

Lesson Description

Students discuss key terms related to credit and learn how creditors use capacity, character and collateral as criteria for making loans. Students learn about credit rights and responsibilities. Groups use role-play scenarios in order to identify and discuss the rights and responsibilities of using credit.

Concepts

Capacity
Character
Collateral
Credit
Creditor
Credit responsibilities
Credit rights
Interest

Objectives

Students will:

- Define credit and creditor.
- Define interest.
- Identify and describe criteria lenders use to make loans.
- 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.

Time Required

45-60 minutes

Materials

- Visual 7.1
- A copy of Handouts 7.1, 7.2, 7.4 and 7.5 for each student
- Copies of Handout 7.3 cut apart to provide scenario cards for members of each group
- A copy of Handout 7.4—Answer Key for the teacher
- A sheet of notebook paper for each student

Procedures

1. Define **credit** as the ability to obtain goods or services now while paying for them in the future. Explain that the ability to have and use credit is a privilege earned by exhibiting behaviors that are related to some broad characteristics that creditors consider when making lending decisions—character, capacity and collateral. Ask the students what they think these terms mean. (*Answers will vary.*)
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. If people borrow money from a bank, they pay interest to the bank because they are using the 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.
3. Tell the students that, in addition to 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. Tell the students that when they apply for credit, the **creditor**, i.e., the person, financial institution or business that lends the money, will look at different types of information about the borrower. Often creditors review information to determine how well a borrower satisfies the three C's of credit. These are criteria that the creditor uses to evaluate potential borrowers: **Capacity, Character and Collateral**. Display *Visual 7.1: The 3 C's of Credit*. Explain that the creditor is interested in the answers to the following three questions:

- **Capacity** – Does the borrower have the ability to repay the loan?
Factors that affect a borrower's ability to repay the loan include how much money the borrower makes, how long the borrower has been at his or her current job and how much debt the borrower already has relative to income.
- **Character** – Will the borrower repay the loan?
The primary factor that affects character is the borrower's past bill-paying history. The creditor wants to know if the borrower has paid his/her bills and if he/she has paid them on time.
- **Collateral** – Is there a financial asset or a piece of property that a creditor can take if the borrower fails to repay the loan? Collateral provides protection for the creditor if the borrower fails to repay the loan. For example, if a borrower fails to repay a car loan, the creditor can repossess the car. The car is collateral for a car loan.

5. Remind students that people earn the privilege of using credit and that this privilege is based to a great extent on their character, capacity and collateral. Consumers should be aware of another key factor, though—with this privilege comes consumer credit rights and responsibilities. **Credit rights** refer to the protections put in place by law to help people obtain and maintain credit. **Credit responsibilities** are the actions or behaviors in which people should engage when they use credit. Distribute a copy of *Handout 7.1: Your Credit Rights* and *Handout 7.2: Your Credit Responsibilities* to each student. Review the statements on the handouts with the students.
6. Tell the students that they are going to be involved in a role-play activity. They are going to play the part either of a person seeking credit or of someone who is providing credit, i.e., a creditor.
7. Divide the class into four groups. Distribute scenario cards from *Handout 7.3: Role-Play Scenarios* to each group member. Distribute Scenario 1 cards to group one, Scenario 2 cards to group two, and so on. Tell each group member to read the scenario silently. Refer students to Handout 7.1 and Handout 7.2. Have the students discuss which rights or responsibilities could be demonstrated in their group's role-play scenario.
8. Distribute one sheet of notebook paper to each student and instruct students to divide the sheet into two columns: one labeled "Rights" and the other "Responsibilities." Tell each student to list the rights and/or responsibilities that should apply to the people described in the scenarios. For example, if a person in a scenario accepts a credit offer without comparing it with other offers and without knowing the interest rate and fees associated with that card, the students should list on their sheet the guidelines from the credit responsibilities list that apply to that situation.
9. Tell each group to consider how its scenario could be transformed into a short skit that group members can perform in front of the class. Have each group select two rights, two responsibilities or a combination of a right and a responsibility from the

group member's lists. Tell the students to develop their skit and be prepared to perform it using the scenario as a guide. Remind group members that they will have to explain which responsibilities persons in their skit should have adhered to and which rights persons in their skit should have been aware of.

