Differentiating between secured and unsecured loans

Students explore characteristics of secured or unsecured types of credit by playing a sorting game.

Learning goals

Big idea

Borrowers may receive different types of loans based on their credit history.

Essential questions

- How might a person's credit habits and decisions influence their ability to borrow money?
- What types of loans help people pay for large purchases or expenses?

Objectives

- Understand the characteristics of secured and unsecured loans in order to make informed borrowing decisions
- Identify items that could be purchased using a secured loan versus an unsecured loan

NOTE

Please remember to consider your students' accommodations and special needs to ensure that all students are able to participate in a meaningful way.

KEY INFORMATION

Building block:

Financial knowledge and decision-making skills

Grade level: High school (9–12)

Age range: 13–19

Topic: Borrow (Getting loans, Managing credit)

School subject: CTE (Career and technical education)

Teaching strategy: Cooperative learning, Gamification

Bloom's Taxonomy level: Understand, Apply

Activity duration: 45–60 minutes

National Standards for Personal Financial Education, 2021
Managing credit: 12-2, 12-10

These standards are cumulative, and topics are not repeated in each grade level. This activity may include information students need to understand before exploring this topic in more detail.

What students will do

- Work collaboratively to sort game cards with loan characteristics into two piles: secured and unsecured loans.
- Work collaboratively to sort game cards with items to show which ones can likely be purchased with secured loans and which can likely be purchased with unsecured loans.

Preparing for this activity

☐ While it's not necessary, completing the "Reading about credit scores" activity first may make this one more meaningful.

☐ Print a single-sided copy of the "Characteristics of secured and unsecured loans" game cards in this guide on one color of paper for each student group.

☐ Print a single-sided copy of the "Items you can purchase with secured or unsecured loans" game cards in this guide on a second color of paper for each student group.

☐ Cut all sheets into individual cards. Make sure each group has each set of game cards.

  - If you prefer, print the cards on sticker paper and affix them to playing cards so you can reuse them in the future.

What you'll need

THIS TEACHER GUIDE

- **Differentiating between secured and unsecured loans** (guide)
  cfpb_building_block_activities_differentiating-secured-unsecured-loans_guide.pdf

STUDENT MATERIALS

- **"Characteristics of secured and unsecured loans" game cards and "Items you can purchase with secured or unsecured loans" game cards** (in this guide)

Exploring key financial concepts

Credit offers seem to be everywhere, but not everyone who applies for a loan will be approved. Creditors often evaluate a person's credit history to determine whether they will lend them money.

For people who are just starting to build their credit or who have lower credit scores, it may be easier to get a secured loan than an unsecured loan. Secured loans require the borrower to provide collateral (something of value like a car, a boat, a home, etc.) that the bank or lending institution can take to get their money back if the borrower can't pay back the loan.

TIP

Because financial products, terms, and laws change, students should be encouraged to always look for the most up-to-date information.

Lenders may offer people with higher credit scores unsecured loans. These loans require no collateral, so the bank or lending institution is trusting that these borrowers will pay them back. This trust is based on their credit history—what borrowers have done in the past that gives them a good credit rating. Because unsecured loans put lenders at higher risk, they may have a higher interest rate than secured loans. If that trust does not result in repayment, the lender can report late or missing payments to the credit reporting companies, can engage in debt collection, and might sue the borrower.

Teaching this activity

Whole-class introduction

- Ask students if they or someone they know has ever lent someone money.
- Ask students what kinds of things people consider before lending someone money.
  - Examples may include whether and when the borrower can pay the money back or how much the lender would be willing to lend.
- Read the "Exploring key financial concepts" section to explain secured and unsecured loans.
- Ask students to take a moment to consider the similarities and differences between secured and unsecured loans.
- Be sure students have a basic context of loans:
  - Loss of collateral isn't the only consequence of nonpayment of a secured loan. Nonpayment can result in such things as negative information on your credit report, a lower credit score, debt collection, or being sued.

- When many factors are equal (e.g., income, job history), secured credit may be easier to get than unsecured.
- People seeking a loan must remember that they're a customer buying a product and that they shouldn't allow lenders to intimidate them or make them feel as if the lenders are doing them a favor by granting credit.

- Be sure students understand key vocabulary:
  - **Interest:** A fee charged by a lender, and paid by a borrower, for the use of money. A bank or credit union may also pay you interest if you deposit money in certain types of accounts.
  - **Lender:** An organization or person that lends money with the expectation that it will be repaid, generally with interest.
  - **Loan:** Money that needs to be repaid by the borrower, generally with interest.
  - **Secured loans:** Loans in which your property (things you own) is used as collateral; if you cannot pay back the loan, the lender takes your collateral to get their money back. The lender can also engage in debt collection, can file negative information on your credit report, and might sue you.
  - **Unsecured loan:** A loan (such as most types of credit cards) that does not use property as collateral. Lenders consider these loans to be more risky than secured loans, so they may charge a higher rate of interest for them. If the loan is not paid back as agreed, the lender can also start debt collection, file negative information on your credit report, and might sue you.

