CREDIT CRISIS 101 (for kids)

Grownups are talking nonstop about the economy, using really scary words like "crisis" and "meltdown." And they're talking about recessions and depressions.

Some grownups seem worried and that can be nerve-wracking for kids, especially if you don't understand what is happening.

So we gathered the biggest kid questions about the economy to explain what is happening, how it happened and what it means to you.

— Emilie Le Beau, McClatchy-Tribune

How did this happen?

Financial problems don't just happen all at once. Usually, there are many factors that build up to a big problem. Here are a few events that contributed to the current situation:

2001: Stock market investment is shaky after the Sept. 11 attacks. Many investors — both companies and individuals — consider real estate a safe place to put their money.

2003: Interest rates are at a 40-year low. That means it's a good deal to borrow money from a bank to buy a house. Many Americans borrow money from banks, and the United States experiences a housing boom. With the boom, home prices increase rapidly. But many borrowers are considered subprime — meaning they cannot afford the mortgage.

2006: Housing prices begin to tumble. Some homeowners now owe more on their house than it's worth. Others begin having trouble paying their mortgages.

2007: Foreclosures — when a person loses his or her house to the bank because of missed payments — begin to increase.

2008: Companies that bought mortgages as an investment start losing money. By mid-year, several big financial companies run out of money and go out of business. Meanwhile, more than 300,000 loans adjust during the summer and these homeowners now owe more money each month. By autumn, investors are afraid of lending money to customers, and the government seizes several banks and lending institutions on the verge of failure. Lawmakers also begin to consider how the government can lend money to troubled companies.

What does this mortgage stuff mean?

A mortgage is a loan given by a bank to an individual or company. Pretend you want to buy a house and it costs $100,000. You don't have $100,000, so you ask a bank to give you a mortgage and lend you the money.

Every month, you pay the bank money. But not all of it chips away at the $100,000 you owe. The bank charges you interest for borrowing their money. So how much you pay each month depends on the interest rate (like 5 percent) and the number of years you have been given to repay the loan (like 30 years).

Sometimes interests rates are fixed, meaning they don't change. Sometimes they change after a set number of years. So you could pay 5 percent for the first five years and then 8 percent for the 20 years.

Normally, a mortgage works smoothly. You get your money for a house and the bank makes money by charging you interest. But subprime mortgages have caused a problem in two ways.

First, there are homeowners who can't afford their mortgage. Some of these homeowners were able to afford their mortgage at first. When the interest rate adjusted, they couldn't keep up. (Remember — the higher the interest rate, the higher the payment.) When a homeowner can't make payments, he or she goes into foreclosure, which means the bank seizes the house and tries to sell it to someone else.

The second problem is a bit complex. Big companies decided mortgages could be bundled into securities and sold to investors. When homes went into foreclosure, these investments lost big money. This is why some companies (heard of Lehman Brothers?) ran out of money and went out of business.

CHUCK KENNEDY/MCT

From left, Federal Reserve Chairman Ben Bernanke, President George W. Bush, Treasury Secretary Henry M. Paulson Jr. and U.S. Securities and Exchange Comission Chairman Christopher Cox.

Who is trying to find a solution?

Many lawmakers are trying to fix the problem. Here are some key players:

Henry M. Paulson Jr.: As head of the Department of the Treasury, Paulson is the guy in charge of a lot of money matters. Paulson led the government's efforts to buy bad loans from struggling banks. The bill, presented to Congress in late September, was nicknamed "The Paulson Plan" because of his influence.

Ben Bernanke: Serves as chairman of the Federal Reserve. Bernanke pushed Congress to pass the Paulson Plan.

Christopher Cox: His job is to oversee financial markets as the chairman of the U.S. Securities and Exchange Commission (SEC). He came under criticism after presidential candidate John McCain said he would fire Cox for failing to regulate Wall Street.

What will these problems mean for my family?

Financial problems will mean different things for different families. Here are a few ways in which families can be impacted:

No new car. When companies starting losing money from investments, they were hesitant to give loans to new and existing customers. Families hoping to get a new car with an auto loan may have to wait until banks are ready to lend again.

Higher bills. Some families have an adjustable rate mortgage, which means their interest rates increase after a set amount of time. The higher the interest rate, the more money a homeowner pays. For some families, this may mean cutting costs and creating a tighter budget.

