

What Is Credit?

LESSON DESCRIPTION AND BACKGROUND

Decisions about credit loom large in the lives of adults as they consider buying big-ticket items—a home or a new car, for example. Young people often use credit, too—using credit cards to buy goods and services, for example, or taking out loans to pay for college expenses—and the decisions they make in these cases can have important consequences. This lesson introduces the concept of credit, with special attention paid to the advantages and disadvantages of using credit. It also describes particular types of loans including home mortgage loans, car loans, college loans, personal loans, and credit card loans.

Lesson 11 correlates with national standards for economics and personal finance as shown in Tables 1-2 in the introductory section of the publication.

ECONOMIC AND PERSONAL FINANCE CONCEPTS

- Credit
- Credit score
- Interest
- Risk

OBJECTIVES

At the end of this lesson, the student will be able to:

- Identify and explain the meaning of key terms such as **credit**, **interest**, **risk**, and **credit score**.
- Explain the advantages and disadvantages of using credit.
- Identify types of financial institutions that offer credit.
- Explain that most credit transactions are voluntary ones in which both sides expect to gain.

TIME REQUIRED

One 45-minute class period

MATERIALS

- A copy for each student of **Theme 4 Introduction** from the *Student Workbook*.
- A copy for each student of **Exercise 11.1**, **11.2**, and **11.3** from the *Student Workbook*

ADDITIONAL RESOURCES



To download visuals, find related lessons, correlations to state standards, interactives, and more visit <http://fffl.councilforeconed.org/9-12/lesson11>.

PROCEDURE

1. Distribute a copy of **Theme 4 Introduction** from the *Student Workbook*. Ask the students to read the section to become acquainted with the concepts presented in this theme.
2. Explain that this lesson focuses on the concept of credit. It raises a basic question: When does it make sense to use credit? Stress the point that decisions about using credit are similar to other decisions people make. Therefore, it is important to understand both the advantages and disadvantages of using credit.
3. Give each student a copy of **Exercise 11.1** from the *Student Workbook*. Ask the students to read this exercise and answer the questions at the end. When they have finished, discuss the answers.
 - a. Why use credit? (**Credit allows people to obtain the use of money that they do not have. In return, people who use credit repay the amount they borrow, plus interest.**)
 - b. What are the advantages of using credit? (**Credit can help people in many ways— by enabling them to acquire valuable assets,**

or by helping out with emergency expenses.)

- c. What are the disadvantages of using credit? **(Goods and services can cost more when purchased on credit. When people buy things on credit, the interest and fees they must pay amount to a deduction from the money they might otherwise use to buy things they currently want. Also, people sometimes borrow too much. That is, they use too much credit in relationship to their income. When people are overextended and making heavy credit payments, they have less money left to pay for food, transportation, clothing, and other bills. And finally, items bought on credit can be repossessed by the lender if borrowers are unable to make the required payments.)**
- d. What institutions are sources of credit? **(Commercial banks, savings and loans, credit unions, and consumer finance companies. Utilities and medical providers extend service credit.)**
- e. What is interest? **(From a borrower's point of view, interest is the price paid for using someone else's money.)**
- f. Who most often wins in a credit transaction? **(Ordinarily, both parties expect to benefit from a credit transaction.)**
- g. How does risk influence the rate of interest? **(As risk goes up, interest rates usually go up too. Higher-risk loans usually result in higher interest rates. Lower-risk loans result in lower interest rates.)**
- h. What is an unsecured loan? **(An unsecured loan is one that doesn't require collateral. It is granted based solely on the borrower's creditworthiness.)**
- i. What is collateral? **(Collateral is an asset used to back a loan. For example, a car loan is backed by the car that is being purchased. If you fail to repay your loan, the lender can repossess the car and sell it to pay off the loan. If there is still a balance**

owed after the sale of the collateral, the borrower will be expected to pay off this remaining balance.)

4. Give each student a copy **Exercise 11.2** from the *Student Workbook*. Ask the students to follow along as you explain the types of credit found in the table, as well as the advantages and disadvantages of each. Make sure that the students understand the key characteristics of the lending institutions identified in the table. These characteristics include the following:
- Commercial banks and savings and loans are very similar in the types of financial services they provide their customers; these include loans, savings accounts, and checking accounts.
 - Credit unions are not-for-profit cooperatives—enterprises owned by their members—that provide many of the same financial services as commercial banks and savings and loans.
 - Consumer finance companies lend money to individuals (and sometimes businesses) for the purchase of such things such as automobiles or household appliances. Sometimes their customers do not qualify for bank credit and therefore pay a higher rate of interest.
 - Department stores and other financial service providers sometimes offer their own credit cards for their customers' use.
5. Ask the students to answer the questions at the end of **Exercise 11.2**. When they have finished, discuss the answers:
- a. What are the advantages of home loans and college loans compared to credit card and personal loans? **(Home and college loans usually help people acquire assets that increase in value. Interest rates on these loans are usually lower than the rates for credit cards or personal loans.)**
- b. What are the disadvantages of credit card and college loans? **(Sometimes young people borrow more than they should for college loans. Upon graduation, new graduates may have difficulty repaying the money they have borrowed. Sometimes young**

people overuse their credit cards. Credit card loans have relatively high interest rates, and large credit card balances therefore can be burdensome for long periods of time.)

CLOSURE

Use the following questions to review the lesson:

- What is a key advantage of using credit? **(Using credit allows you to obtain goods or services today and pay for them later. Using credit can help people acquire valuable assets—like a college education or a home. Using credit can also add to the enjoyment of life.)**
- What is a key disadvantage of using credit? **(When credit is easily available, some people borrow and spend more money than they should. Loans have to be repaid. Lenders charge interest for the use of their money. Individuals who borrow heavily have to give up some things they would like to have today because they are required to pay for goods or services they have already consumed.)**
- Who gains from credit transactions? **(Both sides in a credit transaction expect to benefit. Borrowers are able to purchase something that may be of value today and/or in the future. Lenders are repaid the money that they lent, plus interest and sometimes fees.)**

ASSESSMENT

Assign the students to write an essay outlining their planned use of credit over the next 10 years. What do they plan to buy by using credit? What institution(s) will they use to furnish the credit? What advantages do they expect to gain by using credit? What about the disadvantages? Explain.

EXTENSION

Give each student a copy of **Exercise 11.3** from the *Student Workbook*. Assign the students to contact local financial institutions to determine the annual percentage rate of interest for the various types of loans listed in the chart. You may wish to have the students discuss this information with the other members of the class.