10. Explain that all students will serve as the audience for all skits except their own. Explain that each member of the audience will be responsible for completing a handout related to each skit. (Note to teachers: The skits will be conducted as an assessment activity.)

Closure

11. 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? (*people, financial institutions or businesses that lend money*)
 - What is interest? (*the price of using someone else's money, the price of credit, a fee for the use of money over time*)
 - What is capacity? (*the borrower's ability to repay a debt*)
 - What are factors that affect a borrower's capacity? (*level of income, length of time on the job, how much debt the borrower has relative to income*)
 - What is character? (*the borrower's willingness to repay the debt and the borrower's reputation for paying bills and debts based on past behavior*)
 - What is collateral? (*an asset the creditor can take if the borrower doesn't repay the debt*)
 - If you have a car loan, what serves as collateral? (*the car*)
 - What are some of the rights we have when we use credit? (*Use Handout 7.1: Your Credit Rights to review the various rights.*)
 - What are some of the responsibilities we have as we use credit? (*Use Handout 7.2: Your Credit Responsibilities to review the responsibilities.*)

Assessment

12. Distribute *Handout 7.4: Student Role-Play Tally Sheet* to each student. Tell the students that they should use the handout to record which responsibilities persons in their skit should have adhered to and which rights persons in their skit should have been aware of. Use the following steps:

- As you watch and listen to each skit, mark the tally sheet to indicate which rights or responsibilities are related to each skit by entering the group number on the line in front of the right or responsibility. More than one group number may be listed on any line.
 - Because each skit is supposed to emphasize more than one right or responsibility, you will mark more than one right or responsibility for each group performance.
13. Have each group perform its skit while the students in the audience mark their tally sheets.
 14. After all of the skits have been performed and tallies recorded by students in the audience, ask for volunteers from groups one, two and three to read the rights and responsibilities that they marked for group number four. Have the students explain why they marked those statements.
 15. Have a volunteer from group four tell the class what rights and responsibilities the group was trying to illustrate in the skit and explain why.
 16. Repeat procedures 13 and 14 until all group performances have been discussed. Suggested answers for each skit are provided on *Handout 7.4: Student Role-Play Tally Sheet—Answer Key*.
 17. Distribute *Handout 7.5: 3C's Assessment* to each student. Review the directions with the students and have them complete the handout. Have them turn in the handout. Correct the form and return to the students. You may wish to review Procedure #4 when you discuss their answers. Below is the answer key for Handout 7.5:

1. CH

2. CH

3. CA

4. CO

5. CH

Visual 7.1: The 3 C'S of Credit

CAPACITY

Refers to the ability of the borrower to repay the loan

CHARACTER

Refers to the willingness of the borrower to repay the loan

COLLATERAL

Refers to a financial asset such as savings or stocks or a purchased asset that the lender can seize if the borrower fails to repay the debt

Handout 7.1: Your Credit Rights

- You have the right to see your personal information on credit reports.
- Organizations that use credit reports are required to help you understand the report.
- You have the right to have errors in credit reports corrected.
- You have the right to know why you were denied credit. If you are denied credit because of something in your credit report, the lender must give you the name, address and telephone number of the credit bureau that provided the credit report.
- You have the right to know who has requested information about your credit history.
- Creditors cannot make decisions based on sex, national origin, marital status, color, race or age, nor can they ask for this information.
- Neither the length of the loan, i.e., the term, nor the interest rate may be changed for a fixed-rate loan.
- Lenders must notify you within 30 days of their decision to make a loan to you or not.

