

# CHAPTER 4: Credit Cards



## Did You Know?

*Credit card debt averages nearly \$7,000 per month for families that carry over debt from month to month. Across the U.S., this debt totals more than \$420 billion.<sup>7</sup>*

**Credit** can be a wonderful thing. It allows us to purchase homes, cars, and other items we need for daily life quickly and easily. But it can also spiral out of control very quickly for those who use it as a method for living beyond their means. Credit card users must remember that a purchase made on credit is essentially a loan made to you by the card issuer. And every penny you charge has to be repaid, with interest. The more money you charge, the more interest you pay!

Many consumers are bombarded with credit card advertisements from the day they turn 18. Understanding the risks and benefits of credit cards, and using that knowledge to make informed spending decisions, is the key to maintaining good financial health.

## Credit Card Basics

**Credit cards** are easy to use. When making a purchase in person, you simply scan the card in an electronic card reader or hand the card to the clerk. You may be asked to sign a paper receipt or the screen of the card reader to finalize the transaction. More and more, though, credit card companies are working to phase out signatures and replace them with other forms of identification, such as fingerprint matching or recognition of facial features.

Online purchases are just as simple; you type in your card number and expiration date along with some additional information that proves you are the cardholder. This typically includes your billing address and the security code, or CSC (Card Security Code, sometimes called the CVC, Card Verification Code), which is a three- or four-digit number on the back of your card. Many websites, shopping apps, and mobile wallets will allow you to store credit card information, making the process even more convenient by allowing you to make purchases without even taking the card out of your wallet.

<sup>7</sup> [www.nerdwallet.com/blog/average-credit-card-debt-household/](http://www.nerdwallet.com/blog/average-credit-card-debt-household/)

## Interest and Fees

Remember the lesson on compound interest, and how it could help your money grow in a savings account? With credit cards, that same principle is working against you. Instead of earning interest on money you deposit, with credit cards you *pay* compound interest on the charges you make, which is actually money you “borrow” from the credit card company.

- Interest is typically compounded daily, based on an **annual percentage rate**. When you are granted a credit card account, the card issuer is required to clearly explain the **interest rate** associated with the credit card so that you are aware of how much the loan will cost you over time.
- Some credit card issuers charge an **annual fee** that must be paid for the privilege of using a credit card. These fees can range from as little as \$25 up to \$100 or more, depending on the account.
- Credit card issuers may charge a **late fee** when the minimum payment on a credit card is not paid by the due date. These fees are typically \$25 or more, and are automatically added to the account balance, which adds to the interest you end up paying.
- Finally, most credit cards offer cardholders the option of using the card to obtain cash. The amount of cash is limited, and it is generally only a small percentage of the total credit available on the account. **Cash advances** generally have a higher rate of interest than purchases made from merchants.



## Cardholder Responsibilities

Because a credit card is a loan made to you by a financial institution, you should expect that there are certain responsibilities attached to the privilege of having a credit card.

- Most credit cards have a **credit limit**, which is the maximum balance you can borrow, or **charge** at any time. This limit is based on previous credit history, income, and expected ability to repay the loan; it helps to ensure that you don't spend more money than you can repay. If you try to charge more than the limit, the charge will be denied when the merchant swipes the card for payment and you will have to present an alternate form of payment.
- On each monthly statement, you will see a **minimum payment** that you must make to keep the account current. Making the minimum payment (usually between 1.5% and 3% of the **outstanding balance**) shows the bank that you intend to repay the loan fully and you have the discipline to repay the loan in full. However, making only the minimum payment each month can cost you a lot of money in interest over time.
- Credit card payments must be made by the **payment due date** shown on the statement. If the credit card company does not receive at least the minimum payment by the due date, then they may:
  - Suspend your card so you can no longer use it.
  - Charge you a late fee of \$15 or more.
  - Increase your interest rate.
  - Report you as delinquent to credit rating agencies. If you establish a pattern that indicates you may not repay your debts, it can become difficult for you to get new cards or other types of credit (including loans). You'll learn more about credit reports and ratings in Book 3.

## Choosing a Credit Card

As with any loan, it is important to do your homework before selecting a credit card. Reading the fine print on credit card offers and applications is a must when choosing a card.

