Credit – Teacher's Guide

The purpose of this section of the "Lessons on Insurance and Credit" teaching kit is to:

- Define the basics of credit;
- Inform your students of the challenges of using credit wisely and how credit impacts their overall financial situation; and
- Give them tips on how to effectively use credit cards.

Watch the video segment, assign the students to review the student guide, and then discuss the material by asking them the following questions.

What is credit?

Credit is essentially the offering of goods or services with the expectation of future payment, often with interest. As your students learn the importance of budgeting, they will come to understand the importance of establishing and using credit, as well as being able to set aside enough money each month to make payments on time.

Credit usually takes one of two forms:

- Deferring payments in order to purchase a particularly expensive item or service, such as a house, car, education costs or home repairs; or
- Deferring payments for convenience – this is when credit cards usually come into play.

What do your students need to know about credit cards?

Credit cards have become an essential part of everyday life for many people. Many of us use credit cards for their convenience, efficiency and safety. After all, few people carry large amounts of cash on them when they can use a credit card instead. Before your students get a credit card, they should become familiar with these important features:

- **Annual fee** – a fee charged by the lending institution each year just for the privilege of having the card.
- **Balance** – the amount of money owed on a credit card. This is analogous to the "principle" on a loan.
- **Cash advance or check writing fee** – extra charges incurred for using your credit card to obtain cash or to write a convenience check on the account.
- **Credit limit** – a preset limit for the balance the lender will allow you to incur.
- **Finance charges** – a blanket term covering any cost associated with having credit. This may include fees for having a balance over the preset limit or for using the credit card to get cash.

- **Grace period** – the amount of time you can be late on a payment without being charged an extra fee.
- **Interest rate** – the percentage paid on unpaid balances.
- **Late payment fee** – the penalty you pay for paying the credit card bill after its due date.
- **Over limit fee** – the penalty you pay for going over the credit card's preset limit.

What are some tips for managing how credit cards are used?

Credit cards can be very helpful when it comes to managing spending. But they can also lead to a financial nightmare if they're not used wisely. Here are a few pointers anyone who is just starting to use credit cards should follow:

Read the fine print. Unless you repay the entire balance immediately, fees and finance charges associated with the high interest rates many credit cards charge can continue to pile up and put you in more debt.

Keep the number of credit cards you have to a minimum. It's best to only have one or two credit cards. Even unused cards with a zero balance can impact a credit report. Plus, having large credit lines available can be tempting to use, causing you to spend more than you have budgeted.

Pay as much as you can each month on the credit card balance. Sometimes the minimum payment covers only slightly more than the interest charged each month, which dramatically increases the amount of time it takes to pay off the entire balance.

Keep credit card balances low. This will help you minimize the impact of high interest rates.

What is a credit history? Can it impact more than my ability to borrow?

In addition to the expenses associated with using credit cards, using them creates a trail of information known as a credit history. Each person's credit history basically tracks their history of borrowing money and repaying debt.

Companies known as credit bureaus record all the information that goes into your credit history into a credit report and use it to assign each person a credit score. You might want to compare a credit score to a grade your students earn and how that grade may affect their future.

Lenders look closely at a loan applicant's financial situation and credit history. They use credit reports and credit scores to help make lending decisions. A good or bad credit history can have a major impact on future financial opportunities. Without a good credit report, a person will have fewer options to secure the funding needed for major purchases.

In addition to lenders, insurance companies sometimes look at credit history to get an overall picture of how risky someone may be to insure. And some employers even take a person's credit history into account when making a hiring decision, as they may interpret one's credit score as a measure of trustworthiness.

Because your credit report can impact so many things, it's a good idea to obtain a copy of your credit report annually or whenever you close a credit card account or pay off a loan. Keeping track of your credit history also helps prevent identity theft. Report items that don't belong on your credit history or accounts that should be closed to the credit bureau to make sure they no longer appear on your record or adversely affect your credit score.

Lesson plan:

The following exercise will help your students understand the true cost of obtaining credit. Go over the example below and discuss.

Purchases	Monthly payment	Annual interest rate (16%)	Months to pay off	Total cost
$1,000	$1,000	$0	1	$1,000
$1,000	$100	$81	11	$1,081
$1,000	$50	$171	24	$1,171
$1,000	$20	$659	83	$1,659

You've made purchases totaling $1,000 on a credit card with a 16% annual interest rate. If you pay off the total balance on time, you pay no interest. If you make monthly payments of $100, your account will be paid off in 11 months. Now look at the interest amount and how long it will take to pay off the balance if you pay only $50 a month.

And look what happens if you pay only the minimum monthly payment of $20. It will take 83 months – nearly seven years – to pay off the balance, resulting in a total payment of $1,659.

This example also presumes you never use the card again after the initial $1,000 purchase.

As you can see, it's important to repay debts as soon as possible, especially if you have high interest rates. Imagine also what would happen if you make additional charges over time.

Every dollar you pay in interest on a credit card bill costs you the opportunity to use that dollar for something else. Avoid making hasty decisions that could make cash management more difficult for you.

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