YOU and YOUR CREDIT: Credit Card Basics [1]

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Using credit cards to pay for goods and services is a fact of life for most consumers. Yet, many consumers do not take the time to comparison shop for them. Rebates, bonuses, points, or rewards that allow us to earn credit toward other services or purchases can distract us.

While credit card balances in America average over $8,000, the reality is that only about one out of 20 households who have a credit card actually owes more than $8,000 on their credit card. If you do have $8,000 in credit card debt, at a typical interest rate of 18 percent, it would take 14 years to pay it off, making the minimum payments of 4% of the average daily balance ($320 per month). The cost of credit is $4,715 in interest payments for a total of $12,615.

ADVANTAGES of CREDIT CARDS

- Allow you to shop or travel without carrying large sums of cash. Most cards are accepted all over the world.
- Can give you immediate use of the goods and services, especially important for expensive items like appliances and furniture.
- Can be used to deal with unexpected financial emergencies.
- Can help you to track how much you are spending by giving you a record of your purchases.
- Can offer a protection against theft. If your card is lost or stolen and you notify the credit card company immediately, the most you would typically be liable for is $50 of the unauthorized spending. Many companies currently waive this fee, however.

DISADVANTAGES of CREDIT CARDS

- *Purchases may cost more*, if not paid in full at the end of the month. Interest and other charges are added to the purchase price of goods and services.
- *Ties up future income*. When you use credit, you owe money that must be paid back from income you have not yet earned. This may make it more difficult to deal with unexpected events and emergencies.
- *Can encourage overspending*. You may buy more than you can pay for, and may even buy things you don't need.
- *Can lead to major financial problems* if poorly managed.

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NUMBER OF CARDS

Having too many credit cards can lead to overspending. Generally, consumers want at least one card that is widely accepted which also can be used for identification and services.

TYPES OF CREDIT

- **Bank Cards, such as Visa, Master Card, and Discover,** are sponsored by an individual bank. The bank defines a spending limit, sometimes called credit lines, and each bank offers different terms and conditions.
- **Company or Retail Store Cards,** such as **Sears, J.C. Penney, and Gas Companies.** Typically, these cards are only accepted by the specific company and do not have annual fees. However, the terms and conditions of these cards do vary.
- **Travel and Entertainment Cards** such as **Diners Club.** These cards typically have no pre-determined spending limit and must be paid in full each month. They usually have an annual fee.
- **Utilities,** such as **Electricity, Gas, Telephone,** allow you to use the product and then pay at the end of the month. Note these are typically not listed on your report, nor do they affect your score, unless you have missed payments and are in collections.

QUALIFYING for CREDIT CARDS

The following are examples or positive signals you may show a creditor. These typically increase the chances you will be approved.

- No major blemishes on your credit report such as a bankruptcy, repossession, or a 90-day delinquency
- Active accounts which show that your information is valid - at least two active open accounts including one that has been open for at least two years
- Consistent payments of at least the minimum amount and no recent late payments
- A verifiable address
- No more than 50 percent of your available credit lines used

Apply for a credit card for which you think you are a good candidate. For example, if you have no credit, look for a credit card that is advertised for first time users.

DENIED CREDIT

The following are negative signals you may be sending a potential creditor, which may reduce your chances of approval:

- Too much outstanding debt
- Too little time in current job or at current address
- Unreasonable purpose for requesting credit
- Co-signer cannot take on additional debt
- Errors on credit report

If denied credit, you have the right to get a free credit report.

EVALUATING CREDIT CARDS

Use the credit card comparison worksheet to evaluate different credit cards for the card costs, terms, and options. Then list the features that are best suited to your needs and spending habits. You can analyze each credit card with this information and select the right credit card for you. Printed solicitations must display the following information in easy to read type in a disclosure box.

- **Credit Card terms**: When selecting a credit card, the following credit terms and conditions are important because they affect the total cost of credit:
- **Annual Fee**: A flat, yearly charge, similar to a membership fee, usually $25 to $50. Many credit cards do not require an annual fee.
- **Annual Percentage Rate**: The APR is the measure of the cost of credit expressed as a yearly rate. It may be fixed or variable. If it is variable, this is typically tied to an interest rate index.
- **Finance Charge**: The total cost of credit, which includes interest, late fees, over- the- limit fee, other fees, etc.
- **Grace Period:** Number of days allowed for payment in full to avoid interest.

The four main ways that credit card balances are calculated are:

- **Average daily balance**, **excluding new purchases.** This balance is figured by adding the outstanding balance for each day in the billing cycle, and then dividing by the number of days in the cycle.
- **Average daily balance, including new purchases, which have a grace period.** This balance is calculated by adding the outstanding balance (including new purchases and deducting payments) for each day in the billing cycle, then dividing by the number of days. The grace period only takes effect if the balance from the previous billing cycle was zero.
- **Average daily balance including new purchases with no grace period.** The balance from the previous cycle and all new charges in the current billing cycle are included in the balance calculation even if the previous month's balance was paid in full.
- **Two-cycle average daily balance including new purchases.** Several issuers use the two-cycle average daily balance method. It is used primarily to back-charge interest on a balance on which no finance charges were paid (because the previous balance was zero). This method is not favorable to consumers, especially if they are trying to pay off their credit balance. In essence, you must pay off your balance for at least two months to avoid finance charges.

Extra charges may include:

- **Late payment –** Your payment arrives after the due date. When this happens, you can lose a low introductory rate or trigger a higher default rate**.**
- **Over the Credit Limit** - Any amount charged over your credit line will trigger a fee.
- **Cash Advances –** It is not a good idea to use your credit card for cash advances. The interest rate is higher than when you use your card for purchases and there is usually no grace period for a cash advance. Often, the interest begins accruing *before* you even receive the money.

Read the fine print after the disclosure box. There may be additional fees. Your interest rate may be changed at any time for any reason. For instance, even with a fixed rate card, the rate can still be increased if you miss a payment.

YOUR RESPONSIBILITIES

- **Assess** your financial situation and **determine** how much you can repay monthly.
- **Understand** the total cost of credit.
- **Keep** copies of your transactions and **compare** with your monthly statement.
- **Remove** and **destroy** all credit card carbons; these are not common but you may encounter them.
- **Do not give** your credit card numbers to anyone who has initiated a phone call or via the internet.
- **Pay** bills on time and **notify** creditors if you can't pay on time.
- **Inform** your creditors of any billing errors.
- **Make** a list of all credit card account numbers and the issuer's telephone numbers.

CARD CANCELING PROCEDURE

- Cancel AFTER card is paid in full.
- NOTIFY the card issuer by phone.
- FOLLOW UP with a letter and send by certified mail or "return receipt requested." The letter should say that you are closing your account and that you want your credit report to reflect that it was closed per your request.
- PROVIDE your name, address, and account number.
- CHECK your credit report.

Wait a month or two, then get a copy of your credit report and make sure it says-Closed at customer's request. You don't want your report to say "Account closed by creditor," as that reflects negatively on you. Credit bureaus report what creditors tell them. If your credit report is inaccurate, ask the creditors to correct inaccuracies and update the credit bureaus. You should follow up with the credit bureau to verify this is done. Experts recommend that you check your credit report annually to spot inaccuracies and detect identity theft problems. Note this does not always improve one's score but can eliminate a source of temptation.

DID YOU KNOW?

Universal Default is the industry's name for the practice of raising your interest rate automatically if you're late on any credit card or loan payments. This means that if you are late with a payment on one credit card, the APR on one or more of your other credit cards could increase. In addition, some cards may have tiered rates applying to different purchases. However, payments you make will typically first reduce the amounts tied to the lower rate.