To get you to apply for their card, many banks make special offers that may or may not expire after a



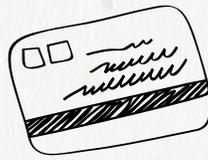
certain period of time. Many banks offer credit cards with no annual fees and special interest rates. The special interest rates may be very low, or even zero percent, but these rates are often temporary and apply for only a short period of time. Some credit cards offer points, frequent flyer miles, or other rewards for selecting a specific card. While these may seem beneficial, it is important to read carefully to see if there are hidden fees or requirements for card use in order to qualify for these types of incentives. Finally, many credit card companies encourage people to transfer debt from higher interest rate credit cards over to another account. All of these options must be considered as you select a card that will meet your purchasing needs.

## Consumer Protection

Credit cards are big business in the U.S. The ability to make purchases even when you may not have the money on hand can be very tempting for consumers, and provides banks with a steadily growing income stream. In 2009, the Credit Card Accountability, Responsibility and Disclosure, or Credit CARD, Act was passed, issuing a set of rules to prevent card issuers from hiding any fees or rates from their customers. It also places restrictions on how and when they can raise your interest rates, and how much they can charge in additional fees.

# Activity 1

## PART 1: READING YOUR STATEMENT



Each month the bank that issued the credit card will send you a credit card statement. This may be mailed to you or can arrive as an email statement, based upon your personal preferences. The statement will include all of the key pieces of information about the status of your account. Use this sample to learn more about the information provided on a credit card statement. Fill in the letters to identify each part of the sample statement defined below.

<b>ACCOUNT NUMBER</b> 1234 2345 3456 4567	<b>STATEMENT CLOSING DATE</b> 6/30/19	<b>PAYMENT DUE DATE</b> ← C 7/23/19			
<b>CREDIT LIMIT</b> \$2,000	<b>AVAILABLE CREDIT</b> \$1555.40	<b>PREVIOUS BALANCE</b> \$390			
L → <b>CASH ADVANCE LIMIT</b> \$500	<b>MINIMUM PAYMENT DUE</b> \$6.60	<b>NEW BALANCE</b> ← A \$444.60			
<b>STATEMENT SUMMARY</b>	<b>B</b>	<b>FINANCE CHARGE SUMMARY</b>			
K → -PAYMENTS \$180		<b>ANNUAL PERCENTAGE RATE</b>			
+PURCHASES & OTHER CHARGES \$230		<b>Purchases</b> 12.00%			
J → +CASH ADVANCES \$0		<b>Cash Advances</b> 20.00%			
H → +FINANCE CHARGES \$4.60		<b>DAILY FINANCE CHARGE RATE</b>			
I → +LATE FEE \$0		<b>Purchases</b> .03287%			
A → =OUTSTANDING BALANCE \$444.60		<b>Cash Advances</b> .05479%			
<b>F → THIS MONTH'S ACTIVITY</b>		<b>D</b>			
		<b>G</b>			
<b>TRANS. DATE</b>	<b>TRANS. POST</b>	<b>REFERENCE #</b>	<b>DESCRIPTION</b>	<b>CREDITS</b>	<b>CHARGES</b>
2-Jun	5-Jun	987654321A	Game Store		\$25.00
9-Jun	9-Jun	123456789B	Video Store		\$45.00
16-Jun	16-Jun	987654321C	Restaurant		\$105.00
24-Jun	24-Jun	123456789D	Gym membership		\$40.00
23-Jun	24-Jun	098765432E	Payment	\$180.00	
25-Jun	28-Jun	121212121F	Annual Fee		\$15.00
			<b>E</b>		

- **Annual fee:** the amount of money the credit card issuer charges you each year for having the credit card account.
- **Annual percentage rate:** yearly interest rate you pay on the outstanding balance.
- **Cash advance limit:** the total amount of money you are allowed to take from the account in the form of cash and have outstanding at any point in time.
- **Cash advances:** money you obtain in the form of cash through the use of an ATM or bank.
- **Daily finance charge rate:** interest rate you pay each day on the outstanding balance.
- **Finance charges:** interest payment charged to you for the statement period.
- **Late fee:** a penalty you are charged for not making your minimum payment by the established payment due date.
- **Minimum payment due:** based on a percentage of the total balance, this is the least amount you can pay to keep your account in good standing.
- **Outstanding balance:** total amount of money you owe; it helps determine the finance charge you will pay.
- **Payment due date:** date by which the credit card company must receive your payment.
- **Payments:** the amount you paid on the last credit card statement you received and any other payments you may have made since the last statement.
- **This month's activity:** a brief history showing purchases made with the credit card since the last statement.