Switching apartments. Even if families are on time with their rent, a landlord can fail to pay the mortgage. If an apartment building forecloses, tenants may have to move. Lawmakers in some states are working to protect tenants in these situations.

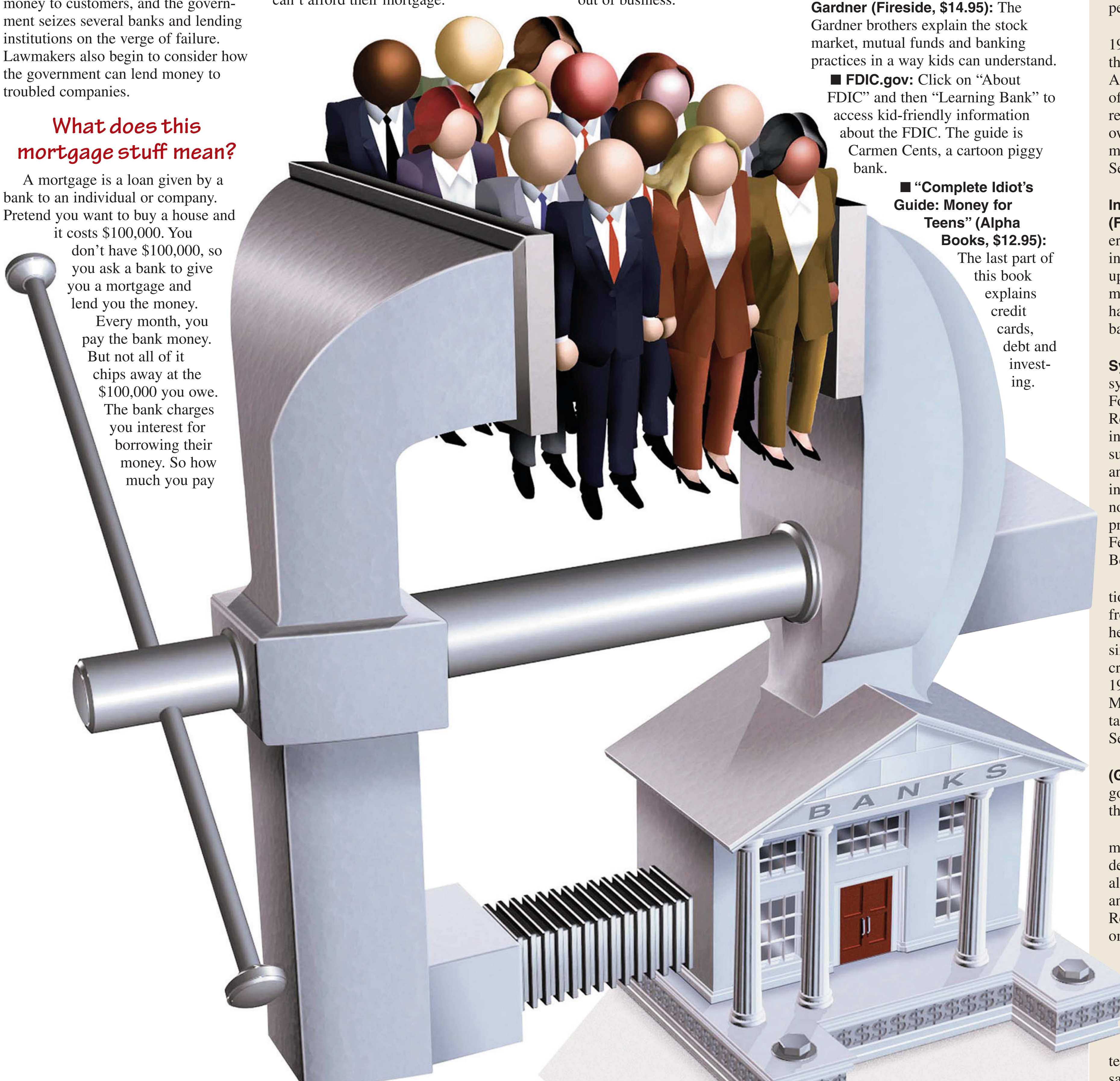
Job loss. Companies of all sizes borrow money from banks. If lending institutions aren't giving loans, some companies may be forced to layoff workers or go out of business.

