

Quick Start Guide

Case Study: Lisa's Rewards

Topic: credit

Don't let your mouth write no check that your tail can't cash.

–Bo Diddley

People who recognize that money won't buy happiness are still willing to see if credit cards will do the trick.

–E.C. McKenzie, *1800 Quips, Quotes, and Squibs*

Introduction

Credit cards offer great convenience and can help individuals budget, manage finances, and build credit to qualify for loans for major purchases such as cars and homes. However, they also come with considerable costs and risks, which can be even more dangerous for uninformed consumers. The CARD Act of 2009 and the more recent work (since 2011) of the Consumer Financial Protection Bureau overseeing student loan programs and credit card scamming, have helped to offer greater protections and more transparency, but credit cards are still aggressively marketed toward college students, who might be unaware of the risks and prone to impulsive behavior.

Used responsibly, a first credit card can be an important tool to help a young person learn about personal finance and gain financial independence, but it can also facilitate overspending and lead to a dangerous cycle of debt. Cash back offers, merchandise discounts, and travel rewards make the prospect of a card even more tantalizing, but these offers often only make financial sense if the balance is paid in full every month and cardholders don't overspend on purchases they wouldn't have made otherwise just to get points toward rewards.

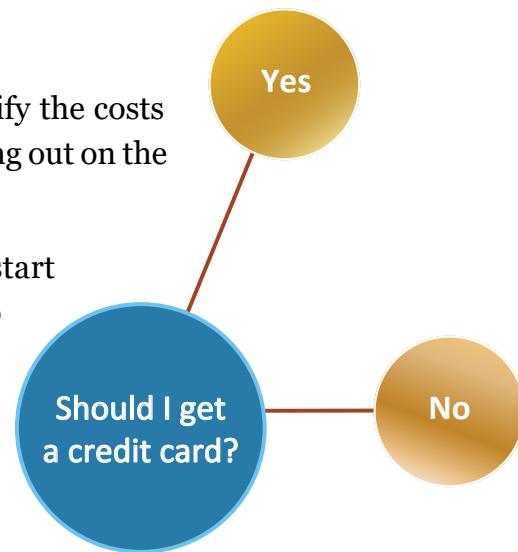
Quick Start Guide to *Lisa's Rewards*

This case engages students in weighing all of these costs, benefits, and risks, and also challenges them to find and analyze the appropriate information to make a thoughtful decision. The case itself offers a financial dilemma that many students will face in the very near future, requiring “just in time” knowledge of complex and important financial information.

Dilemma

When, if ever, do the benefits of a credit card justify the costs and risks, especially for a college student just starting out on the path to financial independence?

- How important is it for a young person to start “building credit,” and what is the best way to start?
- Do the high costs of a card matter if the holder intends to pay the balance in full every month?
- Do the benefits of a “premium” card that offers features like travel rewards or cash back justify higher costs?



What Students Will Learn

Students will face great temptation and marketing pressure to apply for a credit card as soon as they head off to college. This case will equip them with knowledge about the costs and benefits of credit, as well as analytical tools to help them decide on the best options for them.

Problem-Solving Skills

- To conceptualize and engage with a hypothetical case study as a true problem, not one that fits neatly into, and illustrates, a preordained solution
- To analyze a dilemma from multiple points of view (Lisa, parents)
- To analyze a dilemma in terms of the choices presented as well as those not presented (e.g., getting a different card than those presented, not getting a card at all, getting a debit card first)

- To systematically weigh the costs and benefits of a complex decision when some of those costs and benefits are uncertain
- To incorporate and critique multiple sources of information, including technical and financial information, to solve a problem

Related Financial Literacy Concepts

Benefits of credit: Credit, or the opportunity to use future money to pay today's expenses, has several potential benefits, including convenience and the ability to finance large purchases that might be viewed as investments that pay off over time. However, it also comes with risks, including facilitating overspending.

Credit limit: A credit card is an example of “revolving credit,” meaning that users do not borrow a fixed amount for a particular period of time, but rather can use the card to borrow up to an amount agreed to by the bank who issued the card. This amount is known as the credit limit.

Credit report: The ability of a person to borrow money is determined by a number of factors (summarized below—see “Six C's of Credit”) that assess the likelihood of repayment. These factors are summarized in an individual's credit report, which provides lenders with information about the borrowing and repayment history of a person seeking a credit card or loan. Credit reports can also be used as evidence for general trustworthiness and evaluated as part of an application for a job or housing. Go to <http://annualcreditreport.com> for a free copy of your credit report from various reporting agencies each year.

Credit score: A credit score is a numerical summary of an individual's credit-worthiness, or the risk associated with lending to the individual. Like credit reports, scores are calculated by different companies using slightly different methodologies, but they generally take into account factors such as payment history and debt burden. The most commonly used credit score is the FICO score, which is rated on a scale of 300–850, with higher numbers indicating lower risk.

Interest rates (APR): The interest rate is the cost of borrowing money to compensate the lender for the time the money is used and for the risk; borrowers pay interest on loans, and savers receive interest. The annual percentage rate, or APR, is the interest rate paid on a loan expressed as a yearly percentage.

Six C's of Credit: Lenders use these characteristics to determine whether an individual qualifies for credit or loans: character, capacity to repay (i.e., income and other debt), collateral, capital, conditions (e.g., of the economy), and credit history.

In the Classroom . . .

1 HOMEWORK

Assign the case study for homework. Tell students that in order to be completely familiar with the facts of the case, they should read it twice: once to get an overview of the case and then a second time to make note of the facts that seem most important. As they read a second time, students should make a list of the key issues or questions in the case and bring the list to class, prepared to discuss.

2 AS A WHOLE CLASS

Agree on a detailed understanding of the facts. As an entire class, first ask students to recap what they consider to be the key facts of the case so everyone has a shared understanding. Some examples of key facts that students may list include:

- Lisa would like a credit card that offers travel rewards, but it comes with high fees and a high interest rate.
- Lisa's parents would like her to consider a co-signed card without travel rewards and with a lower credit limit, but also with lower fees and a lower interest rate.
- Lisa will be attending college across the country, has limited savings, and at least for the first part of the school year will have no income of her own.

What do you notice? Encourage students to raise important questions, but steer them away from jumping to solutions before they have had a chance to fully examine all of the issues at hand and do more research on how they might help Lisa. Remind them that their role is to help Lisa and her family, so caution them against making value judgments about her or rushing to conclusions.

Identify the dilemma. Show students a sample dilemma map on a different topic from "Using the Quick Start Guides." Walk them through how a dilemma map visualizes a range of options that "branch out" with each branch leading to further options. Once students understand how the map works, begin drawing one for this case, without showing them the model map for this case yet. After agreeing on some of the major issues in the case, tell students that a major part of their group work will be to agree on how to map the decisions embedded in the dilemma.

3 SMALL-GROUP DISCUSSION: PART 1

Break students into groups of about 4–6 based on grouping strategies you normally use. Orally or on the board, give them directions to do the following as a group:

1. First, consider what questions need to be answered in order to complete a dilemma map for Lisa and help her and her family resolve the dilemma. Make a list of what they need to know and where they can find the information.

Examples of questions include, but are not limited to:

- What are the important factors one needs to consider when deciding whether to apply for a credit card, and how to choose among credit cards?
 - What are the benefits of credit cards?
 - What is the likelihood of receiving travel rewards, relative to the additional cost of the rewards card?
 - What are the costs and risks associated with credit cards?
 - What steps can Lisa and her family take to reduce the costs and risks?
2. Scan the list of resources to determine which ones would be most valuable to answer the questions the group has and give them more information to understand the decisions that need to be made.

4 PAIRED RESEARCH

Students should now be divided into pairs. Each pair should receive a small set of the resources deemed valuable in the previous section. Students will then examine each resource so they can first come to their own understanding and then confer with a partner to come to a shared understanding.

For each resource, students should identify relevant information and evidence that answers their questions. They should also consider the credibility of the information and of the resource itself, examining the source of the information, any potential sources of bias, and how well the resource defends the information it provides.

Suggested adaptation: The resources vary in difficulty with regard to reading level. For students who are reading below grade level or whose first language is not

English, teachers may wish to preview all of the resources and assign particular resources to individual students in advance. For students with information processing challenges, teachers may wish to give examples of the types of questions students can answer with each resource to guide their reading and limit the number of cognitive tasks students need to complete simultaneously.

5 SMALL-GROUP DISCUSSION: PART 2

After they have had some time to examine the resources, students should come back together and share what they've learned and how it answers their questions. They should also note what questions remain and what further questions arise from the new information.

Students can use the organizer provided at the end of this guide to keep track of the financial figures in the case. As an adaptation of this case, teachers may wish to model filling in part or all of the organizer for students. Note that students might research and introduce options that are not included in the case, such as in the example below. "Charge card" refers to an account that must be paid in full each month. It has no option to pay a minimum balance.

Example of completed organizer:

Option	Benefits	Relevant Terms	Questions and Comments
Rewards card	Points toward free flights—Lisa estimates she will get 1 or 2 free flights during her college career.	21.6% APR, \$100 annual fee after first year, 33% default APR	What is the likelihood of receiving an award, and what is the value of that? Are there other ways to obtain additional flights home? Lisa says she will pay off the balance in full every month—what are the chances that she will, and what happens if she doesn't?
Family co-signed bank card	Lower interest, parents share responsibility, lower limit ensures less risk.	\$500 limit, 11.2% APR	Are there any other fees or other terms we need to know about this card? Will this card help Lisa build her own personal credit?
Other option: <i>Charge card</i>	Balance must be paid in full every month, reducing risk of ballooning debt; generally no spending limit, which is both a benefit and a potential risk.	N/A (no terms presented in case)	Will a charge card help build credit? What are the relative benefits and drawbacks of a charge card compared to a debit card? Are there any associated fees?

The group should then revisit their map and determine if they wish to add or change anything, now that they have additional information from the resources.

As groups begin to dig into the case, listen for signs that students are beginning to approach the case with a structured, problem-solving approach. Such signs may include:

- Inventorying what is known and unknown about the case
- Specifying the main questions/problems/dilemmas in the case
- Creating a set of criteria by which to evaluate options
- Investigating suggested resources and determining what information can be gleaned from each

If groups very quickly converge on one solution, you may wish to challenge their thinking by introducing some of the “Complicating Factors” listed on the following page. These factors reflect research on the costs and benefits of credit cards, especially for young people, and add complexity to the case.

6 **WHOLE-CLASS SHARE-OUT AND DEBRIEF**

Groups will now share their maps and recommendations to Lisa and her family with the entire class. As they present, the class should discuss what the groups have in common, what is different, and why. Additional discussion questions include:

- What is known and unknown in this case?
- How does uncertainty affect the decision-making process?
- Does the perspective matter? Does your advice to Lisa differ from your advice to her parents?

COMPLICATING FACTORS

- ▶ As of 2009, 70 percent of American college students had credit cards, but five of every six of them did not know their cards' interest rates and most did not know their cards' late payment charges or over-limit fees. Ninety percent carried monthly balances.¹
- ▶ Debit cards do not carry the same risks as credit cards, because they are not a form of debt and use your own current money; however, they do not affect your credit score.
- ▶ In 2010, the *median* household owed \$3,300 of consumer debt, but the *mean* household owed \$7,768 in consumer debt, implying that high average levels of debt are driven by a few households with extremely high levels of debt.²
- ▶ In a study of rewards credit cards in Australia, only 5 of 67 cards returned more than \$100 in rewards to holders. Note that the U.S. context may be somewhat different, but many rewards cards require very high spending to achieve major bonuses, coaxing cardholders to spend more than they otherwise would have.³

¹ http://www.ijbssnet.com/journals/Vol_3_No_7_April_2012/3.pdf

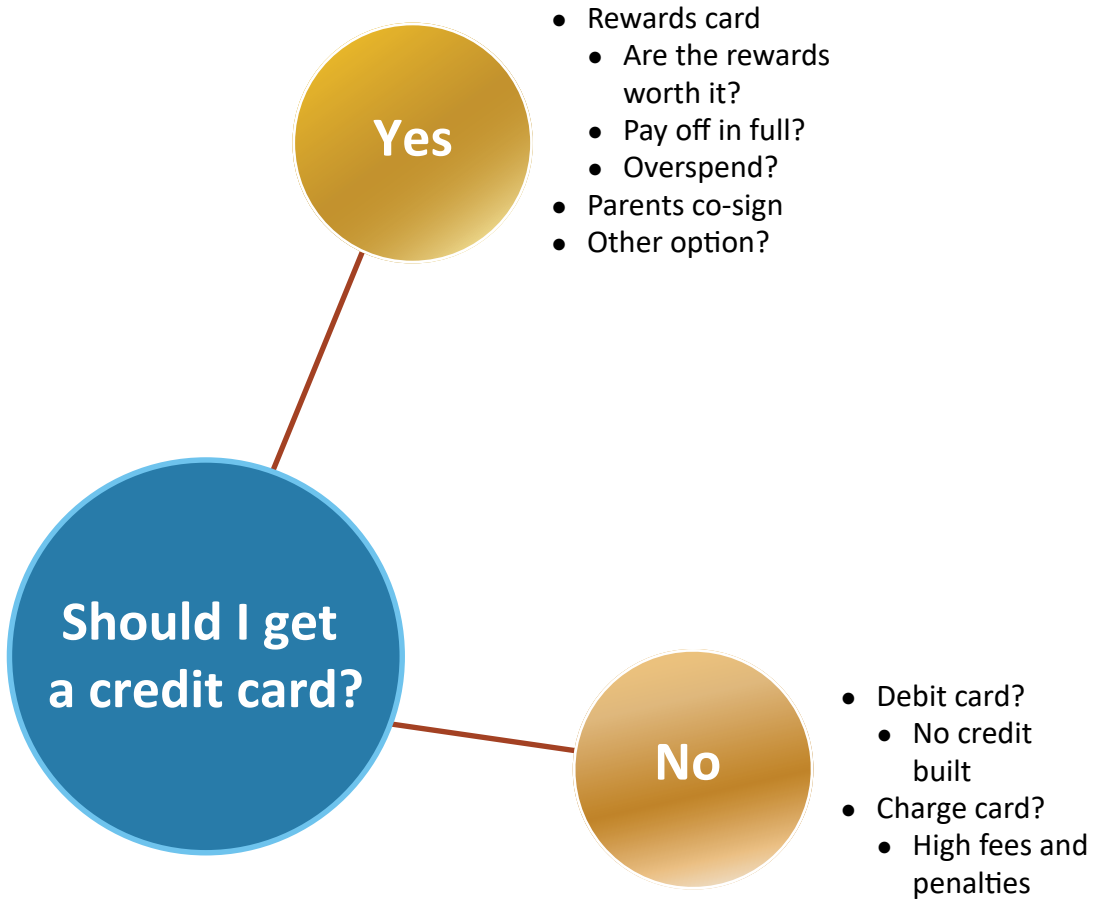
² <http://www.nerdwallet.com/blog/credit-card-data/average-credit-card-debt-household/>

³ <http://business.time.com/2012/08/23/your-credit-card-rewards-arent-worth-as-much-as-you-think/>

Extensions

1. The two options Lisa and her family consider represent just two points on a continuum of options. Encourage students to brainstorm not just more options for Lisa and her family, but also a set of criteria by which they would evaluate those options and a set of questions they would ask about each option to determine which might be the best fit for Lisa and her family. The website <http://www.usa.gov/topics/money/credit/credit-cards.shtml> can help students create criteria. Then, students can scan the Internet, bring in offers they receive in the mail, and otherwise search for real-world examples to evaluate according to their criteria.
2. The Credit Card Accountability, Responsibility and Disclosure (CARD) Act of 2009 specified certain rights of cardholders and responsibilities of card issuers, and the Consumer Finance Protection Board has proposed a prototype credit card agreement form at <http://www.consumerfinance.gov/credit-cards/knowbeforeyouowe/>. Encourage students to review both the relevant regulations and the proposals being considered and provide feedback on what additional regulations would be helpful to protect consumers and the best way to present information about credit cards in a clear, concise manner.

Completed Dilemma Map



Organizer

Option	Benefits	Relevant Terms	Questions and Comments
Rewards card			
Family co-signed bank card			
Other option:			