

Lesson Description

Students complete an activity sheet and discuss the advantages and disadvantages of using credit. Students read a scenario about a young person's use of a credit card and answer some questions regarding repayment. Students learn about credit history, credit reports and credit-reporting agencies.

Concepts

Credit
Credit cards
Credit history
Credit report
Income
Interest

Objectives

Students will:

- Define credit and creditor.
- Define interest.
- Compare the advantages and disadvantages related to using credit.
- Identify the three credit-reporting agencies.
- Explain the importance of maintaining a good credit history.
- Identify features on a credit report.
- Explain the rights and responsibilities related to using credit.

Content Standards

Financial Responsibility and Decision Making: Apply reliable information and systematic decision making to personal financial decisions.

- **Standard 1:** Take responsibility for personal financial decisions.
 - Eighth-grade expectation 1: Identify ways to be a financially responsible young adult.
- **Standard 2:** Find and evaluate financial information from a variety of sources.
 - High school expectation 1: Determine whether financial information is objective, accurate and current.

- **Standard 4:** Make financial decisions by systematically considering alternatives and consequences.
 - Eighth-grade expectation 3: Evaluate the results of a financial decision.
 - High school expectation 6: Give examples of how decisions made today can affect future opportunities.

Credit and Debt: Maintain creditworthiness, borrow at favorable terms and manage debt.

- **Standard 1:** Identify the costs and benefits of various types of credit.
 - Eighth-grade expectation 4: Give examples of “easy access” credit.
 - Eighth-grade expectation 5: Discuss potential consequences of using “easy access” credit.
- **Standard 2:** Explain the purpose of a credit record and identify borrowers’ credit report rights.
 - High school expectation 4: Identify organizations that maintain consumer credit records.
 - High school expectation 7: Discuss ways that a negative credit report can affect a consumer’s financial future.
- **Standard 3:** Describe ways to avoid or correct credit problems.
 - High school expectation 2: List actions that a consumer could take to reduce or better manage excessive debt.

Time Required

60-75 minutes

Materials

- Visual 6.1
- A copy of Visual 6.1 for each student
- A copy of Handouts 6.1, 6.2, 6.4, 6.5 and 6.7 for each student
- A visual of Handout 6.5 for the teacher
- A copy of Handout 6.3—Answer Key, Handout 6.4—Answer Key and Handout 6.7—Answer Key for the teacher
- A copy of Handout 6.6 cut apart to provide strips for 10 students in the class
- Two sheets of notebook paper for each student

Procedures

1. Ask the students if they have ever used credit or heard family members talk about credit. (*Answers will vary.*) Ask the students how they would define credit. (*Answers will vary, but may include using a credit card or borrowing money.*) Define **credit** as the ability to obtain goods or services now while paying for them in the future.
2. Remind the students that credit is not free. People pay a price for using credit—interest. **Interest** is the price of using credit—that is, the price of using someone else’s money. Interest is an expense to the borrower, and it is income to the lender. **Income** is payment received in exchange for resources provided, such as labor. Income payments include wages, rent, profit or interest. If people borrow money from a bank, they pay interest to the bank because they are using money deposited in the bank by others. Those who deposit their money in the bank receive interest as payment for allowing others to use their money. Banks serve as financial intermediaries because they essentially take deposits from savers and lend those deposits to borrowers. For providing this service, banks intend to charge borrowers more in interest than they pay savers and thereby make a profit.
3. Tell the students that in addition to paying interest, people also pay fees for using credit. There may be fees charged to service and maintain credit accounts and other fees if a loan is not paid on time.
4. Point out that there are advantages and disadvantages connected with the use of credit. Distribute a copy of *Handout 6.1: Advantages and Disadvantages of Credit* and *Handout 6.2: Student Answer Guide* to each student. Divide the class into groups. Have each group discuss the statements on Handout 6.2. Have the students fill in the boxes on Handout 6.1 using the statements on Handout 6.2.
5. When the students have completed Handout 6.1, review their answers using the *Handout 6.3: Advantages and Disadvantages of Credit—Answer Key* as a guide.
6. Explain that **credit cards** represent an agreement between a lender—the institution issuing the card—and the cardholder. Credit cards may be used repeatedly to buy products or services or to borrow money on credit. Credit cards are issued by banks, savings and loans, retail stores and other businesses. Ask the students if they have ever received an application for a credit card. (*Answers will vary.*) Point out that when students graduate from high school and when they start college, they begin to receive credit card applications in the mail. It is important to understand some basics about credit cards.
7. Distribute a copy of *Handout 6.4: The Ins and Outs of Credit Cards* to each student. Divide students into pairs. Allow time for pairs to read the scenario. Review the table and answer the questions using *Handout 6.4: The Ins and Outs of Credit Cards—Answer Key*. Discuss the following:

- What was the interest rate that Katarina was charged? (*21.0 percent*)
 - Point out that an interest rate is the price of credit expressed as a percentage. Usually, the interest rate is a percentage of the amount borrowed.
 - Point out that if Katarina had paid only \$10 more each month, she would have made only 31 payments and would have spent only \$605 for the \$500 sound system.
8. Explain that **credit history** is a record of people's payment behavior over time. Distribute a copy of *Handout 6.5: Notes on Credit History* to each student and display a visual of the handout. Tell students that they will use the handout to take notes during the discussion of credit history. Distribute strips from *Handout 6.6: Ideas To Note about Credit History* to 12 students in the class. Call on students to read the statements on the strips one at a time in numerical order. After a student reads a statement, work with the class to summarize and paraphrase the information and write notes on the visual of Handout 6.5. Tell students to record notes on their copy of Handout 6.5.
9. Explain that it is important for people to monitor their credit history to ensure that information reported is accurate and to avoid identify theft. People can monitor their credit history by obtaining and reviewing copies of their credit reports. A credit report is a loan and bill payment history kept by a credit bureau and used by financial institutions and other potential creditors to determine the likelihood that a future debt will be repaid. Ask the students why they think school records, such as transcripts, are important. (*show that you completed high school, college and so forth; affect your ability to move into other programs or jobs*). Tell students that throughout their lives a credit report will be even more important than school records.
10. Point out that a central site, www.annualcreditreport.com, allows people to request a free credit report once every 12 months from each of the nationwide credit reporting companies: Equifax, Experian and TransUnion. Consumers may also request their report by phone.
11. Display *Visual 6.1: Consumer Credit Report* and distribute a copy of the visual to each student. Discuss the following:
- Section "A" of the credit report contains information about the consumer, including name, address and employment.
 - Section "B" contains information about each credit account in the consumer's name, including the name of each creditor. A creditor is a person, financial institution or business that lends money.
 - What are some of the credit accounts recorded on Mikhail's credit report? (*Monster Music, Our Town Bank and Sallie Mae*)

- There are circles, squares and triangles under each account. The ▲ triangles indicate that Mikhail was 30 days late when he made his February and March payments two years ago.
- What do the empty squares □ mean? (*not applicable*)
- Notice that all of the squares are blank under the Sallie Mae loan. This is because it is a student loan, and Mikhail does not have to repay it until he finishes school.
- What do the solid circles ● mean? (*60 days late*)
- Notice that Mikhail has not been 60 days late with any payments.
- What do the solid squares ■ mean? (*90 days late*)
- Notice that Mikhail has not been 90 days late with any payments, either.
- Section “C” contains a list of publicly available information about legal matters affecting the consumer’s credit. There is nothing listed here in Mikhail’s report. If he had filed for bankruptcy, that information would have appeared in section C.
- Section “D” contains a list of anyone who has inquired about the consumer’s credit history. Creditors inquire about a consumer’s credit history before granting the consumer credit. Mikhail’s creditors are listed in this section.
- A landlord will inquire about a consumer’s credit before renting the consumer an apartment or house. This inquiry would appear here, too.
- An employer may inquire about a potential employee’s credit history. That inquiry will appear on the report, too.

12. Remind students that even they should be concerned about their credit history. Discuss the following key principles and steps to establish and maintain a good credit history.

- Establish a credit history.
 - Open a bank account.
 - Purchase a cell phone contract and pay it on time and in full each month.
 - Make car payments and car insurance payments on time.
 - Pay all bills on time to avoid expensive late fees and notes on your credit report.
 - Don’t open too many credit card accounts. Information on every credit card appears on your credit report.
- Monitor your credit usage.
 - Check your monthly credit card statements to make sure that you have not been charged for something that you did not purchase. If you have, call the credit card company immediately.
 - Notice whether or not you are being charged interest on credit cards and create a plan to pay off your cards in full each month.

Closure

13. Review the key points of the lesson by discussing the following.
 - What is credit? (*the ability to obtain goods and services now while paying for them in the future*)
 - Who are creditors? (*a person, financial institution or business that lends money*)
 - What is interest? (*the price of using someone else's money, the price of credit*)
 - What is income? (*payment received in exchange for resources provided, such as the wages received for labor*)
 - What are some of the advantages of using credit? (*not carrying cash, being able to pay for emergencies, using goods and services while paying for them later, purchasing goods or services you couldn't otherwise afford, convenience*)
 - What are some of the disadvantages of using credit? (*possible identity theft, can cost more than paying in cash, poor use can limit future spending and abuse of credit can contribute to a bad credit report*)
 - Why is it best to pay your credit card balance in full every month? (*to avoid paying large amounts of interest*)
 - If you can't pay the entire balance each month, what should you do? (*make the largest payment possible to avoid larger interest payments*)
 - What is a credit history? (*a record of a person's payment activity or behavior*)
 - Why is it important to maintain and establish good credit history? (*Credit history affects almost every aspect of your life. A poor credit history results in higher interest charges in the future and difficulty obtaining credit in the future. A poor credit history can prevent you from renting an apartment, opening a bank account or even getting a job.*)
 - What is a credit report? (*a loan and bill payment history kept by a credit bureau and used by financial institutions and other potential creditors to determine the likelihood that a future debt will be repaid*)
 - What is a credit-reporting bureau? (*an organization that compiles credit information on individuals and makes it available to businesses for a fee*)
 - What are the three credit-reporting bureaus? (*Equifax, Experian and TransUnion*)

Assessment

14. Distribute a copy *Handout 6.7: Credit Assessment* to each student. Review the directions and allow time for students to work. Use *Handout 6.7: Credit Assessment—Answer Key* to review students' work.

Handout 6.1: Advantages and Disadvantages of Credit

The Advantages

1. _____
2. _____
3. _____
4. _____
5. _____

The Disadvantages

1. _____
2. _____
3. _____
4. _____
5. _____

Handout 6.2: Student Answer Guide

Directions: Use the following statements to fill in the boxes on Handout 6.1. Each statement may be used only once.

- possible identity theft
- not having to carry cash
- being able to pay for emergencies
- can cost more than paying in cash
- having goods and services while paying for them later
- purchasing goods or services you couldn't otherwise afford
- if not properly used, may limit future spending
- convenience
- Poor use can affect your ability to get credit in the future.
- It is easy to spend even though you don't have enough money to pay for the item.

Handout 6.3: Advantages and Disadvantages of Credit—Answer Key

The Advantages

1. not having to carry cash

2. being able to pay for emergencies

3. having goods and services while paying for them later

4. purchasing goods or services you couldn't otherwise afford

5. convenience

The Disadvantages

1. possible identity theft

2. can cost more than paying in cash

3. Poor use can affect your ability to get credit in the future.

4. if not properly used, may limit future spending

5. It is easy to spend even though you don't have money to pay for the item.

Handout 6.4: The Ins and Outs of Credit Cards

Directions: Read the information below. Work with your partner to review the table below and to answer the questions on the next page.

Katarina Smavern is 18 and wants a new sound system. The price of the sound system is \$500. She doesn't have enough money saved to buy the sound system. Her friend told her about a credit-card promotion at a local electronics store. If Katarina opens an account with the store, she will be able to buy the sound system and take it home with her. She is so excited that she barely notices that she will be charged a 21 percent interest rate. She thinks to herself, "I have a job now; so, I'll be able to pay this off in no time, which means the interest rate doesn't really matter. The minimum monthly payment is not very much."

