Understanding a Credit Card

"Take Charge of Your Finances" Advanced Level

WHAT IS CREDIT?

Credit is derived from the Latin word "credo" meaning "I believe."

Credit is when goods, services, or money is received in exchange for a promise to pay a definite sum of money at a future date. A **lender** is the person or organization who has the resources to provide the individual with a loan. A **borrower** is the person or organization that is receiving the money from the lender. The lender "trusts" the borrower to repay the money. Therefore, the lender determines whether or not to grant the borrower credit based on their perceived creditworthiness. **Creditworthiness** is an individuals' ability and willingness to pay the money back. If the privilege of borrowing has been extended, the borrower is usually expected to pay interest in addition to the amount borrowed. **Interest** is the price of money. When referring to credit, interest is the charge for borrowing money.

TYPES OF CREDIT

There are two main types of credit: closed-end credit and open-end credit.

Closed-end credit is a loan which the borrower must repay the amount in a specified number of equal payments. Closed-end credit usually has an agreement (contract) which must be signed outlining the repayment terms. Generally, the contract specifies the number of payments, the payment amount, and how much the credit will cost (interest rate or fees). Sometimes, closed-end installment credit requires a down payment. Examples of closed-end installment credit include automobile loans, mortgages, and education loans.

Open-end credit, or revolving credit, is extended as a line of credit established in advance so that the borrower does not have to apply for credit each time new credit is desired. A unique feature of revolving credit is that the loan balance can be repaid in one single payment or a series of equal or unequal payments, usually monthly. The borrower chooses how much to pay each month. However, the lender usually requires that a borrower pay at least a specified minimum amount each month. When a cardholder decides to make a monthly payment less than the total balance on the card, then the remaining unpaid balance is "revolved" to the next month.

WHAT IS A CREDIT CARD?

Credit cards are a form of open-end credit. A **credit card** is pre-approved credit which can be used for the purchase of goods and services now and payment of them later. In the case of credit cards, individuals may continue to borrow as long as they do not exceed the **credit limit**, which is the maximum dollar amount that can be charged on the card. The amount of the credit limit varies based upon an individual's creditworthiness. Credit card interest is charged to the account each month that the balance is not paid in full. The longer the cardholder takes to pay off the total balance, the larger the total interest charges will be. The rate at which interest is charged on a credit card account each month is usually expressed in terms of the **annual percentage rate (APR)**, which is the cost of credit expressed as a yearly interest rate**.**

It is important to note the difference between a credit card and a debit card. A **debit card** is a plastic card which looks like a credit card, but is electronically connected to the cardholder's bank account.

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

Credit card companies require cardholders to make at least a minimum monthly payment each month. But, that minimum required payment is usually only a small percentage (2.5 – 5%) of the total balance, enough to cover the interest charge for that month but not much more. Consequently, a cardholder who only makes the minimum payment each month makes slow progress toward paying off the total balance on the card. Read the scenario below to see the results of only making a minimum payment.

To prepare for her first semester of college, Miranda purchased a new computer for $1000 and textbooks for $500, spending a total of $1500 on her credit card charging 15% APR. If she were to make the minimum payment of $30 (and make no additional charges to the credit card), it will take her 11 years to pay off the balance. She will end up paying $1413 in interest alone!

	Payment Made	~ Time to pay off card	~ Total amount of interest paid	~ Total amount paid
Full Payment	$1500	1 month	$0	$1500
Partial Payment	$135	1 year	$125	$1625
Minimum Payment	$30	11 years	$1413	$2913

Advantages to Using a Credit Card

- 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 rating
- Online shopping is safer than using a debit card
- Possibility of receiving bonuses

Disadvantages to Using a Credit Card

- Interest can be costly when a balance is revolved
- Additional penalty fees may apply
- Tempting to overspend
- Risk of identity theft
- Responsible for lost/stolen cards
- Applying for multiple accounts in a short period of time can lower your credit score

POSITIVE AND NEGATIVE CREDIT CARD USE

When a credit card is used properly, it can help consumers develop a positive credit history and therefore, earn a high credit score. A **credit report** is a record of a consumer’s credit history that includes information about credit card use as well as the use of other types of credit. A **credit score** is a number that summarizes an individual’s credit record and history. It is a numeric “grade” of a consumer’s financial reliability. By using a credit card properly, consumers help increase their credit score. A high credit score gives the consumer the opportunity to have lower interest rates on loans, the privilege to use different forms of credit, and an easier approval process for future credit. However, if a consumer does not use credit cards properly, he/she can develop a negative credit history and lower his/her credit score. In some cases, improper credit card use can prevent individuals from qualifying for loans later in life including a mortgage to buy a home. In addition, consumers with low credit scores have difficulty renting apartments, pay higher interest rates, pay higher insurance rates, and have difficulty obtaining a job.

