

Unit 7: Personal Finance;

Lesson 3: Credit and Borrowing: Trapped by Debt? Or Building Wealth?

Statement of Inquiry: *Students will understand the key elements of effective money management and financial planning through an inquiry into the principles of budgeting and American financial systems related to banking, credit, insurance, and consumer protection.*

Factual Q: *What factors influence creditworthiness, financial stability, and retirement security?*

Debatable: What principles guide responsible financial decision-making?

Conceptual Q: Should adequate housing, income, food, education, and healthcare be individual responsibilities or basic rights that government must guarantee?

WARM UP:

LEFT: How do you think banks make money?

RIGHT: What do you know about how credit scores work?

Unit 7: Personal Finance;

Lesson 3: Credit and Borrowing: Trapped by Debt? Or Building Wealth?

ESSENTIAL QUESTION:

- *How does credit work and why is my credit score important?*

Key Vocabulary:

- See unit overview
- Practice sets on quizlet page

Homework & Deadlines

- **THIS LESSON: READ 498-502;**
 - ANSWER Critical Thinking Q on PG 499, Chart Skills & Making inferences on PG 500; & #s 1-4; 6, & 7 on PG 502
- **3 HW assignments due: _____**

Today's learning goals:

- I can identify factors that influence credit scores
- I can explain the relationship between credit scores and interest rates
- I can distinguish between “good debt” and “bad debt”

Today's Plan:

- Daily Commentary

Unit 6: Microeconomics & Personal Finance


Lesson 3: Banking & Credit

- **Is your budget activity submitted?**
- **QUIZ TODAY/Tomorrow: Lessons 1-3**

DAILY COMMENTARY

- LEFT: How do you think banks make money?
- RIGHT: What do you know about how credit scores work?

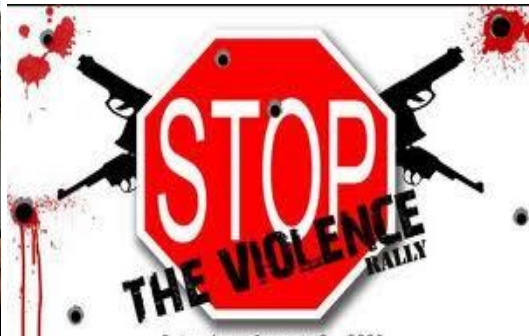
First 20 Minutes: Exam Review:

1. PLUS / DELTA for **Unit 2: The Constitution**
 - Use a Plus: + for things that YOU ARE CONFIDENT you have already learned
 - Use a Delta:  for concepts you are not confident about
 - Tell me in google classroom form what each delta is that you are working on
2. RELEARNING / COMPLETING GRAPHIC ORGANIZER:
 - **PICK 5 concepts you labeled with a FOR EACH UNIT:**
 - Fill in the graphic organizer provided for each concept.
 - The fourth and fifth concepts that you complete will count as extra credit
 - TO FIND THE INFORMATION YOU NEED:
 - Your notes and review packets; your text book; my website; online research

Lesson 3: Banking & Credit

Lesson 3 Performance Task – DUE TODAY:

- ACECES Paragraph: You work for a credit card company. Your job is to process credit card applications. Write an explanation to each of the following applicants explaining whether they will get a high or low interest rate and why.
 - Applicant #1: Credit Score 738
 - Applicant #2: Credit Score 588



Why Does Money Have Value?

Consumer Confidence -- we believe or accept the value of it

WHAT FACTORS MIGHT INCREASE OR DECREASE CONSUMER CONFIDENCE?



