Basic Presentation on Credit and Credit Cards

Level: High school juniors and seniors

This is a basic presentation that introduces students to the concept of credit, credit scoring and reports, and the working of credit cards. The first part of the presentation is interactive in that it requires the participation of two students in a series of hypothetical loan situations. The remaining parts of the program are more typical class room presentations, with the volunteer instructor presenting and explaining the topic. Students should be encouraged to ask questions at any point.

A PowerPoint file accompanies Parts 2 through 5 of the program. It can be used primarily to guide the presentation, and to restate and reinforce the message of the instructor. Graphics and videos have largely been omitted from the PowerPoint file for several reasons: students do not seem to react to them; they quickly become dated; and they result in very large files that are difficult to download and/or run.

You may want to start or end the program with the video “SNL's Don't Buy Stuff You Cannot Afford” which can be downloaded from the download page of <http://www.carechicago.org/videos.html>.

Part 1: Interactive Introduction to Credit and the Different Types pf Credit

Start with asking “*What is CREDIT*?” Some students may say what they think credit is. Explain that credit is *the ability to borrow money.* In other words, if you have credit, can you borrow money.

Next ask: “*How do you get credit?”* You answer this question by going through the following, which is designed to introduce the three principal means by which credit is obtained: character, income, and assets.

Obtaining credit by personal knowledge of character:

*Select two students who seem friendly with each other. Designate one of the students as the lender, and ask that student: “Your friend is hungry but has no money for lunch. She wants to borrow five dollars from you. Will you give her the five dollars”?*

*Whatever the answer, the student has just made a credit decision. Usually, the student will agree to make the five dollar loan. When you ask why, the likely response will be “because I trust her,” or “because I gave her money for lunch and she paid my back.”*

*Explain to the class that the credit decision made was one based on character or reputation. Explain that good character is most common way to get credit, and usually the least expensive way.*

Obtaining credit by a good record of character:

*Now change the facts. The two students do not know one another – they have never heard of each other before they just met. Still, one of the students wants to borrow five dollars from the other for lunch. Ask the class: How can a loan be made based on character when the person who asked to make the loan does not personally know the character of the other person – the borrower?*

*At least one student will know the answer (perhaps with some prodding) – the person making the loan should get a credit history or a credit score. Explain how credit histories and credit scores are the way that each person’s character is tracked. Do not go into detail yet on credit reporting, identity theft, etc – those can wait until the second part of the program.*

Obtaining credit based on income:

*Now change the facts again – back to the two students, a lender and a borrower. The lender does not know the borrower, there is no credit history for the borrower, and the borrower has no collateral to offer. But the borrower does have a regular job, which she can prove with pay stubs. Will the lender student give the other student $5 for lunch? With some coaxing, the answer should be “yes.” Explain that another credit decision has been made, this time based on the income, or wages or pay, of the student wanting the loan. Explain that this is how young adults usually get their first credit card – although they have no reputation for paying loans back and they have no collateral, because they have a job they can still borrow money. Of course the amount they can borrow will depend on how much they make in their job, but still it is a start.*

*Now is a good time to talk about payday loans. Ask the students if they are familiar with payday loans -- many of the students will remember having seen store fronts for payday loan shops. Explain that a payday loan is a way to borrow money based on your pay check – how much you will get paid at your job. Give an example of how a payday loan works. The example I use is this: You go to a payday loan show with a pay stub showing that your take home pay is $800 a week. You borrow $400 and promise to repay the $400 next Friday, when you get your next pay check. On Friday, you can either pay back $400 with $50 more for interest, or you can roll the $400 over for the next Friday, so long as you pay $50 on this Friday. Either way, you have paid a very high rate of interest that could have been avoided if you had a credit card.*

Obtaining credit based on assets:

*Now change the facts again. The two students do not know each other, and the student that wants to borrow money is not old enough to have a credit history and does not have a job. But that student has a big gold ring that she will give to the other until the five dollars has been paid back. Ask the lender student whether she will make the loan -- coax a “yes” out of her if need be. Explain to the class that another credit decision has been made, but not one based on character or income. This credit decision is based on collateral – the giving of an asset to make sure the debt is paid back. Many of the students will be familiar with the word collateral, but use this as an opportunity to explain what it is and how it works. In particular, if the loan is not paid back, the person who made the loans gets to keep the collateral.*

*Now provide two examples of common collateral backed loans. The first is a car loan. The loan is secured by the car that was purchased with the loan. If the loan is not paid back, the car will be repossessed. Use the terms “repo’d” and “repo man” as several of the students will be familiar with those words.*

*The second example is a pawn shop. Ask how many students are familiar with a pawn shop – a surprising number will be. Explain how a pawn shop works, using the example of pawning a grandmother’s wedding ring for a loan. The example I use is this: the wedding ring is pawned for $500; two weeks later, when you go to get the ring back, you have to pay $700. You will have paid $200 for the use of $500 for two weeks, an incredibly high rate of interest. Explain that with a credit card the same amount of money could have been borrowed for no interest.*

Summarize the different ways to obtain credit*:*

*Explain that from these examples there are two lessons: First, having good character, which means having a good credit history and credit score, are very important because they allow you to borrow money from strangers (meaning, banks). Explain that you will talk about credit history and scores later in the program. Second, having a credit card is important because with a credit card you can avoid pawn shops and pay day loans. Explain that to have a credit card you need a good credit score, so the two important things are tied together.*

Part 2: PowerPoint Outline for traditional teaching format with some interactive opportunities:

 **A. Credit Card Basics.**

 1. A credit card is a loan that is based on the character, or reputation, of the person that wants the loan. (Slide 2.)

 A. How does the credit card company know the character of the borrower? As discussed above, by getting that borrower’s credit score or credit history.

 2. A credit card might also be given based on a person’s wages, or what they are paid at their jobs. This is a common way that a young person, who has no credit history, gets his or her first credit card. (Slide 3.)

3. A credit card is not the same as a debit card. Why not? (In every class there are usually several students who can precisely explain that when using a debit card you are directly using your own money in a bank account, but when using a credit card you are, at the moment of use, using someone else’s money). (Slide 4.)

 4. A credit card is not the same as a pre-paid card, such as a CTA card, an iTunes gift card, or a Walmart Moneycard. Why not? (Slide 5.)

 5. A credit card is what is called “revolving credit.” This means that the cardholder is given a credit limit, which is used up when the card is used but is restored when payment is made. We’ll talk about that more later. (Slide 6.)

**B. How to Get a Credit Card?** (Slide 7)

 1. From a bank or credit union where you have an account.

 2. From a bank or credit union where a parent has an account.

 3. From a credit union where you work.

 4. On-line by searching for “credit card application”

 A. A credit card obtained on-line may have a very high interest rate or high fees.

**C. Credit Histories, Credit Reports, and Credit Scores**.

 1. It will be easier to get a credit card if you have (i) good credit character and (ii) a job. A credit card is a mixture of two types of credit – credit based on character and credit based on income, or pay. (Slide 8)

 2. It is easy to show that you have a job – you just need a pay stub. (Slide 9).

 3. But how do you show good credit character to a credit card company that has never heard of you?

4. Every person who has ever had credit, including even a data plan, has a credit history that is tracked by three companies. (Slide 10).

 A. How do these companies know so much about your credit? (Slide 11)

The companies are told about every time a bill is sent to you, and about every time you pay a bill, or fail to pay a bill. For each person, they take all of that information to create a credit report. Once you have a credit report, you can get a credit score. A high credit score will mean that you have good credit character.

B. How can you build a good credit history or score? Start small – use a credit card a few times a month at Dunkin Doughnuts and pay the bill promptly.

 5. What else can credit reports be used for? (Slide 12)

A. Looking for mistakes on your credit report that might be giving you a slow credit score. A common mistake is the mixing of credit information on the reports of a father and son when they both have the same name.

 *What to do? Contact credit reporting companies.*

B. Looking for bad information that is from before you were old enough to have credit. A common problem is a parent’s use of a child’s social security account to open an electricity or gas account. When the parent misses a payment on the account, it goes on the child’s credit report.

*What to do? Contact credit reporting companies.*

C. Looking for identity theft. Bad information on a credit report that you do not recognize may mean that someone is using your name to get credit.

*What to do? Close accounts and contact credit reporting companies. You may also need to make a police report.*

**D. How a Credit Card works.** (Slide 13)

 1. Charges on the card are billed once a month.

 2. Payment of the bill is due in about 25 days.

 3. If you pay the bill on-time and in full, you will pay no interest on the amount of the bill. (Slide 14)

 4. The bill will give you the option of making a “minimum payment.” For example, if the charges on the bill add up to $100, you may be allowed to make a minimum payment of $20 and still be able to use the card. (Slide 15).

 A. But if you make the minimum payment, what happens to the other $80? Like unused minutes for a cell phone or data plan, the $80 dollars will roll over to the next bill.

 B. Interest will be charged on the part of the bill that rolls over to the next bill. The interest rate may be very high. The interest will appear on the next bill received from the credit card company.

 5. The next bill, which will include interest charged on the rolled over part of the last bill, will also have a minimum payment. If you again only pay the minimum payment, then the unpaid part of the bill will roll over again, and interest will be charged again on what rolls over.

 6. If you roll over a bill two months or more in a roll, you will be charged interest on the interest that was charged in a prior month. This is called “compound interest” and it can make the total bill grow very large over several months.

 7. Minimum payments and compound interest can make it take a very long time to pay off a something, like a computer, purchased with a credit card. (Slide 16 and Slide 17 (interactive), Slide 18).

 8. You can get in trouble if you continue to make only the minimum payment on a credit card account. This is because of the interest that is charged on the part of the bill that rolls over. The total bill will become more than you can afford to pay. When that happens, and you cannot even afford to make the minimum payment, the whole bill will immediately become due. If you can’t pay it, the credit card company can sue you and start taking part of your paycheck. This might force you to file for bankruptcy. (Slide 19 and 20)

9. What if you cannot make any payment on the credit card bill?

 Interest will be added to the entire balance. The balance will roll over every month with the new interest, and more interest will be charged on the new balance.

 The credit card company will sue you in court. A judgment will be entered against you, which the credit card company can take to your boss and demand 15% of your pay.

 You may be forced into bankruptcy.