

UNDERSTANDING YOUR CREDIT CARD

FAMILY ECONOMICS AND FINANCIAL EDUCATION

Twenty-one year old Jenny felt rich when she received her first credit card during her junior year of college. She charged \$2,500, her credit limit, the first month. Every month after that, she was careful about paying on time, but only sent in the minimum monthly payment, \$50.00. With an interest rate of 19.8%, even though she never charged another item, it will take her 8 years and 9 months to pay off her account. When her account has a zero balance, she will have paid a total of \$5,325.18. Therefore, she will have paid \$2,825.18 in interest.

CREDIT

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. The lender “trusts” the borrower to repay the money. 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. When 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.

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

TYPES OF 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 (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. Common examples of open-end credit are credit cards, both general purpose cards (e.g., Visa, MasterCard, Discover and American Express) and retail store credit cards. 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 perceived **creditworthiness**; their ability and willingness to pay the money back. 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.

| Characteristics | Closed-end credit | Open-end credit |
|-----------------|--|---|
| Definition | A one-time loan | Credit extended in advance |
| Purpose of loan | Specified in application | May be used for a variety of purposes |
| Payments | Specified number of equal payments | Varies- can be paid in one payment or a series of equal or unequal payments |
| Loan Amount | Agreed upon during the application process | May be increased for responsible consumers |
| Examples | Mortgage, automobile, education loans | Credit cards |

CREDIT CARD INTEREST AND INTEREST RATES

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. 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.

ADVANTAGES & DISADVANTAGES OF CREDIT CARDS

ADVANTAGES

- 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

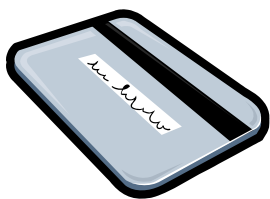
DISADVANTAGES

- 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

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.

IMPACT OF CREDIT CARDS ON CREDIT HISTORY

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, such as auto loans, student loans and mortgage loans. 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 and using a check register in the same manner that individuals keep track of personal checks or debit card transactions
- 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

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** (named after the U.S. senator who led the legislation through Congress) 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 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 , which is 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: <ol style="list-style-type: none"> 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. <ol style="list-style-type: none"> 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.

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; the amount of products and services received depends upon how much money is charged to the card. Cardholders and applicants should know all the terms and conditions regarding credit card benefits. 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.

RECEIVING 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. Most credit card companies have a credit card application on their website that can be submitted online or printed and mailed. 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, including transactions the cardholder has made during that billing cycle, the current balance on the credit card, the minimum payment due, and the payment due date. The 2009 Card Accountability Responsibility and Disclosure (CARD) Act created important requirements for credit card issuers 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-** Credit card statements must include a summary of the transactions on the account- payments, credits, purchases, balance transfers, cash advances, fees, interest charges, and amounts past due. The summary of account activity will also show the new balance, available credit, and the last day of the billing period.
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. Interest charges must be listed by type of transaction (for example, a cardholder may be charged a different interest rate for purchases than for cash advances).
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.

CREDIT CARD STATEMENT

| Summary of Account Activity | | Payment Information | | | | | | | | | | | |
|---|--|---|---|-----------|---|--|---|--------------------------|----------|---------|------|---------|---------|
| Previous Balance | 535.07 | New Balance | 2 | \$1784.53 | | | | | | | | | |
| Payments | -450.00 | Minimum Payment Due | | \$53.00 | | | | | | | | | |
| Purchases | +529.57 | Payment Due Date | | 4/20/12 | | | | | | | | | |
| Balance Transfers | +785.00 | 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% | | | | | | | | | | | |
| Cash Advances | +318.00 | 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... | | | | | | | | | | | |
| Past Due Amount | +0.00 | <table border="1"> <thead> <tr> <th>If you make no additional charges using this card and each month you pay...</th> <th>You will pay off the balance shown on this statement in about...</th> <th>And you will end up paying an estimated total of...</th> </tr> </thead> <tbody> <tr> <td>Only the minimum payment</td> <td>10 years</td> <td>\$3,284</td> </tr> <tr> <td>\$62</td> <td>3 years</td> <td>\$2,232</td> </tr> </tbody> </table> | | | 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 |
| 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 | | | | | | | | | | | |
| Fees Charged | +69.44 | | | | | | | | | | | | |
| Interest Charged | +10.88 | | | | | | | | | | | | |
| 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 | | | | | | | | | | | | |

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, APR for Purchases will increase to 16.99%.
Transactions made before 4/9/12: Current APRs will continue to apply to these transactions.

Transactions

| 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 |
| 2012 Totals Year-to-Date | | | | |
| Total fees charged in 2012 | | | \$90.14 | 9 |
| Total interest charged in 2012 | | | \$18.27 | |

Interest Charge Calculation

| 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 |

CARDHOLDER PROTECTIONS AND RIGHTS

2009 Card Accountability Responsibility and Disclosure (CARD) Act

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, over-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.