Building Your Financial Foundation

including

Road to Retirement Series

Financial Capability Curriculum Series
What Is Credit?

**Warm-Up Activity**

Do you think people are more likely to buy something they do not need when they use a credit card? Why?

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In the financial world, credit refers to an arrangement that defers payment for borrowed money or a purchased item until later. In other words, you get money or stuff now, and you agree to pay it back at a later time. When you buy or borrow on credit, you generally end up paying back more than the original amount in interest. How much interest you pay depends on your credit history (your record of paying bills and handling credit in the past). The percentage of the debt that you’re charged on top of the original amount is called interest and it is determined by a percentage called an interest rate.

Learning how credit works is the key to building an outstanding credit history.

**Credit Cards**

When you use a credit card, it’s the same as a loan. The credit card company is lending you money and charging you fees (interest) to borrow that money. For instance, let’s say you borrow $1,000 and your interest rate is 25%. If you don’t pay the loan off until a year later, you would owe $1,250.

It’s all about convenience. Credit cards are convenient and most businesses accept them.

If you do not have a credit history, the credit cards for which you’re initially approved will charge higher interest rates and higher fees; they’ll have lower spending limits. They have no way of knowing how trustworthy you are since there is no past information. They charge the higher rate to compensate for the unknown. That’s why it is vitally important to remain free of credit card debt.

Credit cards can be handy tools for charging clothes and groceries, as long as you pay the bills in full each month, instead of carrying costs over and racking up interest.
What Is Credit?

The best way to manage a credit card is to be the company’s worst customer. Many Americans carry balances on their credit cards from month to month, and that’s how the companies make their money. If you pay your credit card bills in full each month by properly planning and budgeting for your purchases, you will benefit yourself by building a credit history instead of putting your money into the credit card companies’ pockets.

Credit cards can be a useful financial tool or a debt trap. Use credit cards only to your advantage. That means avoiding credit card debt like the plague! Second, use credit cards to build your credit rating. You can only do that by charging money on your credit card each month and paying it off in full every month. Be sure to follow the guidelines in this section closely!

Start with a Debit Card

Credit cards used improperly will have a negative impact on your finances. Before you get a credit card, start off with a low-cost debit card.

A debit card helps you learn how to manage “plastic money” safely. And unlike a credit card, everyone qualifies for a debit card. You are not required to show proof of income, provide a social security number, or submit to a credit check. Debit cards are accepted almost everywhere a credit card is accepted.

Just load your debit card with cash, and then you can spend the money as you please. It’s impossible to incur late fees (which credit card users often face). Some banks do not approve purchases if the purchase total is greater than the money you have in the account. With such banks you do not need to worry about over-the-limit charges. Other banks do allow you to spend a bit over the amount you have available and will charge you a fee. You will need to verify which type of card your bank provides you. You should, however, always be aware of how much you have available to spend.

Credit Card Plan

Allow yourself to get your first credit card only when you’re able to live within your budget and when you have six months’ worth of expenses in your emergency savings fund. Until then, follow the advice above and practice with a debit card.

When you do get your first credit card, use it only to build your credit rating. Charge an amount of money you know you can pay off in full at the end of the month. When you get the bill, make sure to pay the balance off in full. You will benefit because you’re building your credit history by using the card, but paying off the balance in full each month avoids paying interest.
To reap more benefits, get a credit card that offers special bonuses: travel miles or gift certificates, for example. Earn these other “gifts” by spending and paying off your balance in full each month.

If you follow these tips, you’ll build a credit history while getting cool things in the process. The best part is that it’s not costing you a dime! In essence, you’ll be building your credit rating for free.

**Cut it Out**

If you find you can’t handle the burden of a credit card, you need to literally “cut it out.” That is, snip your plastic card into pieces before you get into real trouble!

A common misperception is thinking it’s okay to pay just the minimum payment calculated for you by the credit card company. This is the bare minimum amount that, if paid, will keep your account active. It’s barely high enough to ever actually retire the debt. If you pay only the minimum payment you could end up paying $1,000 for a pair of new shoes. Your debt will last a lot longer than the shoes.

