

Using Credit Cards with Care

The **BIG** Idea

- What are the advantages and risks of using credit cards?

AGENDA

Approx. 45 minutes

- I. Warm Up: Buy Now, Pay Later!
(10 minutes)
- II. It Adds Up Fast! How Interest Rates Work (15 minutes)
- III. Why It Matters: Financial Troubles and Credit Rating
(10 minutes)
- IV. Wrap Up: Advice to a Friend
(10 minutes)

MATERIALS **STUDENT HANDBOOK PAGES:**

- Student Handbook page 143, Charge It?
- Student Handbook page 144, Things to Remember About Credit Cards

 FACILITATOR PAGES:

- Facilitator Resource 1, Charge It?
(Answer Key)

 Overhead projector Laptop, LCD projector, and speakers Internet access (optional) Ruled paper**OBJECTIVES**

During this lesson, the student(s) will:

- Understand the risks of credit cards and how interest rates can increase your credit card balance.
- Learn about credit records and the importance of good credit.
- Explain why it's important to pay credit card bills in full and on time.

OVERVIEW

In this lesson, students will watch a brief video about a recent college graduate who learned a valuable lesson racking up credit card charges she didn't pay off. They'll discuss advantages and disadvantages of credit cards, specifically the dangers associated with interest rates. They'll review some examples of how interest rates can increase the actual cost of items if credit card charges aren't paid in full and on time. Finally, students will learn about credit reports — and why the way they handle credit now can have a big impact on their futures.

PREPARATION

- List the **BIG IDEA** and the day's activities on the board.
- Write the day's vocabulary words and definitions on the board.
- Print out a copy of the **Student Handbook page 143, Charge It?** onto a transparency to show on an overhead projector.
- Preview the Credit Card Debt: A Student's Story video at...
http://www.aie.org/managing_your_money/Credit-cards/Credit-Card-Debt-A-Student-Story.cfm
(under Credit Cards), and make arrangements to view it in class by downloading it to your laptop (or via Internet connection in class.)

VOCABULARY

Credit: Money you borrow (for example, from a bank) with the promise to pay it back at a later date or over time.

Interest: The amount you pay for the money you borrow, usually a percentage of the money you borrow.

Annual Percentage Rate (APR): The amount of interest you pay over a year.

Credit Record: A record of all the money you've borrowed, including credit cards, and your payment history.

IMPLEMENTATION OPTIONS

The chart on **Student Handbook page 143, Charge It?** is based on an online calculator found at <http://www.practicalmoneyskills.com/>.

Mouse over the “Calculators” tab near the top of the page and select the “Credit & Debt” option from the drop-down menu. Under ‘Select a Calculator,’ click “Cost of Credit.” You can enter a purchase price, interest rate, and monthly payment, then see how long it will take to pay off your credit card and how much total interest you’ll pay. Students may enjoy this as a supplement to the information presented in the chart.

In Activity II, if your students seem completely lost when you are modeling how to predict the number of payments and interest charges on **Student Handbook page 143, Charge It?** feel free to model the last two rows as a class. You should follow the same format as written in section 5 of this activity.

ACTIVITY STEPS

I. Warm Up: Buy Now, Pay Later! (10 minutes)

1. **SAY SOMETHING LIKE:** Who here thinks you'll have a credit card when you turn 18? While credit cards sound very appealing, they should be used with caution. Let's start by watching a short video about a recent college graduate who used her credit card throughout her college years.
2. [Show the class the *Credit Card Debt: A Student's Story* video from the following website: http://www.aie.org/managing_your_money/Credit-cards/Credit-Card-Debt-A-Students-Story.cfm. (See **Preparation**.)]
3. **SAY SOMETHING LIKE:** What can we learn from Robyn's experience? [Have students share their answers.] The video states that 21% of college students graduate with \$7,000 in credit card debt. What happens to that amount the longer it takes to pay off that debt? [Allow students to respond.]
4. **SAY SOMETHING LIKE:** Of course, it can be hard to resist the temptation of credit cards. Let's imagine ourselves in this situation: It's the summer before college and you're shopping for some new clothes. You're about to buy a \$40 sweater, when the salesperson asks if you'd like to open a credit card with the store. If you open an account today, you can save 15% off your purchase. Wow, you think—you could save \$6 on that sweater! Plus, that would leave \$40 cash in your pocket you could spend on something else. What would you do? What do you need to know before making this decision?

[**Note:** There are many financial examples in this lesson that illustrate purchase prices, interest, minimum payments, late fees, etc. Though it's not necessary to go through elaborate calculations for each example, it's helpful to write the numbers on the board so students can follow the discussion.]
5. **SAY SOMETHING LIKE:** Once you turn 18, you're going to receive a lot of enticing offers for credit cards. But it's important to understand the benefits and dangers of credit before you think about credit cards. First, what is **credit**? Credit allows you to borrow money, for example, from a bank, and pay it back at a later date or over time. So a credit card lets you buy something now and pay later. Banks and other financial institutions issue credit cards. So when you use their credit card, you're borrowing money from them.

6. **SAY SOMETHING LIKE:** We're going to spend a lot of time talking about the risks of credit cards today. But they do have some advantages. Can anyone think of any? [Make a list on the board, such as:

- They allow you to make purchases now and pay later.
- They allow you to make purchases in an emergency when you don't have the cash.
- They're safer and more convenient to carry than cash or checks.
- They keep a record of your purchases.
- They're necessary to purchase things online.
- If used responsibly, they allow you to establish a history of good credit, which will make getting loans for a car, school, or a house easier down the road.]

7. **SAY SOMETHING LIKE:** Credit cards sound pretty great, don't they? Well, here's the most important thing to know about credit cards. [You may want to write this on the board.]

If you don't pay your credit card bill IN FULL and ON TIME, it will cost you a lot of money.

You see, if you don't pay back that loan right away, you're going to pay **interest** and late fees. You'll pay interest, or a certain percentage, on any charges that aren't paid in full. So if you owe \$100, and you only pay \$10, you'll owe interest on the remaining \$90. And if you don't make any payment, or don't pay on time, you'll pay a late fee.

Why does it cost so much to borrow money? Well, banks are in the business to make money. And they're going to charge you for borrowing their money. Here's the other important thing to remember:

The longer you put off paying your credit card bill, the more you're going to owe.

In other words, if you charge \$100.00 on your credit card, it's not going to stay at \$100.00. With interest rates and fees, that amount will keep increasing until you may not be able to pay your bills at all.

8. **SAY SOMETHING LIKE:** In today's lesson, we're going to take a closer look at these risks and why it matters in the long term.

II. It Adds Up Fast! How Interest Rates Work (15 minutes)

1. **SAY SOMETHING LIKE:** Let's say you decided to open a credit card account at the store where you bought the sweater. A few weeks later, you receive your first bill for \$34.00. You notice you could make a "minimum payment" of \$15.00, but you really need that money this weekend. You decide not to pay anything now, and stick the bill in your dresser. The next month, you open your bill and you notice it's \$59.61. What happened? You thought you paid \$34 for that sweater! You look closely at the bill and see those charges came from finance charges and late fees.
2. **SAY SOMETHING LIKE:** You owe a *finance charge* any time you don't pay your bill in full. A finance charge is the amount of **interest** you owe. Remember, interest is money you pay for what you've borrowed. Interest rates are described as percentages. The higher the interest rate, the more money you pay.

You owe a *late fee* anytime you don't make a minimum payment, or if you make a payment late. Late fees can be very high, so even if you can't pay in full, it's important to make a minimum payment and pay on time.

3. **SAY SOMETHING LIKE:** Let's take a closer look at how interest rates work. Credit cards describe interest as an **annual percentage rate (APR)**, or the amount of interest you pay over a year. Say you have a new credit card with an APR of 18%. You use your card to pay for a bunch of stuff for your dorm room. Your card has a balance of \$1,000.00. You stop using your card, but don't pay that balance for a full year. A year later, you'll owe an additional 18% in interest—or \$180. Your balance just climbed to \$1,180.00! (And, of course you have to keep making payments and pay a portion of this interest every month.)
4. **SAY SOMETHING LIKE:** A trap some people fall into is thinking they can just make a minimum payment on their credit card and keep on charging. Take the example above. Your credit card balance is \$1,000. You decide to stop using your card, and start making the minimum payment of \$20 every month. How many months would it take to pay off a bill of \$1,000 at \$20 per month? You might think it would take 50 months—after all, divide \$1,000 by \$20 and you get 50, right?

