Lesson 6.2: What is Credit?

Lesson Author

Rebecca G. Chambers, Federal Reserve Bank of Philadelphia

Standards and Benchmarks

See page 5.

Lesson Description

Students will learn about key credit terms and different types of credit in this lesson. Students watch a video explaining credit and some of the advantages and disadvantages of using credit. In pairs, students will complete an activity to identify different types of credit. For the assessment, students will create a brochure or poster explaining how they plan to use credit in the next 10 years. To obtain answer keys for the handouts and assessment in this lesson, create an account on FederalReserveEducation.org.

Concepts

Borrowing
Credit
Interest

Objectives

Students will be able to:

- identify and explain the meaning of key terms such as borrowing, credit, and interest.
- explain the advantages and disadvantages of credit.
- describe various types of loans or credit.

Compelling Question

What are some different types of credit, and what are the costs and benefits of using credit?

Time Required

45 minutes

Materials

- What is Credit? Lesson 6.2 Slides
- Handout 6.2.1: Credit Notes, one copy for each student
- Handout 6.2.2: Types of Credit, cut apart, one set for every 2 students
- Handout 6.2.3: Credit Explanation Signs, one set for classroom
- Answer Key 6.2, one copy for teacher
- Video: Buying on Credit Concept Video, https://player.vimeo.com/video/248483852

- Tape

Preparation

- Make enough copies of Handout 6.2.2 for every 2 students. Cut apart the cards, mix them up, and put into sets for pairs. Each pair of students will receive one full set of cards.
- Hang each sign from Handout 6.2.3 around the room.

Procedure

1. To begin the lesson, ask students:
   a. If you borrow something from a friend, what does that friend likely expect? (*Answers will vary, but students may say something like the friend will let them use the item for a certain period of time and expect them to return it.*)
      i. Tell students that when they borrow money, there are similar expectations to borrowing something from a friend, but it is typically more formal and more costly.
   b. Who uses credit to pay for things? (*Answers will vary.*)
   c. When does it make sense to use credit? (*Answers will vary.*)
2. Distribute one copy of Handout 6.2.1: Credit Notes to each student.
3. Tell students that to better understand **credit**, they need to understand a few key terms.
4. Display Slide 2 and explain the terms on the slide to them. Instruct students to write the definitions on Handout 6.2.1 on Page 1.
   a. Tell students to also put the definitions in their own words.
5. Explain the following to students, and tell them to follow along with Handout 6.2.1. Tell students that understanding credit will help them make better decisions both now and in the future. Also tell them that decisions about credit have advantages and disadvantages.
6. Tell students that to further understand credit, they will watch a video. As they watch the video, they should take notes on Page 2 of Handout 6.2.1.
7. Show the video from Slide 3.

   Note: you can also access the video here: https://player.vimeo.com/video/248483852
8. After watching the video, review the following from Handout 6.2.1 with students:
   a. What are the three main types of credit? (*Installment, revolving, and open.*)

b. What should you try to avoid when using credit? (*You should try to avoid paying back only the minimum monthly payment*.)

c. What are the benefits of using credit? (*Credit allows you to purchase goods and services and pay for them later*.)

d. Why do creditors look at your credit history and credit scores? (*They should know likely you are to repay your loans*.)

9. Explain to students that you will be going over different types of credit.

10. Put students in pairs and give each pair a set of cards from Handout 6.2.2: Types of Credit. Also give each pair of students some tape.

11. Tell students that each card has a type of credit on it. Around the room, they will see explanations of different types of credit, called “Credit Type #1”, “Credit Type #2”, etc. though “Credit Type #8”.

12. With their partners, tell students that they should tape the card they think is correct near the explanation sign. Allow students some time to complete this activity.

13. Once all students have taped their cards up, go over the answers as a class.

    a. *See Answer Key 6.2 for answers*.

Closure

14. Review the key points of the lesson with students by discussing the following:

    a. What are some different types of loans or credit? (*Answers will vary but may include credit card, auto loan, student loan, service credit, installment credit, etc.)*

    b. What are some benefits or advantages of borrowing money/using credit? (*Answers will vary but may include allowing you to obtain goods or services today and pay for them later; using credit can help people to acquire valuable assets like college education or a home; using credit can also add to the enjoyment of life*.)

    c. What are some costs or disadvantages of borrowing money/using credit? (*Answers will vary but may include people borrowing and spending more money than they should; people have to pay money back, including interest charges; people who borrow a lot have to give up some things that they would like today in order to pay back of goods or services they have already consumed*.)

