LESSON 13

Applying for Credit

LESSON DESCRIPTION AND BACKGROUND

This lesson explains what a credit report is and how to read one. To learn about credit reports, the students play the role of loan officers, reviewing excerpts from the credit reports and credit scores of loan applicants. They evaluate each applicant's credit history and use the information to determine whether to grant the loan requested.

Lesson 13 correlates with national standards for economics and personal finance as shown in Tables 1-2 in the introductory section of the publication.

ECONOMIC AND PERSONAL FINANCE CONCEPTS

- Credit history
- Credit report
- Credit score

OBJECTIVES

At the end of this lesson, the student will be able to:

- Identify the qualities that a lender looks for in a loan applicant.
- Describe what a **credit report** is and how it is used.
- Describe the elements of a **credit score**.
- Explain how credit scores affect creditworthiness and the cost of credit.
- Explain the factors that improve a credit score.
- Identify organizations that maintain consumer credit records.
- Compare and contrast favorable and unfavorable credit reports.
- List the types of information contained in a credit report.
- Use a credit report and score to determine whether to grant a loan.

TIME REQUIRED

Two 45-minute class periods

MATERIALS

- A copy for each student of **Exercise 13.1**, **13.2**, and **13.3** from the *Student Workbook*.

ADDITIONAL RESOURCES

To download visuals, find related lessons, correlations to state standards, interactives, and more visit http://fffl.councilforeconed.org/9-12/lesson13.

PROCEDURE

1. Tell the students that this is a lesson about what it takes to qualify for a loan from a financial institution. Explain that a person can't simply walk into a bank and say "Hi there. I'd like to have $14,000, please, to buy a new car." The procedure is more formal than that. It involves an application for credit, and no loan is issued without a favorable evaluation of the application by a loan officer.

2. But what is involved in making an application for a loan? And what goes through the loan officer's mind when she or he evaluates a loan application? In this lesson, the students will learn about credit reports—the principal tool used by loan officers when they evaluate credit applications. The students will assume the role of loan officer, review excerpts from the credit reports of three loan applicants, and make decisions about whether to approve the loans.

3. To get started, ask the students to imagine that an individual has approached them and asked to borrow a substantial sum of money. What would they want to know about this person before they decided to lend the money? Discuss the responses briefly.

4. Give each student a copy of **Exercise 13.1** from the *Student Workbook*. Ask the students

to read the exercise and answer the questions at the end. When the students have finished, go over the questions in class:

a. What are the "3 Cs of Credit?" ***(Character, capacity, collateral.)***

b. Give examples of each of the 3 Cs of Credit. ***(Answers will vary. See Exercise 13.1 for several examples of each.)***

c. What is a credit report? ***(A record of an individual's credit history.)***

d. Why should a person care about his or her credit report? ***(A good credit rating is important if a person wants to borrow money—particularly at a competitive interest rate.)***

e. Are you allowed to check the accuracy of your credit report? ***(Yes. The Fair Credit Reporting Act gives you the right to view your credit report.)***

f. Is there a charge for checking the accuracy of your credit report? ***(The Fair and Accurate Credit Transactions Act gives you the right to receive one free copy of your credit report annually from each of the three credit-reporting agencies. The Fair Credit Reporting Act allows you to receive a credit report for no charge if you are turned down for credit or are a victim of identity theft.)***

g. What is a credit score? ***(Credit scores are summaries of the information in credit reports. The formula for computing credit scores was developed by Fair Isaac Corporation; the scores are commonly referred to as FICO scores. Scores range from 300 to 850. People with lower scores will be more likely to be denied credit or charged higher interest rates.)***

