

Instructor Guide

BORROWING BASICS

FDIC

Money Smart



FDIC Money Smart for Young Adults



Building: Knowledge, Security, Confidence

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Module 5: Borrowing Basics Layering Table

Please read the Layering Table Instructions in the *Guide to Presenting Money Smart for Young Adults*.

Pages	Time (Min.)	Topic	Subtopic & Activities	Target Audiences
8-12	5	Checking In		<ul style="list-style-type: none"> Everyone
13-15	10	Borrowing Basics	Credit, the importance of credit, collateral	<ul style="list-style-type: none"> Everyone
16-22	20	Types of Loans	Credit cards, consumer installment loans, cheaper than alternatives, home loans <ul style="list-style-type: none"> Activity 1: Consumer Installment Loan versus Rent-to-Own Services Activity 2: Types of Loans 	<ul style="list-style-type: none"> Those wanting an understanding of credit and types of loans
23-25	15	The Cost of Credit	Fees, interest, truth in lending disclosures, what lenders must disclose <ul style="list-style-type: none"> Activity 3: Borrowing Money Responsibly 	<ul style="list-style-type: none"> Those who are unfamiliar with the costs of borrowing money
26	1	Equal Credit Opportunity Act	Equal Credit Opportunity Act	<ul style="list-style-type: none"> Everyone
27-40	30-60	How Credit Decisions are Made	The four Cs of credit decision making: capacity, capital, character, collateral; barriers to borrowing money; legal terms for types of debt actions; credit report; tips for managing your credit; catch phrases of abusive lenders <ul style="list-style-type: none"> Activity 4: The Four Cs and Barriers to Borrowing Money Activity 5: Loan Applications Activity 6: John Q. Consumer 	<ul style="list-style-type: none"> Those who use or are considering using credit in the future Those who have begun developing a credit history and those who will be developing a credit history.
41-42	5	Predatory Lending Practices	Catch phrases of abusive lenders, guard against predatory lending practices	<ul style="list-style-type: none"> Those who use or are considering using credit in

Module 5: Borrowing Basics Layering Table

Please read the Layering Table Instructions in the *Guide to Presenting Money Smart for Young Adults*.

Pages	Time (Min.)	Topic	Subtopic & Activities	Target Audiences
				the future
43-47	10	The True Cost of Alternative Financial Services	Rent-to-own services, payday loans, refund anticipation loans, tips for borrowing money	<ul style="list-style-type: none"> • Everyone
48	5	Conclusion		<ul style="list-style-type: none"> • Everyone
49-51	5	Knowledge Check		<ul style="list-style-type: none"> • Everyone

Getting Started

Purpose

The *Borrowing Basics* module will help you learn how to use credit appropriately and determine what forms of credit best suit your needs.

Presentation Time

Each topic has an approximate completion time listed in the *Borrowing Basics* Layering Table. Use the suggested times to personalize the module based on your students' needs and the given time period. Allow extra time for activities and questions when teaching larger groups.

Materials and Equipment

The materials and equipment needed to present all of the *Money Smart for Young Adults* modules are listed in the *Guide to Presenting Money Smart for Young Adults Curriculum*. Review the guide thoroughly before presenting this module.

Module Activities

- Activity 1: Consumer Installment Loan versus Rent-to-Own Services
- Activity 2: Types of Loans
- Activity 3: Borrowing Money Responsibly
- Activity 4: The Four Cs and Barriers to Borrowing Money
- Activity 5: Loan Applications
- Activity 6: John Q. Consumer

Icons

The following icons are used throughout the Instructor Guide and Participant Guide to indicate what type of activity will be conducted.



Learning Objectives

List the objectives to set the stage for learning.



Flip Chart

Use a flip chart to document students' comments or write important points for students to remember.

**Presentation**

Present information or demonstrate an idea.

**Review**

Refer students to and summarize material provided in the Participant Guide.

**Activity**

Guide students through an activity to support their learning.

**Assessment**

Direct students to take a short test.

**Discussion**

Facilitate a discussion about a topic as directed.

**Ask a Question**

Present a problem or question for discussion.

Character Usage

The following characters will be used in the situational comic strips of the module to depict students in a real-world application of the content. The comic strips and characters can be used to facilitate discussions related to the module content.

**Jasmine**

Jasmine is an 11th grade student at Lakeview High School. Her activities include hanging out with friends and going shopping. In school, her favorite subject is English and she also swims on the swim team. She works part time on the weekends around the holidays in her aunt's gift shop nearby, and has a younger brother named Dominique. Jasmine wants to attend an in-state college and plans to be an exercise physiologist.

**Todd**

Todd, a sophomore at Lakeview High School, is shy with a very sarcastic sense of humor. He is always avoiding social situations because he comes from a lower-income family and cannot afford to do the things the other teens are doing. He is very intelligent and is planning to attend college, but he is not sure how he will pay for it or where

he will go. Todd works part-time at a fast food restaurant and the local grocery store, and is saving all he can for college.

**Ramón**

Ramón was born in the United States (U.S.), but his parents are from Peru; they came here when they were teenagers themselves. Ramon is 18 and preparing to graduate from Lakeview High School. He will be attending college on a soccer scholarship and studying mechanical engineering, since his dream job is to work for NASA. Ramón has a little sister, and an older brother who is a pilot in the Air Force. He likes to take his girlfriend to the movies or to play mini golf with the money he earns working as a technician at a local computer shop.

**Grace**

Grace is an artistic student who wants to go to Fashion Design School after she graduates high school, but her parents want her to go to college. She does not really fit in to the “high school scene,” but the teachers really see potential in her to do great things. She works at a clothing store at the mall, and spends her free time on fashion sketches. Since her parents are totally against Grace going to Fashion Design School, she is very careful with her money so she can continue to buy design supplies.

Checking In

Welcome



Welcome to *Borrowing Basics*! Learning to manage credit is an important part of building your financial future. This module will teach you about borrowing money from banks and other financial institutions. You will learn how loans work, and how financial institutions make loan decisions.

Introductions



Before we get started, I will share a little about myself and I would like to know a little bit about you.

[Introduce yourself and share a little of your background and experience.]

Record students' expectations, questions, and concerns on chart paper. If there is anything you will not teach, tell students where the information can be obtained (e.g., another module or a website). Check off their responses at the end of the training to show that the lesson content met their expectations.

As you introduce yourself, state:

- Your expectations
- Questions and/or concerns about the training content

Purpose



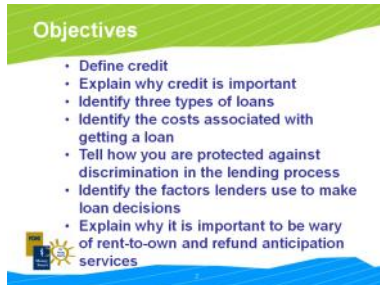
The *Borrowing Basics* module will help you learn how to use credit appropriately and determine what forms of credit best suit your needs.

Objectives



By the end of this module, you will be able to:

- Define credit.
- Explain why credit is important.
- Identify three types of loans.
- Identify the costs associated with getting a loan.
- Tell how you are protected against discrimination in the lending process.
- Identify the factors lenders use to make loan decisions.
- Explain why it is important to be wary of rent-to-own and refund anticipation services.



Slide 2: Objectives

Agenda and Ground Rules



In addition to me presenting material to you, we will have classroom and small group discussions and exercises that allow you to practice what you have learned.

If you have experience or knowledge in some aspect of the material, please share your ideas with the class. One of the best ways to learn is from each other. You might be aware of some method that has worked well for you or some pitfall to avoid. Your class contribution will enhance the learning experience. If something is not clear, please ask questions!

Student Materials



Each of you has a copy of the *Borrowing Basics* Participant Guide. You can take it home and use it as a reference. It contains:

- Information and activities to help you learn the material
- Tools and instructions to complete the activities
- Checklists and tip sheets
- A glossary of the terms used in this module

Refer students to the Participant Guide. Review its contents and organization.

What Do You Know?



Use the Pre-Assessment to gauge students' prior knowledge of the content, and customize your presentation focusing on content with which they are the least familiar.

Before we begin, we will see what you know about banking services.

Take a few minutes to complete the Pre-Assessment beginning on page 6 of your Participant Guide. It will not be scored and you will be able to determine whether you answered each question correctly as we progress through the module.

Which questions were you unsure of or unable to answer? *[Note: If time is limited, make sure you cover these content areas.]*

What questions do you have about the module overview?



Pre-Assessment

1. What is *credit*?
 - a. **Money you borrow and must pay back**
 - b. Free money that you do not have to pay back
 - c. Money you have saved for emergencies
 - d. The balance left on a gift card after you have used it to pay for something
2. Select all that apply. Maintaining good credit is important because it:
 - a. Can help you graduate from college
 - b. Allows you to carry more cash than usual
 - c. **Allows you to purchase large items like a car, house, or furniture and pay over time**
 - d. Might cause your interest rates to be raised
3. What is a *loan*?
 - a. A charge by a financial institution for maintaining or servicing your loan account
 - b. **Money you borrow but must also repay**
 - c. Something valuable that you own and can sell for cash
 - d. The cost of borrowing money

4. Which type of loan is used to pay for personal expenses for you and your family? Select all that apply.
 - a. **Consumer installment loans**
 - b. **Credit cards**
 - c. Home loans

5. A loan for which of the following is most likely to be unsecured? Select all that apply.
 - a. Home
 - b. Car
 - c. **Furniture**
 - d. **Education (e.g., student loan)**

6. Which of the following replaces a loan on your home in order to get a better interest rate?
 - a. Home equity loan
 - b. Home equity line of credit
 - c. **Home refinance loan**
 - d. Home purchase loan

7. What type of an interest rate stays the same?
 - a. **Fixed rate**
 - b. Variable rate
 - c. Waning interest
 - d. Dual rate

8. What should you review and compare when shopping for a loan?
 - a. Annual percentage rate (APR)
 - b. Fees
 - c. Truth in Lending Disclosures
 - d. **All of the above**

9. What four factors do lenders generally use in their loan-making decision?
 - a. Collateral, capacity, capital, and whether you purchase their credit protection insurance

- b. Capital, character, overdraft protection, and collateral
 - c. Capacity, capital, collateral, and character**
 - d. Character, collateral, capacity, and credit limit
10. Getting credit is not cheap. However, which is usually the least expensive over time?
- a. Rent-to-own services
 - b. Bank loan**
 - c. Payday loan
 - d. Refund anticipation services
11. A home equity loan:
- a. Replaces a mortgage at a lower interest rate
 - b. Has the same monthly payment
 - c. Is a loan designed for purchasing a house
 - d. Can be used to pay for any kind of expense**
12. If someone offers you a loan, what can you do to make sure it is a good deal?
- a. Check to make sure the loan provider is reputable
 - b. Shop around and compare all terms and conditions
 - c. Make sure you can afford the loan payments
 - d. All of the above**
13. Which of the following is a short-term loan secured by your expected income tax refund?
- a. Payday loans
 - b. Rent-to-own services
 - c. Refund anticipation services**
14. The Equal Credit Opportunity Act (ECOA):
- a. Ensures you are not discriminated against (e.g., because of your race, color, or gender)**
 - b. Requires lenders to notify you if you are denied a loan or credit
 - c. Requires creditors to promptly credit payments and correct billing mistakes



10 minutes Borrowing Basics



This section will help you gauge how much students know about borrowing money. Share or have students read the comic strip on slide 3 or page 9 of their Participant Guide.

Borrowing Basics



Todd is excited about his new cell phone, but Ramón raised some good questions. What do you think about Todd's purchase? *Answer: It sounds like Todd did not make some wise choices (e.g., he did not read the contract before he signed it and he signed up for a credit card to pay for the cell phone).*



Slide 3: Borrowing Basics

Do you think Todd can afford his new purchase? *Answer: It also does not sound like Todd can afford this purchase if he is always borrowing money from Ramón.*

Is it wise for him to get a credit card so he can pay for the new cell phone? *Answer: If Todd carries a balance on the credit card, he will have to pay interest on his purchase. This may make the cell phone much more expensive than he realizes.*

What do you think might happen if Todd cannot pay his monthly cell phone or credit card bill? How might this affect his credit? *Answers: If Todd is not careful and cannot make his payments, he may be charged late charges and penalty fees. We will talk more about these in this module. It will also be harder for Todd to borrow money in the future if he develops a history of making late payments or not making his*

payments.



What is Credit?

Who can define credit?

Credit is the ability to borrow money. When you borrow money on credit, you get a loan.



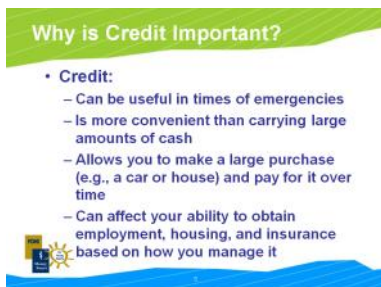
Slide 4: Credit

Click the space bar, right arrow, or mouse to display the definition of credit once students have provided their responses.

You make a promise to pay back the money you borrowed plus some extra. The extra amount is part of the cost of borrowing money. This cost is also called interest.

If you use credit carefully, it can be useful to you. Not being careful in the way you use credit can cause problems.

You have probably heard the term “good credit.” Having good credit means that you make your loan payments on time to repay the money you owe. If you have a good credit record, it will be easier to borrow money in the future. However, if you have problems using credit responsibly, it will be harder to borrow money in the future.



Slide 5: Why is Credit Important?

Why Is Credit Important?

Why do you think credit is important?

Credit is important because it:

- Can be useful in times of emergencies
- Is more convenient than carrying large amounts of cash
- Allows you to make a large purchase (e.g., a car or house) and pay for it over time
- Can affect your ability to obtain employment, housing, and insurance based on how you manage it

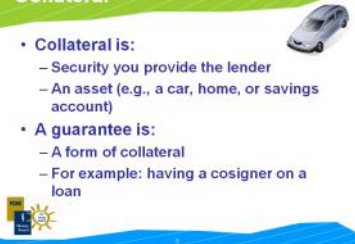


Collateral

Lenders take a risk to lend you money. Therefore, they want to be sure that their money is secure and they get repaid.

Collateral

- **Collateral is:**
 - Security you provide the lender
 - An asset (e.g., a car, home, or savings account)
- **A guarantee is:**
 - A form of collateral
 - For example: having a cosigner on a loan



Slide 6: Collateral

Click the space bar, right arrow, or mouse to display the definitions of collateral and guarantee once students have provided their responses.

You will often hear loans referred to as either “unsecured,” or as secured by *collateral* or *guarantee*.

Credit is often secured. Can anyone tell me what collateral means? Do you know what a guarantee is?

Collateral is security you provide the lender.

- Example: You pledge an asset (something valuable that you own including a car, home, or savings account) to the lender with the agreement that it will be used as repayment if you cannot repay the loan.

Certain items, like the following, generally cannot be used as collateral, unless they are used to secure the purchase of that item itself:

- Furniture for your home
- Clothing
- Kitchenware

Can you think of other assets that could be used to secure a loan?

A *guarantee* is a form of collateral.

- Example: If you do not qualify for a loan, you might ask someone to “cosign” the loan. That means that if you do not make the loan payments to the bank as agreed, the cosigner must pay the money you borrowed plus interest back to the bank.

A secured loan is one where you pledge collateral to repay the loan. Home equity loans and loans to purchase a car are two common examples.

An *unsecured loan* is not backed by collateral.

- Example: Personal and student loans. Credit cards are also often unsecured loans, although some are secured.



What questions do you have about credit?

Now that you know what credit is, let us talk about several different types of loans that you can obtain.

20 minutes **Types of Loans**



At some point in your life, you will need to borrow money (i.e., if you want to purchase a car or a house).

We are going to talk about three types of loans. They are:

- Credit cards
- Consumer installment loans
- Home loans, also known as mortgage loans



Credit Cards

What do people use credit cards for? *Write students' responses on chart paper.*

Credit cards give you the ongoing ability to borrow money for household, family, and other personal expenses.

Having a credit card allows you to buy things without actually having the money right away. Remember that if you are not careful in spending, you can get into big trouble—you could be burdened with debt. You need to be sure you are able to make at least the minimum monthly payment on your credit card bill. Ideally, though, you will pay your bill in full each month to avoid paying costly interest to the lender.

There is more information about credit cards in the Charge It Right module.

Consumer Installment Loans

A consumer installment loan is used to buy personal items for you and your family. It is called an “installment loan” because you pay the same amount each month in installments for a set



Slide 7: Types of Loans
Click the space bar, right arrow, or mouse to display the information about credit cards and consumer installment loans as you are discussing them.

period of time. One of the more common types of installment loans is a loan to purchase a car.

For example, Grace decides to buy a used car. She has saved \$2,500.00 from her summer job for a down payment. She finds a car she likes and the monthly payment is \$225.00 for 60 months with her \$2,500.00 down payment.

A student loan is also repaid in installments over time.

Cheaper Than Alternatives

When you need to borrow money for a larger purchase, there are certain advantages of borrowing through an installment loan instead of through a credit card or rent-to-own service:

- You are aware of the monthly payment amount and the time period given to pay off the loan.
- Installment loans, especially when secured by collateral, generally have much lower rates so it costs you less to borrow money.
- Repaying an installment loan includes principal and interest according to a preset payment schedule. This reduces the original loan balance during the term of the loan.



Activity 1: Consumer Installment Loan versus Rent-to-Own Services

Has anyone used or does anyone know of someone who has used rent-to-own services? *Ask for a show of hands.*

Activity 1: Installment Loan versus Rent-to-Own Services

Complete Activity 1 in your Participant Guide

- Break into 2 groups
- Read through your section of material
- List and describe 5 reasons to choose your payment method



Slide 8: Activity 1 Refer students to Activity

Although there are many similarities between secured installment loans and rent-to-own services, there are very important differences. Let us look take a look.

Use Activity 2 to guide you. Divide students into two groups. One group will read about the characteristics of the consumer installment loans while the other group reads about rent-to-own services. Each group is to come up with three to five

1: Consumer Installment Loan versus Rent-to-Own on page 12 in their Participant Guide.

reasons why their service is better to use and present the reasons to the other side of the class. After the students hold their “debate,” continue with the scenario about Grace wanting to buy a new television for her apartment. Conclude the activity by explaining how rent-to-own services may seem like a good deal, but may cost more in the end.

Consumer Installment Loans	Rent-to-Own Services
<ul style="list-style-type: none"> Secured installment loans are loans that are repaid in equal monthly payments for a specific period and are secured by the item you purchased. You can use the item you purchased while you are paying. 	<ul style="list-style-type: none"> Rent-to-own services allow you to use an item while you make weekly or monthly payments. When renting or leasing the item, you do not have to purchase the item and can return it at the end of the rental period or before you make your next weekly payment. You will not receive a refund of money paid. If you decide to purchase the item, the store may give you a price to buy the item or set up a plan to apply weekly rental payments toward the purchase price. The store is the legal owner until you make the final payment. If you miss a payment the store may repossess the property, which means they take the property back from you.
<ul style="list-style-type: none"> With installment loans, you are charged interest and you can shop for the best deal by comparing APRs. 	<ul style="list-style-type: none"> Rent-to-own agreements are technically not loans, so no interest is charged and, often, no credit check is performed. However, the fees included in your rental payment are just like the interest you would pay on a loan.
<ul style="list-style-type: none"> Generally, installment loans are less expensive than rent-to-own agreements. 	<ul style="list-style-type: none"> By making the weekly payments, you will pay much more than if you paid cash or used an installment loan.

Scenario

Grace is moving into her own apartment after graduation and wants to buy a television. She is trying to decide between

getting an installment loan and using a rent-to-own service for the large purchase. A local electronics store was selling the television for \$1,500.00. A nearby rent-to-own store advertised the same model for \$55.00 every other week. After seeing the advertisement, Grace went to the rent-to-own store to get more details. The manager told Grace she would own the television in 52 payments or 2 years. Grace multiplied $\$55.00 \times 52$ weeks and got \$2,860.00. Grace also found out that if she misses one payment, the rent-to-own service will take the television back. If she makes 50 payments on time (i.e., $50 \times \$55.00 = \$2,750.00$) and misses payment 51, she loses the television and is out \$2,750.00.

The manager told Grace that with rent-to-own services, she could return the television with no obligation. Grace did another quick calculation. If she used the rent-to-own company and returned the television after a year, she would pay \$1,430.00 (26 weeks \times \$55.00).

Help Grace decide which option is better: to use a rent-to-own service or to apply for an installment loan.

Give the students the following chart as the answer to the exercise:

Consumer Installment Loan	Rent-to-Own
Advertised price = \$1,500.00 12 percent APR for 2 years $\$70.61 \times 24$ months = \$1,695.00 <i>Grace saved \$1,165.00.</i>	Advertised price = \$55.00 every other week (hidden costs) $\$55.00 \times 52$ weeks = \$2,860.00

Grace decided to purchase the television at the electronics store for \$1,500.00. She obtained an installment loan with a 12 percent APR. She made timely payments and paid off the loan (\$1,695.00) in 2 years. Her monthly payments for the

installment loan were \$70.61. Grace saved \$1,165.00 (\$2,860.00 - \$1,695.00) by choosing the installment loan.

Although \$55.00 every other week sounds affordable, it actually costs more in the end. You can see how rent-to-own services may seem appealing, but they really are not the best deals.



What questions do you have about why consumer installment loans cost less than rent-to-own services?



Can you think of some other reasons for obtaining a consumer installment loan?

Record responses on chart paper. Let students know that more information on this topic is found in the Paying for College and Cars module.

Home Loans

- Home purchase loans
- Home refinance loans
- Home equity loans

Value of home	\$250,000.00
Minus debt	-\$200,000.00
Equity	\$50,000.00

Slide 9: Home Loans

Home Loans

The third type of loan is a home loan. There are three main types of home loans:

1. Home purchase loans
2. Home refinance loans
3. Home equity loans

All three loans are based on the value of the home. If the borrower does not pay back the loan on time, the lender can take possession of the home.

Home purchase loans are made for the purpose of buying a house. They are usually called mortgages.

Home refinancing is a process by which an existing home loan (or mortgage) is paid off and replaced with a new loan. Homeowners often refinance their home loans for a lower

interest rate or to obtain money for home repairs or other personal needs.

Home equity loans can be used for any reason (e.g., remodeling, education, or other large purchases). The amount that a person can borrow depends on the amount of equity they have in the house. In general, the best uses for home equity loans are to purchase goods or services with long-term benefits (e.g., home improvements that add to the value of your property). One of the riskiest uses of a home equity loan includes paying for a vacation because you could end up paying a lot in interest charges for a purchase that is only of short-term value.

Equity is the value of the home minus the debt (or what you owe) on the home:

Value of home	\$250,000.00
Minus debt	-200,000.00
Equity	\$50,000.00

Remember, if any home loan is not repaid, you might lose your house.

Refer students to the A Roof Over Your Head module for more information on home loans and home ownership.



Activity 2: Types of Loans

This exercise gives you an opportunity to identify the type of loan best suited for the purchase of specific items.

Direct students to select the appropriate loan type for each type of purchase. Give students 5 minutes to complete the exercise. Lead a discussion about their choices.

Read the description of the purchase to be made. Fill in the blank with the most appropriate loan type for that purchase. Note: there may be more than one correct answer.

Activity 2: Types of Loans

Complete Activity 2 in your Participant Guide

- Read the description of the purchase to be made
- Fill in the blank with the most appropriate loan type(s) for that purchase

Slide 10: Activity 2

Refer students to Activity 2: Types of Loans on page 14 in their Participant Guide.

Types of Loans

- Consumer installment loan
- Credit card
- Home loan (purchase, refinance, or equity)

Description of Purchase

1. To finance a college education. *Answer: Consumer installment or home loan. Homeowners often use home equity or home refinance loans to finance college education. People who do not own homes can get a student loan, which is a type of installment loan. Some people use credit cards to pay for tuition, but that usually costs far more than installment or home loans. The best option for most people is government-guaranteed student loans. These generally have better rates and terms than other installment loans.*
2. To make small purchases in a department store (e.g., a \$50.00 household appliance). *Answer: Credit card.*
3. To make large home improvements. *Answer: Home loan or consumer installment loan. Homeowners often use home equity loans or refinance their mortgage to pay for home improvements. But some may use a consumer installment loan.*
4. To consolidate debts. *Answer: Consumer installment or home loan. Homeowners often use home equity or refinance loans to consolidate debts. People who do not own homes often use consumer loans. Borrowers should be careful of consolidation loans and make sure they are getting a better deal than their old loans. Some dishonest lenders trick people into signing up to consolidate bills with a loan that costs more than the old loan. This can leave the borrower paying more in interest and loan origination fees.*



What questions do you have about types of loans?

15 minutes The Cost of Credit



When you get a loan, there are generally two costs you must pay: fees and interest.

Fees

Fees are charged by financial institutions for activities, including reviewing your loan application and servicing the account. Examples:

- A credit card company might charge you an annual fee of \$30.00.
- A credit card company may also charge you a service fee for cash advances or a penalty fee if your balance exceeds your credit limit. Your credit limit is how much money the credit card issuer agreed to loan to you.
- A lender might charge a \$30.00 late fee when you do not pay your bill on time.



Slide 11: Cost of Credit

Interest

Interest is the amount of money a financial institution charges for allowing you to use its money. The interest rate can be either fixed or variable:

- *Fixed rates* stay the same throughout the term of the loan, except in the case of credit cards. With credit cards, the rate may be changed if the bank gives you required notice.
- *Variable rates* might change during the loan term. The loan agreement will show the details of the rate changes.



Truth in Lending Disclosures

How Much Does Credit REALLY Cost? The Federal Truth in Lending Act requires banks to state charges in a clear and uniform manner so you can compare the actual cost of borrowing. This law allows you to comparison shop between lenders for credit cards and other loans.

Truth in Lending Disclosures

- **The Federal Truth in Lending Act:**
 - Requires banks to disclose charges so you can compare the actual cost of borrowing
- **Lenders must disclose:**
 - The amount financed
 - Annual Percentage Rate (APR)
 - Finance charges
 - Total payment

Slide 12: Truth in Lending Disclosures

What Lenders Must Disclose

For a closed-end loan (e.g., when you borrow a set amount of money to purchase a car) lenders are required by law to disclose:

- **The amount financed:** the amount of the loan the lender is letting you borrow (e.g., \$5,000.00 for 1 year).
- **Annual Percentage Rate (APR):** the cost of your loan expressed as a yearly percentage rate (e.g., 12 percent). The APR reflects the total cost of lending rather than just the interest charge. It is the primary tool you should use to compare lending options. The law generally requires that the APR must be easily seen on credit card applications.
 - The *penalty APR* is the APR charged on new credit card transactions if you trigger the penalty terms in your credit card contract. Your credit card issuer may consider you in default if you pay late, go over your credit limit, or if your check is returned. If you become more than 60 days late, the penalty APR may be applied to your existing balance.
- **Finance charges:** fees charged as a cost of borrowing money. These charges may include interest, service charges, and loan fees. For example, if the finance charges on the \$5,000.00 loan are equal 12 percent, the total finance charges would be \$600.00.
- **The total payment:** the amount you will have paid after making all scheduled payments. Using the \$5,000.00 loan as an example, the total payment

including the original amount borrowed, plus the interest, is \$5,600.00 for 1 year. If the length of the loan is longer, the monthly payments will be lower. However, you will end up paying more interest in the end.



Activity 3: Borrowing Money Responsibly

Have students work as a class or in pairs to answer the following questions. Lead a discussion about their answers.

Answer each of the following questions. Be prepared to explain your answer.

Activity 3: Borrowing Money Responsibly

Complete Activity 3 in your Participant Guide
 – Answer each question
 – Be prepared to explain your answers



Slide 13: Activity 3

Direct students to Activity 3: Borrowing Money Responsibly on page 16 in their Participant Guide.

1. What questions should you ask yourself before you decide to apply for credit? *Questions may include:*
 - *Do I need to borrow money or can I wait to purchase the item until I have cash to pay for it?*
 - *Can I get credit?*
 - *How much more will I pay if I buy the item on credit?*
 - *Can I afford the monthly payments?*
 - *What is the total cost of the credit?*
 - *What are the fees?*
 - *What is the APR?*
2. Would you use credit to pay overdue bills? Why?
Answer: No. This will only add to your financial problems because you are paying fees on the overdue bills and interest while you carry the balance of the overdue bills on your credit/loan. If you have problems with paying bills, you may need to reduce spending or negotiate with creditors for smaller payments. Most areas have free credit counseling services that can help you manage your credit problems.
3. If you are trying to establish a credit history, would you use credit to make a purchase even if you could

pay cash? Why? *Answer: Yes. You may want to use credit in such a situation to establish your credit history. Be sure not to charge more than you can pay each month so you can establish a record of responsible credit use.*

4. Would you use credit if you really wanted something, but could not afford the monthly payment? Why? *Answer: No. If you cannot afford the monthly payment, do not buy the item. Credit should only be used for necessary items or in the case of an emergency. Be careful of sales people who try to sell you products based on monthly payments only. Be sure to understand the total cost of the purchase.*

1 minute Equal Credit Opportunity Act



Equal Credit Opportunity Act

- This act:
 - Prohibits discrimination during the loan application process
 - Restricts lenders from requesting certain information
 - Requires the lender to notify you in writing, within 30 days, if you have been approved or denied the loan



Slide 14: Equal Credit Opportunity Act

The Equal Credit Opportunity Act (ECOA) ensures that all **creditworthy** applicants are given an equal chance to obtain credit. This act:

- Prohibits lenders from discriminating against you because of your race, color, marital status, religion, national origin, sex, age, or receipt of public assistance when deciding whether to issue you a loan.
- Restricts lenders from requesting certain information during the loan application process.
- Requires the lender to notify you in writing, within 30 days of the date of the loan application, if you have been approved or denied the loan.

30–60 minutes How Credit Decisions Are Made



The Four Cs of Credit Decision Making

When you apply for credit, the lender will review the Four Cs to decide whether you are a good credit risk, or in other words, whether you are likely to pay back the loan.



Slide 15: The Four Cs

The Four Cs are:

- Capacity
- Capital
- Character
- Collateral

Capacity

Capacity refers to your present and future ability to meet your payments. Lenders may ask:

Slide 16: Capacity

- Do you have a job?
- How much money do you make each month?
- What are your monthly expenses?

Generally, a lender wants to see that you have a job and you have held the same job or the same type of job for at least a year.

A bank will compare the amount you owe and your other monthly expenses with your monthly income. This is called a debt-to-income ratio. It helps determine how much money you can afford to borrow. The bank wants to ensure that your expenses are not too high for you to take on the additional monthly debt of a loan payment. They want to be sure you can repay what they lend.



Write on chart paper as you explain...

Example:

<u>Monthly Income</u>	
Part-time job	\$300.00

Monthly Expenses

Cell phone payment	\$30.00
Computer installment loan payment	+ \$50.00
<hr/>	
Total Expenses	\$80.00

$\$80.00$ (total expenses) / $\$300.00$ (total income) = about 27 percent (debt-to-income ratio)



In most cases, lenders prefer that you have a debt-to-income ratio that is 36 percent or lower.

Lead a short discussion about why a lender wants a 36 percent or lower debt ratio. Ensure students understand that this has to do with the ability to pay back the loan.



Capital

Capital refers to the value of your assets and your net worth.

Lenders want to determine the value of your assets (i.e., things you own that have financial value). Lenders will also compare the difference between the value of your assets and the amount of debt you have. This is called net worth. A positive net worth demonstrates your ability to manage your money.

Capital

- Refers to the value of your assets and net worth:
 - How much money do you have in your checking and savings accounts?
 - Do you have investments (e.g., stocks, bonds) or other assets (e.g., a car)?

Slide 17: Capital

Questions lenders may ask include:

- How much money do you have in your checking and savings accounts?
- Do you have investments (e.g., stocks, bonds) or other assets (e.g., a car)?

Character

- Refers to how you paid your bills or debts in the past
 - Have you had credit in the past?
 - How many credit accounts do you have?
 - Have you ever filed for bankruptcy, had property repossessed, or made late payments?

Character

Character refers to how you have paid your bills or debts in the past. Lenders may ask:

- Have you had credit in the past?
- How many credit accounts do you have?
- Have you ever filed for bankruptcy, had property

Slide 18: Character

repossessed, or made late payments?

Free Annual Credit Report

Visit: www.annualcreditreport.com
 Call: 1-877-322-8228
 Mail:
 Annual Credit Report Request Service
 P. O. Box 105281
 Atlanta, GA 30348-5281


Slide 19: Free Annual Credit Report

Banks will use credit reports to obtain character information. You can obtain free annual credit reports by doing one of the following:

- Submit a request online at www.annualcreditreport.com
- Call toll-free: **1-877-322-8228**
- Complete the Annual Credit Report Request Form from www.annualcreditreport.com or www.ftc.gov/credit and mail it to:

Annual Credit Report Request Service
 P.O. Box 105281
 Atlanta, GA 30348-5281

If you have a good credit history of repaying your other loans, you will have an easier time getting your loan request approved. Having a good credit history shows a lender you can borrow money responsibly.

If you have never had a credit account, you may have difficulty getting approved for a loan. Some lenders may let you prove your creditworthiness by asking for proof that you pay your rent and bills (e.g., utility and phone bills, insurance payments, school tuition, and personal loan payments) on time, or that you make regular deposits to a savings account. Ask the lender to consider alternative forms of history. If a lender is not willing to do this, shop around for one who will.

Collateral

- Refers to property/assets used to secure the loan
- Do you have assets to secure the loan beyond your capacity to pay it off?



Slide 20: Collateral**Collateral**

Collateral refers to property or assets you can offer to secure the loan. Lenders may ask:

- Do you have assets to secure the loan beyond your capacity to pay it off?

Collateral is security you provide the lender. Giving the lender collateral means that you pledge an asset that you own (e.g., a car) to the lender with the agreement that it will be the

repayment source in case you cannot repay the loan.

Sometimes a person with no credit history will ask another person to cosign a loan. The cosigner is equally responsible for repaying the loan. If the borrower defaults (i.e., cannot make the payments), the cosigner has to pay.

Barriers to Borrowing Money

If a lender finds you have a poor credit history, that tells the lender immediately that you are a risk and they may not be willing to lend you money. As you start to develop a credit history, be sure to avoid:

- Making late payments
- Filing for bankruptcy
- Having property repossessed or foreclosed on because you cannot make the payments
- Having a court order requiring you to pay money to the lender



Barriers to Borrowing Money

- Making late payments
- Filing for bankruptcy
- Having property repossessed or foreclosed on because you cannot make the payments
- Having a court order requiring you to pay money to the lender

Slide 21: Barriers to Borrowing Money

Legal Terms for Types of Debt Actions

We briefly mentioned that you should avoid bankruptcy, repossession, and foreclosure. Let us define those words and several other terms you may have heard before:

- **Attachment:** A lien against personal property.
- **Bankruptcy:** A legal declaration of insolvency. Bankruptcy will not fix credit record problems and will be part of your credit history for 10 years. You must get credit counseling before you can file for bankruptcy. If possible, the law also requires you to pay a portion of your unsecured debt.
- **Collection account:** A past-due account that has been referred to a specialist to collect part or all of the debt (e.g., if you do not pay your bills, after a period of time, the creditor may ask a collection agency to collect the amount you owe).
- **Foreclosure:** A legal proceeding initiated by a lender to take possession of collateral that secured a defaulted

Legal Terms for Debt Actions

- Attachment
- Bankruptcy
- Collection account
- Foreclosure
- Garnishment
- Judgment
- Lien
- Repossession

Slide 22: Legal Terms for Debt Actions

loan.

- **Garnishment:** A process by which a lender obtains directly from a third party (e.g., an employer) part of an employee's salary to satisfy an unpaid debt. Part of the employee's salary is taken each pay period until the debt is fully paid. This process must be authorized by a court order.
- **Judgment:** A court order requiring a debtor to pay money to the lender. The judgment places a security lien on the debtor's property until the judgment is satisfied (the debt is repaid).
- **Lien:** A lender's claim against property to secure repayment of a debt.
- **Repossession:** Seizure of collateral that secured a loan in default.



Activity 4: Borrowing Barriers

Complete Activity 4 in your Participant Guide

- Reach each scenario
- Indicate which of the Four Cs are affected by each of the barriers to borrowing money



Slide 23: Activity 4

Refer students to Activity 4: Borrowing Barriers on page 20 in their Participant Guide.

Activity 4: Borrowing Barriers

Note: You may choose to use Activity 4 or Activity 5, rather than both activities. Use your discretion to determine which activity is appropriate for your students. These activities may be completed individually, in groups, or as an entire class. Discuss students' answers as a class.

Reach each scenario. Indicate which of the Four Cs are affected by each of the barriers to borrowing money: Capital, Collateral, Character, and/or Capacity. There may be more than one correct answer.

1. **Consistently making late payments:** Jeremy bought a cell phone because he works late at the movie theater on the weekends. At first, he made all of his payments on time. However, he had to quit his job because he had trouble in school and needed more time to study. He signed a 1-year contract and is having difficulty making payments. He has made late payments for the past 3 months. *Answer: Capacity (he no longer has a job) and character (he has been making late payments).*

2. **Filing for bankruptcy:** Jeremy’s older brother, who is in college, applied for and received several credit cards. He maxed out (met his credit limit on) all of the credit cards, and then he could not afford to make the payments. He filed for bankruptcy, which shows lenders his inability to manage money and pay bills. *Answer: Character.*

3. **Not enough assets:** Joe wants to buy a house. He has a job, and the house will be collateral for the loan. However, Joe does not have enough money in his checking and savings account to reassure the lender that after closing, he will have enough funds to make a payment or home repair in an emergency. *Answer: Capital.*

4. **No credit history:** Sareta wants to apply for a credit card. She is in college and does not have a regular income. She also has no credit history. Therefore, she will need to ask her mother or father to cosign the loan. *Answer: all four Cs because she has no income (capacity), assets (capital), past credit history (character), or collateral.*



Activity 5: Loan Applications

Complete Activity 5 in your Participant Guide

- Review each section of the Uniform Residential Loan Application
- Match the required information with the appropriate C:
 - Capital, Collateral, Character, and/or Capacity

Slide 24: Activity 5

Activity 5: Loan Applications

Note: You may choose to use Activity 4 or Activity 5, rather than both activities. Use your discretion to determine which activity is appropriate for your students. Another option is to provide students with an application (e.g., for a credit card, student loan, car, or home) and have them attempt to complete the application. This will help students understand what information is required and why it is so important to maintain a “good” credit history.

Lenders are able to gather information related to the Four Cs by requiring you to complete a credit or loan application. They will

Refer students to Activity 5: Loans Applications on page 21 in their Participant Guide. This activity may be completed individually, in groups, or as an entire class. Discuss students' answers as a class.

review this information and additional sources of information (e.g., your credit report) before they determine whether to grant you the loan.

Application questions and requirements may vary according to loan type (e.g., credit card, installment loans, home loans, and student loans) and by financial institution.

The following information is taken from the Uniform Residential Loan Application, which is the standard form used for mortgage loan applications. The questions are similar to applications for other types of loans.

Review each section of the form. Match the required information with the appropriate C: Capital, Collateral, Character, and/or Capacity. There may be more than one correct answer.

1. Employment Information: *Answer: Capacity.*

Name & Address of Employer		<input type="checkbox"/> Self Employed	Dates (from – to)
			Monthly Income
			\$
Position/Title/Type of Business		Business Phone (incl. area code)	
Name & Address of Employer		<input type="checkbox"/> Self Employed	Dates (from – to)
			Monthly Income
			\$
Position/Title/Type of Business		Business Phone (incl. area code)	

2. Monthly Income and Combined Housing Expense Information: *Answer: Capacity.*

Gross Monthly Income	Borrower	Co-Borrower	Total
Base Empl. Income*	\$	\$	\$
Overtime			
Bonuses			
Commissions			
Dividends/Interest			
Net Rental Income			
Other (before completing, see the notice in "describe other income," below)			
Total	\$	\$	\$

Combined Monthly Housing Expense	Present	Proposed
Rent	\$	
First Mortgage (P&I)		\$
Other Financing (P&I)		
Hazard Insurance		
Real Estate Taxes		
Mortgage Insurance		
Homeowner Assn. Dues		
Other:		
Total	\$	\$

3. Declarations: *Answer: Character*

VIII. DECLARATIONS				
If you answer "Yes" to any questions a through i, please use continuation sheet for explanation.	Borrower		Co-Borrower	
	Yes	No	Yes	No
a. Are there any outstanding judgments against you?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Have you been declared bankrupt within the past 7 years?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Have you had property foreclosed upon or given title or deed in lieu thereof in the last 7 years?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Are you a party to a lawsuit?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
e. Have you directly or indirectly been obligated on any loan which resulted in foreclosure, transfer of title in lieu of foreclosure, or judgment?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(This would include such loans as home mortgage loans, SBA loans, home improvement loans, educational loans, manufactured (mobile) home loans, any mortgage, financial obligation, bond, or loan guarantee. If "Yes," provide details, including date, name, and address of Lender, FHA or VA case number, if any, and reasons for the action.)				

4. Assets (e.g., checking and savings account, investment products, and car) and Liabilities (e.g., automobile or other loans, charge accounts, and other forms of debt): *Answer: Capital and Collateral.*

ASSETS		Cash or Market Value	Liabilities and Pledged Assets. List the creditor's name, address, and account number for all outstanding debts, including automobile loans, revolving charge accounts, real estate loans, alimony, child support, stock pledges, etc. Use continuation sheet, if necessary. Indicate by (*) those liabilities, which will be satisfied upon sale of real estate owned or upon refinancing of the subject property.	
Description		\$		
Cash deposit toward purchase held by:				
<i>List checking and savings accounts below</i>			LIABILITIES	Monthly Payment & Months Left to Pay
Name and address of Bank, S&L, or Credit Union			Name and address of Company	\$ Payment/Months
Acct. no.		\$		
Name and address of Bank, S&L, or Credit Union			Name and address of Company	\$ Payment/Months
Acct. no.		\$		
Name and address of Bank, S&L, or Credit Union			Name and address of Company	\$ Payment/Months
Acct. no.		\$		
Name and address of Bank, S&L, or Credit Union			Name and address of Company	\$ Payment/Months
Acct. no.		\$		
Name and address of Bank, S&L, or Credit Union			Name and address of Company	\$ Payment/Months
Acct. no.		\$		



What did you learn from this activity? *Facilitate a discussion with students. Often students believe it is easy to apply for and obtain credit. Determine if this activity has changed their view.*

What questions do you have about the Four Cs?

Credit Report

- A credit report tells lenders:
 - Who you are
 - How much debt you have
 - Whether you have made payments on time
 - Whether there is negative information about you in public records

Slide 25: Credit Report

Credit Report

A credit report helps lenders make their decision when deciding whether to extend or give you credit. A credit report is a record of how you have paid your debts. It tells lenders:

- Who you are
- How much debt you have
- Whether you have made payments on time
- Whether there is negative information about you in public records

There are three major credit reporting agencies:

- Equifax
- Experian
- TransUnion

These agencies:

- Receive information from lenders, usually monthly, about whether you are making loan and credit card payments on time
- Collect information about bankruptcy filings, court-ordered judgments, tax liens, and other public record information from courthouse records



Refer students to the Sample Credit Report on page 25 of their Participant Guide.

While each credit reporting agency may have a different format for its credit report, the type of information they contain is basically the same and includes:

1. Personal or consumer information (e.g., name, addresses, and employment)
2. Personal or consumer statement, if you submit a statement to the credit reporting agencies to be included in your credit report
3. Account summary, including: creditor information, account status and type, and account history
4. Inquiries that have been made into your credit history
5. Public record information (tax lien, legal item, bankruptcy, wage item, judgment, etc.) that is not shown in this example

JOHN Q CONSUMER		Report Date
Report #1234567		01/01/2006
Personal Information	1	Employers
123 Main Street #2 Somewhereville, USA 01234 SSN#123-45-6789	DOB 02/01/68	1. ABCDE Engineering Corp, Somewhereville USA 2. Port City Engineering, Anywhere, USA
Consumer Statement		2
No personal statements appear in your report.		
Potentially Negative Items		
Televise Cable Comm.		
Acct#: 1234 5678 1234 5678 Type: Collections Date filed: 05/01/05 Status: Delinquent in collections 120+days Amount: \$125.00 Credit limit/Original Amount: N/A		
Accounts in Good Standing		3
XYZ BANKCARD USA		Automobile Financing Services
Acct#: 0110220 Type: Revolving Date added: 12/12/99 Responsibility: Individual Status: Open/Never late Monthly Payment: \$15 Terms: N/A High balance: \$129 Credit Limit/Original Amount: \$1000 Recent Balance: \$79		Acct#: 0981024057 Type: Installment Date added: 03/29/06 Responsibility: Individual Status: Open/Never late Monthly Payment: \$245 Terms: 60 months High balance: N/A Credit Limit/Original Amount: \$10,000 Recent Balance: \$4,665
Requests for Credit History		
VISA Card		4
Address: PO Box 1414 NY NY 10001 Date: 04/01/05		



Activity 6: John Q. Consumer


Review the sample credit report in your Participant Guide. Use the report to answer the questions about John’s credit history.

JOHN Q CONSUMER	Report Date
Report #1234567	01/01/2006
Personal Information	Employers
123 Main Street #2 Somewhereville, USA 01234	1. ABCDE Engineering Corp, Somewhereville, USA

Activity 6: John Q. Consumer

Complete Activity 6 in your Participant Guide

- Review the sample credit report
- Use the report to answer the questions about John's credit history



Slide 26: Activity 6
Refer students to Activity 6: John Q. Consumer on page 25 in their Participant Guide.

SSN# 123-45-6789	2. Port City Engineering, Anywhere, USA	
DOB 02/01/68		
Potentially Negative Items		
Televise Cable Comm.		
Acct#: 1234 5678 1234 5678		
Date filed: 05/01/05		
Status: Delinquent in collections 120+ days		
Amount: \$35.00		
Credit limit: N/A		
Accounts in Good Standing		
XYZ BANKCARD USA		Homeowner Credit Services
Acct# 0110220		Acct# 0110220
Date added 12/12/98		Date added 04/23/00
Status: Open/Never late		Status: Closed at consumer's request 08/22/2004
Monthly Payment \$15.00		Monthly Payment \$0
High balance \$129.00		High balance \$3,228.00
Credit Limit \$1,000.00		Credit Limit \$1,000.00
Requests for Credit History		
VISA Card		
Address: PO Box 1414 NY NY 10001		
Date: 04/01/05		

John Consumer has an account that has been sent to a collection agency. Where on his credit report would you find this information? *Answer: Potentially negative items in the account summary section.*

Who is the original creditor? *Answer: Televise Cable Comm.*

In August 2004, an account was closed at John's request. What was the high balance on this account? *Answer: \$3,228.00.*

Where did you find this information? *Answer: Accounts in good standing within the account summary section.*

Who does John work for? Where did you find this information? Hint: current employers are listed first. *Answer: ABCDE*



Engineering Corp., Employer box in personal information section.

What questions do you have about how to read a credit report?



Tips for Building Your Credit

What are some ways you can build your credit history or demonstrate your creditworthiness?

Refer students to the Tips for Building Your Credit on page 26 of their Participant Guide.

- Make regular deposits into a savings account. Ask the lender to consider this as proof that you can make payments every month, even if you are making the payments to yourself. Also, ask the lender to review your history of making rent and utility payments to demonstrate your ability to pay.
- Pay all of your bills on time. This will help establish a good credit history so you can get credit in the future. Not paying any bill you receive (e.g., cell phone bills, medical bills, or parking tickets) can harm your credit. If you are not responsible for the bill, do not ignore it. Contact the company that sent you the bill (or others if necessary—e.g., bank, credit card company, or credit reporting agency) to resolve the issue and ensure it does not affect your credit.
- Apply for a small loan at the bank or credit union where you have checking and savings accounts. Also, consider asking the financial institution to loan you money secured by funds in a savings account or a certificate of deposit. This reduces the lender's risk, but it enables you to show that you can make timely payments on a loan.
- Apply for credit with a local store. They typically have a lower credit limit and a higher APR, but they are generally more willing to lend you money.
- Make a large down payment on a purchase and negotiate credit payments for the balance. If you do not have a credit history but have a large down payment, there is less risk to the lender that you will not make the payments. For example, if you are buying a used car for

\$5,000.00 and have enough cash, you might consider making a down payment of \$1,000.00 to \$3,000.00. Although the loan will be very small, it can prove you make your payments on time.

- Ask a friend or relative with an established credit history to be a cosigner for you. A cosigner promises to repay the loan if you do not. The lender should report the payment information for both you and the cosigner to the credit reporting agencies. Remember that you can damage the cosigner's credit history if you do not pay the loan back as promised.
- Keep your debt levels low. The more debt you have in relation to your income or your available credit lines, the more you will be viewed by lenders as a higher risk borrower. All of your monthly obligations (e.g., rent/mortgage, car payments, school loans, credit card payments, etc.) should be less than or equal to 33 to 36 percent of your monthly gross income.
- Consider a no- or low-fee secured credit card if you cannot qualify for a regular credit card. Secured credit cards require you to keep cash (that serves as collateral) in a deposit account. Your credit limit would be based on the amount of cash you have in the deposit account.



Refer students to the Tips for Managing Your Credit on page 28 of their Participant Guide.

Tips for Managing Your Credit

Once you have decided you want to get a loan and have been approved, you need to keep these tips in mind to use the money you have borrowed wisely:

- Pay off your entire credit card bill each month if possible. Try to pay more than the minimum balance due if you cannot. This will reduce finance charges and total interest paid. You may also want to stop using your credit card until you can pay off the balance so you do not accrue more debt than you can afford.
- Pay your credit card or loan payments on time to avoid late fees and protect your credit history. If you cannot pay on time, call your creditor immediately to explain

the situation. The creditor may waive the late fees or be willing to make other payment arrangements. Always check your monthly statement to verify that it accurately lists the things you bought. Call your creditor right away if you suspect errors.

- Ignore offers creditors may send you to reduce or skip payments. You will still be charged finance charges during this period.
- Think about the cost difference if you purchase your item with cash versus if you purchase your item with credit.



What questions do you have about building and managing your credit?

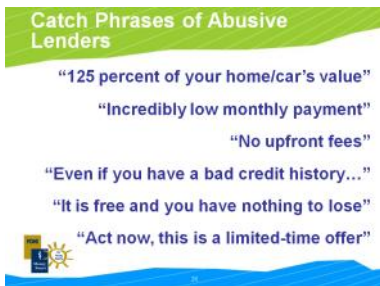
Now let us take a look at examples of when companies use unfair tactics to target you as a customer.

5 minutes **Predatory Lending Practices**



Catch Phrases of Abusive Lenders

Lead a discussion of the phrases below. Ask students if they have seen these and if so, where? Before discussing what the phrase really means, ask them if they can figure out why the phrase is dangerous.



Slide 27: Catch Phrases of Abusive Lenders

There are some catch phrases that should alert you to potential predatory practices. You may have already heard some of these in advertisements, or seen them in the mail or on billboards.

Beware when you hear...

“125 percent of your home/car’s value”

It can be dangerous to borrow more than your home or car is worth. If you stop making payments, you can lose your house or vehicle and still owe money.

“Incredibly low monthly payment”

There is no disclosure as to how the lender intends to calculate monthly payments. There is a possibility the lender might have

you pay only interest and not the principal, so you will never pay off the loan.

“No upfront fees”

Be careful of loans that promise no upfront fees. This does not mean there are no fees. Many times, there are expensive fees added on to the cost of the loan and you will pay interest on these loan fees. This can be very costly. For example, if a \$5,000.00 loan fee is added into the amount you borrow, you are paying \$5,000.00 plus interest on the \$5,000.00 over the life of the loan.

“Even if you have a bad credit history...”

Beware of lenders who promise you loans even if you have a bad credit history. If you have a bad credit history, you may pay higher interest rates and more expensive loan origination fees. All lenders take your credit history into account. Be aware that while some predatory lenders have been known to target low-income communities for high-cost, high-interest loans, no one is immune from their deceptive offers.

“It is free and you have nothing to lose”

If it sounds too good to be true, it probably is. Even though the initial loan evaluation is free, there are other ways predatory lenders will take money from you. There might be hidden fees.

“Act now, this is a limited-time offer”

Beware of “limited-time offers.” Many predatory lenders try to pressure you into acting fast, even though you are not comfortable with the loan conditions.

Predatory Lending Practices

- To guard against predatory lending:
 - Deal with reputable loan providers
 - Shop around to obtain the best terms
 - Read and understand all terms and conditions
 - Ensure you can afford and make payments according to the loan terms



Guard Against Predatory Lending Practices

The best ways to guard against predatory lending practices is to:

- Deal with reputable loan providers
- Shop around with several loan providers *of your choice* to obtain the best terms
- Read and understand all terms and conditions of an

Slide 28: Predatory Lending Practices

offered loan or ask questions until you are sure you understand

- Ensure you can afford and make payments according to the loan terms

10 minutes The True Cost of Alternative Financial Services

True Cost of Alternative Financial Services

- Rent-to-own services
- Payday loan services
- Refund anticipation services

Slide 29: True Cost of Financial Services

Many lenders advertise “easy money.” These types of loans are generally easier to obtain but also cost significantly more.

Getting credit is not cheap. However, getting a bank loan is usually less expensive than other alternatives. We are going to look at three of these alternatives:

- Rent-to-own services
- Payday loans
- Refund anticipation loans

Rent-to-Own Services

- Allow you to use the item while you make monthly or weekly payments
 - The store owns the item until you make your final payment.
- Are generally more expensive than a consumer installment loans

Slide 30: Rent-to-Own Services

Rent-to-Own Services

Rent-to-own services let you use an item for a period of time by making monthly or weekly payments. If you want to purchase the item, the store will set up a plan for you to rent it until you pay enough to own it. The store is the legal owner of the item until you make the final payment. If you miss a payment, the store can take the item back. If this happens, you will not own the item, and you will not get your money back. Rent-to-own agreements are technically not loans, so no interest is charged. However, the difference between the cash price and your total payment is similar to the interest you pay on a loan. Generally, using rent-to-own services is more expensive than getting a consumer installment loan to buy the item outright.

Payday Loans

- Short-term loans (usually up to 2 weeks) that can be costly

Loan Term	Fee	You write a check for:
2 weeks	\$30	\$230



Slide 31: Payday Loans

Payday Loans

Payday loans are short-term loans (usually up to 2 weeks). You write a post-dated check and receive cash that day. The loan service cashes the check on your payday to pay the loan in full. You can also go in to the loan office and pay your loan with cash, at which point the lender returns your check to you.

You must be careful of payday loans. They are usually made to people who need money right away and who plan to pay it back with their next paycheck. However, if unable or unwilling to repay the loan when it is due, many people pay more fees to get another payday loan.

Payday loans can be much more costly than they appear at first glance. If you do not have the money to pay the loan within the agreed-upon time period, the lender may renew the loan and charge you additional fees. This will increase the total amount you owe. Let us look at an example of how payday loan services work. Assume you go to a payday lender and borrow \$200.00:

Loan Term	Fee	You write a check for:
2 weeks	\$30.00	\$230.00

The APR estimate for this transaction is 391 percent! An APR for a typical payday loan may vary and may be even higher than this example. Most payday lenders:

- Allow you to roll over, or renew your loan
- Charge an additional fee for renewal; this time for \$260.00 (\$230.00 + \$30.00 additional fee)
- Are usually not federally insured financial institutions, and are not as closely monitored by the Federal Government as are banks.

Refund Anticipation Loans

- Short-term loans secured by your expected income tax refund
- Consider electronically filing (e-file) your tax return and request direct deposit instead



Slide 32: Refund Anticipation Services

Refund Anticipation Loans

Refund anticipation loans are short-term loans secured by your expected income tax refund. Although the business preparing your income tax return will give you the money, you are actually receiving a loan from a bank or finance company. You do not have to pay any fees associated with obtaining a refund anticipation loan at the time you receive the money. Therefore, you may not realize how much this loan is really costing you.



Record the dollar figures in the example on chart paper.

For example, if your tax refund totals \$1,500.00 and you receive a refund anticipation loan for \$1,200.00, the remaining \$300.00 is the fee associated with filing your income tax return and getting the refund anticipation loan.

It is important to remember that the paperwork you sign to receive a refund anticipation loan will legally obligate you to repay a \$1,500.00 loan. If your actual refund is only \$800.00, you are responsible for repaying \$700.00 plus interest to the lender that made the refund anticipation loan. The higher the loan amount, the higher the refund anticipation loan fee.

Record the dollar figures in the example on chart paper.

Here are some typical costs associated with getting a refund anticipation loan:

Tax preparation fee	\$100.00
Refund anticipation fee	\$75.00
Electronic filing fee	\$40.00
Document preparation	+ \$33.00
<hr/>	
Total Cost	\$248.00



When you electronically file (e-file) your tax return and request direct deposit, your refund is often deposited in your bank account within 2 weeks. Sometimes, refund anticipation loans take just as long yet cost you substantially more money. Many organizations host Volunteer Income Tax Assistance (VITA) sites. VITA is an Internal Revenue Service (IRS) coordinated program that provides free income tax assistance and e-filing. Income eligibility restrictions apply. Contact the IRS for a location near you.



What questions do you have about these alternative financial services?



Be Smart! Tips for Borrowing Money

If you are thinking about borrowing money, keep in mind the following guidelines.

Refer students to the Be Smart! Tips to Borrowing Money on page 31 of their Participant Guide.

Do:

- Pay your bills on time to build good credit history. Make sure your credit history is correct by reviewing your credit report every year.
- Be an informed customer. Make sure to shop around for the best deal. If a creditor is not willing to give you information to compare, you probably do not want to do business with him or her.
- Ask friends, family, and credit counselors for advice. Take someone along with you when you talk to a lender.
- Take your time before deciding on the best loan or lender.
- Be careful of lenders who tell you they do not care about your credit history or how much you earn. Many of these lenders charge higher interest rates and higher fees.