**LATE PAYMENT WARNING:** If we do not receive your minimum payment by the date listed above, you may have to pay a late fee of up to \$37 and your APRs may be increased up to the variable Penalty APR of 29.99%.  
**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 the statement in about...	And you will end up paying an estimated total of...
Only the minimum payment \$14.00	9 years, 5 months 3 year(s)	\$742.00 \$531.00

# Activity 1

## PART 2: FIGURING FINANCE CHARGES



The **finance charge** is an interest payment that is compounded daily, based on your **average daily balance (ADB)**. This is calculated by adding together the ending balance for each day in the billing period (even the days that your balance didn't change), and then dividing by the total number of days.

$$\text{Average Daily Balance} = \text{Sum of the Ending Daily Balances} \div \text{Number of Days in the Billing Period (assume 30 days)}$$

Use the data in the sample statement in Part 1 to calculate the average daily balance for June.

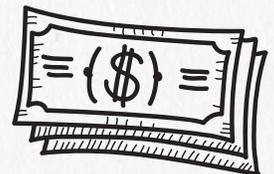
Sum of ending daily balances: \$ \_\_\_\_\_  $\div$  30 = \$ \_\_\_\_\_ Average Daily Balance

Once you know the average daily balance, you can calculate the finance charge.

1. Find the annual percentage rate: \_\_\_\_\_ %
2. Divide by 365 to get a daily percentage rate: \_\_\_\_\_ %
3. Finance Charge = Daily Percentage Rate x Days in Billing Period x Average Daily Balance

$$\underline{\hspace{2cm}} = \underline{\hspace{2cm}} \times \underline{\hspace{2cm}} \times \underline{\hspace{2cm}}$$

Date	Daily Balance
1-Jun	\$390.00
2-Jun	\$
3-Jun	\$
4-Jun	\$
5-Jun	\$
6-Jun	\$
7-Jun	\$
8-Jun	\$
9-Jun	\$
10-Jun	\$
11-Jun	\$
12-Jun	\$
13-Jun	\$
14-Jun	\$
15-Jun	\$
16-Jun	\$
17-Jun	\$
18-Jun	\$
19-Jun	\$
20-Jun	\$
21-Jun	\$
22-Jun	\$
23-Jun	\$
24-Jun	\$
25-Jun	\$
26-Jun	\$
27-Jun	\$
28-Jun	\$
29-Jun	\$
30-Jun	\$
<b>Total</b>	\$
	$\div$ 30
<b>ADB</b>	\$



### Minimums Matter

The minimum payment is an important detail because the amount you pay each month determines how long it will take to pay off your credit card debt. The minimum payment amount is typically calculated as a percentage of the outstanding balance. Use the data in our sample statement to calculate the minimum payment percentage for this account.

$$(\text{Minimum Payment} \div \text{Outstanding Balance}) \times 100 = \underline{\hspace{2cm}} \% \text{ Minimum Payment Percentage}$$

You can use an online credit card payoff calculator to determine how long it will take you to pay off a card based on how much you pay each month (see [www.creditcards.com/calculators/minimum-payment](http://www.creditcards.com/calculators/minimum-payment)).

It is important to remember that the longer it takes you to pay off your debt, the more you will pay in finance charges and fees.

# Activity 1

## PART 3: EXTRA PRACTICE

Use this data to answer the questions below.

### CREDIT CARD A:

- Annual percentage rate = 22.99%
- 30-day billing period
- \$22,640 total daily account balance
- \$700 statement balance
- Minimum payment – 2% or \$15, whichever is greater



### CREDIT CARD B:

- Annual percentage rate = 18.5%
- 31-day billing period
- \$9,200 total daily account balance
- \$275 statement balance
- Minimum payment – 2% or \$10, whichever is greater

