Understanding Credit Cards

Advanced Level
What is a Credit Card?

**Credit card** - a plastic card that you can use to access a line of credit that has been established in advance.

A person can borrow up to an established credit limit.

**Credit limit** – maximum dollar amount that can be borrowed.

Is a credit card open-end or closed-end credit?
Credit Card Interest

Interest is charged **each month** the balance is not paid in full.

Rate at which interest is charged is referred to as:

**Annual Percentage Rate (APR)**

The cost of credit expressed as a yearly interest rate.
Minimum Payment

A minimum payment is due each month the card has a balance.

To prepare for her first semester of college, Miranda purchased a new computer for $1,000 and textbooks for $500, spending a total of $1,500 on her credit card charging 15% APR. How much would Miranda pay in interest if she makes the minimum payment?

<table>
<thead>
<tr>
<th>Payment Made</th>
<th>Time to pay off card</th>
<th>Total amount of interest paid</th>
<th>Total amount paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>Full Payment</td>
<td>$1,500</td>
<td>1 month</td>
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<td>$135</td>
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<td>Minimum Payment</td>
<td>$30</td>
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Credit Card = Helpful Financial Management Tool

...if managed responsibly

- Develop positive credit history
- Convenient payment tool
- Protected from unauthorized charges
- Credit card safer for online shopping
- Credit card bonuses
Develop a Positive Credit History

Follow these positive behaviors:

- Pay credit card balances in full every month
- Pay credit card bills on time
- Be conscious of how credit cards affect your credit history
- Check the monthly credit card statement for errors

Credit card use can have a positive or negative impact on your credit history.
Convenient Payment Tool

- No need to carry large amounts of cash
- Useful in emergencies
- Often required to hold a reservation

How is a credit card a convenient payment tool?

Be conscientious of all credit card purchases to not overspend!
Protect Yourself from Unauthorized Charges

- Report lost or stolen cards immediately!
- Check your statements monthly!

Maximum Liability

- Unauthorized use: $50
- If the credit card number is used fraudulently, but the credit card itself is not used: $0
- If a lost credit card is reported before it is fraudulently used: $0

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Funded by a grant from Take Charge America, Inc. to the Norton School of Family and Consumer Sciences Take Charge America Institute at the University of Arizona
Safer Online Shopping

What is the difference between a credit card and a debit card?

- More protection against fraud
- Credit cards are **safer** than debit cards
- Less liability for unauthorized credit card charges
- Money is not connected to depository institution account
Should you choose “debit” or “credit” at a point of sale (POS)?

Point of Sale

If you pick “credit”
- A receipt must be signed (optional if purchase is under $25)
- Potential benefit: Extra liability protection from fraudulent charges

If you pick “debit”
- Must enter the card’s personal identification number (PIN)
- Potential benefit: Option to withdraw cash from your depository institution account for no fee
Additional Benefits

Rewards, Rewards, Rewards...

- Cash rebates
- Airline miles
- Warranties for items purchased
- Travel insurance

May charge additional fees or higher interest rates
Carefully evaluate if the benefits outweigh the cost

Would you be willing to pay higher/additional fees or higher interest rates to obtain credit card benefits? Explain.
Credit Cards
Advantages & Disadvantages

How many advantages can you think of?

How many disadvantages can you think of?
Credit Cards
Advantages & Disadvantages

• Convenient payment tool
• Useful for emergencies
• Often required to hold a reservation
• Able to purchase “big ticket” items and spread out payments
• Protection against fraud
• Opportunity to establish a positive credit history
• Online shopping is safer than using a debit card
• Possibility of receiving bonuses

• Interest can be costly when a balance is revolved
• Additional penalty fees may apply
• Tempting to overspend
• If not used responsibly, it will have a negative impact on your credit score
Credit Card Offers

Credit card issuers are required to disclose the terms and fees of credit cards in an easy to read box format called the **Schumer Box**.
### Interest Rates and Interest Charges

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* How We Will Calculate Your Balance: We use a method called “average daily balance (including new purchases).”

* Loss of Introductory APR: We may end your introductory APR and apply the Penalty APR if you become more than 60 days late in paying your bill.

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Credit cards may charge many different types of interest rates.

### Annual Percentage Rate (APR) for Purchases

- Interest rate paid for purchases.
- Multiple interest rates may be listed.
  - Final interest rate may depend on creditworthiness of applicant.
**Introductory Rate**

- **Introductory rate**: APR that may be charged (usually increased) after the introductory period ends.
- Not all credit cards have an introductory rate.

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How does credit worthiness impact APR?

It will influence if a person receives a credit card and the APR. APR will by higher if a person has a poor credit history.