<table>
<thead>
<tr>
<th>Good Credit</th>
<th>Bad Credit</th>
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</thead>
<tbody>
<tr>
<td>Purchases</td>
<td>$1,000</td>
</tr>
<tr>
<td>Interest rate</td>
<td>7%</td>
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<tr>
<td>Monthly payment</td>
<td>$10</td>
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<tr>
<td>Years to pay in full</td>
<td>12</td>
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<tr>
<td>Interest paid</td>
<td>$440</td>
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<tr>
<td>Actual Cost</td>
<td>$1,440</td>
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<th>Good Credit</th>
<th>Bad Credit</th>
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<tbody>
<tr>
<td>Purchases</td>
<td>$1,000</td>
</tr>
<tr>
<td>Interest rate</td>
<td>27%</td>
</tr>
<tr>
<td>Monthly payment</td>
<td>$23</td>
</tr>
<tr>
<td>Years to pay in full</td>
<td>12</td>
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<tr>
<td>Interest paid</td>
<td>$2,312</td>
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<tr>
<td>Actual Cost</td>
<td>$3,312</td>
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<thead>
<tr>
<th>Making Purchase in the Future with Savings</th>
<th>Making Purchase Now with Savings</th>
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<tbody>
<tr>
<td>Purchases</td>
<td>Purchases</td>
</tr>
<tr>
<td>Amount saved each month</td>
<td>Amount saved each month</td>
</tr>
<tr>
<td>Months to save $1,000</td>
<td>Months to save $1,000</td>
</tr>
<tr>
<td>Interest earned on savings</td>
<td>Savings interest forgone</td>
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<tr>
<td>Actual Cost</td>
<td>Actual Cost</td>
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<th>Bad Credit</th>
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<tbody>
<tr>
<td>Purchases</td>
<td>$1,000</td>
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<tr>
<td>Amount saved each month</td>
<td>$125</td>
</tr>
<tr>
<td>Months to save $1,000</td>
<td>8</td>
</tr>
<tr>
<td>Interest earned on savings</td>
<td>$30</td>
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<tr>
<td>Actual Cost</td>
<td>$970</td>
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<th>Bad Credit</th>
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<td>8</td>
</tr>
<tr>
<td>Interest earned on savings</td>
<td>$30</td>
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<tr>
<td>Actual Cost</td>
<td>$1,030</td>
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Once you fully understand the dangers of credit cards, you can see how it’s possible to use them to your advantage. When emergencies happen, a credit card can be a lifesaver.
However, remember that until you have your six-month emergency fund you should not apply for a credit card.

Already in Debt

If you’re already in credit card debt, it’s not the end of the world. It will just take added dedication to get out of the hole. The key to getting out of credit card debt is to prioritize the payments.

Call the credit card companies to which you owe money and find out the interest rate they’re charging you. While you have them on the line, ask about any promotional rates you may be approved for. Once you have the rates each credit card company charges you, organize a payment structure.

Pay the minimum payment on all credit cards except for the one with the highest interest rate. Put all the money you possibly can toward paying down the high-rate credit card first. Once that card is paid off, take the card with the next-highest rate and pay that one down. Following this payment structure will save you a lot in interest. Keep up that plan until all the cards are paid off.

Building and maintaining a good credit rating will save you thousands of dollars over your lifetime. That means a lot less work and more fun for you—so take time now to handle your credit situation responsibly.

Lending Money to Friends

Money shouldn’t—but often does—come between friends and family. As a general rule, you should only lend money to loved ones if you do not expect it back. Money is not worth losing friends over; protect your friendships by outlining the details of the loan in writing. Avoid any misunderstandings later on.

Many times when friends need money it is due to poor money management. Of course, emergencies do occur and you may want to treat emergency situations differently. But if your friends already are unable to pay their bills, there’s a good chance they won’t be able to pay you either.

If you want to help out a friend but can’t afford to lose the money, take some form of security as collateral. Hold your friend’s bike, car, watch, or something else of value. That will help motivate your friend or relative to pay you back. However, with this alternative, realize that if you execute your claim on the collateral you very well may end the relationship.
**Lesson Activity: What’s the Best Payment Option?**

Look at the items below and determine the best method for purchasing the items. You can choose: save money over time, cash, or credit. Make sure to defend your choices.