1. Calculate the **daily finance charge rate**.

Card A: \_\_\_\_\_ %

Card B: \_\_\_\_\_ %

2. Calculate the average daily balance for each account.

Card A: \$ \_\_\_\_\_

Card B: \$ \_\_\_\_\_

3. Calculate the minimum payment on each account.

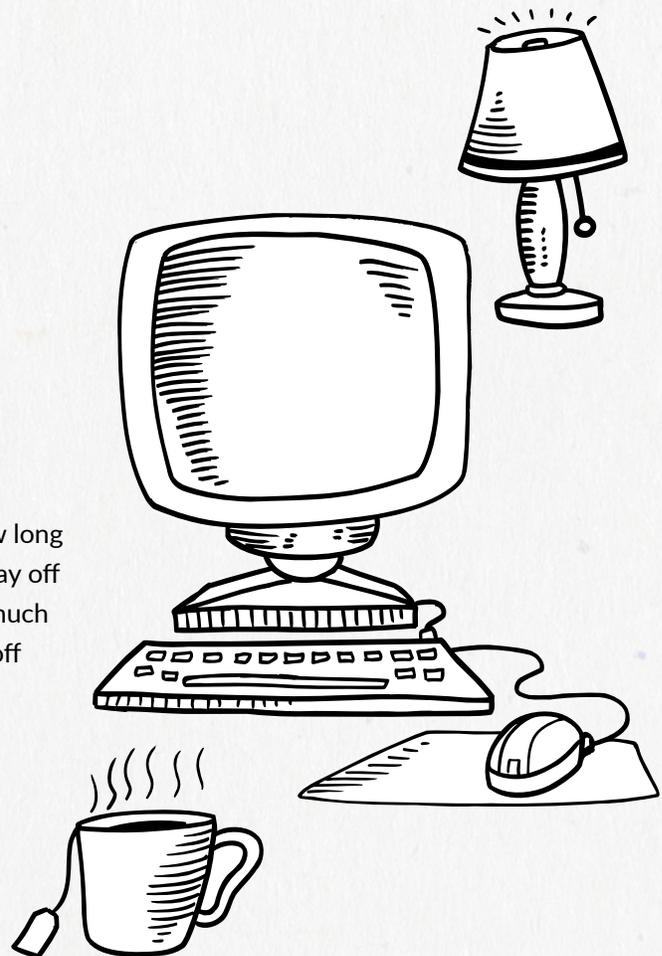
Card A: \$ \_\_\_\_\_

Card B: \$ \_\_\_\_\_

4. For each account, use the online payoff calculator at [www.creditcards.com/calculators/payoff](http://www.creditcards.com/calculators/payoff) to determine how long it will take to pay off the balance. How long will it take to pay off the balances if you only pay the minimum payment? How much money would you have to pay each month in order to pay off the total debt in 6 months?

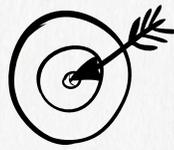
Card A: Minimum payment payoff in \_\_\_\_\_ months  
6 month payoff at \$ \_\_\_\_\_ per month

Card B: Minimum payment payoff in \_\_\_\_\_ months  
6 month payoff at \$ \_\_\_\_\_ per month



# Take-Home Lesson

## PUTTING IT ALL TOGETHER



You have just purchased a new gaming system and some new games using your credit card. You paid \$325 for the system and the games. Your credit card has an annual percentage rate of 22%, and the minimum payment is 3.5% of the outstanding balance or \$10, whichever is greater.

Assuming that all months have 30 days, analyze how long it will take you to pay off the balance, making monthly payments of various amounts, and the total cost of the purchase, including all finance charges. You can use the appropriate calculators at [www.creditcards.com/calculators](http://www.creditcards.com/calculators) or download a spreadsheet at [www.ymiclassroom.com/byf/byf\\_book1\\_credit\\_card\\_calculations.xlsx](http://www.ymiclassroom.com/byf/byf_book1_credit_card_calculations.xlsx). Note that in order for all months to have 30 days, assume that the year has 360 days.

1. For the first month, what will be the finance charge: \$ \_\_\_\_\_; the minimum payment: \$ \_\_\_\_\_
2. How long will it take you to pay off the credit card balance if you make only minimum monthly payments?  
\_\_\_\_\_
3. If you make only minimum monthly payments, what will the total cost of the purchase be once you have paid it off? \$ \_\_\_\_\_
4. How much of this amount will you have paid in interest?  
\$ \_\_\_\_\_

Update your spreadsheet or use the [online calculators](#) to see what would happen to the overall cost of the items if you made a payment of \$50 per month.

5. If you make a payment of \$50 per month, what happens to the overall cost of the item? \_\_\_\_\_
6. How long will it take you to pay it off? \_\_\_\_\_
7. How much will you pay in interest using this scenario? \$ \_\_\_\_\_
8. Based on what you have learned, is it wise to purchase the gaming system and games using a credit card? Explain your answer. \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_
9. If you had the opportunity to purchase something you really wanted using a credit card vs. waiting until you saved the money needed to make the purchase, which option would you choose? Explain your answer.  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

