Credit Cards: More than Plastic

Standard 8

The student will describe and explain interest, credit cards, and online commerce.

Lesson Objectives

- Describe how credit cards are used to purchase today's wants with tomorrow's money.
- Compute the total cost of purchasing goods using credit cards at different interest rates when making minimum payments.

Personal Financial Literacy Vocabulary

Credit card: A plastic card that authorizes the delivery of goods and services in exchange for future payment with interest, according to a specific schedule.

Revolving credit: A consumer line of credit that can be used up to a certain limit or paid down at any time.

Introduction

Austin receives two credit card applications, both stating he is preapproved for a credit card at 1.5 percent interest. Austin thinks that sounds pretty great. After all, there are several things he would like to buy, and his friends have credit cards so he signs both applications and mails them back to the companies.

Norman receives the same two offers in the mail. He does not want another credit card, so he just throws them in the trash can.

Wichita also receives the offers. She reads both carefully to decide if either would be beneficial to her. One offer states the 1.5 percent introductory rate is good for six months, then converts to 22 percent on all future charges. The other 1.5 percent introductory rate is good only for balance transfers. She shreds both offers and throws them away.

Who made the best choice?

Lesson

Credit cards are more than just plastic used to make purchases. They are a specific form of consumer credit originating in the United States during the 1920s when individual companies, such as hotels and oil companies, issued them to customers to make purchases at their businesses. The use of credit cards has grown since then, and they are now one of the primary sources of purchases for many consumers around the world.

The primary benefit of using credit cards is to help you make emergency purchases. For example, if you need to purchase a new tire because of a blow out and you do not have enough cash on hand, a credit card can allow you to get going again. While credit cards are a convenient way to make purchases, they can promote "impulse buying" and overspending. Spending money is fun and easy; paying off credit card bills is not!

The growth of credit cards goes back to the late 1950s when Bank of America in California issued the first bank credit card. It was originally called BankAmericard, before being renamed Visa in 1976. Other banks followed with other credit card plans, and the rest is history. Almost 40% of the households in the United States have some type of credit card debt, and the average household who uses credit cards now owes almost $16,000 on their cards.

A credit card is different from a debit card; debit cards remove money from your checking account when a purchase is made. They are very similar to a check and basically serve as a substitute for cash. A credit card is also different from a charge card; charge cards must be paid in full at the end of each month.

A credit card, however, is a type of consumer loan called a revolving credit loan. As a loan, the amount (the balance) you owe must be repaid to the credit card company. If the balance is not paid in full each month, it will accumulate interest on the amount due. When you use a credit card to make a purchase, the credit card company pays the merchant for your purchase. The credit card company sends you a bill called a statement at the end of the month showing what purchases you made, any additional fees you owe, and the total amount that you owe. In addition, your statement shows the minimum payment you are required to pay each month.

When you receive your monthly statement, it is important to review all the charges listed to ensure they are correct. Like any other business, credit card companies can, and do, make mistakes. More importantly, reviewing your statement provides an opportunity to be sure no one else has access to your credit card number and is using it to make purchases without your permission. Should you find something wrong when reviewing your statement, you have the right to dispute the charges. All disputes need to be handled in a timely manner; otherwise, you may be required to pay the charges with interest that accumulated from the date of purchase. The process for disputing incorrect charges or correcting any other errors with your account is outlined on the back of your monthly statement.

Before accepting and using any credit card, be sure you read the terms very carefully. Credit card terms vary greatly and can easily become a financial nightmare when the bills start rolling in.

Credit CARD Act of 2009

The Credit Card Accountability, Responsibility and Disclosure Act of 2009, commonly called the Credit CARD Act, made several changes impact the credit card industry. Following is a summary of some of those changes:

1. If you are under the age of 21, you must either show proof of income sufficient to qualify for the card or to have someone over the age of 21 co-sign for you to be approved for the account. Basically, this change in legislation banned the practice of credit card companies sending credit cards to high school or college students who had little or no means to make their payments. In addition, the legislation requires credit card companies to stay at least 1,000 feet from a college campus if they are using freebies such as pizza or T-shirts to entice students to apply for a card.

2. Credit card companies must also inform you about the impact of making minimum payments on your account. Most credit card companies now include that information on each monthly statement they send to you. They must also show you how much you would have to pay each month if you want to pay off your account balance, plus the interest, in 36 months.

3. You must now “opt in” if you want the ability to charge more than your credit limit. This change is designed to help you better manage your credit and avoid any fees for exceeding the limit on your account. If you attempt to charge more than your credit limit, your card will be rejected and you will need to find another to pay for your purchase.