Positive

- Paying credit card balances in full every month
- Paying credit card bills on time
- Applying for only credit cards that are needed
- Keeping track of all charges by keeping receipts
- Checking the monthly credit card statement for errors

Negative

- Making late credit card payments (this may trigger penalty fees, a higher penalty interest rate, and will hurt the credit score)
- Paying only the minimum payment
- Exceeding the card’s credit limit (usually triggers a penalty fee)
- Charging items that can’t be paid off immediately
- Owning too many credit cards

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

CREDIT CARD OFFER

Credit card issuers are required to disclose the terms and fees of credit cards in an easy to read box format on all credit card applications and solicitations. The **Schumer Box** displays the main costs of the credit card. A sample Schumer Box is displayed below with explanations of each section.

Interest Rates and Interest Charges	What This Means for You
Annual Percentage Rate (APR) for Purchases	This section discloses the interest paid for purchases on the card. Some credit cards have an **introductory rate**, which is the APR charged during the credit card's introductory period after a credit card account is opened. If the card has an introductory rate, the introductory rate along with the rate that applies after the introductory rate ends will be shown here. Multiple interest rates may be listed here, because the final interest rate may depend on the creditworthiness of the applicant. Some cards will have a **variable-rate APR**, which is an APR that may change depending on other factors, such as the prime rate. The **prime rate** is an index that represents the interest rate most banks charge their most credit-worthy customers.
APR for Balance Transfers	This section discloses the interest paid for **balance transfers** (the act of transferring debt from one credit card account to another). Balance transfer fees may apply, even if the balance transfer APR is 0%.
APR for Cash Advances	This section discloses the interest paid for cash advances, such as withdrawing cash from an ATM using a credit card. Cash advance fees may also apply.
Penalty APR and When it Applies	**Penalty APR** is the interest rate charged on new transactions if the penalty terms in the credit card contract are triggered, which is almost always higher than the APR for purchases. This section discloses the penalty APR, as well as the penalty terms that trigger the penalty APR.
How to Avoid Paying Interest on Purchases	This section explains how you can avoid interest charges on purchases by paying your bill in full by the due date.
Minimum Interest Charge	Credit card companies often have a minimum interest amount. These charges typically range from $0.50 to $2 per month and are disclosed in this section of the credit card offer.
For Credit Card Tips from the Federal Reserve Board	This section directs consumers to the Federal Reserve website to obtain more information about credit cards.
Fees	**What This Means for You**
Set-up and Maintenance Fees	This section discloses any set-up and maintenance fees for the card, which can include: 1. **Annual Fee**- A yearly fee that may be charged for having a credit card. 2. Account Set-up Fee- Usually a one-time fee for opening and setting up the account. 3. Participation Fee- Usually a monthly fee charged for having a credit card. 4. Additional Card Fee– Usually a one-time fee for having a second card on an account.
Transaction Fees	This section discloses any transaction fees for the card (balance transfer fees and cash advance fees).
Penalty Fees	This section discloses the penalty fees for the card, which can include late-payment, over-the-limit, and returned payment fees. 1. A **late payment fee** is charged when a cardholder does not make the minimum monthly payment by the due date. 2. An **over-the-limit fee** is charged if the account balance goes over the set credit limit. The cardholder will not be charged this fee unless he/she has authorized the credit card company to permit transactions that exceed the credit limit. 3. A returned payment fee may be charged if the cardholder makes a payment but does not have enough money in that account to cover the payment.

* How We Will Calculate Your Balance	The four balance calculation methods are: adjusted balance, average daily balance including new purchases, average daily balance excluding new purchases, and previous balance. Depending on the balance you carry over and the timing of your purchases and payments, you'll usually have a lower finance charge with the adjusted balance method, the average daily balance excluding new purchases method, or the previous balance method.
* Loss of Introductory APR	If the card has an introductory rate, this area will list how the lower introductory rate can be lost.