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**Fixed vs. Variable-rate APR**

- **Fixed-rate APR**: cannot change during the period of time outlined in a credit card agreement

- **Variable-rate APR**: may change depending on other factors (such as economic conditions)

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Would you prefer a fixed or variable rate credit card? Why?
### APR for Balance Transfers & Cash Advances

- **Balance transfer**: act of transferring debt from one credit card to another
- **Cash advance**: withdrawing cash from an ATM using a credit card
- **Fees may apply (even if the APR is 0%)**

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### Penalty APR & When it Applies

**Penalty APR:** interest rate charged on new transactions if the penalty terms in the contract are triggered

**What could trigger a Penalty APR?**

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To learn more about factors to consider when applying for or using a credit card, visit the website of the Federal Reserve Board at [http://www.federalreserve.gov/creditcard](http://www.federalreserve.gov/creditcard)

**Fees**  
**Set-up and Maintenance Fees**  
NOTICE: Some of these set-up and maintenance fees will be assessed before you begin using your card and will reduce the amount of credit you initially have available. For example, if you are assigned the minimum credit limit of $250, initial available credit will be only about $209.

- Annual Fee: $20  
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- Participation Fee: $12 annually ($1 per month)  
- Additional Card Fee: $5 annually (if applicable)  

**Transaction Fees**  
- Balance Transfer: Either $5 or 3% of the amount of each transfer, whichever is greater (maximum fee: $100)  
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- Late Payment: $29 if balance is less than or equal to $1000 OR $35 if balance is more than $1000  
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- Returned Payment: $35

* How We Will Calculate Your Balance: We use a method called “average daily balance (including new purchases).”

* Loss of Introductory APR: We may end your introductory APR and apply the Penalty APR if you become more than 60 days late in paying your bill.

Explore the Federal Reserve Board website  
[www.federalreserve.gov/creditcard](http://www.federalreserve.gov/creditcard)

Identify **three** resources on this site that could help you in the future when it comes to managing your credit cards.
Set-up and Maintenance Fees

- Annual fee: yearly fee that may be charged for having a credit card
- Set-up fee: fee for opening the account
- Participation fee: monthly fee for having the credit card
- Additional card fee: fee to have a second person on the account

Why would a consumer choose a credit card with an annual fee? Benefits, such as airline miles, the card offers are of greater value to them.
### Interest Rates and Interest Charges

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*How We Will Calculate Your Balance: We use a method called “average daily balance (including new purchases).”*

*Loss of Introductory APR: We may end your introductory APR and apply the Penalty APR if you become more than 60 days late in paying your bill.*
## Penalty Fees

Penalty fees in addition to Penalty APR

- **Late-payment fee**: charged when a cardholder does not make the minimum monthly payment by the due date
- **Over-the-limit fee**: charged if the account balance goes over the set credit limit
- **Returned payment fee**: applies if the cardholder does not have enough money to cover a payment.

### Interest Rates and Interest Charges

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### How to Avoid Paying Interest on Purchases

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### Minimum Interest Charge

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### How We Calculate Your Balance

Credit card companies use one of several methods to calculate an outstanding credit card balance.

*How We Will Calculate Your Balance*: We use a method called "average daily balance (including new purchases).

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*How We Will Calculate Your Balance: We use a method called “average daily balance (including new purchases).”*

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Credit Card Chaos

Two credit card terms will be provided

Identify which term is true on your credit card offer

Move to the correct side of the room indicated by the arrow
Credit Card Chaos

Does your credit card offer have a:

- Fixed-rate APR for Purchases
  - Card 3 – 15.99%

OR

- Variable-rate APR for Purchases
  - Card 1 – 14.99%
  - Card 2 – 14.99%
Credit Card Chaos

Does your credit card offer have an **Introductory Rate**?

**No Introductory Rate**

Card 2

**Introductory Rate**

OR

Card 1 – 12.99-14.99% for one year

Card 3 – 11.99% for one year
Credit Card Chaos

Does your credit card offer have an:

- APR for Purchases greater than or equal to 15%
- OR
- APR for Purchases less than 15%

Card 3
Card 1
Card 2
Credit Card Chaos

Does your credit card offer have a **Minimum Interest Charge**?

**Minimum Interest Charge**

- Card 1 - $1.50
- Card 3 - $2.00

**OR**

**No Minimum Interest Charge**

- Card 2
Credit Card Chaos

Does your credit card offer have an *Annual Fee*?

Annual Fee

Card 1 - $20
Card 3 - $15

OR

No Annual Fee

Card 2
Credit Card Chaos

Does your credit card offer have a **Balance Transfer Fee**?

No Balance Transfer Fee

OR

Balance Transfer Fee

Card 3

Card 1 - $5 or 3%
Card 2 - $25 or 5%
Credit Card Chaos

Does your credit card offer have a Late Payment Fee?

Late Payment Fee

Card 1 - $29 if balance less than $1000 or $35 for balances greater than $1000
Card 2 - $30
Card 3 - $35

OR

No Late Payment Fee
How Do I Obtain a Credit Card?

Shop around

Compare credit card offers and determine which card best fits your needs

Complete a credit application

A form requesting information about a person’s ability to repay

Approval?