Interest on Credit Cards

Most credit cards provide you a 30 day grace period, meaning you do not have to pay interest on your purchases if you pay the entire amount in full each month. Otherwise, the credit card company will charge interest on the unpaid balance from the date of your purchase. More information about interest on each specific credit card should be included on the back of your monthly statement.

Credit card interest rates vary from zero to about 30 percent. Low interest rates are frequently special incentives to encourage you to use that credit card and may be only temporary. In addition, they may or may not cover all purchases on your credit card. Before making purchases, transferring balances, or getting cash advances in hopes of a low interest rate, be sure you read the fine print carefully and understand the credit terms.

Using credit cards for a cash advance means you are borrowing money from the credit card company. While convenient, it tends to be one of the most expensive ways to borrow money or obtain cash. Even if you think you can repay it by the end of the month with little or no interest, chances are you will end up paying high interest rates on the advance. Also, you may be charged additional fees for the advance. In most cases, you will not have extra money at the end of the month to repay your loan if you do not have extra money in the middle of the month. Getting cash with a cash advance on your credit card is a practice to avoid unless absolutely necessary.

Credit card companies often offer other special incentives tempting you to use your credit card instead of another means of payment. Some of these incentives include frequent flyer points on airlines, cash back on purchases, and gift certificates. These rewards are certainly great fun to receive, but they can also be very costly unless you are already in the habit of paying the total balance due each month. In many cases, you may end up paying more in interest than the value of the reward. Keep in mind that credit card companies are in business to make money — not to give it away.

Credit card accounts are classified as revolving credit, which means you can use the amount for which you are approved as long as you continue making payments on it. Revolving credit has more flexible terms than other forms of credit, which can create problems if you are not aware of your rights and responsibilities. For example, credit card companies can change the interest rate, late fee charges, other fees, and terms of credit as long as they notify you in advance.

However, the Credit CARD legislation also provides you with some protection against interest rate increases on your credit card account. Basically, it outlines five reasons credit card companies can increase your interest rate, which also increases your monthly payments. These include the end of a "promotional" interest rate where the company gave you a special rate for a specified amount of time; you are more than 60 days late on your payments; you have a drop in your credit score; you have a variable interest rate that is tied to another interest rate such as the prime rate and the prime rate increases, or you have had your credit card more than 12 months. In each case, they must give you 45 days notice of any rate increase.

Increases in interest rates and other fees impact the amount of your monthly payments and wreck your budget rather quickly. Even though those mailings from the card companies look pretty boring, taking a few minutes to read them will help you monitor any changes.

Your Credit Card Statement

Each month you should receive a statement from your credit card company. While statements from different card companies do not look the same, they generally have the same information. Some of the main parts of the statement include:

REMINDER

When preparing your budget, be sure to include deposits to your savings account as a FIXED expense. The best budgets always start with paying yourself first!

Purchases or new charges: This section contains a list of everything you have purchased or anything charged to your bill since the last statement. It should also show the rate of interest you are paying on those charges. Cash advances tend to have higher interest rates, but will also be listed on your statement. If you find something listed in this section that you have not purchased or authorized, then you need to contact the credit card company immediately. Otherwise, you will be responsible to pay for it.

Payments and credits: This section of your statement shows how much you have paid on your balance since the last statement. Again, you want to check to be sure they have credited your account with any payments you have made since the last statement and any credit you may have received because of a returned item that was charged to your credit card.

Due date or pay-by date: In order to avoid any late fees, you need to be sure the credit card company receives your payment before this date. It is best to mail your payment at least ten days before this date to ensure it arrives in time to be processed by the due date. Late fees can be hefty, and they add to the burden of paying off your credit card. In addition, late payments are generally reported to the credit bureaus and will drop your FICO credit score. Paying bills online tends to shorten the time-frame and help your payments arrive on time.

Credit limit: Your credit limit is the maximum amount you are allowed to charge on your credit card without incurring additional "over the limit" fees. Be sure to watch your limit monthly to ensure you are aware of how much cushion you have before reaching that limit. If you have opted to allow your account to accept charges over the limit, you will be charged a fee for exceeding that limit and those fees will vary depending upon the amount you exceeded it.

Reading your statement each month is your protection against errors or incorrect charges on your credit card as well as being charged unnecessary fees. Those incorrect charges, fees, and other potential problems with your statement can be a budget buster! You, and only you, are responsible for monitoring the monthly activity on your credit card. Any time you see an item you do not recognize, whether it is a charge or a fee, call the company and ask for an explanation.