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

CREDIT CARD BENEFITS

In addition to researching the Schumer Box, consumers should also research benefits they can receive from a credit card. Credit card companies compete against one another to earn business by offering different benefits to individuals. Popular incentives may include cash rebates, warranties for items purchased with the card, or travel accident insurance. Some credit cards may offer products and services, such as frequent flyer miles. Some credit cards that offer extra benefits may also charge fees or higher interest rates to use the card. It is important to evaluate possible fees and rates to determine if the benefits outweigh the costs.

Would you be willing to pay additional fees or higher interest rates to obtain credit card benefits?

HOW DO I OBTAIN A CREDIT CARD?

The first step to receiving a credit card is to compare different credit card offers and determine which card to apply for. Once the best card is chosen, applicants must complete a **credit application**, a form requesting information about a person's ability to repay and the applicant's age. Credit card applications can be completed through the mail, the internet, or over the phone. Credit card companies also send their applications through the mail to potential applicants. Often, consumers will receive pre-approved credit card applications in the mail. If an individual is **pre-approved** for that particular card, it means that they have passed the initial credit check. Once an individual completes a credit application, lenders conduct a **credit investigation**, which is a comparison of information on a credit application to information on a credit report, to insure all information is correct. Credit card applicants may or may not be approved for the credit card they apply for. Approval depends on the applicant's credit history.

CREDIT CARD STATEMENTS

Credit card statements outline important information about the card. The 2009 Card Accountability Responsibility and Disclosure (CARD) Act created important requirements for credit card issues to follow in regards to credit card statements. In order for consumers to use credit cards in a responsible manner, they need to understand how to read and evaluate their credit card statements. The information included on a credit card statement is explained below. The numbers in the statement correspond to the credit card statement on page 5.

1. **Summary of Account Activity–** This section includes an overview of all the basic information for the credit card.
2. **Payment Information-** The total new balance, the minimum payment amount, and the date payment is due is included in the payment information. A payment is considered on time if received by 5 p.m. on the day it is due**.**
3. **Late Payment Warning-** The late payment warning states any additional fees and the higher interest rate that may be charged if a payment is late.
4. **Minimum Payment Warning-** A minimum payment warning includes an estimate of how long it can take to pay off a credit card balance if only the minimum payment is made each month, and an estimate of the total amount paid, including interest, if the bill is paid in three years (assuming no additional charges are made).
5. **Notice of changes to your interest rates-** If a cardholder triggers the Penalty APR, the credit card issuer must notify them on their statement that their rates will be increasing.
6. **Other changes to your account terms-** Cardholders must be notified of any raise in rates or fees or any other significant changes to the account on their statement.
7. **Transactions-** A list of all the transactions that have occurred since the last statement.
8. **Fees and Interest Charges-** Credit card issuers must list the fees and interest charges separately on the monthly statement.
9. **Year-to-date Totals-** The total amount paid in fees and interest charges for the current year.
10. **Interest Charge Calculation-** A summary of the interest rates on the different types of transactions, account balances, the amount of each, and the interest charged for each type of transaction.

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

Credit Card Statement

Summary of Account Activity 1

Previous Balance	535.07
Payments	-450.00
Purchases	+529.57
Balance Transfers	+785.00
Cash Advances	+318.0
Past Due Amount	+0.0
Fees Charged	+69.4
Interest Charged	+10.8
New Balance	$1,784.53
Credit Limit	$2,000.00
Available credit	$215.47
Statement closing date	3/22/2012
Days in billing cycle	30

Payment Information 2

New Balance	$1784.53
Minimum Payment Due	$53.00
Payment Due Date	4/20/12

3 **Late Payment Warning**: If we do not receive your minimum payment by the date listed above, you may have to pay a $35 fee and your APR's may be increased up to the Penalty rate of 28.99%

4 **Minimum Payment Warning**: If you make only the minimum payment each period, you will pay more in interest and it will take you longer to pay off your balance. For example…

If you make no additional charges using this card and each month you pay…	You will pay off the balance shown on this statement in about…	And you will end up paying an estimated total of…
Only the minimum payment	10 years	$3,284
$62	3 years	$2,232

Notice of Changes to Your Interest Rates 5

You have triggered the Penalty APR of 28.99%. This change

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

Important Changes to Your Account Terms 6

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, APR for Purchases will increase to 16.99%.

Transactions made before 4/9/12: Current APRs will continue to apply to these transactions.