Purchase made on Jan. 24, 2008	
Sound system with Katarina's credit card	\$500.00
Katarina pays only the minimum payment in month 1	-25.00*
Charges for month 1: (grace period)	0
Amount owed in month 2	\$475.00
Katarina pays only the minimum payment in month 2	-23.75*
Charges for month 2: $21.0\% \times (475/12) =$	+8.31
Amount outstanding on card	\$459.56
Amount owed in month 3	\$459.56
Katarina pays only the minimum payment in month 3	-22.98*
Charges for month 3: $21.0\% \times (459.56/12) =$	+ 8.04
Amount outstanding on card	\$444.62
Amount outstanding on card at the end of three-month period	\$444.62
Amount repaid ($\$25.00 + \$23.75 + \$22.98$)	\$71.73
Amount by which debt was actually reduced ($\$500.00 - \444.62)	\$55.38
Amount paid to credit card company in interest charges ($\$8.31 + \8.04)	\$16.35

* As the balance owed on a credit card changes, the minimum monthly payment changes. In this case, the balance is becoming slightly smaller; so, the minimum monthly payment is slightly less.

If Katarina continues to make only the minimum payments, she will have to make payments for 52 months and will spend \$697.

1. Once she has paid off the sound system, how much interest will Katarina have paid?
2. If she is 18 when she buys the sound system, how old will she be when the system is paid off if she makes only the minimum payments?
3. What could Katarina have done with the money she paid in interest on the sound system?
4. What could Katarina have done to reduce the amount of interest she paid?
5. What could Katarina have done instead of using a credit card to purchase the sound system?
6. Was making the minimum payment each month on the credit card a smart way for Katarina to handle her credit?

Handout 6.4: The Ins and Outs of Credit Cards—Answer Key

Directions: Read the information below. Work with your partner to review the table below and to answer the questions on the next page.

Katarina Smavern is 18 and wants a new sound system. The price of the sound system is \$500. She doesn't have enough money saved to buy the sound system. Her friend told her about a credit-card promotion at a local electronics store. If Katarina opens an account with the store, she will be able to buy the sound system and take it home with her. She is so excited that she barely notices that she will be charged a 21 percent interest rate. She thinks to herself, "I have a job now; so, I'll be able to pay this off in no time, which means the interest rate doesn't really matter. The minimum monthly payment is not very much."

Purchase made on Jan. 24, 2008	
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Charges for month 2: $21.0\% \times (475/12) =$	+8.31
Amount outstanding on card	\$459.56
Amount owed in month 3	\$459.56
Katarina pays only the minimum payment in month 3	-22.98*
Charges for month 3: $21.0\% \times (459.56/12) =$	+ 8.04
Amount outstanding on card	\$444.62
Amount outstanding on card at the end of three-month period	\$444.62
Amount repaid ($\$25.00 + \$23.75 + \$22.98$)	\$71.73
Amount by which debt was actually reduced ($500.00 - 444.62$)	\$55.38
Amount paid to credit card company in interest charges ($\$8.31 + \8.04)	\$16.35

* As the balance owed on a credit card changes, the minimum monthly payment changes. In this case, the balance is becoming slightly smaller; so, the minimum monthly payment is slightly less.

If Katarina continues to make only the minimum payments, she will have to make payments for 52 months and will spend \$697.

Handout 6.4: The Ins and Outs of Credit Cards—Answer Key—Cont.

1. Once she has paid off the sound system, how much interest will Katarina have paid? $\$697 - \$500 = \$197$
2. If she is 18 when she buys the sound system, how old will she be when the system is paid off if she makes only the minimum payments?
52 months = 4 years and 4 months. 18 years + 4 years = 22 years
3. What could Katarina have done with the money she paid in interest on the sound system? *Answers will vary, but could include pay car insurance, save money for college expense, etc.*
4. What could Katarina have done to reduce the amount of interest she paid?
Katarina could have paid more than the minimum payment.
5. What could Katarina have done instead of using a credit card to purchase the sound system? *She could have waited until she saved \$500 or bought a less expensive stereo for which she was able to pay cash.*
6. Was making the minimum payment each month on the credit card a smart way for Katarina to handle her credit? *No, because she paid so much in interest.*

Handout 6.5: Notes on Credit History

1. What is credit history?
2. What information does a credit history contain?
3. Why is credit history important?
4. How does credit history affect a person's life?
5. Why should everyone, even teenagers, be concerned about their credit history?
6. What is a credit report?
7. What are the names of the three credit reporting agencies?

Handout 6.6: Ideas to Note about Credit History

Directions: Cut the strips apart and distribute a strip to 12 students in your class.

1. Credit history is a report of a person's payment activity over time. A person's credit history is a vital part of a credit review process. When a person applies for loans or credit cards, the lender checks the borrower's credit history. A person's ability to get credit depends to a great extent on the person's credit history.
2. A credit history contains information such as where you live, where you work and the type of credit you already have, as well as outstanding debt information.
3. A credit history reports credit problems, such as past-due payments or accounts turned over to a collection agency.
4. A bill that remains unpaid for a period of time is often turned over to a collection agency. The agency may call the borrower constantly in an attempt to obtain payment. If the account is for a car loan, the car may be repossessed.
5. Credit history affects all aspects of your life including your ability to open a bank account, buy a car, get a cell phone, obtain a credit card or rent an apartment.
6. Credit history may affect your ability to obtain a job. Many employers check applicants' credit history prior to hiring.
7. Credit history may affect the price you pay for car insurance. Insurance companies check credit history because they think there is a correlation between risky financial behavior and risky driving behavior.
8. If you do not demonstrate the ability and willingness to repay what you have borrowed in the past, your ability to obtain credit in the future will be limited. And the cost of future credit may be higher. You may have to pay a higher interest rate because you are considered a risky borrower.
9. Even teenagers should be concerned about their credit history because it will affect their ability to rent an apartment, buy a car or even obtain a cell phone contract.
10. Another reason to be concerned about credit history is identity theft. Identity theft occurs when someone uses your name, Social Security number, date of birth or other identifying information, without authority, to commit fraud.
11. A credit report is a loan and bill payment history kept by a credit bureau and used by financial institutions and other potential creditors to determine the likelihood a future debt will be repaid.
12. Equifax, Experian and TransUnion are the three credit reporting companies. Consumers can request their report by phone or through the web site www.annualcreditreport.com.

Handout 6.7: Credit Assessment

Directions: Read the scenario below and answer the questions that follow.

Your friend Todd is a college freshman. Last week, there was a credit card company on campus in the Student Activities Building distributing credit card applications. Students who completed an application received a T-shirt and a frisbee. Todd thought this was terrific and completed the credit card application. He is excited because he thinks that he will have “free money”—he’ll be able to buy whatever he wants whenever he wants and won’t have to worry about paying. Todd’s roommate told Todd to get a copy of his credit report and review it. Todd doesn’t know what a credit report is. He comments to you, “I am already getting credit. Why do I need to look at some report?”

1. What would you tell Todd about the advantages and disadvantages of using credit cards?

2. What would you tell Todd about his comment that he will have “free money”?

3. What would you tell Todd about the importance of getting and reviewing his credit report?

Handout 6.7: Credit Assessment—Answer Key

Directions: Read the scenario below and answer the questions that follow.

Your friend Todd is a college freshman. Last week, there was a credit card company on campus in the Student Activities Building distributing credit card applications. Students who completed an application received a T-shirt and a frisbee. Todd thought this was terrific and completed the credit card application. He is excited because he thinks that he will have “free money”—he’ll be able to buy whatever he wants whenever he wants and won’t have to worry about paying. Todd’s roommate told Todd to get a copy of his credit report and review it. Todd doesn’t know what a credit report is. He comments to you, “I am already getting credit. Why do I need to look at some report?”

1. What would you tell Todd about the advantages and disadvantages of using credit cards? *There are many advantages to using credit. It is convenient, you don't have to carry lots of cash, you have a record of purchases, and you can buy things today and pay for them later. However, there are disadvantages, too. Using credit may make it easier for someone to steal your identity. And, if you don't pay on time and pay at least the minimum balance, you can hurt your potential for obtaining credit in the future.*
2. What would you tell Todd about his comment that he will have “free money”? *Credit cards aren't free money. There are costs to using credit—interest payments, fees and the inability to buy something you want in the future. If you don't pay the entire balance each month on time, you will be charged interest and fees.*
3. What would you tell Todd about the importance of getting and reviewing his credit report? *A credit report is a loan and bill payment history kept by a credit bureau. A credit report affects people's ability to rent an apartment, buy a home, obtain additional credit and, in some cases, obtain a job. People should obtain a copy of their credit report each year to determine if the information recorded there is accurate and to protect themselves against identify theft.*