Well, think again. Even though you're paying \$20 each month, the bank is charging you interest (18% APR) on the money you still owe. Each month, that interest is adding up. Meaning the longer it takes to pay, the more you owe! So even though you're paying \$20 a month to cover the \$1,000 balance, it will take almost EIGHT YEARS to

pay off the loan. In the end, you will have paid \$862 in interest (finance charges). In other words, you'd have to pay \$1,862 for items worth only \$1,000!

5. **SAY SOMETHING LIKE:** Turn to your **Student Handbook page 143, Charge It?** [Display the page on an overhead projector.]

Here's a look at how much you'd end up paying for items when you make small payments and are charged interest every month. We just discussed the first example, in which you paid off a \$1,000 balance with payments of \$20. Look at the second example. What happens if you increase your monthly payments to \$40? In this case, you would be doubling your minimum payment. How many payments do you think you'll need to make? [Allow students to respond.] In this case, I would have guessed that the number of payments would have decreased by one half since we doubled the minimum payment. This would mean that it would take 47 months to pay off a \$1,000 bill with a minimum payment of \$40. In reality, it would take 32 months to pay off this bill. Why? (Because the balance is reduced more quickly, you'd pay less interest.)

Now we're going to predict the amount of interest you would be charged for a minimum payment of \$40. If a minimum payment of \$20 results in interest of \$862.23, what do you think the interest charges would be for a minimum payment of \$40? [Allow students to respond, and then fill in the correct answer for the interest charges and final cost on the overhead.] Increasing the minimum payment by \$20 saved about \$600.

[Then instruct the students to make predictions for the remaining blank sections. Explain to the students that it's OK if they get the wrong answer. They should try to make their predictions reasonable, but there is no penalty for answers that are way off. Give them three minutes to complete this work, and then go over the correct answers as a class. (See **Facilitator Resource 1, Charge It? Answer Key**).]

SAY SOMETHING LIKE: So remember: *If you only pay your minimum payments, it will take years to pay off your credit card—and you'll end up paying a lot more!*

III. Why It Matters: Financial Troubles and Credit Rating (10 minutes)

1. **SAY SOMETHING LIKE:** Every year, millions of Americans make the mistake of ignoring their ever-growing credit card bills. The credit card debt carried by the average American is over \$8,000! And Americans pay *billions* of dollars in finance charges every year. Maybe they hope the problem will go away. Or they might think that it won't get any worse. But the longer they ignore the problem, the worse it gets.

Even if someone stops using his credit card altogether, his balance will keep growing as finance charges keep adding up.

2. **SAY SOMETHING LIKE:** Financial trouble is just one reason to pay your bills on time. You could also get into legal trouble. After all, when you sign a contract for a credit card, you are making a legal obligation to the bank or department store to pay the money back on time. If you fail to do so, they could take legal action against you.
3. **SAY SOMETHING LIKE:** But there's another very important reason you should be careful to pay your credit card bills on time: your **credit record**. Your credit record is basically a record of all the money you've borrowed—including all your credit cards—and your payment history. If you have borrowed money and paid it back on time, you will have good credit. If you have not paid back money on time, you'll have bad credit.
4. **SAY SOMETHING LIKE:** You might be wondering why this matters — after all, who's going to see your credit record? The answer is, *lots of people— from banks to future employers*. You see, your credit record follows you wherever you go. Any time you apply for a loan or any other credit card, your credit record is checked. Future employers may also check your credit record. After all, people want to see if you are reliable and trustworthy — do you keep your promise when you owe people money? With a bad credit rating, you could get turned down for a job you really want. Or you might not be able to get a loan to purchase something really important, such as a home or a car.

In some cases, you may still receive a loan, but at a much higher interest rate. For example: If you have good credit, you might be able to borrow money to buy a house at 6% interest. If your credit is bad, it will cost you more, such as 7% interest. That might not sound like a lot, but over the 30 years it takes to pay off a \$200,000 mortgage, bad credit will cost you \$47,340 more!