Assessment

15. Students should create a brochure or poster outlining their planned use of credit over the next 10 years. Tell students to be creative! Have them answer the following questions with their work:

    a. What do you plan to buy with credit over the next 10 years?

    b. What institutions will you use to obtain credit?

    c. What are the advantages of using credit? Disadvantages?

    d. What advice would you give to a peer about using credit?

Standards and Benchmarks

National Standards for Personal Financial Education

Standard 5: Managing Credit

Credit allows people to purchase and enjoy goods and services today, while agreeing to pay for them in the future, usually with interest. There are many choices for borrowing money, and lenders charge higher interest and fees for riskier loans or riskier borrowers. Lenders evaluate creditworthiness of a borrower based on the type of credit, past credit history, and expected ability to repay the loan in the future. Credit reports compile information on a person's credit history, and lenders use credit scores to assess a potential borrower's creditworthiness. A low credit score can result in a lender denying credit to someone they perceive as having a low level of creditworthiness. Common types of credit include credit cards, auto loans, home mortgage loans, and student loans. The cost of post-secondary education can be financed through a combination of grants, scholarships, work-study, savings, and federal or private student loans.

Benchmarks: Grade 4

1. Interest is the price a borrower pays for using someone else's money, and the income earned by the lender.

2. When a person pays with credit, they have immediate use of purchased goods or services while agreeing to repay the lender in the future with interest.

Benchmarks: Grade 8

6. When people borrow money to invest in higher education or housing, the risks and costs may be outweighed by the future benefits.

7. Borrowing increases debt and can negatively affect a person's finances.

Benchmarks: Grade 12

2. Loans that are secured by collateral have lower interest rates than unsecured loans because they are less risky to lenders.

6. Down payments reduce the amount needed to borrow.

Handout 6.2.1: Credit Notes (Page 1 of 2)

Key Terms

Borrowing	Credit
Definition: **In My Words:**	**Definition:** **In My Words:**
Interest **Definition:** **In My Words:**	

Handout 6.2.1: Credit Notes (Page 2 of 2)

Video Notes

Handout 6.2.2: Types of Credit

Credit	Personal Loan
Installment Credit	Auto Loan
Charge Card	Home Loan (Mortgage)
Credit Card	Student Loan

Credit Type #1

- Issuers: utility services (e.g., water, electricity, or Internet)

- Receive services for a given period (usually a month) and pay at the end of that period

- No interest charged if bill is paid on time

Credit Type #2

- Issuers: stores or companies
- Buy goods or services with equal payments over a set period (e.g., a year)
- Down payment often required
- Finance charges (interest) possible
- Example: Purchase a $700 bike at the bike shop with a down payment and pay it off over 3 years.

Credit Type #3

- Issuers: stores or companies (e.g., credit card companies and store credit cards)
- Buy goods or services and repay in full at the end of the month
- Generally interest free
- Often an annual fee

Credit Type #4

- Issuers: stores or companies (e.g., credit card companies and store credit cards)
- Buy goods or services up to a given dollar limit, with a minimum payment due each month
- No interest charged if paid in full at the end of the month; interest charge the next month on the unpaid balance
- May have an annual fee

Credit Type #5

- Issuers: financial institutions
- Make purchases or pay off past debts
- Finance charges assessed
- Typically unsecured (no collateral [valuable asset] required)
- Example: Borrow $5,000 from a credit union to purchase a boat

Credit Type #6

- Issuers: financial institutions or auto dealerships
- Buy a car with equal payments over a set period (usually several years)
- Typically secured, with the car being the collateral
- Finance charges assessed
- Example: Borrow $40,000 from a commercial bank and make monthly payments

Credit Type #7

- Issuers: financial institutions
- Purchase a house or property
- Typically secured, with the collateral being the house or property
- Finance charges assessed

Credit Type #8

- Issuers: the federal government or financial institutions
- Pay for education beyond high school with the obligations to repay after graduation
- Finance charges assessed
- Unsecured
- Example: Stafford loan