

Take Control of Debt—Are You Creditworthy?

Lesson Description

In this lesson, students will explore how lenders gather and use information about potential borrowers to make loans to creditworthy individuals. Students will first brainstorm how well they would need to know an individual before loaning a personal item to that individual. Then, as an extension, students will brainstorm and list on the board questions they would want to ask someone before deciding whether to loan them money. Students will discuss how the impersonal nature of many loans requires standards of evaluating the likelihood of a loan being repaid. Using a Flash interactive, students are introduced to the Three C's as a method for classifying information about borrowers. Students will complete a graphic organizer about the Three C's and about the information that lenders can and cannot use in making lending decisions. Students will use an interactive to explain the difference between credit reports, credit reporting companies and credit scores and then analyze a fictitious credit report to ascertain the information included within it.

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

Credit and Debt

Standard 2: Explain the purpose of a credit report 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 credit score.
- Identify consumer actions that improve a credit report.

Time Required

One 50-minute class period

Materials Required

- SmartBoard (optional) *If using a computer and projector, please click when procedure says touch.*
- Interactive PDF file
- Handout 1: Applying for Credit
- Handout 2: Personal Consumer Credit Report

Warning

The first time you teach the lesson, save a master copy to your computer or a flash drive. If you do not, you will not be able to save notes from each class. Before each class, reload the master copy of the notebook file to be certain that all of the elements on each page are ready for use.

Procedure

1. **Display Slide 1.** Tell students that today we will be learning about creditworthiness.
2. **Display Slide 2.** Display the instructional objectives for the lesson.

- 3. Display Slide 3.** Use the graphics and space on the slide and the information below to lead a discussion about lending decisions.
- 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.
- 4. Display Slide 4.** Use the text box on the slide to lead a brainstorming activity related to the information a student would want to ask an unknown borrower to facilitate making an informed lending decision. Student responses will vary but should include questions about who the person is, the quality of their character and their ability to repay.
- 5. Display Slide 5.** Use the graphic on the slide to explain that the problem they have gathering information about potential borrowers is a problem of anonymity. In many cases, when lenders are choosing borrowers to whom they will lend, they do not know the person directly. When this is the case, the lender must find other ways, besides personal experience with a person, to determine their ability and willingness to repay a loan. Developing standards that accurately predict the riskiness of a person is a key to making good loans to people who are relatively unknown to a lender.
- 6. Display Slide 6.** Use the interactive on the slide to explain to students that to categorize the information gathered about borrowers and determine their creditworthiness, or how likely they are to repay the loan in full, many borrowers will use the Three C's: capacity, character and collateral.
- Touch the pile of money and paycheck on the slide to display information about capacity.
 - Capacity is information that creditors gather about a borrower's ability to repay a loan. Questions about capacity will deal with earnings, other debts, monthly expenses or obligations that consume a borrower's income.

- Touch the person on the slide to display information about character.
 - Character is information that lenders gather about a borrower’s willingness to repay a loan. Character information includes previous repayment history, how often and how much you borrow, and stability, such as length of time at your current employer or at your current address.
- Touch the house on the slide to display information about collateral.
 - Collateral is protection for creditors in the event they are not repaid. Collateral is other real assets that a creditor could collect to pay them back, such as savings, property or other investments.

Explain to students that each creditor establishes what is important to them when making a loan. However, creditors are not allowed to consider certain information when they are making loan decisions.

- 7. Display Slide 7.** Give each student a copy of Handout 1: Applying for Credit. Tell them this will review the Three C’s and provide students information about what a creditor cannot factor into a loan decision. Use the images on the slide and the information in the handout and below to label the pictures on the slide with the discriminatory information a creditor cannot use.
 - Ask students what they think each picture represents. From left to right on the top row, the pictures are age, gender and race; on the bottom row, they are marital status, religious affiliation and nationality.
 - Ask students why it is important that this information not be the basis for denying a loan application. Answers will vary but should include that this information does not by itself tell you if a person is more or less likely to repay a loan.
- 8. Display Slide 8.** Use the information on the slide to show students the actions of a creditor that are forbidden related to the characteristics listed on the previous slide. Once the information has been reviewed, give students the opportunity to complete the graphic organizer on page 3 of Handout 1. Explain that the top half is related to the Three C’s. Students should include the name and a brief explanation of what each C is in the first-level boxes and examples in the second-level boxes. The bottom half deals with information creditors cannot use. All the answers were covered on slides 6, 7 and 8 and in the information on the handout. Suggested answers are included.
- 9. Display Slide 9.** Use the interactive on the slide and the information below to explain the three pieces involved in the creation of a credit report: the credit reporting company, credit report and credit score.
 - Touch the corporate building to display information about a credit reporting company.
 - The companies compile borrower information and sell it to lenders for a fee. The information is based on the reporting of lenders and other entities who are paid by consumers. Three major credit reporting companies are Equifax, Experian and TransUnion. Lenders may check any or all of these companies’ reports to make a lending decision.
 - Touch the credit report to display information about a credit report.
 - Credit reports tell a lender about a potential borrower’s previous credit activities, including borrowing and repayment history. The information helps determine the likelihood of repayment of future debts.
 - Touch the credit scores to display information about credit scores.
 - The ranges for the three major credit reporting agencies are listed on the scoreboard. Each company uses its own statistical model to determine the score that a borrower receives based on the information contained in the report.

