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Focus on Credit Cards

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Focus on Financial Management Series

Unit 6

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Focus on Credit Cards

Credit Card Terms

Americans are addicted to credit cards. The average household has more than seven credit cards, and invitations to sign up for more arrive in the mail every day. However, shopping for the best credit value is more complicated than ever. Not all credit cards are alike. