load — the amount of credit that a person can afford and still stay within a safe budget.

net income — the amount of pay available to spend after deductions are taken.

7-4 **The student will compare features and costs of various credit cards.**

what features do credit cards offer? how do you read a credit card statement?

- Begin by asking students if they know what a credit card is. Explain that each card carries a line of credit. Stress that credit cards usually have high interest rates, so it's best for customers to pay bills in full each month to avoid interest charges.
- Remind students that finance charges are calculated based upon three factors: interest rate, amount of money borrowed, and the length of time before the money will be paid off.
- Have students name as many credit cards as they can and list them on the board. Then, list other sources of credit cards (e.g. banks, businesses, phone companies, stores).
- Discuss how costs and features vary between credit cards. It is a wise idea to shop around and compare credit cards. (slide 7-4a)
- Discuss questions that consumers should ask before selecting a credit card or using credit. (slide 7-4b)
- Collect samples of mailed promotional offers from credit card companies to show students. Ask students if they have seen or received similar credit card solicitations. Explain that credit companies target teenagers as a growing group of consumers with money to spend. Interest rates and fees may be higher and credit limits lower for cards geared for teenagers than they are for other cards.
- Have students analyze the solicitations. (slide 7-4c) Can they identify promises used to tempt consumers? Can students identify advertisements that specifically target teenagers? Which claims appeal to consumers with a poor credit history? Remind students to beware of promotions that promise credit cards regardless of previous credit history.
- Emphasize that as appealing as these offers sound, students need to comparison shop before signing up for the first low-rate offer they receive. Have students examine the fine print of a sample promotion for a complete description of the terms of the agreement (e.g. annual fees, penalties, how long the low introductory rate lasts, etc).

discussion

slide 7-4a

slide 7-4b

- Discuss how to distinguish promotional materials from a credit card bill. (slide 7-4b)
- Remind students to dispose of unwanted promotional materials carefully: always cut up credit cards and tear up pre-approved credit applications or papers containing personal information.
- Explain that it is easiest for students to obtain their first credit from a department store. Advise them that stores usually require parents to cosign for their teenagers' credit cards.
- Divide students into teams. Guide teams in using the Internet and credit application forms to compare features of two credit cards: a major credit card and a department store credit card. Have students research answers to specific questions and enter the information onto a chart. (activity 7-4a) Ask the teams to report their findings to the class.
- Guide students in examining a credit card statement to determine what information it contains. (slide 7-4e)
- Explain that credit card customers can catch unauthorized charges and/or billing errors by checking their statements. Tell students they should check their statements carefully each month. Tell them that it sometimes "pays" to know how to read a statement!
- Using the credit card statement, have students answer questions related to it. (activity 7-4b)
- Provide students with additional practice analyzing credit card statements, if needed, by making entries on a credit card statement template and asking students related questions. (activity 7-4c)

student activity 7-4a

slide 7-4d

student activity 7-4b

student activity 7-4c

terms you should know

credit card — A plastic card that gives access to a line of credit. Users are limited in how much they can charge. They are not required to repay the full amount each month. Interest is added to the balance with only a minimum payment due.

line of credit — An authorized amount of credit given to an individual, business, or institution.

APR (annual percentage rate) — The finance charge a borrower pays on a credit card.

installment credit — A plan in which the borrower makes regular, partial payments of a debt.

grace period — The length of time a customer has to make payment on a credit card account before interest is charged.

minimum payment — The smallest amount that can be paid on a credit card account without incurring a fee for non-payment.

types of credit card accounts

1. Bank card — Examples (Visa, MasterCard)
2. Store card or priority card — Examples (Sears, Home Depot)
3. Travel and entertainment cards — Examples (American Express, Diner's Club)

shopping for a credit card

activity 7-4a

1. How will you use your credit card?
   - pay bill in full each month and avoid interest charges
   - repay bill over time and pay interest charges
2. What are some of the costs and features of credit cards?
   - Type of account
   - How widely card is accepted
   - Annual fee
   - Annual Percentage Rate (APR)
   - Grace period
   - Credit limit
   - Minimum monthly payment
   - Late payment fee
   - Other features
3. How do I compare the costs and features of credit cards?
   - the credit card statement:

A credit card statement provides information such as how and when you've used your credit card, how much you owe, how much interest you're paying to use the card, how much your minimum payment is, and how much credit you have left. Knowing how to read your credit card statement can also help you catch unauthorized charges and/or billing errors.

lesson 7 quiz: credit card features and costs

quiz 7-4

7-5 The student will identify critical actions to take when in financial trouble.

discussion

what should you do if you get into financial trouble?

- Discuss how easily consumers can get into trouble using credit. Do students know of friends or family members who have experienced difficulties? As a class, list some possible causes.
- Talk about the warning signs of financial difficulties. (slide 7-5a)
- Remind students of the responsibilities associated with using credit. Discuss actions a consumer can take when in financial trouble. Explain that most creditors are willing to work with and make adjustments for customers who act responsibly. (slide 7-5b)
- Let students know that there are resources available if they need further assistance with their finances. Describe the debt management services provided by non-profit credit-counseling centers. Warn students to avoid companies that promise to erase a poor credit history and get consumers out of debt quickly and easily. Explain that no one has an "easy fix," but over time, it is possible for consumers to improve their credit records by working hard to pay off their debts. (slide 7-5c)

slide 7-5a

slide 7-5b

slide 7-5c

how you can get in trouble using credit

- Overspending
- Mismanaged budget
- Increased cost of living
- Unemployment
- Illness or disability
- Family emergencies

warning signs of financial difficulties

- You don't know how much you owe.
- You often pay bills late.
- You obtain a new loan to pay old loans.
- You pay only the minimum balance due each month on credit cards and other charge accounts.

- You spend more than 10% of your net income (after paying rent) on loans and credit card payments.
- You would have an immediate financial problem if you lost your job.
- You are spending more than you earn.
- You use savings to pay day-to-day expenses.

first steps to take if you can't pay your bills

1. Cut living expenses. Be realistic about what you can afford.

2. Contact your creditors immediately. Call before you get behind, and ask for a voluntary plan for paying debts.

slide 7-5b

credit counseling

1. National Foundation for Credit Counseling (NFCC)
   - Non-profit financial counseling service
   - Arranges repayment plans that work for both debtor and creditor.
   - Helps you set a realistic budget.
   - Finding the office nearest to you

2. Cooperative Extension Service
   - County-based source of education and information on financial and consumer topics, offering educational programs and/or direct guidance on budgeting and other financial management matters

slide 7-5c

lesson 7 quiz: avoiding financial trouble

quiz 7-5

additional activities for practice and generalization of concepts related to credit

- Invite a bank representative to discuss procedures for applying for a credit card and responsibilities associated with using credit.
- Invite a department store credit manager to discuss procedures for applying for a credit card. Compare with the procedures for obtaining a bank credit card.
- Obtain credit card applications from local department stores that teenagers are likely to frequent. Have students practice completing the forms and reading the credit agreements. Compare interest rates and features of various stores.
- Give students a concrete experience in understanding the concept of debt. Collect rocks of various sizes. Have each rock represent a specific item, purchased on credit (ex. DVD player, new sneakers, a car). Determine an appropriate cost for each purchase and affix the item's name and "price tag" to a designated rock. The size of the rock should correspond to the value of the purchase (the more expensive the item, the heavier the rock). Give each student a mock credit card and a "debt" bag. Allow them to go on a "shopping spree" and "charge" as many purchases as they wish. The only "catch" is, they must carry their rock-laden bags for as long as the "creditor" (you, the teacher) asks them to! Discuss the experience and students' observations afterward (ex. loading a debt bag with many small purchases can "weigh" as much as one or two large ones).
- Take advantage of Internet sites that allow students to personalize their study. For example, using www.bankrate.com, students type in answers about their spending and charging habits to find the best credit card for them.
- Introduce students to the interactive calculator on the Practical Money Skills for Life website. The "Cost of Credit" calculator allows students to find the true cost of their credit card purchases. Have students shop a catalog for items. Using the calculator, students then insert the price of their purchases, a selected credit card APR, and the amount they plan to pay each month.

name: ______________________ date: ______________

lesson 7 quiz: credit knowledge

choose the correct answer.

1. ___c___ **A common advantage of using credit is:**
a. less impulse buying.
b. lower cost for items purchased.
c. ability to obtain items now.
d. lower chance of overspending.

2. ___a___ **You may pay more for an item bought on credit because of:**
a. interest payments.
b. sale prices.
c. debts.
d. financial problems.

3. ___c___ **A common disadvantage of using credit is:**
a. having to carry extra cash.
b. having a record of your purchases.
c. spending more than you should.
d. buying now, paying later.

4. ___b___ **If you use credit, you *should:***
a. run up as much debt as you can.
b. notify the credit company immediately if your credit card is lost.
c. give your credit card number to anyone who asks for it.
d. borrow more than you can repay.

5. ___a___ **If you use credit, you *should not:***
a. give your card number over the phone.
b. pay debts promptly.
c. read and understand the credit contract.
d. tell anyone if your credit card is lost.

name: ______________________ date: ______________

lesson 7 quiz: establishing a credit history

choose the correct answer.

1. __a__ **When you pay all your bills on time, you are showing good:**
   a. character
   b. capital
   c. collateral
   d. capacity
   e. conditions

2. __d__ **A steady job and regular income is referred to as:**
   a. character
   b. capital
   c. collateral
   d. capacity
   e. conditions

3. __d__ **Which one of these would not be used to repay a debt?**
   a. income
   b. owned property
   c. collateral
   d. character references
   e. conditions

Put a check beside the four best ways to build a credit history:

____ always pay in cash.

__x__ establish a steady work record.

__x__ pay all your bills on time.

____ bounce checks in your checking account.

____ use your savings to buy items instead of using credit.

__x__ make regular payments in a savings account.

__x__ apply for a local store credit card and pay regularly.

____ get a co-signer to pay back your loans.

name: ______________________ date: ______________

how much is a safe debt load?

directions

Read each of the following scenarios. How much debt can each person safely carry?

1.

