

Lesson 7: Creditors' Criteria and Borrowers' Rights and Responsibilities

Standards and Benchmarks (see page C-33)

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 to identify and discuss the rights and responsibilities of using credit.

Grade Level

6-12

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, and
 - explain the rights and responsibilities related to using credit.
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Time Required

45-60 minutes

Materials

- Visual 7.1
 - Handout 7.1, one copy of each for each student
 - Handout 7.1—Answer Key for the teacher
 - Handout 7.2, enough copies cut apart to provide one numbered scenario card for each member of four groups
 - Handout 7.3, one copy for each student
 - Handout 7.4, one copy for each student
 - A sheet of notebook paper for each student
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Procedure

1. Define **credit** as the granting of money or something else of value in exchange for a promise of future repayment. Explain that the ability to have and use credit is a privilege earned by exhibiting behaviors related to some broad characteristics that creditors consider when making lending decisions. These characteristics are called the three C's of credit: **character**, **capacity**, and **collateral**. Ask the students the following:
 - What do you think character, capacity, and collateral 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 income to the lender. When people borrow money from a bank, they pay interest to the bank because they are borrowing money deposited in the bank by other people. 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 a person applies for credit, the **creditor**—that is, the person, financial institution, or business that lends the money—will look at different types of information to evaluate the potential borrower. Specifically, creditors review information to determine how well the borrower satisfies the three C's of credit: capacity, character, and collateral.
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5. Display *Visual 7.1: The 3 C's of Credit*. Explain that a 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 or her bills and if he or 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.
6. Remind students that people earn the privilege of using credit; this privilege is based to a great extent on their capacity, character, and collateral. Consumers should be aware, though, that with that privilege comes consumer **credit rights** and **credit responsibilities**. Credit rights are 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.
7. Tell the students that they are going to be involved in a role-play activity. They are going to play the part of either a person seeking credit or someone who is providing credit, that is, a creditor. Distribute a copy of *Handout 7.1: Your Credit Rights and Responsibilities* to each student. Tell the students they will use the handout with the role-play activity, but first the class will review the rights and responsibilities statements on the handout. Review the statements with the students.
8. Divide the class into four groups. Distribute scenario cards from *Handout 7.2: Role-Play Scenarios* to each group member. Distribute Scenario 1 cards to Group 1, Scenario 2 cards to Group 2, and so on. Instruct the students to read their group's scenario silently and allow time to do so.
9. Refer students to Handout 7.1. Instruct the students to discuss which rights or responsibilities could be demonstrated in their group's role-play scenario.
10. Instruct students to work individually and circle on the handout the rights and/or responsibilities they believe apply to the people described in their group's scenario. 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 student should circle "Compare offers for similar types of credit. For example, compare different credit card offers or the cost (fees and interest charges) of a loan from different sources."

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11. Instruct the groups to discuss how to transform their scenario into a short skit that the group members will perform in front of the class. Each group is to discuss the rights they individually circled and then as a group select two rights, two responsibilities, or a combination of one right and one responsibility that the people in their skit should have adhered to or been aware of and clearly present these items in their skit. Allow time for students to prepare the skits.
12. Explain that the students will serve as the audience for all skits except their own. Instruct students to complete Handout 7.1 based on the skits, including their own, as follows:
 - Mark the handout 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 may mark more than one right or responsibility for each skit.
 - Mark the handout for your own group now.
13. Have each group perform its skit.
14. After the skits are performed and tallies recorded, ask for volunteers from Groups 1, 2, and 3 to read the rights and responsibilities that they marked for Group 4. Have the students explain why they marked those statements.
15. Have a volunteer from Group 4 tell the class what rights and responsibilities the group was trying to illustrate in their skit and explain why.
16. Repeat procedures 13 and 14 until all skits have been discussed. Suggested answers for each skit are provided on *Handout 7.1: Your Credit Rights and Responsibilities—Answer Key*.
17. Distribute a copy of *Handout 7.3: Three C's Assessment* to each student. Review the directions with the students and have them complete and then turn in the handout. Correct and return the handout to the students. You may wish to review Procedure number 5 when you discuss their answers. Below is the answer key for Handout 7.3:
 1. *CH*
 2. *CH*
 3. *CA*
 4. *CO*
 5. *CH*

Closure

18. Review the key points of the lesson by discussing the following:
- What is credit? (*The granting of money or something else of value in exchange for a promise of future repayment*)
 - 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*)
 - What is capacity? (*A borrower's ability to repay a debt*)
 - What are factors that affect a borrower's capacity? (*How much money the borrower makes, how long the borrower has been at his or her current job, and how much debt the borrower has relative to income*)
 - What is character? (*A borrower's reputation for paying bills and debts based on past behavior*)
 - What is collateral? (*Property required by a lender and offered by a borrower as a guarantee of payment on a loan; also, a borrower's savings, investments, or the value of the asset purchased that can be seized if the borrower fails to repay a 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 to review rights.*)
 - What are some of the responsibilities we have when we use credit? (*Use Handout 7.1 to review responsibilities.*)

Assessment

19. Distribute *Handout 7.4: Darryl's Credit Debacle* to each student. Instruct the students to read Darryl's story and write a short essay detailing the credit rights and credit responsibilities evident in the story. They may reference Handout 7.1 if necessary.
20. Use the guidance below to correct student essays.
- Items that students should include in their essay about "Darryl's Credit Debacle":*
- **You have the right to know why you were denied credit.** Darryl wisely asked why he had been denied credit.
 - **You have the right to see your personal information on credit reports.** The salesman first said Darryl couldn't see the credit report, but then said yes when Darryl said it was his right.
 - **Organizations that use credit reports are required to help you understand the report.** The salesman explained a few key components of the credit report.

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- **If you are denied credit because of something on your credit report, the lender must give you the name, address, and telephone number of the credit bureau that provided the credit report.** The salesman told Darryl the name of the company that provided the credit report.
- **You have the right to have errors in credit reports corrected.** When Darryl noticed an error, he called the store and the credit agency and successfully cleared up the matter.
- **Pay your bills on time.** Darryl had late payments, which were reported on his credit report.
- **Pay your credit card balances in full each month.** Since Darryl had late payments, it is clear that he did not pay his balances in full.
- **Don't ignore credit problems. Much of your credit history can remain on your credit report for seven years or more.** Darryl cleared up the error on his credit report as soon as he learned about it. He did not ignore it.
- **Compare offers for similar types of credit.** Darryl should have checked the cost of the loan from other sources.
- **When you borrow money, know what you are agreeing to.** Darryl quickly filled out the application and should have taken more time to read the agreement carefully.

Visual 7.1: The Three C's of Credit

Capacity

A borrower's ability to repay debt

Character

A borrower's reputation for paying bills and debts based on past behavior

Collateral

Property required by a lender and offered by a borrower as a guarantee of payment on a loan. Also, a borrower's savings, investments, or the value of the asset purchased that can be seized if the borrower fails to repay a debt

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Handout 7.1: Your Credit Rights and Responsibilities (page 1 of 2)

Directions: Place the group number or numbers on the line next to the rights and responsibilities you identify for each skit. Different groups' skits may represent the same rights or responsibilities and each group may have more than one right or responsibility.

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 your 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. This information is included on your credit reports.

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

- _____ Neither the length of the loan, that is, 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 7.1: Your Credit Rights and Responsibilities (page 2 of 2)

Credit Responsibilities

_____ Pay all 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 or the cost (fees and interest charges) of a loan from different sources.

_____ Make informed, reasonable choices about credit usage.

_____ Know how much you can afford to spend.

_____ Keep your receipts for purchases/returns to check against purchases/returns listed on credit card statements.

_____ Check monthly statements to make sure charges are correct.

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

_____ When you borrow money, know what you are 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.

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Handout 7.1: Your Credit Rights and Responsibilities—Answer Key (page 1 of 2)

Directions: Place the group number or numbers on the line next to the rights and responsibilities you identify for each skit. Different groups' skits may represent the same rights or responsibilities and each group may have more than one right or responsibility.

Credit Rights

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

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

 You have the right to have errors in your 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. This information is included on your credit reports.

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

 Neither the length of the loan, that is, 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 7.1: Your Credit Rights and Responsibilities—Answer Key (page 2 of 2)

Credit Responsibilities

_____ Pay all your bills on time.

 3 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 or the cost (fees and interest charges) of a loan from different sources.

 2 Make informed, reasonable choices about credit usage.

 1,3 Know how much you can afford to spend.

 3 Keep your receipts for purchases/returns to check against purchases/returns listed on credit card statements.

 3 Check monthly statements to make sure charges are correct.

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

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

 1,2,4 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.

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Handout 7.2: Role-Play Scenarios

Group 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."

Group 2

Carlos was shopping at his favorite electronics store when he found the home theater system of his dreams. When he asked about payment options, the salesperson presented him with the in-store credit plan. The salesperson started to rattle off the details of the loan, but Carlos told him to save his breath—he wasn't concerned with the details, he just wanted to take the system home that day. He quickly filled out the forms and turned them in. The salesperson took the forms back to get approval from the store manager. In a few minutes the salesperson returned with bad news; his application was denied. Carlos asked for a reason, but the manager asked Carlos to leave the store.

Group 3

Max uses his credit card to buy many things. He earns "cash-back points" for using the card. He normally pays the entire balance each month. Last month, he purchased a new monitor, but later that day he had to purchase a new tire. He decided he couldn't afford the new monitor and returned it unopened the next day. When he checked his next credit card statement, he noticed that the refund for the monitor was not listed. He called the credit card company's toll-free number and talked to a customer service representative named Susan. She checked his account and said there was no record of a refund. She asked if he had a receipt for the return. He told her he was just not good at keeping track of all those little slips of paper.

Group 4

Amanda was at the mall and signed up for a credit card in order to get the freebies being offered. Two weeks later, a PassWorld 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 just got a credit card in the mail. 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. His final words were "Never spend more in a month than you can pay in full when you receive the bill."

Handout 7.3: Three C's Assessment

Directions: Identify which one of the Three C's of credit each statement represents. Write **CO** for collateral, **CA** for capacity, or **CH** for character in the space provided.

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 he is earning a profit each month.
4. _____ Franklin owns a small house 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.

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Handout 7.4: Darryl's Credit Debacle

Directions: Read Darryl's story below and write a short essay detailing the credit rights and credit responsibilities evident in the story. You may reference *Handout 7.1: Your Credit Rights and Responsibilities*.

Darryl went to visit Arena Used Cars because he had his eye on a red 1967 Ford Mustang on its lot. Darryl talked with a salesman, Nathan, about the features and condition of the car. It was just what Darryl wanted. 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 credit plan that would be just perfect for Darryl. All Darryl had to do was fill out a credit application. Darryl quickly filled out the application and gave it to Nathan. Nathan took the application and said 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, but Nathan shrugged and said it just wasn't possible for the dealership to grant him credit. Nathan didn't provide any specific reasons. Fortunately, Darryl knew about his credit rights and told Nathan that he had a right to know why his credit application had been denied. Nathan then told Darryl that he was denied credit based on his credit report. Darryl asked Nathan to show him the report, and he did. Darryl verified his personal information, and Nathan explained a few key components of the report. Darryl knew he needed more time, though, to examine the credit report more fully. Nathan told Darryl he had gotten the report from TransUnion and gave him the necessary contact information for that company.

When Darryl got home, he went online to access his credit report. As he looked over the report, he noticed that it said he had not paid a few bills on time. He thought back and realized it was correct because he had forgotten to pay his credit card bill on time a few times that year. Then he noticed an error on the report. An electronics store claimed he had not paid his store credit card bill. Darryl had never even heard of the company and did not have a credit card from that store. He called the electronics store and the credit agency and eventually cleared the matter up. A week later Darryl signed the loan papers for the Mustang.

Standards and Benchmarks

National Standards for Financial Literacy

Standard 4: Credit allows people to purchase goods and services that they can use today and pay for those goods and services in the future with interest. People choose among different credit options that have different costs. Lenders approve or deny applications for loans based on an evaluation of the borrower's past credit history and expected ability to pay in the future. Higher-risk borrowers are charged higher interest rates; lower-risk borrowers are charged lower interest rates.

- **Benchmark 1, Grade 4:** Interest is the price the borrower pays for using someone else's money.
- **Benchmark 4, Grade 4:** Borrowers who repay loans as promised show that they are worthy of getting credit in the future. A reputation for not repaying a loan as promised can result in high interest charges on future loans, if loans are available at all.
- **Benchmark 7, Grade 8:** Lenders charge different interest rates based on the risk of nonpayment by borrowers. The higher the risk of nonpayment, the higher the interest rate charged. The lower the risk of nonpayment, the lower the interest rate charged.
- **Benchmark 3, Grade 12:** Loans can be unsecured or secured with collateral. Collateral is a piece of property that can be sold by the lender to recover all or part of a loan if the borrower fails to repay. Because secured loans are viewed as having less risk, lenders charge a lower interest rate than they charge for unsecured loans.
- **Benchmark 5, Grade 12:** Lenders make credit decisions based in part on consumer payment history. Credit bureaus record borrowers' credit and payment histories and provide the information to lenders in credit reports.
- **Benchmark 8, Grade 12:** Failure to repay a loan has significant consequences for borrowers such as negative entries on their credit report, repossession of property (collateral), garnishment of wages, and the inability to obtain loans in the future.

Common Core State Standards: English Language Arts

Reading: Informational Text

- **Key Ideas and Details**

CCSS.ELA-Literacy.RI.8.3: Analyze how a text makes connections among and distinctions between individuals, ideas, or events (e.g., through comparisons, analogies, or categories).

CCSS.ELA-Literacy.RI.9-10.1: Cite strong and thorough textual evidence to support analysis of what the text says explicitly as well as inferences drawn from the text.

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Common Core State Standards: Literacy in History/Social Studies, Science, and Technical Subjects, Grades 6-12

History/Social Studies

- **Craft and Structure**

CCSS.ELA-Literacy.RH.9-10.4: Determine the meaning of words and phrases as they are used in a text, including vocabulary describing political, social, or economic aspects of history/social science.

Science & Technical Subjects

- **Key Ideas and Details**

CCSS.ELA-Literacy.RST.6-8.2: Determine the central ideas or conclusions of a text; provide an accurate summary of the text distinct from prior knowledge or opinions.