Applicant may or may not be approved (depends on creditworthiness)

If approved, review the final credit terms closely

Credit card companies send pre-approved credit card applications in the mail when the individual has passed the initial credit check
Obtaining a Credit Card

You must be 21

Or, have proof of sufficient income to make payments

Or, have a co-signer

If a credit card is not managed responsibly, what impact does that have on a co-signer?
What is a Credit Card Statement?

It is important to review each monthly credit card statement closely!

Andrew’s Credit Card Statement
Please help Andrew interpret his credit card statement.
Andrew’s Credit Card Statement

**Summary of Account Activity**

- Previous Balance: $535.07
- Payments: -$450.00
- Purchases: +$517.12
- Balance Transfers: +$785.00
- Cash Advances: +$318.00
- Past Due Amount: -0.00
- Fees Charged: +$69.45
- Interest Charged: +$11.36
- New Balance: $1,786.00
- Credit Limit: $2,000.00
- Available credit: $214.00
- Statement closing date: 3/22/2012
- Days in billing cycle: 30

**Payment Information**

- New Balance: $1,786.00
- Minimum Payment Due: $53.00
- Minimum Payment Due Date: 4/20/12

**Notice of Changes to Your Interest Rates**

You have triggered the Penalty APR of 28.99%. This change will impact your account as follows:

Transactions made on or after 4/9/12:

- As of 5/10/12, the Penalty APR will apply to these transactions. We may keep the APR at this level indefinitely.

Transactions made before 4/9/12:

- Current rates will continue to apply to these transactions. If you become more than 60 days late on your account, the Penalty APR will apply to those transactions as well.

**Important Changes to Your Account Terms**

The following is a summary of changes that are being made to your account terms. For more detailed information, please refer to the booklet enclosed with this statement. These changes will impact your account as follows:

Transactions made on or after 4/9/12:

- As of 5/10/12, any changes to APR’s described below will apply to these transactions.

Transactions made before 4/9/12:

- Current APRs will continue to apply to these transactions.

If you are already being charged a higher Penalty for purchases:

In this case, any changes to APR’s described below will not go into affect at this time. These changes will go into effect when the Penalty APR no longer applies to your account.

**2012 Totals Year-to-Date**

- Total fees charged in 2012: $90.14
- Total interest charged in 2012: $18.74

**Interest Charge Calculation**

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<tr>
<th>Type of Balance</th>
<th>Annual Percentage Rate (APR)</th>
<th>Balance Subject to Interest Rate</th>
<th>Interest Charge</th>
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<tbody>
<tr>
<td>Purchases</td>
<td>14.99%</td>
<td>$538.32</td>
<td>$6.57</td>
</tr>
<tr>
<td>Cash Advances</td>
<td>21.99%</td>
<td>$305.00</td>
<td>$6.79</td>
</tr>
<tr>
<td>Balance Transfers</td>
<td>0.00%</td>
<td>$576.97</td>
<td>$0.00</td>
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How much did Andrew charge in new purchases during this credit card billing cycle? $517.12
What is Andrew’s minimum payment due for this billing cycle?

$53.00
Late Payment Warning
What will happen if a payment is late—usually additional fees and a higher interest rate

Minimum Payment Warning
Estimate of how long it can take to pay off balance if only minimum payment is made

How long will it take Andrew to pay off the balance of his credit card if he only pays the minimum payment?

8 years
Notice of Changes to Your Interest Rates

Notifies card holder if rates are changing (typically a result of the Penalty APR being triggered)

Has Andrew triggered the Penalty APR?
Yes, he will pay 28.99% on all transactions made after 4/9/12
Important Changes to Your Account Terms

- Must be notified of any significant changes
- Any changes can only apply to new charges
- Account can be closed before the changes go into effect

Other than implementation of the Penalty APR, will there be any other changes to Andrew’s account terms?

Yes, his APR for Purchases is increasing to 16.99%
Transactions
- List of all transactions since the last statement
- Should be reviewed for errors

Fees and Interest Charged
- Fees and interest charges must be listed separately

Does Andrew owe a late fee?
Yes, he owes a $35.00 late fee
Year-to-Date Totals
Total amount paid in fees and interest charges for the current year

What is the total amount of interest Andrew has paid in the year 2012?
$18.74

Interest Charge Calculation
Summary of the different types of transactions

Why is it important to understand how to read a credit card statement?
Be Andrew’s Financial Advisor

Andrew has come to you and voiced his concerns about having a credit card. He is considering getting rid of his credit card.

As a “financial advisor,” you understand that credit cards are financial tools that can be used or abused.

What three pieces of advice will you give Andrew?
Summary

To avoid paying interest on a credit card, pay the balance in full every month.

A credit card can have a positive or a negative impact on credit history.

Credit card companies are required to disclose the terms and fees of a credit card.

If you apply for credit and are approved, be sure to review the final credit terms offered.

Credit card statements outline important information about a credit card and should be checked carefully for errors.