

Credit Cards

“Making Good Choices”

Life Smarts:

- Analyze the required information on credit card statements.

What is a credit card?

A **credit card** is a card issued by a merchant (such as The Gap or REI) or a financial institution (e.g., credit union or bank). This card, sometimes referred to as “plastic,” identifies an individual and allows that individual to make real-time (immediate) purchases without cash. This card has a fixed-dollar amount, otherwise known as the **credit limit**. The issuer determines the maximum dollar amount a user may spend based on the individual’s unique credit profile (how well he/she pays his/her bills). The amounts of the purchases, plus an interest rate, are repaid over time. Many card issuers also charge additional costs and fees for the privilege of their services.

Did You Know?

CBS Money Watch reported that in 2012, MasterCard reported \$2.8 billion in profits, up 45% from a year earlier.

According to Michael M. Thomas, “Last year, credit card companies earned more than \$14 billion from interest.”

<http://ezinearticles.com/?The-Three-Most-Common-Reasons-for-Credit-Card-and-Personal-Debt&id=431415>

Why do you need a credit card?

Credit cards serve many positive and useful functions. They help establish a credit history and are often required as an additional form of identification. Credit cards can “save the day” when you encounter an emergency situation, such as a medical crisis or travel breakdown. Credit cards are often required to complete telephone or online purchases. They are also necessary in order to make lodging and/or rental car reservations.

1. For what purposes have you seen your parents or others use their credit cards?

Answers will vary.

2. List three situations in which it is better to pay with cash vs. a credit card.

Answers may include: Eating out, small purchases of \$40 or less, or donations to charity.

Advantages of a credit card

Credit cards are convenient, provide insurance on purchases, and also offer security by reducing the need to carry large amounts of cash. Another benefit is if you rent a car and use a credit card to pay for it, some credit card companies offer accident insurance. (Be sure to verify this coverage with your credit card company). Also, if you purchase a defective product with a credit card, the credit card company may compensate you directly if you have difficulty obtaining a refund from the company where you purchased it.

In addition to building your credit (which is very important when borrowing money), credit cards sometimes offer “cash back” on purchases and rewards programs for airline travel, lodging, rental cars, and other services. Some discounts can only be realized through the use of a credit card.

3. List three advantages of using a credit card.

Answers may include: Convenience, rewards, cash back, discounts, security, or build up credit.

Disadvantages of a credit card

If not used responsibly, use of credit cards can have serious consequences. Credit card interest, fees, and penalties can be quite high if your bill is not paid in full and on time. It can also result in a negative impact on your credit history and credit score. In addition, credit cards enable impulse spending, which may lead to large debt. Identity theft is also a major concern, and recovery from identify theft can be a painful and drawn-out experience. Without proper management of credit card use, large amounts of debt can impact getting hired for a job, renting an apartment, or taking out a loan to purchase a home or a car.

4. List three disadvantages of using a credit card.

Answers may include: Interest, fees, and penalties; Enables impulse spending; Increases debt; or Identity theft.

Five tips for using credit cards

- Make timely payments.
- Remain under your credit limit.
- Avoid unnecessary fees.
- Pay more than the minimum monthly payment.
- Review your account regularly and beware of any changes.

Making timely payments

Late fees and interest penalties can be avoided by paying your credit card balance on time. Making timely payments is the single biggest key to maintaining a good credit record, which may also result in a higher credit score and lower interest rates. When qualifying for a credit card, contact your credit card company to arrange for the billing cycle that most favors your cash flow. If you change jobs and your pay cycle or frequency changes, discuss this with them, as they will most likely adjust your billing cycle to coincide with your pay cycle.

Remain under your credit limit

If you exceed your credit card limit, the credit card company will charge a fee and increase your interest rate as a penalty. If you own a smart phone, many credit card companies offer apps that make it easy to check your balance frequently. This provides current information about your charges to avoid going over your credit limit.

Keep in mind that it is common for hotels, rental cars, etc., to place a “hold” amount equivalent to more than the estimated amount of your purchase. For example, when reserving a car, the car rental agency may place a \$500 hold on your card until you return the car and settle the transaction. This \$500 counts toward your credit limit. Not knowing this could cause you to unknowingly exceed your limit. It is always good to ask in advance when making rental reservations what the “hold” amount will be.

Avoid unnecessary fees

Late payment and “**over-the-limit fees**” are not the only fees or penalties that credit card companies charge. **Additional fees** include **cash advances**, **convenience checks**, transferred balances, or having a payment returned. In addition, some companies charge a fee when you pay your bill by phone instead of mailing it or paying it online.

Pay more than the minimum monthly payment

You should pay as much as possible toward your total balance each month. If you pay the minimum monthly payment, the majority of the payment goes toward the interest with very little paying down the principal (the original amount owed). Paying greater than the minimum reduces the principal much faster and the total amount you repay. Remember, as your principal decreases, so do your interest charges. The lower your principal and interest charges, the faster you can pay off the balance.

Review your account regularly and beware of changes

Credit card companies can and do change the terms and conditions of your account. It is important to carefully read your monthly statement and to look for any changes to your account. Credit card companies are required by law to list your interest rate on the monthly statement, to disclose the fees on your agreement, and provide an explanation of what generates those fees. Changes to the agreement must be provided in writing on your monthly statement or in a new agreement prior to going into effect. These agreements and change notifications are usually printed in a very small font and placed at the bottom or on the back of your statement. This is commonly referred to as “the fine print.” Don’t let the de-emphasis of the words fool you! This is extremely significant information, and it is essential that you review your account to learn about the fees and/or penalties imposed by your credit card company. In addition, if you don’t read your statement carefully, you won’t know if your interest rate has increased or if new penalties are in place. Being aware of these changes allows you to adjust how you use your credit card and avoid these increases.

Useful websites:

All You Need to Know About Credit Cards - <http://www.federalreserve.gov/creditcard/default.htm>

Center for Student Credit Card Education Inc. - <http://www.theabcsofcredit.com/#/Home-01-00/>

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Find information to answer the following questions at: <http://www.schumerbox.com/>

What is the Schumer Box?

Answer: A regulation created by Sen. Charles E. Schumer under the 1988 Truth-in-Lending Act (TILA). It went into effect in 2000 and requires all credit card companies to present borrowers with key facts and figures about the lending agreement in a clear and concise manner, set out in a table.

What items must be listed in the Schumer Box?

Answer: Annual fee (if applicable), Annual Percentage Rate (APR) for purchases, Other APRs (balance transfers, cash advances), Grace period, Finance calculation method, Other transaction fees (such as balance transfers, cash advances, late payments, going over the credit limit, etc.)

Find information to answer the following questions at: <http://www.federalreserve.gov/creditcard/default.htm#>

What does APR stand for and what does it mean?

Answer: Annual Percentage Rate – the interest rate charged on a credit card.

For what reasons will the APR go up and by how much might it increase?

Answer: Balance transfers, cash advances, penalties – the increase could go as high as 28.99%.

When determining to open a credit card account, what should you consider in determining which card is the best offer?

Answer: Lowest APR, no annual fee, late fees.

Reading a credit card statement

You can find information to answer the following questions at: <http://www.federalreserve.gov/creditcard/default.htm#>

a) What part of the credit card statement will show how much you owe?

Answer: Summary of Account Activity section.

b) What part of the credit card statement will show late fees and interest charged?

Answer: Summary of Account Activity section.

c) Where will you find the new balance that must be paid?

Answer: Payment Information Section.

d) What kind of information is given in the Late Payment Warning section?

Answer: The late fee amount and the interest rate charged for paying late.

e) On the credit card statement listed, what is the late fee that is charged if payment is not received on time?

Answer: \$35.00.

f) What will happen if you only make the minimum payment required?

Answer: You will pay more in interest and it will take longer to pay off your balance.

g) On the statement shown, how much can you save if you were to pay an extra \$9 over the minimum payment?

Answer: \$553.00.

h) What transaction occurred on February 25 of the statement?

Answer: A payment of \$450.00 was made.

i) How much was charged for fees?

Answer: \$69.45.

j) How much were the Year-to-Date fees?

Answer: \$90.14.

k) How long will it take to pay off a credit card balance given the following information:

Balance	APR	Minimum Payment	Interest Charged	Length of Time to Pay Off
\$1,000.00	11.99%	\$20	\$393.00	6 years
\$2,000.00	12.99%	\$40	\$1,628.00	12 years
\$4,000.00	13.99%	\$80	\$4,702.00	20 years
\$8,000.00	14.99%	\$160	\$12,225.00	30 years

l) What are five things you can do to improve a credit score?

Answer: Get copies of your credit report – then make sure information is correct; Pay your bills on time; Understand how your credit score is determined; Learn the legal steps you can take to improve your credit report; Beware of credit-repair scams.