Standard 7: **The student will identify the procedures and analyze the responsibilities of borrowing money.**

Your Credit Score

Priority Academic Student Skills
Personal Financial Literacy

Objective 7.1: Identify and analyze sources of credit (e.g., financial institutions, private lenders, and retail businesses) and credit products (e.g., student loans, credit cards, and car loans).

Objective 7.2: Identify standard loan practices, predatory lending practices (e.g., rapid tax return, rapid access loans, and payday loans), and legal debt collection practices.

Objective 7.3: Explain the importance of establishing a positive credit history (e.g., maintaining a reasonable debt to income ratio), describe information contained in a credit report, and explain the factors that affect a credit score (e.g., the relationship between interest rates and credit scores).

Objective 7.4: Explain how the terms of a loan (e.g., interest rates, fees, and repayment schedules) affect the cost of credit.

Lesson Objectives

⇒ Describe the purpose of a credit report.
⇒ Define the role of credit scores.
⇒ Explain the importance of a good credit score.

Julie did not understand why she was turned down from her loan application. She had several friends with more credit cards than she had. They all laughed about missing payments, even though they sometimes worried about all of those late fees. Julie decided maybe she would not worry either. She would go borrow money where they did. If they could get credit, so could she.

Susan knew she had missed a couple of payments and that her debt was mounting. She had borrowed too much money, and she was getting concerned about her FICO credit score. When she got a copy of her credit report, she knew she was in big trouble. Her score was only 450, so she began taking immediate steps to improve her credit score for the future.

Who was right? Julie or Susan?

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Personal Financial Literacy Vocabulary

Credit bureau: An establishment that collects and distributes credit history information of individuals and businesses.

Credit history: A record of borrowing and repayments.

Credit report: An official record of a borrower's credit history, including such information as the amount and type of credit used, outstanding balances, and any delinquencies, bankruptcies, or tax liens.

Credit score/rating: A measure of creditworthiness based on an analysis of the consumer's financial history, often computed as a numerical score, using the FICO or other scoring systems to analyze the consumer's credit.

PRESENTATION

The multimedia slide presentation for this lesson outlines the content in this section. You may want to use it with your students, or print off the slides to use as lecture notes.

FICO: The most commonly used credit score. The name comes from the Fair Isaac Corporation, which developed the scoring model.

Introduction

When people apply for loans, lenders want to be sure they will repay the money. Most lenders rely on a person's credit score to make this decision. Lenders use credit scores to determine the level of risk associated with loaning money to that person. Credit scores are based on information gathered by credit bureaus and placed in a credit file.

Lesson

Most lenders know very little about you when you apply for a loan. However, they must make some conclusion about your ability to fulfill the terms of the loan agreement and repay the money you borrow. To help them make this decision, they tend to rely on your credit history.

Your **credit history** is simply the way you have handled other loans and payments. It includes every application you have made for a loan, a charge account, or a credit

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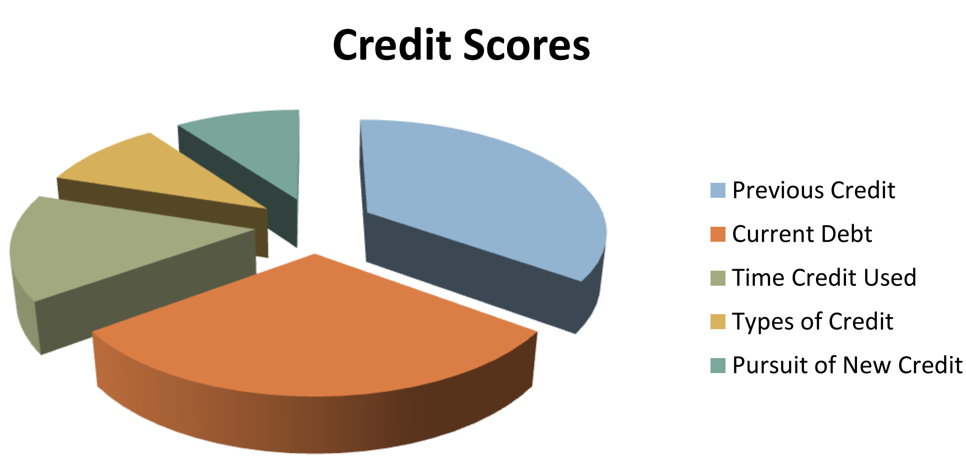
card, along with the amount of credit you have, your required monthly payments, and other information about you. Lenders want to be sure you have not borrowed so much money that you cannot pay your bills, and they want to see whether or not you pay your bills on time.

Your credit history is compiled into a report by a credit bureau who provides information to lenders and others who need information about you. A **credit bureau** is a business that specializes in gathering information from various sources. Your credit file may also include information about your income, your work history, and any legal actions taken against you.

Credit bureaus use the information to develop a credit score based on five major factors: your credit history, your current level of debt, how long you have used credit, the types of credit you have, and how often you apply for new credit.

The most important factor is your ability to pay your bills, or how you have managed credit in the past. Second is how much debt you have currently. Following is a percentage breakdown of the credit scores and a pie chart that shows those percentages:

1)	Your credit history	35%
2)	Your current level of debt	30%
3)	How long you have used credit	15%
4)	The types of credit you use	10%
5)	Your pursuit of new credit	10%



Source: www.myfico.com

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Lenders in the United States rely on three main credit bureaus: Equifax, Experian, and TransUnion. Lenders pay a fee to one or more of those bureaus to get your credit file and make their decisions based on your **FICO score**. FICO stands for Fair Isaac Corporation which developed a special software program to rate your creditworthiness. Because the information reported to each credit bureau may differ, you actually have three FICO scores, one from each credit bureau. FICO scores are designed to help standardize the way lenders make decisions and give consumers more information about their ability to access credit.

While your FICO score is important, it only reflects the information on your credit report. Lenders may also look at many other factors before making a final decision, such as your income, how long you have worked at your job, the kind of credit you are requesting, and any other characteristics that give them a complete picture of your ability to repay the loan.

What Difference Does It Make?

Your credit score impacts more than just your ability to get credit. It may determine whether or not you get a job or can rent an apartment. It also plays a major role in the rate of interest you are charged when you borrow money. A higher credit score shows you are a good money manager; you pay your bills on time; you are a responsible consumer; and you show maturity in your actions. Low credit scores show the opposite, indicating that you are a high risk as a potential borrower, renter, or employee.

FICO scores range from a high of 850 to a low of 300. The higher your FICO score, the better! The table below shows how your FICO score affects the rate of interest and your monthly payment on a $150,000 mortgage.

Your FICO® Score	Your interest rate	Your monthly payment
760 - 850	5.66%	$867
700 - 759	5.89%	$888
680 - 699	6.06%	$905
660 - 679	6.28%	$926
640 - 659	6.71%	$969
620 - 639	7.25%	$1,024

Source: www.bankrate.com

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As you can see, people with lower scores pay higher interest rates and higher interest rates result in higher monthly payments. Why? People with higher scores have proven to be a better risk and more trustworthy when managing their money, so they are rewarded with lower interest rates than people who have not been as reliable.

Even though the table above stops in the low 600s, it does not mean people with lower scores cannot qualify for loans. Some lenders are willing to make loans to you regardless of how low your score may be, but you will definitely pay even higher interest rates and have higher monthly payments.

In addition, most landlords and potential employers check your FICO score to find out how responsible you are. You can be turned down for a job or denied a place to live if you have a low score. One employer in Oklahoma City recently said they turn away four out of every ten job applicants because of low credit scores.

Information NOT Included In Your FICO Score

- Your race, color, religion, national origin, sex, and marital status.
- Your age.
- Your employer, job title, salary, or other employment history.
- Your address.
- Any interest rates you pay on other loans or credit cards.
- Items such as child support or rental obligations.
- Certain requests for your credit information, such as inquiries from potential employers or promotional offers such as preapproved credit card letters.
- Any information not found in your credit report.
- Any history of credit counseling.

Negative or Inaccurate Information

Negative information, such as late payments and loan defaults, stay in your credit files for seven years. Other information, such as bankruptcy, remains in your files even longer. Bankruptcy remains for a maximum of ten years; information about lawsuits or unpaid judgments remains seven years or until the statute of limitations expires, whichever is longer.

The best way to improve your FICO score is to pay your bills on time and reduce your debt.

If the information in your credit file is accurate, there is little you can do about it. However, if you believe the information is incomplete or inaccurate, you have a right to file a dispute with

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the credit bureau. Disputes can be filed online, by phone, or by certified letter.

Both the credit bureau and the company providing the information are required by law to investigate any disputed information. If the information is inaccurate, they are also required to correct it. Even though the dispute might not be resolved to your satisfaction, you can send the credit bureau a statement explaining your side of the story and ask them to provide a copy of your statement to anyone requesting information about you. However, you may have to pay a fee for this service.

Before applying for a loan, it is highly recommended that you check your credit report. Getting a copy of your credit report gives you the opportunity to review what is reported and to check it for errors. You are allowed to receive one free copy of your credit report from each credit bureau annually. You can also receive a free copy of your credit report any time you are denied credit, insurance, or a job based on your credit history.

COMPLETE: Making a Loan – Activity 7.3.1

Review student answers before continuing with this lesson.

While Julie may be able to still get credit, she will definitely be paying higher interest rates and higher payments.

Susan, however, starting shredding all of the credit applications she received in the mail. She set up her bills for automatic payment from her checking account, and she quit spending until she could get a handle on her debt. When possible, she is making extra credit card payments instead of eating out every day with her friends. It will take a little time, but Susan is well on her way to improving her FICO score. Her disciplined behavior will result in lower interest rates and lower payments in the future. Way to go, Susan!

Conclusion

Your credit report is one of the most important sources of information that others use to make decisions about your creditworthiness. The information contained in your file can help determine whether or not you qualify for a loan, a job, an insurance policy, or even a place to live. The best way to maintain a positive credit history is to control your level of debt and pay your bills on time.

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Name: ______________________________ Class Period: ____________________________

Your Credit Score
Review Lesson 7.3

Answer the following questions and give the completed lesson to your teacher to review.

1. Explain the role of a credit bureau.

2. What is a FICO score, and why do lenders use it?

3. Why do people with high FICO scores pay lower interest rates than people with low FICO scores?

4. What should you do if you find inaccurate information in your credit report?

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Name: ____________________________ Class Period: ___________________________

Making a Loan – Activity 7.3.1

Each of the following individuals has applied for a $10,000 loan. Would you loan the money to them? Why or why not?

Matt *Age 20*	Matt started working at a local auto parts store when he graduated from high school. He had a credit card, but lost it and never got another one. He rarely used it and has no other credit. He listed his favorite teacher and his boss as references for the loan. He has a checking account with a low balance, lives at home with his parents, and has no savings account. He makes a $200 monthly car payment. He wants to use the money to invest in a new business.	**Yes or No** **Explain:**
Merideth *Age 18*	Merideth lives at home but is planning to get married this summer. She wants to use the money to help pay for the wedding because her parents have limited funds available. She has a good job, has a good credit history, and has never been late with a payment. Her future husband is unemployed, and she helps pay his bills.	**Yes or No** **Explain:**
Al *Age 25*	Al dropped out of college to work because he got into debt with credit cards. He has been working to pay off the bills, and his credit score is improving as his debt drops. He has lived in an apartment with a friend for five years, has a $25,000 loan on his truck, and makes good money working in the oil fields. He recently opened a savings account and has a retirement fund with his employer. He wants to buy a motorcycle to reduce his gasoline payments.	**Yes or No** **Explain:**

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Rhoda *Age 30*	Rhoda just recently bought a house and wants to borrow money to remodel it. She has a great job as an assistant to the president of a big company. She has one credit card, makes her payments on time, and has an excellent credit report. She owns a small house not far from work so she can walk everyday. She bought a new car five years ago, and it is now paid off.	**Yes or No** **Explain:**

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