Types of Bank Accounts

- **Checking Accounts** ~ used to pay bills or to transfer money from one person to another quickly
 - DEBIT CARDS – connected to checking accounts
 - Used like a credit card, ***but you are paying right away*** instead of paying back the card company later
- **Savings Accounts** ~ banks pay interest to customers based on how much money they have deposited
- **Brokerage Accounts**
 - used for money you are investing in the stock market



Basic Banking Transactions

- **Deposits – put money in**
 - At the bank or using online banking app via phone
- **Withdrawals:** At your bank: no fees
 - **ATM Machines** – convenient with a debit card, ***BUT***...most charge a fee
- **Transfer** – moving your \$\$\$ from one account to another (checking, savings, brokerage, etc.)
- **Electronic Funds Transfer (EFT)** – used to wire money directly from your account to someone else
 - DIRECT / AUTO Pay is quick and easy, ***BUT***...some risks
 - If your account balance is low you could be charged overdraft fees
 - Have to call the bank to stop payment if you wish to discontinue it
- **Writing a Check – often used to pay bills or make major purchases**
 - **Risk: Bouncing a Check**
 - When you write a check but don't have the money in your account to pay for it; bank charges you a penalty fee

Lesson 3 Banking & Credit:

What's going on in this picture?



YOU
deposit money
with Bank at
3%



THE BANK
uses Your
Money to earn
4%



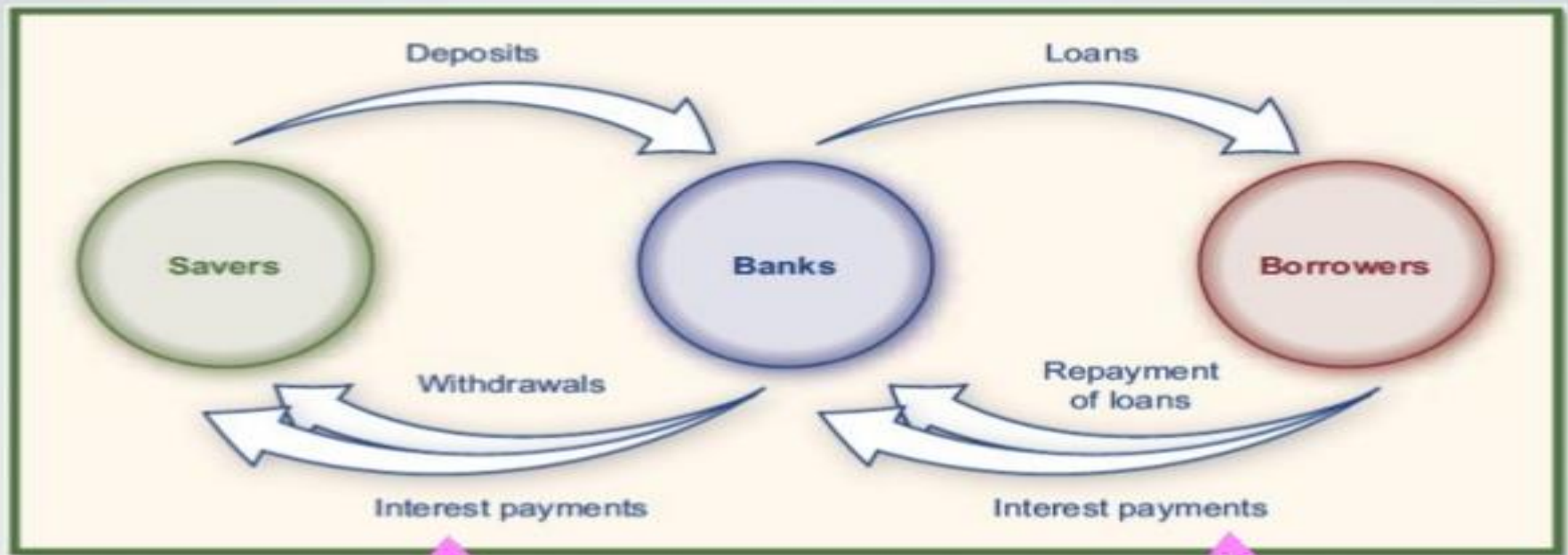
**Mortgage Holder
(Home Buyer)**
Borrows from
Bank at
7%

How do Banks Make Money?

<https://www.bing.com/videos/search?q=how+do+banks+make+money&&view=detail&mid=FE5ABBCC4DA97EF7582CFE5ABBCC4DA97EF7582C&&FORM=VRDGAR>

- banks lend money to businesses and individuals and charge interest on repayment

BANKS...

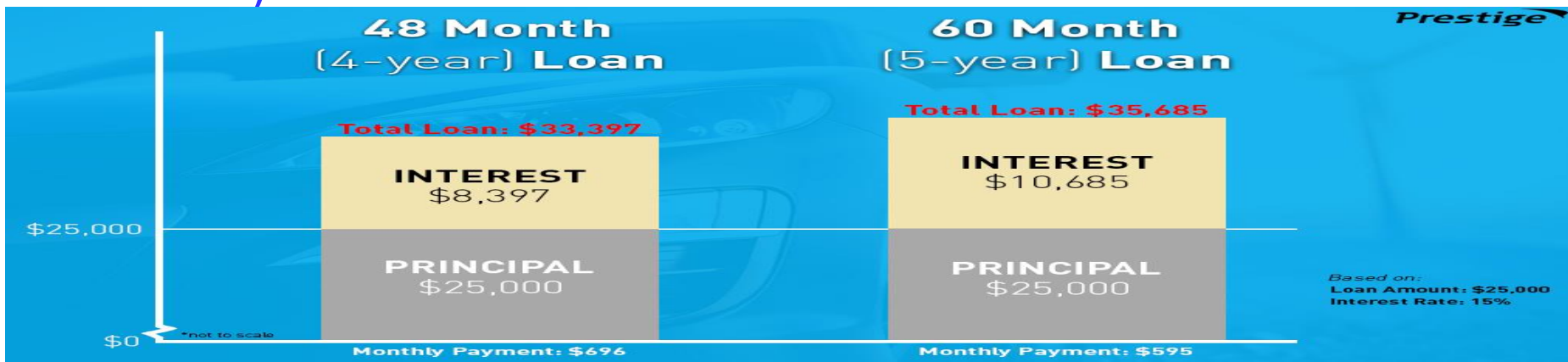


You collect interest from the bank when you make a bank account!

The bank collects interest from you when you purchase a loan!

How Loans Work – Basic Vocab

- Principal – the total amount you BORROW
- Interest – extra amount you pay back; COST of borrowing
 - Interest RATE – % of principal that is owed in interest
 - Usually **DEPENDS** on your credit score
- Length / Term of loan - # of months you have to pay back the loan
- Monthly Payment – amount owed to lender each month;
 - **INTEREST** gets paid off **BEFORE** the **Principal**
- Loan Balance – total amount still owed to the lender (principal **PLUS** interest)



Fixed v. Variable Rate Loans: Mortgages

FIXED RATE

- Locks interest rate in for defined period of time
- Usually 30 years long
- Payments never change
 - (unless you miss payments)

VARIABLE RATE

- Interest rate changes with the market
- Often given to people with bad credit; interest rate can change, meaning monthly amount owed can change



Other Types of Loans

- **Car Loans** – used to finance cars
 - Usually have a high cost interest rate
 - Usually for 10 or fewer years
- Refund Anticipation Loan – **tax loans**
 - Tax companies give you your tax refund early
 - In exchange, they take a big cut of it – you pay them to get money early
 - Used by H&R Block, Liberty Tax, & Jackson Hewitt, etc.



Quick Writes In your Packet:

1. Describe how banks make money by making loans.
2. What do you think the difference is between a DEBIT card and a CREDIT card?

Lesson 3 Banking & Credit: What's going on in this picture?



Credit

- When a store lets you buy something on the **promise that you will pay later**
 - Concept has existed for centuries
 - Helps people & businesses make big purchases
 - <https://www.youtube.com/watch?v=qWWZ77-1YuA>



Lesson 3 Banking & Credit: What's going on in this picture?

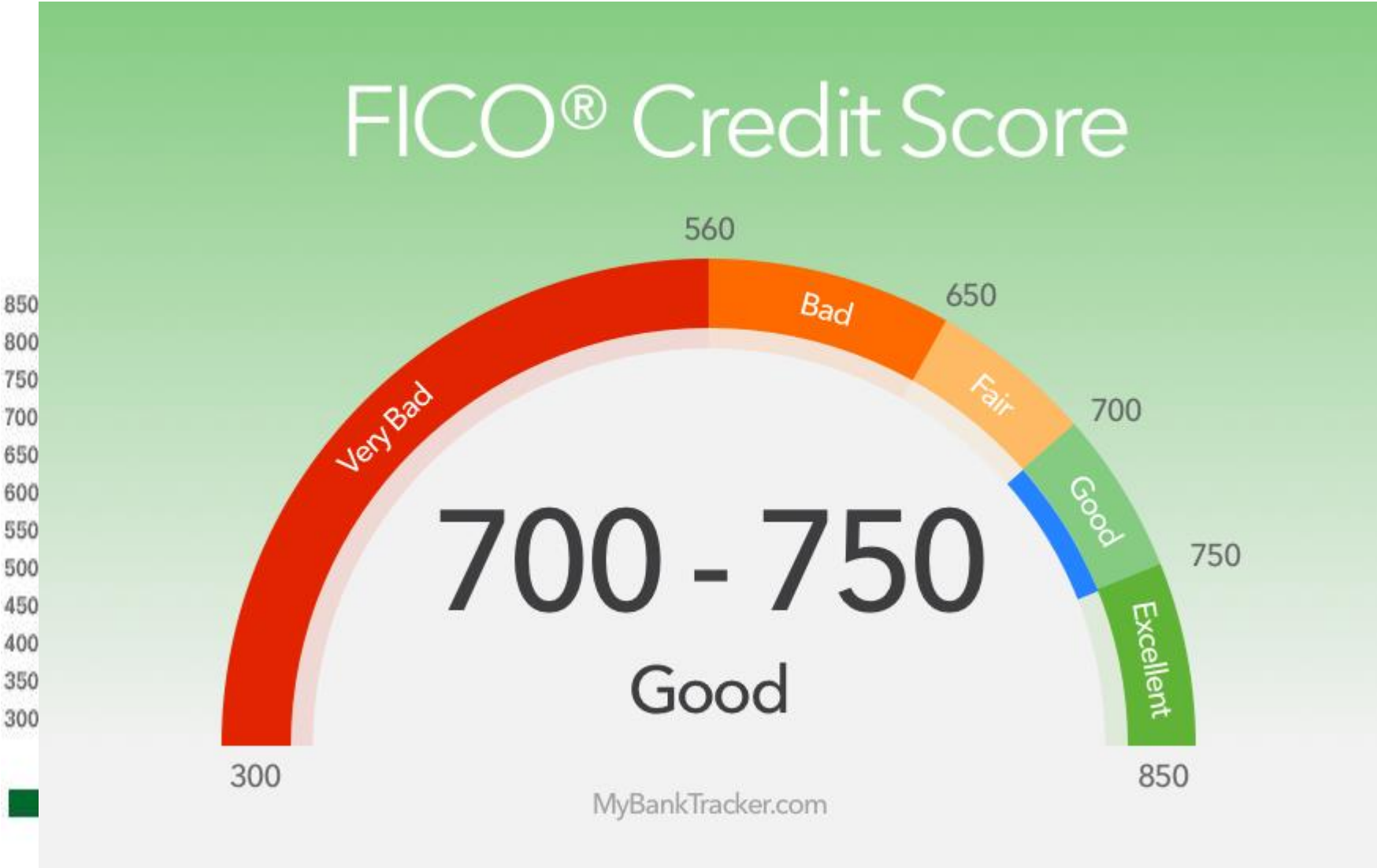


Interest: The cost of Credit

- Credit Score – determines your interest rate
 - Companies check your credit before making a loan or giving you a credit card,
 - Based on how reliable you have been about paying your bills on time
 - People that consistently pay off your bills on time
 - LOW CREDIT RISK and will have GOOD credit scores
 - People that miss payments are viewed as HIGH RISK & get BAD credit scores



Credit Scores & Credit Reports



Credit Rating Agencies & Credit Reports

<https://vimeo.com/121930493>

- Financial companies & debt collectors send information about your payment history to 3 main credit rating agencies:
 - Equifax, Experian, Transunion
 - These companies take all the information and give you a CREDIT SCORE based on how reliable you have been
- You have the right to get a free CREDIT REPORT each year.