Eviction. If a homeowner does not pay the mortgage for a few months, the bank has the right to seize the property and make the family move.

How can I learn more?

There are plenty of resources online and in libraries where kids can learn more about financial stuff.

- **HowStuffWorks.com:** Click on the "Money" section to learn the basics about finances, including information about trading, saving and lending.
- **FederalReserveEducation.org/Fed101:** This Web site is from the Federal Reserve and includes a glossary, games and detailed explanations about how The Fed operates.
- **"The Motley Fool Investment Guide for Teens," by David and Tom Gardner (Fireside, $14.95):** The Gardner brothers explain the stock market, mutual funds and banking practices in a way kids can understand.
- **FDIC.gov:** Click on "About FDIC" and then "Learning Bank" to access kid-friendly information about the FDIC. The guide is Carmen Cents, a cartoon piggy bank.
- **"Complete Idiot's Guide: Money for Teens" (Alpha Books, $12.95):** The last part of this book explains credit cards, debt and investing.



DEAN HOLLINGSWORTH/THE DALLAS MORNING NEWS

Terms to know

Don't worry, even grownups find financial matters confusing. Here is a glossary of terms to help it all make more sense.

■ **Bank failure:** When regulators must take control of an institution. Assets and liabilities are transferred to a temporary bank (called a bridge bank) or a healthy institution. Washington Mutual is an example of a recent bank failure. But don't be scared — the FDIC (see below) insures deposits so most money is safe.

■ **Debt:** National debt is a buildup of budget deficits. Because of these deficits, the U.S. government borrows money by selling bonds, notes and Treasury bills to the public.

■ **Deficit:** When the government spends more than it receives from taxes and other revenue.

■ **Department of the Treasury:** Manages the government's finances. Led by Secretary Henry M. Paulson, Jr. Treasury officials provide economic and financial advice to the president. The Treasury also collects taxes, duties and debt owed to the United States, and manages government accounts and public debt. The Treasury oversees several agencies including the U.S. Mint and the Bureau of Engraving and Printing.

■ **Depression:** There is no formal definition for depression. (Unlike recession, which is declared by the National Bureau of Economic Research.) An informal definition suggests there is a depression when output falls by more than 10 percent.

■ **Deregulation:** When government regulations are either partly or completely eliminated in order to improve economic performance.

■ **Fannie Mae:** Created in 1938 as a government agency, the Federal National Mortgage Association, to ensure a supply of mortgages. In 1968, Congress reorganized it as a shareholder-owned company. The government seized control in September.

■ **Federal Deposit Insurance Corporation (FDIC):** This independent government agency insures deposits in bank and thrift institutions for up to a set amount. Since its formation in 1933, no depositor has lost money as a result of bank failure.

■ **Federal Reserve System:** The central banking system for the United States. Founded in 1913, the Federal Reserve's responsibilities include setting interest rates, supervising banking institutions and maintaining stability. It is independent and its decisions do not need to be approved by the president. Also called "The Fed"; chairman is Ben Bernanke.

■ **Freddie Mac:** A corporation that purchased mortgages from lending institutions. It helped finance one out of every six American homes. Initially created as a federal enterprise in 1970, the Federal Home Loan Mortgage Corporation. It was taken under federal control in September.

■ **Gross Domestic Product (GDP):** The market value for all goods and services produced in the United States.

■ **Recession:** A period of market slippage that includes a decline in employment, industrial production, real income, GDP and whole-sale retail sales. Recessions are tracked by economists for several financial quarters. So a recession may not be identified until after it is over. The most recent recession was January to November 2001.

■ **Thrift institution:** A term used to generally describe savings banks, and savings and loan institutions.

■ **Writedown:** Reducing the value of an asset on a balance sheet during bookkeeping.

SOURCES: FINANCIAL TIMES, CHICAGO TRIBUNE, WASHINGTON POST, MINNEAPOLIS STAR-TRIBUNE, THE LOS ANGELES TIMES, CNN, U.S. DEPARTMENT OF TREASURY, FDIC, "RECESSIONS AND DEPRESSIONS" BY TODD A. KNOPP, ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT