



## Lesson Four

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### Credit



Consumers may use credit frequently, but many struggle to manage it wisely. To optimize credit and make sound financial decisions, students need to: understand their credit; assess their credit scores; and manage their budget.

For related links and resources on this lesson, visit:  
**[practicalmoneyskills.com/college/4](http://practicalmoneyskills.com/college/4)**

## overview

In today's world, credit is integrated into everyday life. From renting a car to reserving an airline ticket or hotel room, credit cards have become a necessary convenience. However, using credit wisely is critical to building a solid credit history and maintaining fiscal fitness. While most students have a general idea about the advantages and disadvantages of credit, this lesson provides an opportunity to discuss these issues in more detail.

Young people and others commonly wonder how to establish credit. In this chapter, students will learn about the creditworthiness factors of character, capital, and capacity in order to help them gain an understanding of how to start and maintain a credit record.

This chapter will also introduce students to different types of credit: single-payment credit, installment credit, and revolving credit. Finally, this section will educate students about how much credit might be appropriate for their situation.

## goals

Provide an awareness and understanding of what credit is and the rights and responsibilities of using credit.

## lesson objectives

- Understand some of the reasons for getting credit
- Understand some of the advantages and disadvantages of using credit
- Understand why banks issue credit
- List and understand some of your rights and responsibilities as a consumer
- Understand creditworthiness
- List some of the reasons for establishing a credit history and understand how a credit history is built
- List and understand the three principal types of consumer credit
- Determine a safe debt load



## presentation slides

- 4-A** advantages and disadvantages of using credit
- 4-B** the three Cs
- 4-C** your responsibilities
- 4-D** your rights
- 4-E** building a credit history
- 4-F** a credit report

**4-G** manner of payment codes

**4-H** types and sources of credit

**4-I** how much can you afford (the 20-10 rule)

### **student activities**

**4-1** Should They Use Credit?

**4-2** Test Your Credit Knowledge

- Distribute the test and give students approximately 15 minutes to complete it. When they are finished, discuss their answers. Reinforce facts and concepts of credit.




**4-3** How Much Can They Safely Carry?

- Students plan and calculate safe debt loads for other consumers.
- Distribute the exercise, giving students about 20 minutes to complete it. When they are finished, discuss the answers, writing their calculations on the board.

**4-4** Lesson Four Quiz

**For more information, please refer to the Appendix.**

Learning activities appropriate to varied target audiences for lesson four

|                      |  |  |  |
|----------------------|---|--|---|
| <b>activity</b>      | <b>teenagers<br/>(14 18)</b>  | <b>young adults<br/>(19 25)</b>  | <b>adults<br/>(26+)</b>   |
| Student Activity 4-1 | ●   | ●  |   |
| Web Activity         | ●   | ●  | ●   |
| Oral Presentation    | ●   | ●  |   |
| Student Activity 4-2 | ●   | ●  | ●   |
| Student Activity 4-3 |   | ●  | ●   |
| Lesson Four Quiz 4-4 | ●   | ●  | ●   |

## what is consumer credit?

1. Definition
2. Brief history



discussion

## why get credit?

1. Establish a credit history
2. Advantages of having credit
  - Buying needed or wanted services and goods using anticipated future income
  - Having a record of purchases
  - Consolidating bills
3. Disadvantages of having credit
  - Interest payments
  - Overspending becomes too easy
  - Financial trouble may arise if card is not managed properly



discussion



student activity 4-1



slide 4-A

## why banks issue credit

1. To make money
2. To offer service to customers



discussion

## creditworthiness

1. Character
2. Capital
3. Capacity



discussion



student activity 4-2



slide 4-B

## your responsibilities

1. Not to run up more debt than you can comfortably repay
2. Not to exceed the credit limit established by your creditor
3. Not to re-sell merchandise before completely paying the creditor, if the creditor has retained the title or has a lien against it
4. To notify the creditor immediately if your credit card is lost or stolen



discussion



slide 4-C

## your rights

1. Truth in Lending Act
2. Fair Credit Reporting Act
3. Equal Opportunity Act
4. Fair Credit Billing Act
5. Fair Debt Collection Practices Act
6. State Statutes
  - Restricting the amount of interest that can be charged (usury laws)
  - To obtain more extensive information



discussion



slide 4-D

## building a credit history

1. Credit bureaus—what they are and how they work
2. How to establish a good credit history
  - Pay bills on time
  - Get a low-limit credit card or other loan and pay bills promptly



discussion



web activity:

Have students visit one or more of the websites of major credit reporting companies:

**equifax.com**

**experian.com**

**transunion.com**



slide 4-E

## a credit report

1. What a credit report covers and what it looks like
  - Identification and employment data
  - Payment history
  - Inquiries
  - Public record information
2. Credit scoring, manner of payment codes
  - How you can get a black mark
  - What creditors look for—the three Cs
3. What to do if you have a bad credit report
4. How time affects your credit report
5. How to handle mistakes



oral presentation

Have students present in class (or on video) several positive and negative actions that would affect a person's credit history.



slides 4-F & 4-G



## types of credit

1. Noninstallment credit
  - Regular
  - 30-day charge accounts
  - Travel and entertainment cards
  - How to use and best time to use (paid off every month)
2. Regular installment credit
  - Car loan
  - How to use and best time to use
3. Revolving credit
  - Department store cards
  - Bank cards
  - How to use and best time to use



discussion



slide 4-H

## test your credit knowledge

1. Multiple choice, fill-in-the-blank, and matching test



student activity 4-2

## how much can you afford?

1. The 20-10 rule
  - What it means
  - Examples
2. Exercises



discussion



student activity 4-3



slide 4-I

## lesson four quiz



quiz 4-4



# should they use credit?

## answer key

### directions

For each of the following situations, circle **YES**, **NO**, or **DEPENDS** to indicate your opinion on whether these people should use credit. Also, give reasons for your response.

*Answers may vary*

**1:** Marge, age 18, plans to buy a car on credit so that she is able to drive to school.

**YES**

**NO**

**DEPENDS**

**2:** Fran and Bud recently took out a loan for a new roof.

**YES**

**NO**

**DEPENDS**

**3:** Edgar, age 20, recently used his credit card to pay for textbooks for his new semester of classes.

**YES**

**NO**

**DEPENDS**

**4:** Marcia, age 28, charges all her groceries on her credit card.

**YES**

**NO**

**DEPENDS**

**5:** Sandy and Carla, age 24 and 27, are planning on buying a boat on credit for use during summers. Carla will be the main signer for the loan, with Sandy being the co-signer.

**YES**

**NO**

**DEPENDS**



# test your credit knowledge

## answer key

The following questions are designed to help you remember the credit information just covered in class.

### directions

In the spaces provided, answer each of the following questions about credit:

#### List five things you can do to build a credit history.

1. *Establish a steady work record.*
2. *Pay all bills promptly.*
3. *Open a checking account and don't bounce checks.*
4. *Open a savings account and make regular monthly deposits.*
5. *Apply for a small loan using your savings account for collateral and then pay it back as agreed.*
6. *Get a co-signer for a loan and pay back the loan as agreed.*

When a prospective creditor evaluates a credit application, they look for the three Cs: Character, Capital, and Capacity. **For each of the following statements, write the letter that corresponds to each statement's specific characteristic.**

**a) Character      b) Capital      c) Capacity**

7.   **b**   Do you have a savings account?
8.   **a**   Have you used credit before?
9.   **a**   How long have you lived at your present address?
11.   **c**   Do you have a steady job?
12.   **a**   Do you pay your bills on time?
13.   **c**   What are your current debts and your current living expenses?

#### List four things you can do to build a credit history.

*Any of these answers are correct:*

- *Establish a steady work record.*
- *Pay all bills promptly.*
- *Open a checking account and don't bounce checks.*
- *Open a savings account and make regular deposits.*
- *Apply for a local store credit card and make regular monthly payments.*
- *Apply for a small loan using your savings account as collateral.*
- *Get a co-signer on a loan and pay back the loan as agreed.*

# test your credit knowledge answer key

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In the space provided, write the letter of the type of credit each statement represents.

a) Single payment credit

b) Installment credit

c) Revolving credit

14.   b   Monthly payment on a car loan
15.   a   Monthly telephone bill
16.   a   Monthly heating bill
17.   c   Using a credit card to buy a new jacket from a department store and then paying the charge off over several months
18.   a   Using a major credit card to buy a pair of shoes and then paying the total amount of the credit card balance within a month

For each of the following statements, write a **T** in the space provided if the statement is true, and **F** in the space provided if the statement is false.

19.   f   It is legal for a creditor to deny an applicant credit based on marital status or age.
20.   f   If you are denied credit, the creditor is not legally obligated to explain why.
21.   t   When creditors evaluate your income, they can't legally refuse to consider income from public assistance in the same manner as other income.
22.   t   If you are refused credit because of a credit report, upon request from you, the lender must give you the name and address of the credit bureau that issued the report.
23.   f   Your credit report is available to anyone, regardless of the reason.
24.   f   A debt collector has the right to contact you at any time of day or night.
25.   t   To be within a safe debt load, your total credit should not exceed 20% of your net pay after subtracting rent.
26. What should you do if you find there is inaccurate information on your credit report?  
*Contact the credit bureau. Under the Fair Credit Reporting Act, the credit bureau must investigate your report.*
27. Generally, how long can a consumer reporting agency report unfavorable information?  
*7 years*
28. How long can bankruptcy information be reported by a consumer reporting agency?  
*Up to 10 years*



# how much can they safely carry?

## answer key

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Most people can afford a certain amount of credit and stay within a safe budget. This amount is called a “safe debt load.” The following exercises will give you practice determining safe debt loads based on various incomes and fixed expenses.

### directions

Read each of the following scenarios and determine the largest amount of debt each person can safely carry. **Write your answers in the blanks provided. Use the space below each question to show how you arrived at each answer.**

- 1.** David has a monthly net income of \$1,360. His fixed monthly expenses consist of a rent payment of \$450. He is paying off a student loan of \$116 per month.

David would like to buy a new television set using a credit card. What is the largest monthly payment David can afford for the television set so that his credit card payments and student loan keep him within a safe debt load of 20%?

*\$20.00*

$$\$1,360 \times 10\% = \$136$$

$$\$136 - \$116 = \$20$$

- 2.** Marsha and Michael have a combined monthly net income of \$3,500. Their fixed monthly expenses consist of \$675 for rent. They also have an outstanding student loan balance of \$6,000 and a balance of \$1,000 for the stereo they bought last month.

How much more debt can they take on and still be within a safe debt load?

*\$1,400.00*

$$\$3,500 \times 12 = \$42,000$$

$$\$42,000 \times 20\% = \$8,400$$

$$\$8,400 - \$6,000 - \$1,000 = \$1,400$$

- 3.** Juanita has a monthly net income of \$2,500. Her fixed monthly expenses consist of \$500 for rent. She also pays a car insurance premium of \$68 and a car payment of \$167. Are these payments within Juanita’s safe debt load?

*Yes*

$$\$2,500 \times 10\% = \$250$$

$$\$250 - \$167 - \$68 = \$15$$



# lesson four quiz: about credit

## answer key

### true-false

1.   t   A disadvantage of using credit is impulse buying.
2.   t   Capital refers to a person's assets.
3.   t   A steady employment record helps a person's credit history.
4.   f   Installment credit usually allows a person to make additional purchases on an account.
5.   t   Using the 20-10 rule, a person making \$40,000 a year after taxes should have no more than \$8,000 of outstanding debt.

### multiple choice

6.   C   A common advantage of using credit is:  
**A.** less impulse buying  
**B.** lower cost for items purchased  
**C.** ability to obtain needed items now  
**D.** lower chance of overspending
7.   D   A person's regular income is referred to as:  
**A.** character  
**B.** capital  
**C.** collateral  
**D.** capacity
8.   A   To build a credit history, a person could:  
**A.** establish a steady employment record  
**B.** file his or her federal income taxes on time  
**C.** use an ATM several times a month  
**D.** request to view her or his credit file
9.   B   Utility companies and medical service organizations commonly offer \_\_\_\_\_ credit.  
**A.** revolving  
**B.** single-payment  
**C.** installment  
**D.** retail
10.   A   Using the 20-10 rule, a person earning \$1,500 a month should not have monthly credit payments that exceed:  
**A.** \$300  
**B.** \$150  
**C.** \$20  
**D.** \$30

### case application

Ana Gonzalez is considering a loan to finance her college education. She currently owes money on several charge accounts and credit cards. What actions would you recommend? *While this is a valid reason for using credit, Ana might consider paying off some of her other debts before taking on this new loan. She might delay starting school full time until she has paid off her other accounts.*