Making Minimum Payments

In addition to the information noted above, your credit card statement will also indicate your minimum monthly payment. This amount is the payment you must make to keep your account current; any amount less than the minimum will result in late fee charges added to your bill and to your minimum payment the following month. And, the credit card company will probably increase your interest rate. If you make a habit of paying less than the minimum, the credit card company has the right to demand the entire amount you owe immediately. Paying less than the minimum is a good sign you need to quit spending!

Even though a minimum monthly payment is the amount shown on your statement, it is not the amount you SHOULD pay each month. The minimum payment is basically just enough to cover the interest charges, and little, if any, is applied to your principle. As a result, you will be paying for your purchases for more years than you use the item you purchased.

CREDIT CARD TIPS

- ***If you can only make minimum payments on your credit cards, you are overspending or overcharging on your credit cards.***
- ***Save or track your credit card receipts for each purchase so you can match them with the charges on your monthly statement and find any errors.***

Suppose you buy a new notebook computer for $2,000 and charge it on your credit card. How long will it take you to pay off the balance if you make minimum payments? The table below shows what happens when you make only the minimum payments for that $2,000 at three different interest rates:

Interest Rate	Number of Months	Total Interest Paid	Total Cost of Your Purchase
18	222	$2,615.43	$4,615.43
24	403	$6,812.23	$8,812.23
10	145	$ 888.49	$2,888.49

For example, the notebook computer would cost you over $8,000 if you make minimum payments at 24% interest. ($2,000 + $6,812.23 = $8,812.23)

It would also take you over 33 years to pay for it. (403/12=33.58) Do you really think your notebook computer would last that long?

The table below shows what will happen when you increase your monthly payments. So, before you make a credit card purchase, be sure you can pay more than the minimum. Otherwise, it may be better to wait to make your purchase.

$2,000 Credit Card Balance @ 24% APR		
Payment	**Number of Months**	**Total Interest Paid**
Minimum monthly payment of	403	$6,812.23
Add $10 a month, $60 monthly payment	56	$1,328.23
Add $20 a month, $70 monthly payment	43	$ 995.22
Double the payment to $100 a month	26	$ 579.75

Conclusion

Using credit cards is a great convenience for most consumers, but it can also be a very costly choice. If you are not paying off your credit card balance in full every month, then you are increasing the cost of your purchases and reducing the amount of money you could put in savings to meet your future goals. The cost and benefits of using credit cards depend on the interest rate charged by the credit card company and the amount of payments you are able to make on a monthly basis. Making minimum payments on credit card purchases means you are paying for an extended period of time, and doubling or tripling the cost of the items purchased. In addition, it is important to review your monthly statement to ensure it is correct and to keep from paying unnecessary fees.

FINAL NOTE: Who made the best choice? If you said Wichita, then you are correct!

Austin will probably be very surprised to learn he will be paying 22 percent on his credit purchases after the introductory rate stops, unless he pays the entire balance each month. And, unless he is transferring a balance on the second card, he will not have 1.5 percent interest on any of his purchases charged to that account.

By just throwing away the credit card applications, Norman is at risk to become a victim of identity theft. Scammers often dig through the trash to find careless consumers like Norman and use their personal information to get credit for themselves, with someone like Norman left to contest the charges with the credit card companies.

Wichita showed she was a savvy credit user. She read the terms for both cards, decided the costs were greater than the benefits, and shredded the applications before throwing them away to prevent possible identity theft.

This lesson was written and created by Oklahoma educators in partnership with Oklahoma Council on Economic Education

Name:______________________________Class Period: ______________________________

Credit Cards: More Than Plastic Review 8.1

Answer the following questions and give the completed lesson to your teacher to review.

1. List one cost and one benefit of using credit cards.

2. Identify and explain three items on your monthly credit card statement.

3. What is one step you can take to reduce the costs of paying interest?

4. What are two factors should you consider when selecting a credit card?

Name:_______________________________Class Period: _______________________________

Comparing Credit Cards Activity 8.1

Use three credit card offers to complete the following comparison of credit cards. (Note: Your teacher may require you to contact three banks or credit unions in your area or go online to find the information needed to complete this assignment.)

	Credit Card #1	**Credit Card #2**	**Credit Card #3**
Issuer			
Introductory Interest Rate/ No. of Months			
Interest Rate			
Annual Fee			
Transaction Fees or Other Fees?			
Days in Grace Period			
Credit Limit			
Incentives			
Will you use these incentives?			

Which of the three credit cards would you prefer to have? Explain your answer.