

Lesson 11

Take Control of Debt: Are You Credit Worthy? Check Your Credit Report

Lesson Description

Students take on the role of lender in the introduction to this lesson as they consider the information that they would require before loaning various items to other people. The Three C's of Credit are introduced as a method of classifying information about borrowers, and the students read a selection and complete a graphic organizer about a borrower's information. After discussing the difference between credit reports and credit scores, students work in pairs to analyze a fictitious credit report. At the conclusion of the lesson, students are asked to create a brochure that describes ways to improve a borrower's credit report.

National Standards in K-12 Personal Finance Education (www.jumpstart.org)

Credit and Debt

Standard 2: Explain the purpose of a credit record and identify borrowers' credit report rights.

Instructional Objectives

Students will:

- Identify information that is contained in and excluded from a credit report.
- Distinguish between a credit report and a credit score.
- Identify consumer actions that improve a credit report.

Time Required

One 50-minute class period

Materials Required

- Copies of the following visuals
 - *Visual 1: Lending Decisions*
 - *Visual 2: Credit Reports*
- Copies of the following handouts for each student
 - *Handout 1: Applying for Credit*
 - *Handout 2: Personal Consumer Credit Report*

Procedure

Building Wealth, pages 19–24, and the **Take Control of Debt** section of the CD-ROM contain information and visuals related to this lesson.

1. Display *Visual 1: Lending Decisions*. Ask students to think about their own willingness to lend these items and to consider information that they would like to know before loaning the items to someone else. Use

the following questions to guide the discussion:

- What information would you want to know before lending the pen, the money or the cell phone to a friend? Do you feel differently about any of the items?

Answers will vary but should include considerations of the value of the item being lent and information about the borrower such as past experience.

- What information would you want to know before lending the pen, the money or the cell phone to someone in this class? Do you feel differently about any of the items? How are these loans different from lending to your friend?

Answers will vary but should once again include consideration of the item's value. However, the lender may or may not have a personal relationship with the borrower.

- What information would you want to know before lending the pen, the money or the cell phone to someone in the school? Do you feel differently about any of the items? How are these loans different from the loans to your friend or classmate?

Answers will vary but in addition to considering the item's value, the lender is increasingly unlikely to lend if the borrower is unknown. Students might suggest that they could talk to a friend of the borrower to get a reference. However, gathering borrower information is difficult.

- What information would you want to know before lending the pen, the money or the cell phone to a stranger? Do you feel differently about any of the items? How are these loans different from the loans to your friend, your classmate or your schoolmate?

Answers will vary but should focus on the difficulty of gathering information about a borrower if something of value is being loaned.

- How is the loan of an inexpensive pen different from the loan of a valuable cell phone?

Answers will vary but should focus on the differing levels of potential loss to the lender.

2. Tell students that banks and other lenders do not have personal knowledge about loan applicants. Information about borrowers generally falls into three categories called the **Three C's of Credit**. While lenders can consider a wide variety of facts, federal laws prohibit the use of certain personal information by a lender.

3. Distribute copies of *Handout 1: Applying for Credit* to each student. Have students work in pairs to complete the graphic organizer using the information in the handout. Discuss responses using the *Suggested Answers* and the information below.

- Capacity – Can you repay the debt?
 - *Employment information* (occupation, length of employment, salary)
 - *Expenses* (number of dependents, obligations such as alimony or child support, housing expenses, payments on other debt)
- Character – Will you repay the debt?
 - *Credit history* (overall debt, frequency of borrowing, on-time payments, debt–income ratios)
 - *Signs of stability* (length of time at present address, own or rent home, length of present employment)
- Collateral – Is the creditor fully protected if you fail to repay?
 - Security for the loan (other means, besides income, to repay the debt)
 - Types of collateral include savings, investments and property

Discuss factors that cannot be considered by lenders. Federal law protects borrowers from discrimination based on a variety of characteristics.

4. Display *Visual 2: Credit Reports* and ask a student to read the three definitions to the class. Review the following points:
 - Anyone who has used credit will have a credit report.
 - The credit report shows everything about a borrower's payment history, including late payments.
 - The information in a credit report is used to create a borrower's credit score, which ranges from under 500 to 800 and above.
 - Banks and other lenders use credit reports and scores to make lending decisions and to set interest rates on loans.
 - Insurance companies, potential landlords, employers and others can consider credit scores.
 - Consumers can request one free copy of their credit report from each of the credit reporting companies annually.
5. Distribute *Handout 2: Personal Consumer Credit Report*. Allow students to work in pairs to answer the questions. Review the suggested answers after students complete the work.

Closure

6. Read the following statements to the class. Ask students to indicate whether each statement would reflect positively or negatively on a person's creditworthiness. Students should give a "thumbs up" to statements that would have a positive impact on a borrower's credit history. A "thumbs down" goes to statements that would have a negative impact.
 - Credit cards are charged to the maximum limit
 - Recently applied for many credit cards to receive free gifts
 - Has changed jobs often and is currently not working
 - Has never filed for bankruptcy
 - History of timely payments
 - Increasing levels of debt
 - Little credit history
 - Low balances on credit lines
 - Maintains a savings and checking account
 - Outstanding debt is large compared to current income
 - Owns a house and is current on the mortgage
 - Pays bills on time
 - Prior loans have been paid in full
 - Steady employment history
7. Tell students that credit reports and credit scores are important in many areas of their financial lives. Other businesses besides lenders rely on this information for decisions. Credit information might be considered by insurance companies that provide home and auto policies, landlords and even potential employers.

Assessment

8. Have students work individually or in pairs to design an informative brochure called *Building Better Credit* that could be used to teach others how to improve their credit report and credit score. Suggestions in the brochure should include information about the Three C's. Additional information for the brochure can be found on the handout *5 Tips for Improving Your Credit Score*, found at <http://www.federalreserve.gov/pubs/creditscore/>.

Student brochures should be assessed by considering the following criteria:

- Is the information in the brochure accurate?
- Is the information in the brochure complete and comprehensive?
- Is the brochure well organized and visually appealing?

For more information on credit scoring, material from the Federal Trade Commission can be found at <http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre24.shtm>.

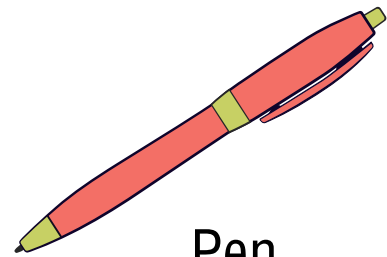
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Visual 1: Lending Decisions

Think about three items



\$5 cash



Pen



Cell Phone

Would you lend any or all of those items to:

- your best friend?
- someone in this class?
- someone in this school?
- someone you do not know at all?

Visual 2: Credit Reports



Credit reporting company: an organization that compiles credit information on individuals and businesses and makes it available for a fee. (Three major credit reporting companies are Equifax, Experian and TransUnion.)

Credit report: a loan and bill payment history, kept by a credit reporting company and used by financial institutions and other potential creditors to determine the likelihood a future debt will be repaid.

Credit score: a number generated by a statistical model that objectively predicts the likelihood that a debt will be repaid on time.

Reviewing your credit report:

Consumers have the right to receive annually a free copy of their credit report from each of the three major credit reporting companies.

Note: The three companies have set up a central website for ordering free reports at www.annualcreditreport.com

Name: _____ Date: _____

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Handout 1: Applying for Credit

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When you're ready to apply for credit, you should know what factors creditors think are important in deciding whether you're creditworthy. You should also know what factors they cannot legally consider in their decisions.

What Law Applies?

The Equal Credit Opportunity Act requires that all credit applicants be considered on the basis of their actual qualifications for credit and not be rejected because of certain personal characteristics.

What Creditors Look For

The Three C's. Creditors look for an ability to repay debt and a willingness to do so—and sometimes for a little extra security to protect their loans. They speak of the three C's of credit: capacity, character and collateral.

- **Capacity.** Can you repay the debt? Creditors ask for employment information: your occupation, how long you've worked and how much you earn. They also want to know your expenses: how many dependents you have, whether you pay alimony or child support and the amount of your other obligations.
- **Character.** Will you repay the debt? Creditors will look at your credit history: how much you owe, how often you borrow, whether you pay bills on time and whether you live within your means. They also look for signs of stability: how long you've lived at your present address, whether you own or rent your home and the length of your present employment.
- **Collateral.** Is the creditor fully protected if you fail to repay? Creditors want to know what assets, other than income, you have that could be used to pay back your loan, such as savings, investments or property. Creditors may require that you provide collateral, assets that you pledge to secure a loan.

Creditors use different combinations of these facts to reach their decisions. Some set unusually high standards; others simply do not make certain kinds of loans. Creditors also use different rating systems. Some rely strictly on their own instinct and experience. Others use a "credit-scoring" or statistical system to predict whether you're a good credit risk. They assign a certain number of points to each of the various characteristics that have proved to be reliable signs that a borrower will repay. Then they rate you on this scale. Different creditors may reach different conclusions based on the same set of facts. One may find you an acceptable risk, whereas another may deny you a loan.

Information the Creditor Cannot Use

The Equal Credit Opportunity Act does not guarantee that you will get credit. You must still pass the creditor's tests of creditworthiness. But the creditor must apply these tests fairly and impartially. The act bars discrimination based on age, gender, marital status, race, color, religion and national origin. The act also bars discrimination because you receive public income, such as veteran's benefits, welfare or social se-

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Handout 1: Applying for Credit

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curity, or because you exercise your rights under federal credit laws, such as filing a billing error notice with a creditor. This protection means that a creditor may not use any of these grounds as a reason to

- discourage you from applying for a loan;
- refuse you a loan if you qualify;
- lend you money on terms different from those granted another person with similar income, expenses, credit history, and collateral;
- close an existing account because of age, gender, marital status, race, color, religion, national origin, receipt of public income or because you exercise your rights under federal credit laws.

Although creditors may not discriminate on the basis of national origin, they may consider your immigration status when making a loan decision.

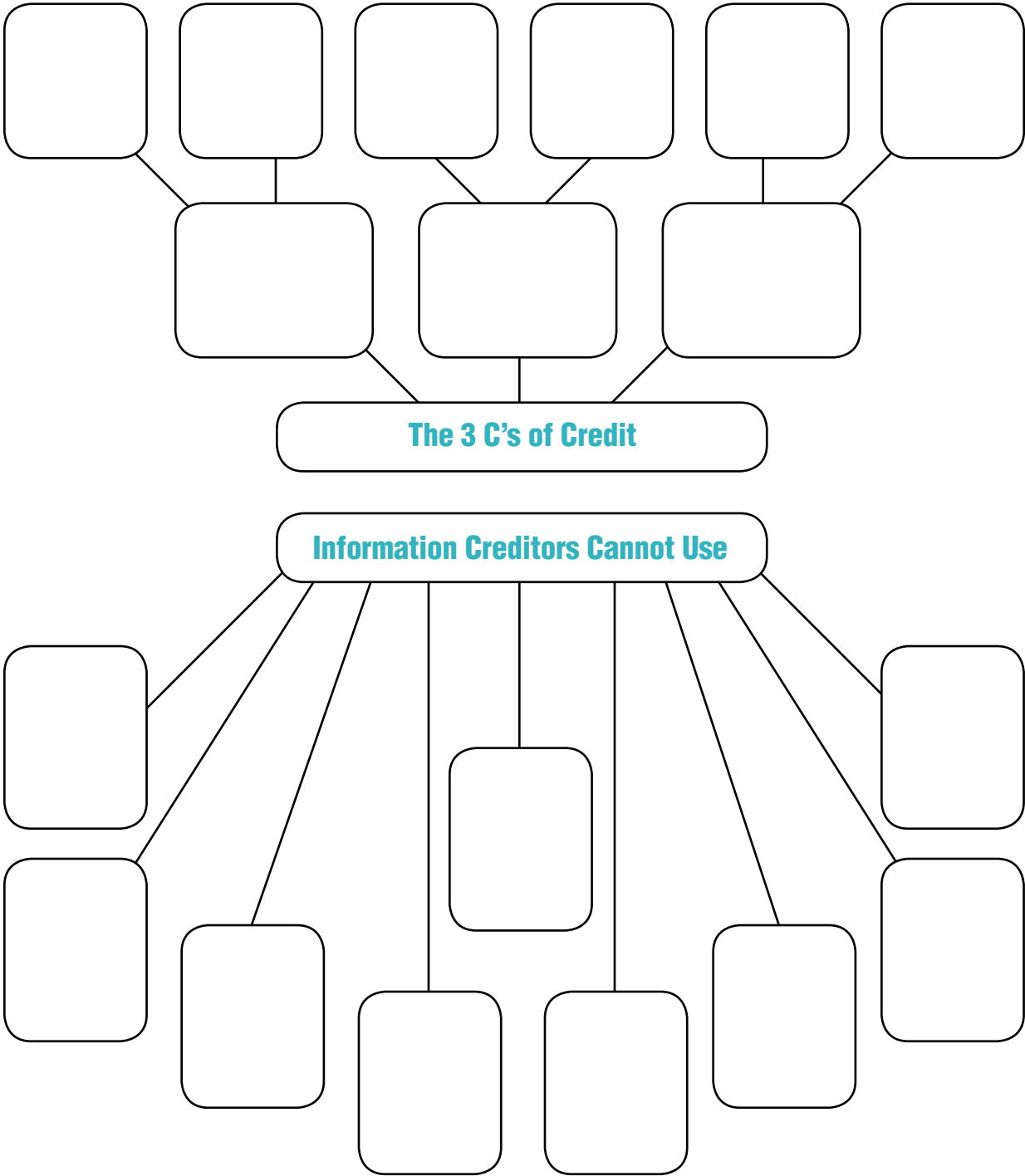
Excerpted from *Consumer Handbook to Credit Protection Laws*, Board of Governors of the Federal Reserve System. Available at www.federalreserve.gov/pubs/consumerhdbk/

Name: _____ Date: _____

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Handout 1: Applying for Credit

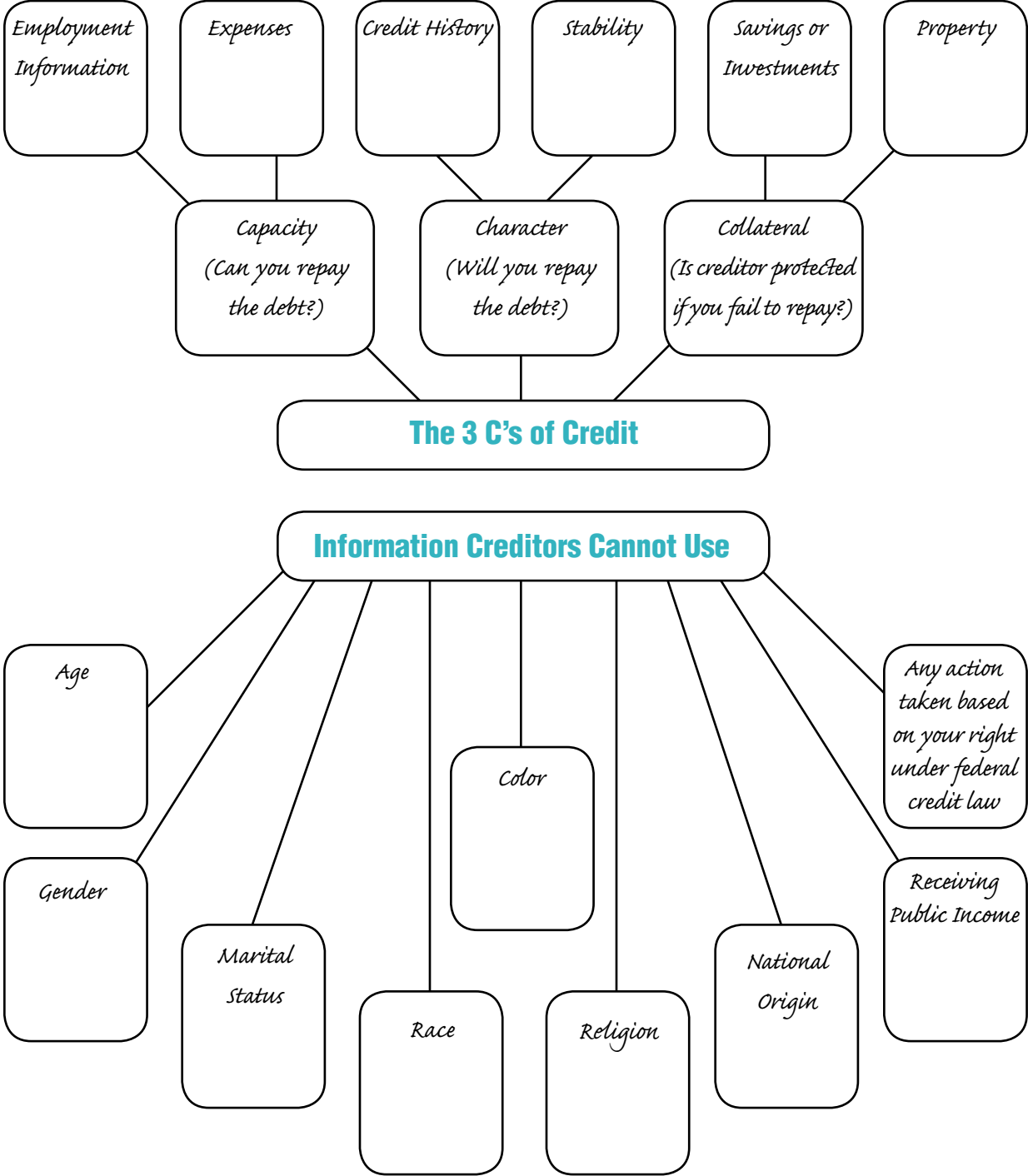
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Handout 1: Applying for Credit

Suggested Answers



Name: _____ Date: _____

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Handout 2: Personal Consumer Credit Report

This section contains the person's name and address, along with the Social Security number and date of birth. It also tells the previous address and employment information.

This section contains publicly available information about legal matters related to credit. It might include judgments, tax liens or bankruptcy history.

This section lists information about each credit account opened in the person's name. It identifies the lender and contains balance and payment information for the loan.

Personal Identification Information

Name 1234 Any Street
Dallas, TX 75000

Social Security #: 123-45-6789
Date of Birth: 07/01/1980

Previous Address 456 Other Rd.
Houston, TX 77000

Employer: ABC, Inc.
Location: Dallas, TX

Public Record Information

Dallas County Clerk
Dallas, TX 75000

Civil Claim
Status: Paid
Amount: \$1,000
Date: 04/01/2005

Credit Account Information

ABC Auto Finance 1000 Exchange Street
San Antonio, TX 78000

Account Number: 123456789
Date Opened: 5/2005
Loan Type: Installment – Auto

Balance	\$7,600
Credit Limit / Original Amount	\$15,000
High Balance	NA
Terms	60 months
Monthly Payment	\$297
Past Due	0

My Bank 5000 Main Street
El Paso, TX 79000

Account Number: 123456789
Date Opened: 8/2000
Loan Type: Revolving credit card

Balance	\$845
Credit Limit / Original Amount	\$3,000
High Balance	\$1,100
Terms	NA
Monthly Payment	\$20
Past Due	0

Name: _____ Date: _____

Gas Card of America Account Number: 123456789
9999 Petroleum Street Date Opened: 2/2004
Fort Worth, TX 76000 Loan Type: Revolving credit card

Balance	\$175
Credit Limit / Original Amount	\$500
High Balance	\$352
Terms	NA
Monthly Payment	\$20
Past Due	0

Account history:
60 days as of 6/2006
30 days as of 5/2006

Recent Credit Inquiries

01/2008 ABC Auto Finance
10/2007 Department Store, Inc.
8/2007 Home Loan Mortgage Company

This section lists information about anyone who has accessed this credit report.

1. What is the total credit limit on the two revolving credit card accounts?
2. What is the person's current debt?
3. Are there any accounts that are past due?
4. Why would the information in Personal Identification Information be important to a lender?
5. Why would the information in Public Record Information be important to a lender?
6. Why would the information in Credit Account Information be important to a lender?
7. Why would the information in Recent Credit Inquiries be important to a lender?

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Handout 2: Personal Consumer Credit Report

Suggested Answers

1. What is the total credit limit on the two revolving credit card accounts?
\$3,500
2. What is the person's current debt?
\$8,620
3. Are there any accounts that are past due?
None
4. Why would the information in Personal Identification Information be important to a lender?
Lenders might use this section to verify residential and employment information from the credit application. The date of birth and the Social Security number allow the lender to match a credit application to the credit report.
5. Why would the information in Public Record Information be important to a lender?
This section could provide important information about a borrower's past credit issues, including such negative items as bankruptcy or tax liens.
6. Why would the information in Credit Account Information be important to a lender?
This section lists information about each credit account opened in the person's name. It identifies the lender and contains balance and payment information for the loan. This information describes the borrower's use of credit and payment history. It can also be used to determine a person's current monthly obligations and total indebtedness.
7. Why would the information in Recent Credit Inquiries be important to a lender?
This section lists information about anyone who has accessed this credit report. Multiple credit inquiries might indicate that other loans could be taken out in the future, thus increasing the borrower's debt/credit ratio.