Jessie has a monthly net income of $1,000.

He pays $300 a month for rent.

He pays $80 each month for a credit card bill.

Now, he wants to buy a car.

How much does Jessie have left in his budget for a car payment?

(Hint: His monthly payment should be less than 10% of his monthly net income.)

Answer: *Less than $62 a month*

Work:

2.

Carla has a monthly net income of $450.

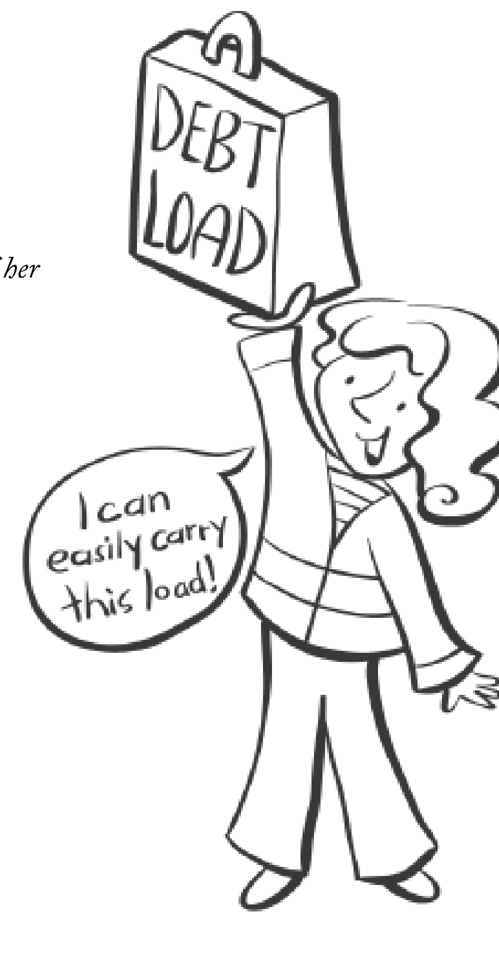
She wants to buy a new bike with a credit card.

What is the largest monthly payment she can make?

(Hint: Her monthly payments should be less than 10% of her monthly net income.)

Answer: *Less than $45 a month*

Work:



how much is a safe debt load? (cont.)

3.

David has a monthly net income of $1,360.

He has a monthly rent payment of $450.

He is paying $116 a month for a student loan.

David would like to buy a new television set using a credit card.

How much can David safely pay each month for his debts?

(Hint: His monthly payments should be less than 10% of his monthly net income.)

Answer: *Less than $79.40 a month*

Work:

4.

Marsha and Michael have a combined monthly net income of $3,500.

They pay $675 a month for rent.

They have an outstanding student loan balance of $6,000.

They owe a balance of $1,000 on a new stereo.

How much more debt can they safely take on?

(Hint: They should not borrow more than 20% of their yearly net income.)

Answer: *$1,400*

Work:

5.

Juanita has a monthly net income of $2,500.

She pays $500 a month for rent.

She pays a car insurance premium of $68.

She also makes a car payment of $167.

Are these payments within Juanita's safe debt load?

(Hint: Her monthly payments should be less than 10% of her monthly net income.)

Answer: *Yes*

Work:

name: ______________________ date: ______________

lesson 7 quiz: credit card features and costs

choose the correct answer.

1. _c_ **Comparing the APR of different credit cards allows you to get the:**
   a. longest grace period.
   b. lowest annual fee.
   c. lowest interest rate.
   d. lowest minimum payment.

2. _b_ **The grace period refers to the time:**
   a. taken to process a credit card application.
   b. for paying an account without an interest charge.
   c. allowed to notify the creditor of a billing error.
   d. used for calculating interest.

3. _d_ **The smallest amount you can pay on a credit card account without paying a late payment fee is called the:**
   a. late payment fee.
   b. credit limit.
   c. annual fee.
   d. minimum payment.

4. _c_ **Which of the following is not important when shopping for a credit card?**
   a. the costs of the card
   b. the features of the card
   c. what the card looks like
   d. how you plan to use the card

5. _a_ **Which of the following is not included on a credit card statement?**
   a. the balance in savings and checking accounts
   b. the previous credit account balance
   c. the names of stores where purchases were made
   d. the new credit account balance

name: ______________________ date: ______________

lesson 7 quiz: avoiding financial trouble

Put a check in front of the five statements about financial trouble that are true.

__x__ A warning sign of financial trouble is not knowing how much you owe.

_____ It is a good idea to get a new loan to pay old loans.

_____ If you have a high-paying job, you can afford to spend more than 20% of your net income on debt maintenance.

__x__ It is a good idea to contact creditors immediately if you begin falling behind in your payments.

_____ A credit repair company can erase a poor credit history quickly.

__x__ The National Foundation for Consumer Credit will help you set up a realistic budget, contact your creditors, and plan future expenses.

__x__ Financial difficulties are commonly caused by overspending.

_____ The National Foundation for Consumer Credit offers customers a quick, easy fix for financial problems.

_____ You should never admit to a creditor that you cannot pay your bills.

__x__ Setting up a realistic budget is a good way to avoid financial trouble.