SOURCE: *What Your Credit Report Says about You and Your Credit Rating*, Federal Reserve Bank of Philadelphia

Handout 7.2: Your Credit Responsibilities

- Pay your bills on time.
- Pay off your credit card balances in full each month.
- Compare offers for similar types of credit. For example, compare different credit card offers.
- Make informed choices about credit usage.
- Keep your receipts for purchases.
- Check monthly statements to make sure charges are correct.
- Know how much you can afford to spend.
- Understand that if a deal sounds too good to be true, it probably is.
- When you borrow money, know what you're agreeing to.
- Make certain that you know the interest rate and fees you are paying for a loan and the interest rate and fees associated with any credit card for which you apply.
- Notify credit card companies and financial institutions immediately when credit cards, debit cards or checks are lost or stolen.
- Don't ignore credit problems. Much of your credit history can remain on your credit report for seven years or more.

SOURCE: *What Your Credit Report Says about You and Your Credit Rating*, Federal Reserve Bank of Philadelphia

Handout 7.3: Role-Play Scenarios

Scenario 1

Alissa recently graduated from high school. She received cash gifts totaling \$500 from friends and relatives. She decided to put that money in a savings account at the bank. She also took a job at a local athletic shoe store. She read an ad in the local newspaper about a sound system for her car for \$850. It was a great system and at an even greater price! Her friend told her about a wonderful credit card offer at the electronics store. When Alissa arrived at the electronics store a salesperson told her that if she opened an account that day, she could have the system installed and drive away with some great sound. Alissa was very excited and said to herself, "I have a great job now. I'll be able to pay this off in no time, which means the interest rate doesn't really matter."

Scenario 2

Darryl went to visit Arena Used Cars because he had his eye on a black 2003 Ford Mustang on Arena's lot. Darryl met a salesman, Nathan, at the car lot. Darryl had spoken to Nathan several days before on the phone. Darryl told Nathan he didn't have the cash to pay for the car but would like to buy it on credit. Nathan said that he could work out a plan that would be just perfect for Darryl. All Darryl had to do was fill out a credit application. Darryl filled out the application and gave it to Nathan. Nathan took the application and said that he would be back in a few minutes. After a short time, Nathan returned with some bad news: Arena Used Cars could not extend any credit to Darryl. Darryl asked why and was told that it just wasn't possible to grant him credit, but Nathan wouldn't provide any specific reasons.

Scenario 3

Max used his credit card to pay for some birthday gifts for his girlfriend. One night when he stopped at the local gas station to get gas for a date later in the evening, he noticed his credit card was gone. He called the credit card company's toll-free number and talked to a customer service representative named Susan. He was told he would have to pay a fee to get a new card. He told her he was afraid someone might have used the card. She asked him if he had receipts for his recent transactions. He told her he was just not good at keeping all of those little slips of paper. She suggested he check his recent credit card statement. Max responded, "I'm not sure where it is. My place is a mess."

Scenario 4

Amanda doesn't remember asking for a credit card when she opened a checking account before starting her freshman year at the local university. Yet two weeks after establishing the account, a Visa card arrived in her mailbox, accompanied by reams of fine print. She didn't read the materials. Instead, she called her father and said, "I have a credit card, I haven't used it, but I'm not afraid to. I just need to know whether there is an interest charge." Her father explained the advantages and disadvantages of using credit cards.

Handout 7.4: Student Role-Play Tally Sheet

Directions: Place the group number or numbers on the line next to rights and responsibilities you identified for each skit. Different groups' skits may represent the same rights or responsibilities.

Credit Rights

_____ You have the right to see your personal information on credit reports.

_____ Organizations that use credit reports are required to help you understand the report.

_____ You have the right to have errors in credit reports corrected.

_____ You have the right to know why you were denied credit. If you are denied credit because of something in your credit report, the lender must give you the name, address and telephone number of the credit bureau that provided the credit report.

_____ You have the right to know who has requested information about your credit history.

_____ Creditors cannot make decisions based on sex, national origin, marital status, color, race or age, nor can they ask for this information.