TIP

Visit CFPB's financial education glossary at consumerfinance.gov/financial-education-glossary/.

Group work

Working with the "Characteristics" cards

- Divide students into groups of three or four and give the "Characteristics" cards to each group.
- Instruct the groups to review the cards and sort them into three piles:
  - Characteristics that apply to secured loans
  - Characteristics that apply to unsecured loans
  - Characteristics that apply to both types of loans

- When all groups have finished sorting, review their answers by calling on each group to share a characteristic and whether it represents a secured or unsecured loan or both.
- As students answer, invite them to share their reasoning.
- As needed, help students understand where characteristics fit.

Working with the "Items" cards

- Distribute the "Items" cards to each group and ask students to sort them into two piles:
  - Items that would likely be paid for using secured loans
  - Items that would likely be paid for using unsecured loans
- When all groups have finished sorting, call on different groups to share their responses.
- As needed, help them understand where items fit.
  - Some items could fall into either category, so have students discuss which characteristics they used to make their choice.

Wrap-up

If time allows, ask students to complete an exit ticket responding to the following prompt: "How would you describe the difference between a secured and an unsecured loan?"

Suggested next steps

Consider searching for other CFPB activities that address the topic of borrowing, including getting loans and managing credit. Suggested activities include "Qualifying for loans" and "Calculating loan payments".

You also may consider having students get an estimated credit score at the FICO Score Estimator[1] at https://www.myfico.com/fico-credit-score-estimator/estimator.

1 The CFPB does not endorse this third party or guarantee the accuracy of this third-party information.

Measuring student learning

Students' answers during the game and during discussion can give you a sense of their understanding.

These answer guides provide possible answers for the game. **Keep in mind that students' answers may vary.** The important thing is for students to have reasonable justification for their answers.

Answer guide for "Characteristics of secured and unsecured loans" cards

Connected to collateral **(secured loan)**	Lender can take possession of your collateral **(secured loan)**	Might be easier for borrowers to get **(secured loan)**
Less risky to lenders **(secured loan)**	If you have no credit history or are rebuilding your credit, you're more likely to be approved for this type of loan **(secured loan)**	Usually have lower interest rates **(secured loan)**
Usually have higher borrowing limits **(secured loan)**	Lender holds title or an interest in the property until the loan is paid in full **(secured loan)**	Usually offers longer repayment time period **(secured loan)**
Your property may be sold to pay off the loan **(secured loan)**	You could use personal property such as a bank deposit or a car to back this loan **(secured loan)**	Lender not protected by any collateral **(unsecured loan)**
If you default on the loan, the lender can't automatically take your property **(unsecured loan)**	You can set up automatic payments to help make sure your payments go in on time **(both)**	You obtain this loan based on your income and credit record **(unsecured loan)**

Make your payments on time to protect your credit report **(both)**	May require a down payment **(secured loan)**	Riskier for lenders **(unsecured loan)**
Lenders may use stricter lending criteria **(unsecured loan)**	Face debt collection or get sued if you don't repay **(both)**	Usually has lower borrowing limits **(unsecured loan)**

Answer guide for "Items you can purchase with secured or unsecured loans" cards

Car **(secured loan)**	Boat **(secured loan)**	Recreational vehicle **(secured loan)**
Home **(secured loan)**	Home equity line of credit **(secured loan)**	Home improvement loan **(secured loan)**
Credit card **(unsecured loan)**	Student loan **(unsecured loan)**	Personal loan **(unsecured loan)**
Jewelry **(secured loan)**	Vacation **(unsecured loan)**	Business equipment **(secured loan)**
Unexpected expenses **(unsecured loan)**	Automobile repairs **(unsecured loan)**	Wedding expenses **(unsecured loan)**

“Characteristics of secured and unsecured loans” game cards

Print these cards one-sided on colored paper (try to use a different color than what you use for the “Items you can purchase with secured or unsecured loans” game cards).

Connected to collateral	Lender can take possession of your collateral	May be easier for borrowers to get
Less risky to lenders	If you have no credit history or are rebuilding your credit, you’re more likely to be approved for this type of loan	Usually have lower interest rates
Usually have higher borrowing limits	Lender holds title or an interest in the property until the loan is paid in full	Usually offers longer repayment time period
Your property may be sold to pay off the loan	You could use personal property such as a bank deposit or a car to back this loan	Lender is not protected by any collateral
If you default on the loan, the lender can’t automatically take your property	You can set up automatic payments to help make sure your payments go in on time	You obtain this loan based on your income and credit record
Make your payments on time to protect your credit report	May require a down payment	Riskier for lenders
Lenders may use stricter lending criteria	Face debt collection or get sued if you don’t repay	Usually has lower borrowing limits

“Items you can purchase with secured or unsecured loans” game cards

Print these cards one-sided on colored paper (try to use a different color than what you use for the “Characteristics of secured and unsecured loans” game cards).

Car	Boat	Recreational vehicle
Home	Home equity line of credit	Home improvement loan
Credit card	Student loan	Personal loan
Jewelry	Vacation	Business equipment
Unexpected expenses	Automobile repairs	Wedding expenses