Transactions 7

Reference Number	Trans Date	Post Date	Description of Transaction or Credit	Amount
XXXX1	2/22	2/23	Store #1	$529.57
XXXX2	2/25	2/26	Payment	$450.00 -
XXXX3	2/26	2/26	Cash Advance	$318.00
XXXX4	3/15	3/17	Balance Transfer	$785.00
			Fees	
XXXX5	2/23	2/23	Late Fee	$35.00
XXXX6	2/27	2/27	Balance Transfer Fee	$23.55
XXXX7	2/28	2/28	Cash Advance Fee	$10.90
			Total Fees for this Period	**$69.45**
			Interest Charged	
			Interest Charge on Purchases	$6.31
			Interest Charge on Cash Advances	$4.58
			Total Interest for this Period	**$10.89**

8

2012 Totals Year-to-Date 9

Total fees charged in 2012	$90.14
Total interest charged in 2012	$18.27

Interest Charge Calculation 10

Type of Balance	Annual Percentage Rate (APR)	Balance Subject to Interest Rate	Interest Charge
Purchases	14.99%	$512.14	$6.31
Cash Advances	21.99%	$253.50	$4.58
Balance Transfers	0.00%	$637.50	$0.00

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

CARDHOLDER PROTECTIONS AND RIGHTS

The 2009 CARD Act created many new credit card protections for consumers. Some of these protections include:

- To receive a credit card, consumers must be 21 years of age or older. Consumers under 21 can still get a credit card, but they need to either have a co-signer or show documentation of sufficient income to make payments. If someone agrees to be a co-signer on an account, they are equally responsible for the loan. Therefore, the loan is also on their credit report, positively or negatively impacting it depending upon how the credit is managed.
- Credit card interest rates on existing balances generally can't be raised unless a cardholder is 60 days or more past due.
- Issuers are required to send a monthly statement at least 21 days before a credit card payment is due.
- Credit card payment due dates must be consistent month to month.
- Credit card companies cannot increase rates for the first 12 months after an account is open. There are some exceptions which allow an earlier adjustment of the interest rate, including:
  - If the card has a variable interest rate
  - If the cardholder is more than 60 days late in paying their bill, the rate can go up.
  - If the card has an introductory rate, it must be in place for at least 6 months and then it can revert to the previously disclosed purchase APR
- Cardholders must be notified of any significant changes in rates and fees at least 45 days before the changes take effect. In addition, any changes made to an account can only apply to future transactions (new charges) and the consumer has the option of closing the account before the changes go into effect.
- Some set-up and maintenance fees are charged before the card is used and may reduce the amount of credit initially available. These non-penalty fees cannot exceed 25% of the initial credit limit. For example, if a credit card has a credit limit of $1,000 the total fees for the first year (not including penalty fees) cannot exceed $250.
- Cardholders now have to "opt-in" to allowing transactions that take them over their credit limit. Otherwise, overt-the-limit transactions are denied. If a cardholder "opts-in" to allowing over-the-limit transactions, the company can impose only one over-the-limit penalty fee per billing cycle.

The Truth in Lending Act

The Truth in Lending Act limits a person's liability for unauthorized credit card charges to $50.00 per card. To take advantage of this law, a person must write a letter within 60 days of the first bill containing the error. If an individual's card has been stolen, it should be reported and canceled immediately. If an individual's credit card number is used fraudulently, but the credit card itself is not used, the individual has no personal liability.

CREDIT CARD SAFETY TIPS

- When using a credit card, sign the back with a signature and "Please See I.D."
- Do not leave cards lying around the home or office.
- Close unwanted accounts in writing and by phone, then cut up the card.
- Never give out the account number unless making purchases.
- Keep a list of all cards, account numbers, and phone numbers separate from cards.
- A lost or stolen credit card should always be reported immediately. Promptly reporting a lost or stolen credit card will reduce the cardholder's liability for any fraudulent purchases.
- If you shop online, consider using a temporary credit card number. A set amount will be charged to your credit card. Then, a number will be given to you to do your shopping. This card is a one-time use only number. This will decrease the threat of an individual's credit card number getting into the hands of the wrong individual. If you choose to not use a temporary card number the second best solution is to pay for purchases using a credit card. If products are not delivered or if an incorrect product is delivered, the consumer is responsible for only the first $50 of the purchase. The remaining portion of the charge will be removed from the consumer's account. Billing disputes are covered by the Fair Credit Billing Act.
- If a pre approved credit card, application, or solicitation is delivered to an individual, it is a safe practice to use a paper shredder to destroy the documents. This will help protect individuals from identity theft.

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