Inside the Vault

An Economic Education Newsletter from the Federal Reserve Bank of St. Louis

Just Sign Here:
Bottom-Line Personal Finance Myths

LESSON PLAN
FALL 2006

Federal Reserve Bank of St. Louis

Table of Contents

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Just Sign Here:
Bottom-Line Personal Finance Myths

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Consumers must make many financial decisions, from basic spending and saving to complex investment choices and retirement planning. What does an individual need to do or know to be financially literate? At a minimum, consumers must be able to keep track of their cash resources and all payment obligations, know how to open a savings account and how to apply for a loan, and have a basic understanding of health and life insurance. In addition, a financially savvy consumer knows how to compare competing offers and plan for future financial needs, such as paying for college, buying a car or house, and retiring.

Unfortunately, this type of financial knowledge is in short supply. A survey conducted in 2006 by the Jump$tart Coalition found that 12th-graders could correctly answer only 52 percent of the questions on a basic financial skills quiz. Although adults sometimes do better on tests like these, statistics indicate that U.S. households do not consistently demonstrate the basic skills of financial literacy. (See table at right.) This lack of basic financial knowledge often results in poor financial management, including such behaviors as using payday lenders or check-cashing services, incurring late fees on credit cards, or passing up employer-matching contributions to retirement accounts.

Being aware of some common personal finance myths—beliefs, rules of thumb or marketing pitches that are misleading or untrue—may help consumers make better-informed financial decisions.

Myth #1: "All that matters is your monthly payment."

When a consumer is financing a car or a house, borrowers are often assured that, despite the staggering sum of total interest payments, the only relevant question is, "Can you make the monthly payment?" Your monthly payment is not all you need to know about your loan, of course. The effective annual rate you are paying, the fees, the term to maturity, numerous contract contingencies and other details also matter a great deal. Borrowers who believe this myth may not understand all the costs involved in a loan, or they may not consider the trade-off they are accepting between less-burdensome early payments and more-burdensome later payments.

Indicators of Basic Financial Literacy

Financial Behaviors	Percentage of consumers who engage in this financial behavior
Pay bills on time	88
Balance checkbook monthly	67
Have emergency savings	63
Track expenses	49
Use a spending plan or budget	46
Save for long-term goals such as education, car, home or vacation	39
Compare offers before applying for a credit card	35

Myth #2: "Rising house prices make us all richer."

Over the past several years, house prices in many regions have increased significantly, perpetuating the "housing wealth" myth. To see the fallacy in this myth, imagine a simple economy with exactly two home-owning households. Suppose the "market value" of each house was $200,000 as of yesterday. Today, both households believe their houses have doubled in value. One household sells its house to the other for $400,000, pocketing a $200,000 capital gain—an apparent increase in the economy's housing wealth.

But the first household needs somewhere to live, and the second household has an extra, empty dwelling. So, household one buys household two's original house at the inflated price of $400,000, generating a $200,000 gain for household two. Neither household has more cash or other assets than it had before, and each owns one house as before. What has changed? We can say that the housing wealth of the economy has doubled, but it has no economic significance—it is a myth. Compare this concept to automobile price changes. Do we feel richer when automobile prices rise? Probably not; in fact, many of us would feel poorer because we know we'll have to spend more to buy our next car. The point is that the value of a house or a car is derived solely from the housing or transportation services it provides.

Myth #3: "It's always better to buy than to rent."

The renting vs. buying decision is particularly important when households are purchasing housing services. In becoming an owner-occupier, a household effectively is a landlord renting a house to itself. Some of the critical considerations in making this decision include the following:

- A household with a steady income may be more suited to home ownership because it is better able to undertake the fixed financial commitment represented by a mortgage. A household with a highly variable income, on the other hand, may need to reduce housing expenses relatively rapidly if income declines significantly and may, therefore, be better off renting.
- Because the transaction costs involved in selling a house and moving to a new residence are high—probably about 10 percent of the value of the house, including sales commissions, financing-related fees and moving expenses—it may be better for a household that expects to move within a short period of time to rent rather than own.
- Owning a house provides a hedge against unexpected future increases in rent. A household that has a low tolerance for bearing the risk of future "rent shocks" will benefit more from owning a house than a household that is more tolerant of such risk.

Classroom Discussion

1. What are some details about a loan that a savvy borrower should find out?
2. How is it possible that an increase in the price of your house would not result in your being better off?
3. According to the table on Page 1, what are some conclusions that might be drawn regarding financial behavior? What could be done to improve financial behavior?