5. Give each student a copy of **Exercise 13.2** from the *Student Workbook* and ask the students to use the information found in the credit report to answer the questions. When they have finished, go over the questions in class:

a. Whose credit report is this? ***(John Q. Consumer.)***

b. How many potentially negative items are listed? ***(Four. Two are from public records and two are from accounts with creditors and others.)***

c. How many accounts are in good standing? ***(Three.)***

d. On page 2, there are two very negative items. What are they? ***(Dime Savings filed a civil claim against John Q. Consumer; John Q. Consumer filed for bankruptcy, and it was discharged, or granted.)***

e. Have any of John Q. Consumer's credit cards been lost or stolen? ***(Yes: The card issued by American Finance Corporation.)***

f. Does John Q. Consumer have a good credit record with First Credit Union and National Credit Card? What are the reasons for your opinion? ***(Yes. The status is open—never late.)***

g. Who requested John Q. Consumer's credit report in 2009? ***(Credit R Us; World Bank; Fidelity Bank NA.)***

h. Is John Q. Consumer a homeowner? ***(Yes.)***

i. What is the most negative item on this report, and for how many years does that item remain in the credit report? ***(The bankruptcy. It will remain in the report until 11/2015 or ten years after the bankruptcy was discharged.)***

j. What is John Q Consumer’s credit score? ***(550)***

k. If you were a lender, would you grant John Q. Consumer credit? Why or why not? ***(Answers will vary.)***

CLOSURE

Conclude the lesson by placing the students in small groups; ask each group to draw up a list of steps that can be taken to establish or re-establish a good credit rating. Have each group report to the class. Answers include the following:

- ***Pay bills on time.***

- ***Borrow only what you need.***
- ***Apply for and use only a few credit cards.***
- ***Open a savings account and make deposits monthly.***
- ***Open a checking account and don't bounce checks.***
- ***Report a lost or stolen credit card immediately.***
- ***Use collateral to strengthen loan requests.***
- ***Avoid bankruptcy.***
- ***Stay employed.***
- ***Own a home and don't move too often.***
- ***Make sure your loans aren't too great as a percentage of your income.***

ASSESSMENT

1. Tell the students that they will now play the role of a loan officer. Give each student a copy of **Exercise 13.3** from the *Student Workbook*. Note that **Exercise 13.3** presents credit report summaries for each of three individuals who are applying for credit. The students will play the role of the loan officer and check a box that either grants or denies the credit request, based on the information presented.

Ask the students to review the three credit applications and explain their decisions to grant or deny credit and the interest rate that is offered. Possible answers include the following:

- Janice Brown. (Credit score 450.) ***She should be denied. Her credit score is low and her credit record demonstrates difficulties paying her bills. She may need to seek a financial counselor. Eighty-seven percent of borrowers with credit scores similar to hers have been delinquent in paying their debts.***
- Tito Sanders. (Credit score 770.) ***He should be approved. He has an excellent credit score and a very good credit record. He has handled credit responsibly in the past. Only 2 percent of the borrowers with scores similar to his have been unable to successfully manage their past credit. He qualifies for a low interest rate of 6.098 percent.***
- Maria Martinez. (Credit score 620.) ***She is a candidate for the "not sure" category. Her score indicates that she could have some difficulty managing credit, but her credit record so far seems OK. Nearly one-third of those with scores like hers have had delinquent accounts. She would probably qualify for a higher-interest loan (11.761 percent). If she improves her score she might be able to refinance the car at a lower rate.***

2. To underscore the importance of having a good credit score, compare Tito's cost (in interest payments) for a loan to Maria's cost, given their respective credit scores:

If Tito and Maria both were approved for a $15,000 four-year car loan, how much difference would their credit scores make in what they pay in interest over the life of the loan? ***(With an interest rate of 6.098 percent over four years, Tito would pay about $1,941 in interest. Maria's interest rate of 11.761 percent would make it much more costly for her to finance an auto purchase over the same time period. Her total interest cost would be about $3,875, or about twice the interest paid by Tito.)***

EXTENSION

Invite a bank loan officer to come to your class and outline the steps that are taken when bankers make decisions on loan applications. Arrange with the loan officer to distribute the documents that are actually used in loan applications; ask the loan officer to discuss interest rates that are charged for different sets of customers.