The screenshot displays the Credit Sesame dashboard for a user as of January 5, 2016. The dashboard is divided into several sections:

- Header:** Includes the Credit Sesame logo and navigation tabs for "My Finances", "My Recommendations" (with a red notification badge), "My ID Protection", "Credit Cards", and "Loans".
- MY CREDIT SCORE IS EXCELLENT:** Shows a large green score of 795, provided by TransUnion.
- MY CREDIT ANALYSIS:** Features a series of colored boxes representing different credit factors: B (green), F (red), A (green), B (green), and A (green). Below this is a "Payment History" section stating the user is generally on time but missed a payment in the last 24 months. It also shows "Total Accounts with Negative Marks 3" and a "VIEW DETAILS" link.
- MY DEBT ANALYSIS:** Labeled as "TRENDING", it shows "Total Debt Balances" of \$47,300, a "Monthly Payment" of \$3,987, and a "Debt to Income Ratio" of 58%. A "VIEW DETAILS" link is provided.
- Footer:** Includes an "Advertiser Disclosure" link and a promotional message: "Well your credit's fantastic, test! Take advantage of your Excellent credit with these actions."

Lesson 3 Banking & Credit:

What's going on in this picture?

CREDIT SCORE FACTORS

The approximate makeup of the FICO score used by U.S. lenders



- On-time payments
- Capacity used
- Length of credit history
- Types of credit used
- Past credit applications

Interest Rates

- Annual Percentage Rate (APR) – the percentage of interest that a company charges individuals if they are late in repaying their credit card balance
- GOOD CREDIT SCORE = LOW RISK to lender → LOW INTEREST RATE
- BAD CREDIT SCORE = high risk to lender → high interest rate
 - Giving credit to someone who has a history of not paying their debt is risky
 - To cover their risk, companies usually give these people a HIGH INTEREST RATE
 - Company makes money by charging interest on late payments
 - Consumer gets stuck paying off the interest & it's hard to pay off the original amount



How to Avoid Paying Interest

- **Pay off the bill on time every month**
 - If you always pay on time, you will never owe interest
 - DO NOT MAKE PURCHASES YOU CANNOT AFFORD!!!!
- DO NOT GET FOOLED AND MAKE JUST THE “MINIMUM PAYMENT”!!!!

Minimum Payments

- Card companies allow & ENCOURAGE people to pay less than what they owe
 - This allows the company to collect more interest and earn a larger profit
 - [New: https://edpuzzle.com/media/5c8fdbdce9ec1f40a9ff2568](https://edpuzzle.com/media/5c8fdbdce9ec1f40a9ff2568)
 - [Old Water: https://www.youtube.com/watch?v=Vz05A6cP6lw](https://www.youtube.com/watch?v=Vz05A6cP6lw)

Credit & Debt:

- 312.7 million Americans
- 609.8 million credit cards
- Average credit card holder has 3.5 cards
- 14.89% - average interest rate on new credit card offers
- **\$15,799** – average credit card debt for households with credit cards
- **\$2.43 trillion** – total American consumer debt



Good Debt vs. Bad Debt

- Good debt – money owed on loans that are likely to INCREASE the borrowers wealth over time
 - A mortgage (at a good interest rate)
 - Student loans
 - Small business loans (if the business succeeds!)
- Bad debt – money owed that is DIFFICULT to pay off or that DECREASE a borrower's wealth over time
 - Credit card debt
 - Payday loans
 - Tax refund loans
 - Small business loans (if the business failed!)

End of Lesson Review:

Please Complete on paper and submit:

1. What are the risks and benefits of getting a credit card?
2. What must be done to earn a good credit score? Indicate at least three specific elements that contribute to credit score ratings.

3. Lesson Summary Task:

- You work for a credit card company. Your job is to process credit card applications. Write an explanation to each of the following applicants explaining whether they will get a high or low interest rate and why.
 - Applicant #1: Credit Score 738
 - Applicant #2: Credit Score 588
- THEN:
 - Quizlet Practice
 - QUIZ coming up