Do Not:

- Let lenders pressure you into a decision before you are ready.

- Respond to advertisements that make lending sound cheap and easy.
- Respond to offers to refinance your loan shortly after you just refinanced it. Make sure you really need the loan or the loan makes economic sense for you.

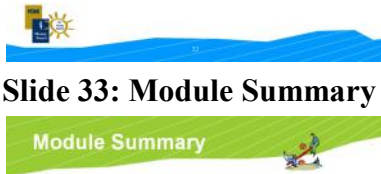


Module Summary



Share or have students read the comic strip on slide 32 or page 32 of their Participant Guide. Facilitate a conversation about what Todd learned.

What have you learned about borrowing money?



Slide 33: Module Summary

Congratulations! You learned about:

- Credit and what “good” credit means
- Types of loans
- The cost of credit and the cost of using non-loan services
- How lenders make credit decisions

Have students complete the Knowledge Check and answer any final questions they may have.

Now turn to page 33 in your Participant Guide. Complete the Knowledge Check and see what you have learned today.

What final questions do you have?

Slide 34: Module Summary Review what was covered in the module, and student expectations listed at the beginning, to make sure all students’ questions have been covered.

Congratulations! You have completed the *Borrowing Basics* module. We have covered a lot of information today about loans and credit. You learned about:

- Credit and what “good” credit means
- Types of loans
- The cost of credit and the cost of using non-loan services
- How lenders make credit decisions

You should now be able to decide when and how to use credit.



Knowledge Check

1. If you buy something on credit, you must pay back the amount you borrowed:
 - a. All at once
 - b. Plus interest
 - c. According to the credit terms
 - d. b and c**

2. A loan is the amount of money a financial institution charges for allowing you to use its money.
 - a. True
 - b. False**

3. The three main types of loans are:
 - a. Consumer installment loans
 - b. Credit cards
 - c. Home loans
 - d. All of the above**

4. What is used as collateral for a home loan?
 - a. The home**
 - b. The furniture or furnishings
 - c. Personal assets (e.g., a car)
 - d. All of the above

5. Which of the following is an example of a secured loan?
 - a. Home loans and home equity loans**
 - b. Most credit cards
 - c. Personal loans
 - d. Student loans

6. Which type of interest rate can change during the loan term?
 - a. Fixed interest rate
 - b. Variable interest rate**

7. Which of the following must be included in the Truth in Lending Disclosure?
 - a. Amount financed
 - b. APR
 - c. Finance charge
 - d. Total payments
 - e. All of the above**

8. Lenders will review the Four Cs to determine whether you are a good credit risk. Which of the following refers to property or assets offered to secure the loan?
 - a. Capacity
 - b. Collateral**
 - c. Capital
 - d. Character

9. Which of the following information is included in your credit report? Select all that apply.
 - a. A list of inquiries for your credit report
 - b. Personal identifying information
 - c. Credit history of your accounts
 - d. Public record information
 - e. All of the above**

10. You must be careful of rent-to-own services, payday loans, and refund anticipation loans because they often cost more than an installment loan.
 - a. True**
 - b. False

11. An installment loan:
 - a. Always has changing interest rates
 - b. Generally has the same payment every month**
 - c. Can be used like a check
 - d. Is the same as rent-to-own agreements

12. Why is credit important?
- a. It allows you to make a large purchase (e.g., a car or house) and pay for it over time
 - b. It can be useful in times of emergencies
 - c. It is more convenient and safer than carrying large amounts of cash
 - d. All of the above**
13. Which of the following let you use an item for a period of time by making monthly or weekly payments?
- a. Payday loans
 - b. Rent-to-own services**
 - c. Refund anticipation services
14. Which act ensures you are not discriminated against because of your race, color, or gender?
- a. The Equal Credit Opportunity Act (ECOA)**
 - b. The Fair Credit Reporting Act (FCRA)
 - c. The Truth in Lending Act
 - d. All of the above

Glossary

Annual Percentage Rate (APR): The cost of your loan expressed as a yearly percentage rate.

Attachment: An attachment is a lien against personal property.

Asset: An asset is something valuable that you own.

Bankruptcy: A legal declaration of insolvency. Bankruptcy will not fix credit report problems and will be part of your credit history for 10 years. A new law now requires that you get credit counseling before you can file for bankruptcy.

Credit: The ability to borrow money.

Collateral: The security you provide the lender.

Capacity: Your present and future ability to meet your payments.

Capital: The value of your assets and your net worth.

Character: Proof of how you have paid your bills or debts in the past.

Consumer Installment Loan: A loan used to pay for personal expenses for you and your family over a set term or period of time.

Credit Cards: Plastic cards with magnetic strips on the back. The front displays your account number, name, and bank name. With a credit card, you can buy goods or services and pay for them over time, receiving a bill each month. Credit cards give you the ongoing ability to borrow money for household, family, and other personal expenses.

Fees: The amounts charged by financial institutions for activities like reviewing your loan application and servicing the account.

Finance Charge: The total dollar amount the loan will cost you. It includes items like interest, service charges, and loan fees.

Fixed Rate: The interest rate stays the same throughout the term of the loan, except in the case of credit cards where the rate may be changed.

Foreclosure: A legal proceeding initiated by a creditor to take possession of collateral that secured a defaulted loan.

Garnishment: A process granted by a court order by which a lender obtains directly from a third party (e.g., an employer) part of an employee's salary to satisfy an unpaid debt. Part of the employee's salary is taken out in each pay period until the debt is fully paid.

Guarantee: A form of collateral. It occurs when someone you know agrees to be responsible for any money that you owe the lender but have not paid.

Home Equity Loan: A loan that allows a homeowner to borrow money that is secured by their home.

Home Purchase Loan: A loan for the purpose of buying a house. This loan is secured by the house you are buying.

Home Refinancing Loan: A loan process by which an existing home loan is paid off and replaced with a new loan.

Interest: The amount of money a financial institution charges for letting you use its money.

Judgment: A court order requiring a debtor to pay money to the creditor. The judgment places a security lien on the debtor's property until the judgment is satisfied (the debt is repaid).

Lien: A lien is a creditor's claim against property to secure repayment of a debt.

Loan: Money borrowed on credit.

Payday Loan: A short-term loan. The loan service cashes the check on your payday, at which time your loan is paid in full.

Penalty Annual Percentage Rate (APR): The terms of your credit card agreement may provide that the creditor will permanently increase the interest rate on your credit card by a large amount if you do not pay your credit card bill on time, or if you exceed your credit limit.

Predatory Lending: Use of certain marketing tactics in making loans (e.g., abusive collection tactics and loan terms that deceive borrowers into thinking they are receiving better loan terms than they really are).

Refund Anticipation Loans: Short-term loans secured by your income tax refund.

Rent-to-Own Service: A service that lets you use an item for a period of time by making monthly or weekly payments. You can opt to purchase the item(s) you are renting, but it is usually much more expensive than purchasing the item (s) outright.

Repossession: Repossession is the seizure of collateral that secured a loan in default.

Unsecured Loan: A loan not backed by collateral. Credit cards are often unsecured loans, although some are secured by a bank account.

Variable rate: An interest rate that may change during the loan term.

For Further Information

Federal Deposit Insurance Corporation (FDIC)

www.fdic.gov/consumer

1-877-ASK-FDIC (275-3342)

Visit the FDIC's website for additional information and resources on consumer issues. For example, every issue of the quarterly *FDIC Consumer News* provides practical hints and guidance on how to become a smarter, safer user of financial services. Also, the FDIC's Consumer Response Center is responsible for:

- Investigating all types of consumer complaints about FDIC-supervised institutions
- Responding to consumer inquiries about consumer laws and regulations and banking practices

U.S. Financial Literacy and Education Commission

www.mymoney.gov

1-888-My-Money (696-6639)

MyMoney.gov is the U.S. Government's website dedicated to teaching all Americans about financial education. Whether you are planning to buy a home, balance your checkbook, or invest in your 401k the resources on MyMoney.gov can help you. Throughout the site you will find important information from federal agencies.

Federal Consumer Information Center

www.pueblo.gsa.gov

1-800-688-9889

The Federal Consumer Information Center (FCIC) provides free online consumer information to help the public. The FCIC produces the Consumer Action Handbook, which is designed to help citizens find the best sources for assistance with their consumer problems and questions.