<table>
<thead>
<tr>
<th>Item</th>
<th>Cost</th>
<th>Save money over time</th>
<th>Buy now with cash</th>
<th>Buy now with credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>New computer</td>
<td>$800</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New clothes for summer</td>
<td>$500</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Birthday present for a friend</td>
<td>$100</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Brakes for your car</td>
<td>$250</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New TV for your room</td>
<td>$475</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Extra money you have:</td>
<td>$400</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amount of credit:</td>
<td>$1,000</td>
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</tbody>
</table>

**Lesson Activity: Apply for Your Credit Card**

Visit www.StudentExperienceCard.com and review the website in detail. Complete the credit card application. If you agreed to the terms then answer the questions below.

- What was the most important thing you learned about this credit card from reviewing the application?

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- Did your opinion of the credit card offering change as you learned more about it? Please describe.

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Lesson Activity: Credit versus Cash

Watch the video of Tyler Christopher speaking at one of NFEC’s Money X- Live events.

Tyler Christopher is best known for his role as Nikolas Cassadine on the ABC daytime drama General Hospital, a character which he originated in 1996 and played off-and-on until 2011. He was nominated for a Daytime Emmy for the role in 1998, 2005, and 2006. Tyler currently plays on the TV show The Lying Game. Follow Tyler on Twitter at @Tyler2929.

Now answer the following questions based on Tyler’s experience with money when he was a young man.

1. Did Tyler Christopher really need the purchases he made with the credit card? Why or why not?

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2. How could Tyler Christopher have used his credit card to build his credit in college rather than ruin it?

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3. How did his choices about credit hurt him later on?

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Lesson Questions:

1. Which of the following is the correct definition of “interest”?
   a. The time a lender allows between a purchase and payment due.
   b. The fee charged by a lender for borrowing money.
   c. The rate associated with stock investments.
   d. The amount a person can purchase.

2. Making a purchase now with money that could have been saved and built interest is an example of _____.
   a. A credit card purchase.
   b. A debit card purchase.
   c. Opportunity cost.
   d. Good credit.

3. What is credit?
   a. An arrangement for future payment of a loan or purchase.
   b. Purchasing an item with cash.
   c. Purchasing an item with an EFT from your bank account.
   d. None of the above.
### Essential Questions:

**Why is credit important?**

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**What is an interest rate?**

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**Why do you pay interest on your purchases with a credit card?**

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**How can you have a credit card and not pay finance or interest charges?**

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Parts of Insurance

Warm-Up Activity
What type of bill do you think is the leading cause of bankruptcy? How can this be avoided?
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The Importance of Insurance

An insurance policy is a contract between an individual and an insurance company that transfers the risk of such a loss—for a fee—from the individual to the insurance company.

You are going to learn extensively about health, automobile, and renter’s insurance. In addition, you will hear briefly about the following types of insurance, which will be important once you own properties and/or become established in a career.

- Property Insurance covers any properties that you own.
- Umbrella Policies provide additional coverage on insurance policies you have — and additional protection to cover accidents and other issues that medical, property, and auto insurance policies don’t cover.
- Life Insurance provides your loved ones with coverage in case of your death.
- Wills and trusts are not insurance per se but will help your family avoid probate if you pass away. Wills or trusts are not necessary until you own things of value, but they are important to put in place once you start to acquire assets.

Insurance protects your financial future by reducing your risk. Without insurance, if you have an accident or health problems, you may end up paying a large bill, and that may have a negative effect on your credit. In today’s age, it is incredibly important to have automobile and health insurance.

Health Insurance

Medical costs are the number one reason for bankruptcy in the United States. Insurance (including vision, medical, and dental) is a must. If you rarely get sick, there are cheaper forms of
Parts of Insurance

insurance that will protect you just in case of a major medical emergency. Automobile insurance (for both you and your vehicle) is a must. Talk to an insurance agent to make sure you have enough coverage.

Paying health insurance premiums might seem like a waste of money, especially for healthy people. However, having health insurance will protect you from sky-high medical bills if you get injured or experience a sudden illness. It’s tempting to think, “I’m young and I never get sick,” and not to sign up for health insurance if you have to pay. Don’t make this bad decision. You may be young, but you can break your leg snowboarding just as easily as anyone else. Any catastrophic accident or illness could lead to bankruptcy if you don’t have insurance.

These catastrophes happen to many people every year. Don’t be one of the 47 million uninsured Americans who play Russian roulette with their health and finances. Many employers provide health insurance and only have a certain amount of the insurance premium will be deducted from your paycheck.

Health insurance is a form of risk management that protects people against unpredictable health losses. Not all policies are the same. You need to review and understand your policies. Here are the most important aspects to consider:

- **Doctor and medical facility availability** — Make sure the doctors, hospitals, and medical groups you want to use are contracted with the insurance company.

- **Premium (monthly cost)** — The monthly fee, which is paid by the individual, should be affordable and you should be able to maintain that premium over a period of time within your budget.

- **Deductible** — The amount that the policyholder must pay out-of-pocket before the health insurance plan pays its share.

- **Co-payment** — The amount that the insured must pay before the health plan pays. This is a lot like a deductible, but is applied to individual services, which are usually waived from the deductible (except for prescription drugs).

- **Exclusions** — Not all services are covered in some plans. A lot of new plans have no coverage for maternity expenses or brand-name prescription drugs. These exclusions can lower premiums.

- **Out-of-pocket maximums** — The amount where the policyholder’s obligation under coinsurance ends; after the insured has paid this amount, the insurance company pays 100% of costs.

Health insurance policies can be very confusing. The best choice is to find an insurance agent who specializes in health care coverage and meet with the agent to review the details. Insurance plans are no more expensive when you go through an agent than when you purchase direct
Auto Insurance

Purchasing and maintaining car insurance is vital. Without it, you take a huge amount of risk to yourself, to others, and to your future finances. Say you get in an accident without car insurance and you cause $80,000 in damages and medical costs. The courts will probably determine that you are responsible to pay that entire amount of money.

The court can garnish your wages (automatically take your pay) to repay the money you owe. Your income will be severely stifled for many years to come.

With all the expensive cars on the road today, even a little fender bender without insurance can result in being forced to make payments to the court for many years to come. Explain the following facts around the different types of necessary insurance.

Shopping for insurance takes time, but you can obtain quotes fast on the Internet. However, make sure to read the policies and special provisions carefully to make sure you are evaluating comparable insurance packages.

**Bottom line:** Younger Americans pay higher insurance costs than older people. Why? It’s a fact: teenage drivers cause a lot of accidents. In fact, the number one killer of teens does not have a trigger or a plunger – it has a steering wheel.

To help lower auto insurance costs, students should consider the following:

- Good driver discounts
- Good grades
- Good Car
Renter’s Insurance

Renter’s insurance covers your personal belongings in the place that you rent, and is important for people who have nicer things. If you have a 20-year-old TV and a couch you found in the alley, renter’s insurance may not be as important.

Renter’s insurance is relatively inexpensive, and can protect you in the event of theft or fire. Take an inventory of your possessions and what it would cost to replace them. If your belongings consist of an old couch and some clothes, you probably won’t want the added expense of renter’s insurance.

On the other hand, if you have designer clothes, computers, furniture, and other valuables that would cost a lot to replace, look into renter’s insurance.
Lesson Activity: What’s That Insurance?

Create your own definition for each of the types of insurance below.

1. Health (medical) insurance

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2. Automobile insurance

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3. Renter’s insurance

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Lesson Questions

1. Which of the following can help your family with expenses after you pass away?
   a. Will
   b. Trust
   c. Life insurance
   d. All of these

2. Which of the following types of insurance can help you replace damaged items?
   a. Renter’s insurance
   b. Health insurance
   c. Life insurance

3. A co-payment is
   a. a payment wo people make at the same time.
   b. the amount that the insured must pay before the health plan pays.
   c. a payment no one has to make
   d. the part of insurance that the government pays

Essential Questions

What types of insurance are there?
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What types of insurance do I need to obtain?
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