5. **SAY SOMETHING LIKE:** The bottom line is this: *The way you handle your money now can have a big impact on your future.*

IV. Wrap Up: Advice to a Friend (10 minutes)

1. Have students turn to their **Student Handbook, page 144, Things to Remember About Credit Cards**. Review the list as a class.
2. **SAY SOMETHING LIKE:** We talked a lot about the dangers of credit cards today. But if used carefully, credit can play an important role in our lives. Credit allows people to afford big purchases that will be useful for many years. For example, in your lifetime, you will probably take out loans for a house, a car, and maybe even college. Not only do these loans carry lower interest rates than credit cards, these purchases can often be a very wise investment because they have lasting value. Your college education will help you throughout your life. Your home provides a place for your family to live—and will probably increase in value over time.
3. **SAY SOMETHING LIKE:** Before we end today, I'd like you to imagine you're out shopping with a friend. You're at one of your favorite stores and the salesperson asks your friend about opening a new card and saving on today's purchase. Your friend is ready to sign up on the spot. What would you say to your friend to help him or her make an informed decision? Write a note with your advice.

Charge It? (Answer Key)

Give students three minutes to complete the predictions on the chart below and then review the answers as a class.

Item and Original Cost	Minimum Payment	Number of Payments	Interest Charges	Final Cost
Stuff for dorm room \$1,000	\$20	94 months (Seven years and 10 months)	\$862.23	\$1,862.23
Stuff for dorm room \$1,000	\$40	32 months (Two years and eight months)	\$262.72	\$1,262.72
Stereo \$500	\$20	32 months (Two years, eight months)	\$131.39	\$631.39
Stereo \$500	\$40	14 months	\$57.85	\$557.85
Miscellaneous expenses (clothes, CDs, dinners out) \$3,000	\$50	155 months (almost 13 years!)	\$4,732.78	\$7,732.78
Miscellaneous expenses (clothes, CDs, dinners out) \$3,000	\$75	62 months (Five years and two months)	\$1,615.73	\$4,615.73

To create your own examples showing the cost of credit cards, click on <http://www.practicalmoneyskills.com/wizards/credit/index.php> and try the online calculator.

Charge It?

You have a new credit card with an 18% APR, or annual percentage rate. The chart below gives you a look at what you'll really spend on different items — and how long it will take to pay the bill — if you don't pay the bill in full each month.

Directions: Predict the number of payments, interest charges, and final cost for the blank spaces below.

Item and Original Cost	Minimum Payment	Number of Payments	Interest Charges	Final Cost
Stuff for dorm room \$1,000	\$20	94 months (Seven years and 10 months)	\$862.23	\$1,862.23
Stuff for dorm room \$1,000	\$40			
Stereo \$500	\$20	32 months (Two years, eight months)	\$131.39	\$631.39
Stereo \$500	\$40			
Miscellaneous expenses (clothes, CDs, dinners out) \$3,000	\$50	155 months (almost 13 years!)	\$4,732.78	\$7,732.78
Miscellaneous expenses (clothes, CDs, dinners out) \$3,000	\$75			

To create your own examples showing the cost of credit cards, click on <http://www.practicalmoneyskills.com/wizards/credit/index.php> and try the online calculator.

Things to Remember About Credit Cards

Thinking about getting a credit card when you turn 18? Here are some important things to remember:

- When you use a credit card, you are borrowing money from a bank with the promise to pay it back.
- **If you don't pay your credit card IN FULL and ON TIME, you will end up owing MORE than the money you borrowed. Two major reasons are:**
 - Late Fees:** If you don't make any payment when the bill is due—or if you make a payment after the due date—you will be charged late fees. Late fees can be very high, such as \$25.00 per late payment.
 - Interest Charges** (or finance charges): If you don't pay your bill in full, you must pay interest on the money you owe. The interest is a percentage of the money you owe. This interest keeps adding up as long as you owe the money.
- **The longer you put off paying your credit card bill, the more you're going to owe.**
 - Even if you make minimum payments every month, the interest is still adding up on the money you still owe.
- **If you only pay your minimum payments, it will take years to pay off your credit card. If you don't pay your credit card bills in full and on time, you could face:**
 - Financial Trouble:** The longer you ignore your bills, the more your balance will grow—until your bills may be impossible to pay.
 - Legal Trouble:** When you sign a contract for a credit card, you're making a legal obligation to the bank or department store to pay money back on time. If you fail to do so, they could take legal action against you.
 - A Poor Credit Record:** Your credit record tracks all the money you've borrowed and your payment history. When you apply for a loan, another credit card, and even a job, people will check your credit record. You could get turned down for future loans and jobs with a poor credit record.
- **The way you handle your money now can have a big impact on your future.**