Tell students that they have the right to receive a free report from each company once a year. The reports can be ordered at www.annualcreditreport.com.

Give each student a copy of Handout 2: Personal Consumer Credit Report. Use the information contained in the handout to guide students through the pieces of a credit report. After you have discussed the pieces and students have had a chance to read the information on their handout, give students the opportunity to answer the questions on page 2. Suggested answers are included.

Closure

1. 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
2. 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

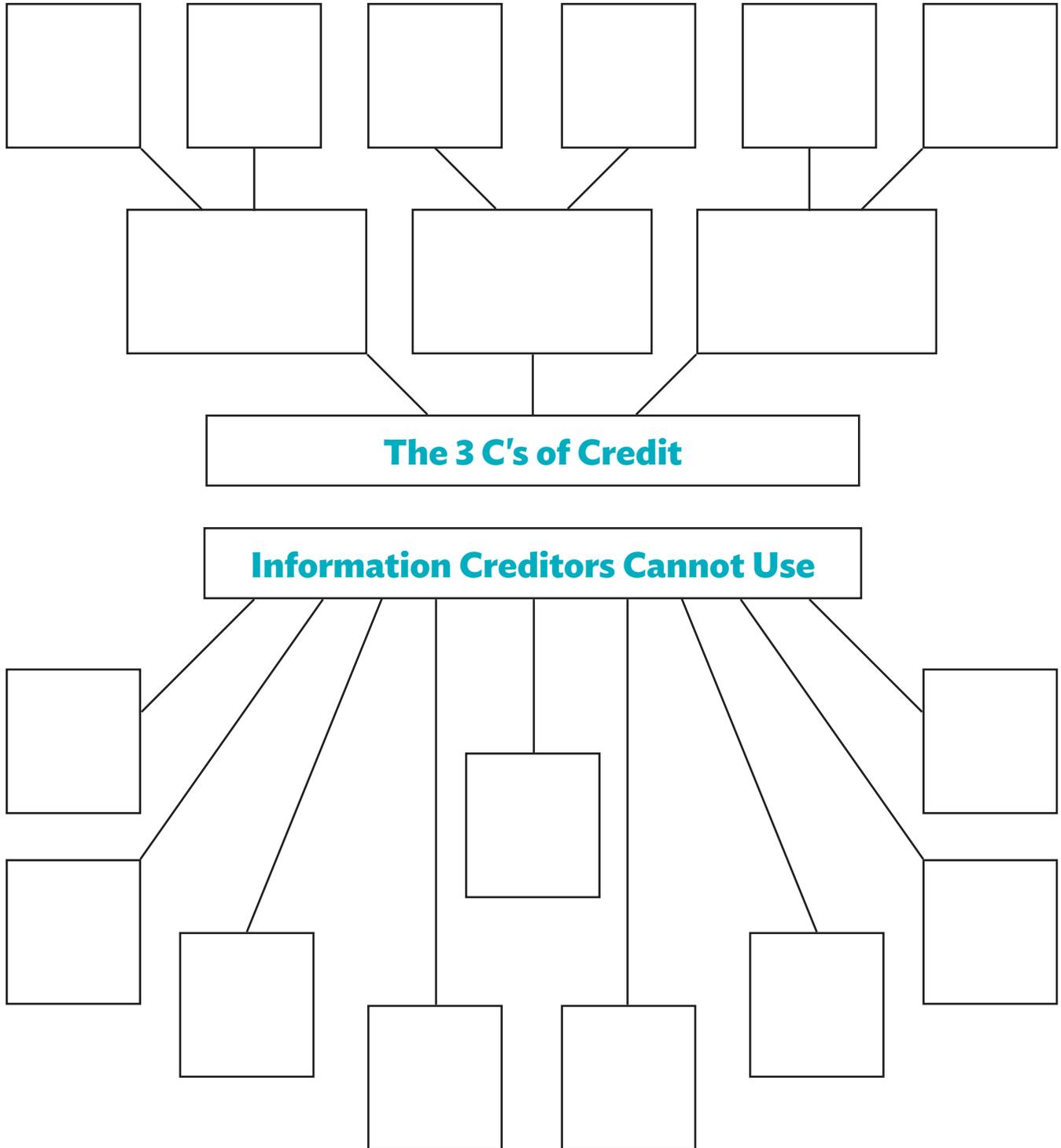
Have students work individually or in pairs to design an informative brochure called Building Better Credit that could be used to teach others how to improve their credit report and credit score. Suggestions in the brochure should include information about the Three C's. Additional information for the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

Student brochures should be assessed by considering the following criteria:

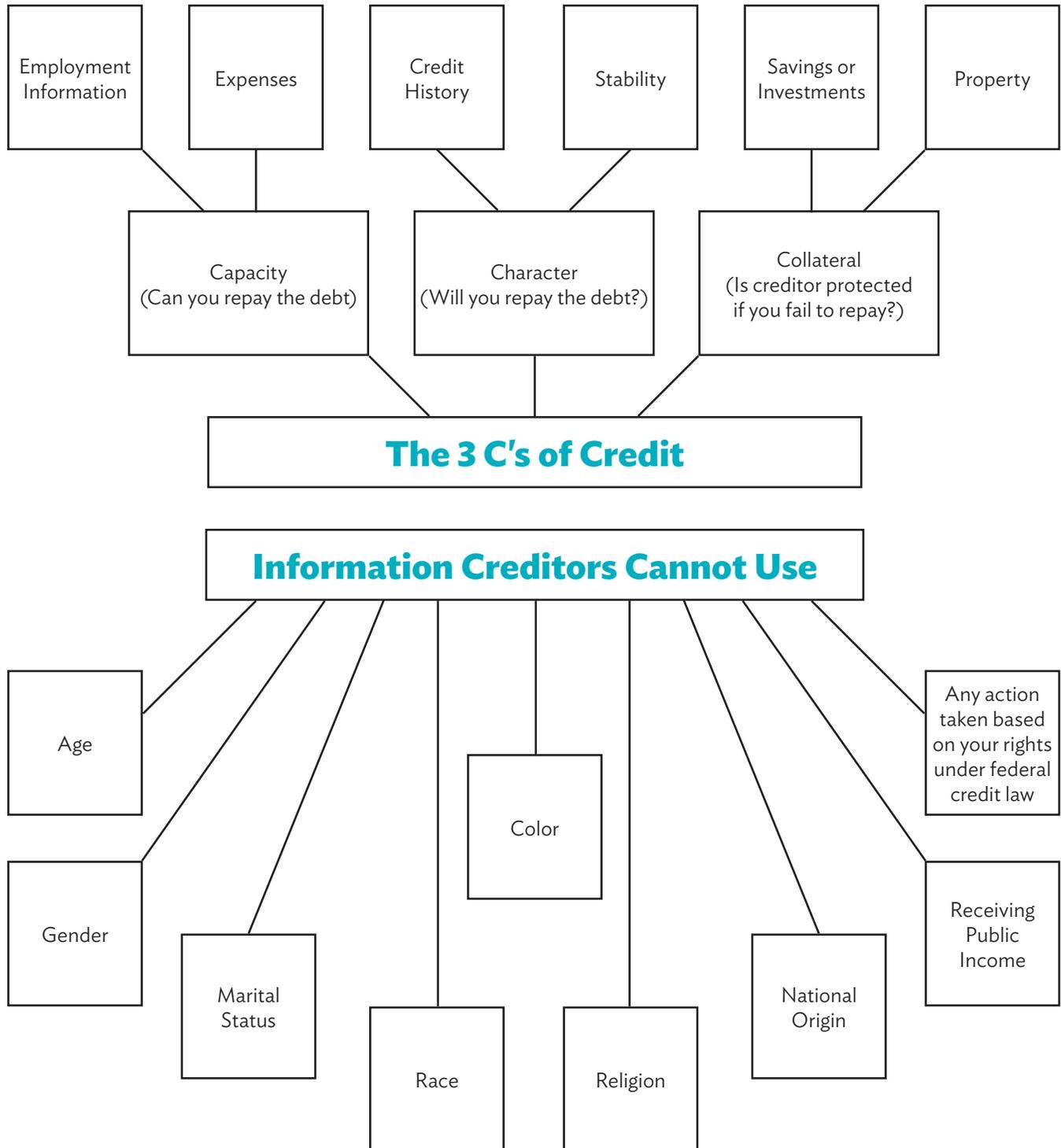
- Is the information in the brochure accurate?
- Is the information in the brochure complete and comprehensive?
- Is the brochure well-organized and visually appealing?

For more information on credit scoring, view material from the Federal Trade Commission at www.ftc.gov/bcp/edu/pubs/consumer/credit/cre24.shtm.

Handout 1: **Applying for Credit**



Suggested Answers



Name _____

Date _____

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 judgements, 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	Social Security #: 123-45-6789
1234 Any Street	Date of Birth: 07/01/1980
Dallas, TX 75000	
Previous Address	Employer: ABC, Inc.
456 Other Road	Location: Dallas, TX
Houston, TX 77000	

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	Account Number: 123456789
1000 Exchange Street	Date Opened: 5/2005
San Antonio, TX 78000	Loan Type: Installment-Auto

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

My Bank	Account Number: 123456789
5000 Main Street	Date Opened: 8/2000
El Paso, TX 79000	Loan Type: Revolving credit card

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

Name _____ Date _____

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.

Gas Card of America Account Number: 123456789
9999 Petroleum Street Date Opened: 2/2008
Fort Worth, TX 76000 Loan Type: Revolving credit card

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

Account History

60 days as of 6/2006

30 days as of 5/2006.

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

Recent Credit Inquiries

01/2013	ABC Auto Finance
10/2012	Department Store, Inc
8/2012	Home Loan Mortgage Company

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?