Personal finance is becoming more complex every day; yet, the widespread belief in these myths shows that the average level of U.S. households' financial literacy is low. If consumers want to make informed decisions, they need to arm themselves with knowledge of basic economic and financial principles and to exercise smart spending and saving behaviors.

This article was adapted from "Consumer-Finance Myths and Other Obstacles to Financial Literacy," *written by Senior Economist William R. Emmons and published as a Federal Reserve Bank of St. Louis* Supervisory Policy Analysis *Working Paper 2005-03 in April 2005.*

Lesson Description

Consumers must make many financial decisions, from basic spending and saving to complex investment choices and retirement planning. What does an individual need to do or know to be financially literate? At a minimum, consumers must be able to keep track of their cash resources and their payment obligations, and they must know how to apply for a loan. This lesson helps students develop a basic understanding of credit and the importance of a credit history. Students will learn how a credit history affects their lives.

National Standards in Personal Finance (National Jump$tart Coalition on Financial Literacy)

Spending and Credit:

- Students should be able to analyze the benefits and costs of consumer credit.
- Students will be able to explain factors that affect creditworthiness and the purpose of credit records.

Personal Finance Concepts

Benefit: Something that is favorable to the decision-maker.

Cost: Something that is unfavorable to the decision-maker

Credit: The ability of a customer to obtain goods or services before payment, based on an agreement to pay later.

Creditor: A person, financial institution or other business that lends money.

Credit history: A person's payment activity over time.

Credit report: A document compiled by a credit bureau that provides businesses with information about a consumer including the consumer's credit history.

Interest: The price of using credit.

Interest rate: The price of using credit expressed as a percentage of the amount owed.

Grade Level:

8-12

Objectives

Students will be able to:

1. Explain the costs and benefits of credit.
2. List and define the 5 Cs (Capacity, Credit History, Capital, Collateral and Character) of credit that creditors use to assess borrowers.
3. Explain the role of a credit history in obtaining a loan.

Time Required:

90-140 minutes

Materials

- One copy for each student of the article "Just Sign Here: Bottom-Line Personal Finance Myths" from *Inside the Vault,* a newsletter for educators produced by the Federal Reserve Bank of St. Louis. (A copy of this article is provided on pages 1-2 of this lesson plan.)
- A copy for each student of Handouts 1, 2, 3, 4, 5, 6 and 7
- Transparencies 1, 2, 3, 4, 5, 6, 7 and 8
- Six credit card offers, copied so that each student receives at least two offers (for Extension Activity)

Procedure

1. Have the students read "Just Sign Here: Bottom-Line Personal Finance Myths" from the fall 2006 issue of *Inside the Vault.* Ask the students why it is important for consumers to compare competing offers for credit. *(Answer: When credit card offers are compared, consumers can:*
   - *choose a card which they have the ability to pay,*
   - *acquire the best interest rate possible and*
   - *obtain the services that best fit their financial needs.)*

2. Explain that *benefits* are things favorable to people making decisions and *costs* are things that are unfavorable to people making decisions. Ask the students to identify the costs and benefits of choosing to study for an economics test. *(Costs: give up doing other things in order to spend time studying, disappoint friends who want you to spend time with them; Benefits: learn, do better on the test, make parents happy)* Display Transparency 1 and ask students to identify the costs and benefits of using credit cards. Record students' ideas about the costs and benefits of credit cards on the transparency.

3. Display Transparency 2 and ask the students how their list compares with the list on the transparency. *(Answers will vary.)* What conclusions can be drawn from these comparisons? *(Financial literacy includes making wise decisions when involved in financial planning. Planning, protecting and paying on time are all a part of maintaining good credit. Decision-making skills are very important in making wise use of personal resources.)*

4. Display Transparency 3 and discuss the following points.
   - Credit is the ability of a customer to obtain goods or services before payment, based on an agreement to pay later.
   - A person's credit history is a record of payment activity. Credit bureaus are organizations that collect credit information. Business firms apply to credit bureaus for credit information on prospective customers. Credit bureaus furnish credit reports, which are statements that contain information about prospective customers and their credit history.

Credit scores are developed based on credit reports. Credit scores range from 300 to 850. Someone with an excellent credit history will receive a high credit score. Someone with an average credit history will receive an average score, and someone with a poor credit history will receive a low credit score.

- A credit report is a consumer's financial fingerprint. It identifies your financial behavior. Credit problems remain on your credit report for seven years. It can affect every aspect of your life, including your ability to qualify for loans, the rate of interest you pay on loans, employment opportunities and even insurance premiums.
    - For example, the better your credit history (and the higher your credit score), the lower interest rate you most likely will pay on a car loan, a mortgage or a credit card.
    - Someone with an excellent credit history (a high credit score) will often receive a discount of 15 percent or more on home and auto insurance. Numerous studies have found that people with lower credit ratings file more claims.
    - Employers check credit history, and a poor credit history can keep people from obtaining the jobs they want.
- Six out of ten Americans have a poor credit history and, as a result, a bad credit score or rating. This is usually the result of imprudent choices, maxed-out credit cards, lack of savings and overdue payments. The result is that negative comments will be included on the credit report, and those with delinquent accounts often receive letters from collection agencies.

5. Display Transparency 4. Explain that *interest* is the price of using credit. An *interest rate* is the price of using credit expressed as a percentage of the amount owed. Explain that the table shows that people with different credit scores are charged different interest rates. Ask students to answer the problems on the transparency. Then discuss the problems and answers.

    a. In the table above, borrowers with a credit score of 680 paid how much more in interest over the life of the loan than those with a credit score of 725? ($31,002)

    b. In the table above, borrowers with a credit score of 575 paid how much more in interest over the life of the loan than those with a credit score of 725? ($127,128)

    Point out that those with an interest rate of 7.734 percent pay $55,947 more than the middle-score borrower and $86,949 more than the borrower with an excellent credit score.

6. Distribute a copy of Handout 1 to each student. Explain that this is an example of a credit report providing a credit history for an individual. Explain that credit report information comes from three major credit reporting bureaus. The reports include credit histories of consumers, information about where consumers live, where they work, the type of credit they have and what they owe. The reports also include credit problems, such as past-due payments and accounts turned over to collection agencies.

Give students a few minutes to review the document. Then discuss the following questions.

a. What kind of information is included in Section A? *(personal information and employment history)*

b. What kind of information is included in Section B? *(account and payment history)*

c. What does this include? *(a list of bank accounts current and past, a list of accounts current and past, information about how regularly the accounts are paid)*

d. What kind of information is included in Section C? *(public record information)*

7. Point out that public record information could include records of tickets, lawsuits or other legal problems. Continue the discussion of the handout with the following questions.

   a. What kind of information is included in Section D? *(inquiry information)*

   b. What do you think inquiry information means? *(Answers will vary.)* Point out that if an employer, insurance agency or creditor has inquired about the person's credit history, the employer, insurance agency or creditor will be listed here.

8. Distribute a copy of Handouts 2 and 3 to each student. Tell the students to prepare a consumer credit report for Chris Green using the information provided on Handout 3. Explain that there are some areas of the form they will not be able to complete because Chris' credit history is incomplete. Point out that this is a good thing; Chris has time to build a good credit history and to think carefully about the use of credit. Transparency 5 shows a sample completed Credit Report Information form for Chris Green.

9. Define *creditor* as a person, financial institution or other business that lends money, such as banks, credit unions, department stores and car dealerships.

10. Explain that there are certain characteristics that creditors consider when deciding whether or not a person is creditworthy. Only one of these characteristics is a credit history. Display Transparency 6 to discuss the 5 Cs of credit.

    - **Capacity** is the ability to repay debt. The creditor wants to know that the customer has adequate income to repay the debt.
    - **Credit history** is a review of the customer's past payment history. From this, the creditor can tell whether in the past the customer has paid on-time and as agreed.
    - **Capital** in this case refers to financial capital—that is, cash. Does the customer have cash in bank checking and savings accounts? If the customer was unable to work for a period of time, would he/she have cash on hand to repay the debt?

- **Collateral** refers to valuable assets that the lender might take if the customer fails to repay the loan. For example, an automobile can be collateral for auto loan. If the customer fails to repay the loan as agreed, the lender can take ownership of the automobile.
- **Character** refers to attributes the customer has that indicate responsibility and an ability to handle the debt.

11. Point out that an important form of credit for which most people apply is a *credit card.* When people purchase goods and services with credit cards, the bank that issued the credit card pays the store owner or person from whom the purchase was made. Essentially, the card-issuing bank is lending the customer money to make a purchase now, with the agreement to pay the bank later, after the bank sends the consumer a bill or statement. If consumers pay the bill in full, they aren't charged interest on the loan. However, if consumers only pay part of the bill, they incur interest on the loan.

12. Distribute a copy of Handout 4 to each student. Tell the students to use the information about Chris Green on Handout 3 and complete the credit card application as Chris Green. Transparency 7 shows a sample completed credit card application for Chris Green.

13. Allow time for students to complete the applications. Have students form groups of two, bringing Chris Green's credit history forms and Chris' credit card applications with them. Tell the students that one person in each pair should be the creditor and the other should play the role of Chris, the applicant. Explain that the creditor will use the 5 Cs of Credit to determine whether the applicant is eligible for a credit card. Distribute a copy of Handout 5 to each creditor, and explain that the creditor should use this as a guide while reviewing the applicants' credit history and application.

14. Allow time for students to work. Ask the creditors what factor they considered to be most important when deciding whether to give the applicant a credit card and ask them to explain why. *(Answers will vary.)* Ask the applicants what they might do to improve the possibility of obtaining credit for themselves in the future. *(Repay debts on time. Use credit wisely. Save for emergencies.)*

Closure

Review the key points in the lesson by asking the following questions.

a. What are benefits? *(things that are favorable to the decision maker)*

b. What are costs? *(things that are unfavorable to the decision maker)*

c. What are the costs and benefits of using credit cards? *(Refer to Transparency 2.)*

d. What is credit? *(the ability of a customer to obtain goods or services before payment, based on an agreement to pay later)*

e. What is a creditor? *(a person, financial institution or other business that lends money)*

f. What is a credit history? *(a person's payment activity over time)*

g. What is a credit report? *(a document compiled by a credit bureau that provides businesses with information about a consumer, including the consumer's credit history)*

h. What is interest? *(the price of using credit)*

i. What is an interest rate? *(the price of using credit expressed as a percentage of the amount owed)*

j. What are the 5 Cs of credit? *(capacity, collateral, cash, credit history and character)*

k. How does a poor credit history/low credit score affect a person's life? *(may not be able to obtain credit, pays higher interest rates for loans, pays higher insurance rates, has difficulty finding a job)*

Assessment

Have students assume the role of a creditor. Using the Consumer Credit Report on Handout 1, ask the students to write a letter to the applicant, John A. Dough, in which the creditor (student) decides whether or not to grant a credit card to John A. Dough. Students should include examples from his employment data, account history, public record and from the inquiry information to explain why they are approving or denying the loan. *Teacher note: When people open credit card accounts, buy insurance or apply for credit, it is noted in their credit report in the inquiry information. Having many inquiries for credit can negatively affect the applicant's ability to obtain loans or credit cards.*

Extension

1. Obtaining a credit card involves more than just applying for the card. Each credit card has advantages and disadvantages that wise consumers consider when looking for credit. Knowing the vocabulary of credit will help consumers who are applying for credit and making credit decisions.

2. Ask the students how many of them receive credit card offers in the mail. *(Answers will vary, but most will respond "yes.")*

3. Explain that credit card offers seem simple enough. Most of the important information, however, is in the small print and requires an understanding of credit vocabulary.

4. Distribute a copy of Handout 6. Review the credit vocabulary with the students. Tell students to use the handout to make notes as needed.

   - **Annual fee:** A fee charged by the card issuer for being a card holder. It is paid yearly on the anniversary of the opening of the account.

- **Annual Percentage Rate (APR):** The yearly percentage rate of the finance charge. The annual percentage rate may be either a fixed or a variable rate. The credit card holder agrees to pay a percentage of the outstanding balance in interest each month if he/she does not pay the balance off each month.
- **Balance transfer:** Transferring the whole or partial balance of one credit card to another credit card. Balances may be transferred to a card with a lower annual percentage rate.
- **Billing cycle:** The number of days between the last statement date and the current statement date.
- **Cash advance:** Obtaining cash from the card instead of using the card to make a purchase. The grace period does not apply to cash advances. This advance is an instant loan, and finance charges will be levied on this money from the time it is obtained until the loan is paid in full.
- **Finance charge:** Finance charges are levied on consumers who carry balances from month to month. These charges often vary according to the size of the balance. Finance charges can be avoided by paying the card balance in full each month.
- **Grace period:** The period of time in which consumers have to pay off a new balance if they do not have an existing balance on the account and have not accrued interest. No grace periods are provided if you carry a balance on your credit card. Finance charges are charged from the date you make a purchase.
- **Introductory rate:** A low interest rate that is offered for a limited time as an incentive.
- **Late payment fee:** If a payment is not received by the due date listed on the credit card statement, then the payment is considered past-due (late) and late fee charges may be added to your bill. Late payments may show up on credit reports, and numerous late payments make it difficult to secure additional credit.
- **Minimum payment:** The minimum amount a card holder must pay each month. Most card issuers require a minimum payment of 2 percent of the outstanding balance.
- **Over-the-credit-line fee:** Consumers are assigned a credit limit by the card issuer. This is the maximum amount a consumer may borrow. When a consumer exceeds this limit, a fee is charged. This fee is the over-the-credit-line fee.
- **Periodic rate:** The interest rate described in relation to a specific amount of time. The monthly periodic rate, for example, is the cost of credit per month; the daily periodic rate is the cost of credit per day.
- **Truth in Lending Act:** A federal law that requires lenders to provide certain information so borrowers can compare one loan to another. The most important facts lenders must provide are: finance charges in dollars and as an annual percentage rate (APR); the credit issuer or company providing the credit line; length of grace period, if any, before a payment must be made; minimum payment required; any annual fees; and fees for credit insurance, if any.

5. Display Transparency 8 and distribute a copy of Handout 7 to each student. Ask students to refer to Handout 6 as needed. Emphasize that it is important to read the entire disclosure sheet in order to understand the rate information related to any given credit card. Discuss the following.

    - **APR information:** Special offers only apply to certain terms that are mentioned in the credit card disclosures. If a credit card offers a 0.00% balance on the APR for purchases, it may be until the balance is paid off or until a date specified in the disclosure. Other APRs are mentioned separately and may not be offered for the "special" rate for purchases. For example, a balance transfer has a rate of 11.99% until December 1, 2006. After December 1, 2006 the balance rate becomes the purchase rate. And, this rate will fluctuate along with other interest rates in the market.

    - **Interest rate information:** *Variable interest rate* means that an interest rate may change during any period of the loan term, as written in the contract. The interest rate varies according to the *U.S. prime rate.* If the prime rate is 10 percent, the purchase and balance transfer rate will be 10 percent plus 5.24 percent, or 15.24 percent. *Fixed interest rate* means that the interest rate remains the same throughout the term of the loan.

    - **Grace period:** Notice that for this card the grace period is less than 20 days, and it only applies if the balance is paid in full each billing period.

    - **Method used for computing the balance for purchases:** For this card, the method used is the average daily balance. The interest charged will be based on the average balance that existed each day during the billing cycle. Interest charges under this method are usually higher than under the adjusted balance method, but lower than under the previous balance method. So, it makes a difference: Read carefully.

    - **Annual fees:** This card does not have an annual fee. Some cards do have an annual fee that is charged to the customer each year on the anniversary date of the account.

    - **Finance charges:** There are a number of finance charges related to this card. These include transaction fees for using the card in a foreign country, fees for cash advances and fees for late balances. Notice that the fees for late balances vary according to the amount of the balance. There is also a finance charge or fee for spending beyond the credit limit.

6. Distribute copies of two credit card offers to each student. Tell the students to compare the offers using the criteria and vocabulary discussed. Tell them to choose the credit card that best meets their credit needs. Tell the students to write a brief essay explaining why they chose the credit card they chose.

Lesson plan written by David B. Ballard, Louisville Branch economic education specialist, and Billy J. Britt, Little Rock Branch economic education specialist.

What's in a Report?

Consumer Credit Report

A

Consumer Information		Date of Report: 2/3/2009	
Name:	**John A. Dough**	**SSN:**	123-45-6789
Spouse:	N/A	**Date of Birth:**	1/1/90

Current Address	Previous Address
321 Any Street	123 Main Street
Our Town, USA	Our Town, USA

Employment Data			
Employer Name:	ABC Mart	**Employer Name:**	N/A
Location:	Our Town	**Location:**	N/A
Date Hired:	1/11/06	**Date Hired:**	N/A

B

Account History Information

Monster Music	**Balance:**	$85.78	**Pay Status:**	As Agreed
Our Town, USA	**High Balance**:	$500.00	**Loan Type:**	Credit card
	Credit Limit:	$500.00	**Date Opened:**	1/24/06
	Past Due:	$0		

Two-Year Payment History:

Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec

Our Town Bank	**Balance:**	$1,900	**Pay Status:**	As Agreed
Our Town, USA	**High Balance**:	$4,500	**Loan Type:**	Automobile
	Credit Limit:	N/A	**Date Opened:**	1/3/08
	Past Due:	$0		

Two-Year Payment History:

Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec

Sallie Mae	**Balance:**	$5,000	**Pay Status:**	As Agreed
Washington, DC	**High Balance**:	$5,000	**Loan Type:**	Educational
	Credit Limit:	N/A	**Date Opened:**	8/5/08
	Past Due:	N/A		

Two-Year Payment History:

Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec

C

Public Record Information

None

D

Inquiry Information

Creditor Name	Date of Inquiry	Credit Bureau
Sallie Mae	8/5/08	TransUnion
Monster Music	1/24/06	Experian
Our Town Bank	1/3/08	Equifax

Not Applicable · Current · 30 days late · 60 days late · 90 days late

A—The Consumer Information section contains information about your name, addresses and employment.
B—The Account History Information section provides detailed information about all credit accounts in your name.
C—The Public Record Information section lists publicly available information about legal matters affecting your credit.
D—The Inquiry Information section lists details about each inquiry that has been made into your credit history.

Credit Report Information

Consumer Information	**Date of Report:**
Name:	SSN:
Spouse:	Date of Birth:
Current Address:	Previous Address:
Street	Street
City State Zip	City State Zip
Employment Data	
Employer Name:	Employer Name:
Location:	Location:
Date Hired:	Date Hired:
Account History Information	
Account Name	
Balance:	Pay Status:
Credit Limit:	Loan Type:
Date Opened:	Past Due:
Account Name	
Balance:	Pay Status:
Credit Limit:	Loan Type:
Date Opened:	Past Due:
Account Name	
Balance:	Pay Status:
Credit Limit:	Loan Type:
Date Opened:	Past Due:
Public Record Information	
Inquiry Information	
Creditor Name	Date of Inquiry Credit Bureau

Who Is Chris Green?

Chris A. Green is a 21-year-old with an associates degree in computer technology from Tesonville Community College. After graduation, Chris accepted a job as an entry-level computer analyst at a local computer consulting firm, ITS Inc. ITS made an inquiry with the credit bureau before hiring Chris. ITS is located at 1111 Industrial Drive in Tesonville. The company's phone number is 636-530-1111.

Chris began work on June 30, 2006, with an annual gross salary of $38,750. Chris borrowed $5,000 to attend school and has been regularly repaying the loan. He currently owes $3,600. Chris' car is three years old with one year left to pay on the car loan. The car loan was obtained from Tesonville Community Bank in May 2002. The monthly payment is $225. The balance is $2,700. Unfortunately, Chris got a speeding ticket last week. That could affect the insurance costs for the car.

Chris has been renting an apartment at 27 Mason, Apt. E, Tesonville, MO 63016 for 18 months. The rent is $550 per month. Prior to that Chris lived at home. Chris' phone number is 636-530-1530. Chris' social security number is 491-61-2345. Chris was born on July 4, 1985. Chris has only one credit card—a PB gas card with a $500 limit. Chris has paid the account balance in full each month.

Credit Card Application

ABC Finance Company | Credit Card Application

No prepayment fee and no application fee! • Offer expires Dec. 31, 2007.

APPLICANT INFORMATION AND SIGNATURE

First Name

Initial

Last Name

Address

City

Home Phone

State

ZIP

Date of Birth (mm/dd/yy)

Social Security Number

Annual Household Income

Number in Household:

Monthly Housing Payment

Housing: Rent Own

Check Here if: Self-Employed Retired

Occupation

Business Phone

Employer

Employer Address

REQUEST ADDITIONAL CARD

First Name

Initial

Last Name

Applicant's Signature

Date

I have read and agree to the product information and understand that I will be considered for the credit card disclosed in this offer. I agree to the annual percentage rate (APR) interest terms of this offer and authorize ABC Co. to check my credit and employment history.

Credit Card Application Review

The 5 Cs of Credit

Capacity: Is the applicant employed?
How long has the applicant been employed?

Credit history: Does the applicant have any other loans or sources of credit?
Has the applicant repaid other loans on time and as agreed?

Cash: Does the applicant have funds in a savings account? A checking account?

Collateral: Does the applicant have valuable assets that might be used/sold to repay the loan in the event the applicant doesn't pay?

Character: Does the applicant have a good work history? Has the applicant had the same job for a while? Does the applicant appear to be responsible in his/her use of credit?

On Your Own Terms

Annual fee: A fee charged by the card issuer for being a card holder. It is paid yearly on the anniversary of opening the account.

Annual Percentage Rate (APR): The yearly percentage rate of the finance charge. The annual percentage rate may be a fixed or variable rate. Card holders agree to pay a percentage of the outstanding balance in interest each month if the balance is not paid off each month.

Balance transfer: Transferring the whole or partial balance of one credit card to another credit card. Balances are usually transferred to a card with a lower annual percentage rate.

Billing cycle: The number of days between the last statement date and the current statement date.

Cash advance: Obtaining cash with the card instead of using the card to make a purchase. The "grace period" does not apply to cash advances. This advance is an instant loan, and finance charges will be applied on this money from the time it is obtained until the loan is paid off.

Finance charge: Finance charges are levied on consumers who carry balances.

Grace period: A grace period is the time you have to pay off new balances if you do not have a balance already on your card and have not accrued interest charges. No grace periods are given if you carry a balance on your credit card. Finance charges are charged from the date you make a purchase.

Introductory rate: A low interest rate that is offered for a limited time as an incentive.

Late payment fee: If payments are not received by the due date listed on the statement, they are considered past-due (late) and late fee charges may be added to the bill. Late payments may show up on credit reports and numerous late payments make obtaining additional credit difficult.

Minimum payment: The minimum amount a card holder must pay each month. Most card issuers require a minimum payment of 2 percent of the outstanding balance.

Over-the-credit-line fee: A fee charged when balances go over credit limits.

Periodic rate: The interest rate described in relation to a specific amount of time. The monthly periodic rate, for example, is the cost of credit per month; the daily periodic rate is the cost of credit per day.

Truth in Lending Act: A federal law that requires lenders to provide certain information so borrowers can compare one loan to another. The most important facts lenders must provide are: finance charges in dollars and as an annual percentage rate (APR); the credit issuer or company providing the credit line; the size of the credit line; the length of the grace period, if any, before payment must be made; minimum payment required; any annual fees; and fees for credit insurance, if any.

Credit Card Disclosure Information

Bank Disclosures	
Annual percentage rate (APR) for purchases	0.00% until December 1, 2006. After that, **11.99%**
Other APRs	Balance transfer APR: 11.99% until December 1, 2006. After that, your purchase APR will apply. Cash advance APR: 20.74%. Default APR: 27.74%. See explanation below.*
Variable rate information	Your APRs may vary each billing period. The purchase and balance transfer rate, including the balance transfer APR described above, equals the U.S. Prime Rate** plus 5.24%. The cash advance rate equals the U.S. Prime Rate plus 14.99%, with a minimum cash advance rate of 11.99%. The default rate equals the U.S. Prime Rate plus up to 23.99%.
Grace period for repayment of balances for purchases	Not less than 20 days if you pay your total new balance in full each billing period by the due date.
Method of computing the balance for purchases	Average daily balance (including new purchases).
Annual fees	None.
Minimum finance charge	50 cents.
Transaction Fee for Purchases made in a Foreign Currency	3% of the amount of each foreign currency purchase after its conversion into U.S. dollars.
Transaction fee for cash advances: **Transaction fee for balance transfers:** **Late Fee:** **Over-the-credit-line fee:**	3% of the amount of each cash advance, $5 minimum. 3% of the amount of each balance transfer, $5 minimum, $75 maximum. However, there is no fee with the 11.99% APR balance transfer offer described above. $15 on balances up to $100; $29 on balances of $100 up to $1000; and $39 on balances of $1000 and over. $35

* All your APRs may automatically increase up to the Default APR if you default under any Card Agreement you have with us because you fail to make a payment to us when due, you exceed your credit line, or you make a payment to us that is not honored.

** For each billing period we use the U.S. prime rate published in the Wall Street Journal two business days prior to the Statement/Closing Date for that billing period.

*** Factors considered in determining your default rate may include how long your account has been opened, the timing or seriousness of a default, or other indications of account performance.

We apply your payments to low APR balances before higher APR balances. That means your savings will be reduced if you make transactions that are subject to higher APRs.

Rates, fees, and terms may change: We may change the rates, fees, and terms of your account at any time for any reason. These reasons may be based on information in your credit report, such as your failure to make payments to another creditor when due, amounts owed to other creditors, the number of credit accounts outstanding, or the number of credit inquiries. These reasons may also include competitive or market-related factors. If we make a change for any of these reasons, you will receive advance notice and a right to opt out in accordance with applicable law.

What Are the Costs and Benefits?

Benefits	Costs

Costs and Benefits of Credit Cards

Benefits	vs.	Costs

Benefits

- Convenient to carry and use.
- Safer than carrying around a lot of cash.
- An extra source of money in emergency situations.
- A means of building up your credit record, which may eventually help you in obtaining a loan to purchase home, car, etc.
- Accepted at most U.S. businesses and in many other countries worldwide.
- May be used as a short term (20-25 day) interest-free loan, depending on the specific credit card.
- Benefits such as frequent flier mileage, cash rebates, etc. may be provided depending on specific credit card.
- A means to purchase items you may not be able to pay for in full at one time.

Costs

- Perhaps too convenient to use (may lead to charging too much). Personal misuse may lead to debt and/or a poor credit history.
- May be stolen and used fraudulently.
- A favorite target for scam artists—be careful about releasing your credit card information!
- Penalties for late payments may go up as high as 20 percent or more.
- Not accepted at all stores, restaurants or locations, nationwide or worldwide.
- Finance charges appear when you do not pay your monthly bill in full or on time, or when you make cash advances.
- Severe late fees ranging from $20 to $25 may apply for late payments.

What Does a Credit Report Tell?

- Record of how you have handled your personal financial obligations.
- Credit report is your "financial fingerprint"
- Credit scores affect every aspect of our financial lives, including qualification for loans and mortgages, the interest rates we pay, employment opportunities and even insurance premiums.
- Six out of ten Americans have a poor credit history and as a result suffer from a bad credit rating or score. Bad credit starts with imprudent choices, maxed-out credit cards, exhausted savings and overdue bills—and can end with a letter from a collection agency.

Credit Scores and Interest Rates

Credit Scores and Loans

Credit Score	Interest rate on a $200,000 30-year fixed mortgage rate	Payment	Interest over the life of the loan
720-850	5.922%	$1,189 a month	$228,072
675-699	6.584%	$1,275 a month	$259,074
620-674	7.734%	$1,431 a month	$315,021
560-619	8.531%	$1,542 a month	$355,200

Source: MSN Money

1. In the table above, borrowers with a credit score of 680 paid how much more in interest over the life of the loan than those with a credit score of 725?

2. In the table above, borrowers with a credit score of 575 paid how much more in interest over the life of the loan than those with a credit score of 725?

Credit Report Information Sample for Chris Green

Consumer Information	**Date of Report:**
Name: Chris A. Green	SSN: 491-61-2345
Spouse: N/A	Date of Birth: July 4, 1985
Current Address:	**Previous Address:** Not Known
Street: 27 Mason, Apt. E.	Street:
City: Tesonville State: MO ZIP: 63016	City: State: ZIP:
Employment Data	
Employer Name: ITS	Employer Name: Not Known
Location: Tesonville, MO	Location:
Date Hired: June 30, 2006	Date Hired:
Account History Information	
Account Name: Tesonville Community Bank	
Balance: $2,700	Pay Status: Good
Credit Limit:	Loan Type: Automobile
Date Opened:	Past Due:
Account Name: PB Credit	
Balance: 0.0	Pay Status: Good
Credit Limit: $500	Loan Type: Credit Card
Date Opened:	Past Due:
Account Name: Tesonville Community College	
Balance: $3,600	Pay Status: Good
Credit Limit:	Loan Type:
Date Opened:	Past Due:
Public Record Information	
Speeding ticket	
Inquiry Information	
Creditor Name: ITS	Date of Inquiry: Credit Bureau:

Five Cs of Credit

Capacity: ability and source to repay debt

Credit history: willingness to pay on time and as agreed

Capital: cash

Collateral: valuable assets or property used to back up a loan

Character: attributes that show skill and ability to handle requested debt

Credit Card Application—Answers

ABC Finance Company | Credit Card Application

No prepayment fee and no application fee! • Offer expires Dec. 31, 2007.

APPLICANT INFORMATION AND SIGNATURE

First Name	Initial	Last Name
Chris	A	Green

Address: 27 Mason, Apt E

City: Tesonville

Home Phone: 6365301530

State: Missouri

ZIP: 63016

Date of Birth (mm/dd/yy): 07 04 1985

Social Security Number: 491 62 2345

Annual Household Income: 38750

Number in Household: 1

Monthly Housing Payment: 550

Housing: X Rent ☐ Own

Check Here if: ☐ Self-Employed ☐ Retired

Occupation: Computer Analyst

Business Phone: 6365301111

Employer: ITS

Employer Address:

REQUEST ADDITIONAL CARD

First Name Initial Last Name

Applicant's Signature Date

I have read and agree to the product information and understand that I will be considered for the credit card disclosed in this offer. I agree to the annual percentage rate (APR) interest terms of this offer and authorize ABC Co. to check my credit and employment history.

Credit Card Disclosure Information

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Other APRs	Balance transfer APR: 11.99% until December 1, 2006. After that, your purchase APR will apply. Cash advance APR: 20.74%. Default APR: 27.74%. See explanation below.*
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Over-the-credit-line fee:	$35

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