_____ Neither the length of the loan, i.e., the term, nor the interest rate may be changed for a fixed-rate loan.

_____ Lenders must notify you within 30 days of their decision to make a loan to you or not.

Handout 7.4: Student Role-Play Tally Sheet—Cont.

Credit Responsibilities

- _____ Pay your bills on time.
- _____ Pay off your credit card balances in full each month.
- _____ Compare offers for similar types of credit. For example, compare different credit card offers.
- _____ Make informed, reasonable choices about credit usage.
- _____ Keep your receipts for purchases.
- _____ Check monthly statements to make sure charges are correct.
- _____ Know how much you can afford to spend.
- _____ Understand that if a deal sounds too good to be true, it probably is.
- _____ When you borrow money, know what you're agreeing to.
- _____ Make certain that you know the interest rate and fees you are paying for a loan and the interest rate and fees associated with any credit card for which you apply.
- _____ Notify credit card companies and financial institutions immediately when credit cards, debit cards or checks are lost or stolen.
- _____ Don't ignore credit problems. Much of your credit history can remain on your credit report for seven years or more.

Handout 7.4: Student Role-Play Tally Sheet—Answer Key

Directions: Place the group number or numbers on the line next to rights and responsibilities you identified for each skits. Different groups' skits may represent the same rights or responsibilities.

Credit Rights

_____ You have the right to see your personal information on credit reports.

_____ Organizations that use credit reports are required to help you understand the report.

_____ You have the right to have errors in credit reports corrected.

2 _____ You have the right to know why you were denied credit. If you are denied credit because of something in your credit report, the lender must give you the name, address and telephone number of the credit bureau that provided the credit report.

_____ You have the right to know who has requested information about your credit history.

_____ Creditors cannot make decisions based on sex, national origin, marital status, color, race or age, nor can they ask for this information.

_____ Neither the length of the loan, i.e., the term, nor the interest rate may be changed for a fixed-rate loan.

_____ Lenders must notify you within 30 days of their decision to make a loan to you or not.

Handout 7.4: Student Role-Play Tally Sheet—Answer Key—Cont.

Credit Responsibilities

_____ Pay your bills on time.

_____ Pay off your credit card balances in full each month.

1, 2, 4 _____ Compare offers for similar types of credit. For example, compare different credit card offers.

_____ Make informed, reasonable choices about credit usage.

3 _____ Keep your receipts for purchases.

_____ Check monthly statements to make sure charges are correct.

_____ Know how much you can afford to spend.

_____ Understand that if a deal sounds too good to be true, it probably is.

_____ When you borrow money, know what you're agreeing to.

1, 4 _____ Make certain that you know the interest rate and fees you are paying for a loan and the interest rate and fees associated with any credit card for which you apply.

_____ Notify credit card companies and financial institutions immediately when credit cards, debit cards or checks are lost or stolen.

_____ Don't ignore credit problems. Much of your credit history can remain on your credit report for seven years or more.

Handout 7.5: 3C's Assessment

Directions: Place the letters **CO** for Collateral, **CA** for Capacity and **CH** for Character in front of the statement which best represents that criteria.

1. _____ Angela is very willing to work and keep her business running. Even though January and February were difficult months because of the weather, she kept her credit-card payments current.
2. _____ Jordan contacted Equifax Credit Bureau to request a copy of her credit report to make sure that it shows that she always pays her bills and pays them on time.
3. _____ Fred owns a very successful motorcycle repair shop in the city. The first year was a struggle, but now each month he is earning a profit.
4. _____ Franklin owns a small house that he received in his mom's will when she passed away. He wants to borrow some money to put a new roof on the 20-year-old home.
5. _____ Enrique, who works for Earth Bank, reviewed Barbara's loan application and saw that she had borrowed money from a local bank and an out-of-state bank and had paid off both of the loans. He called the local bank to verify the information with its loan officer.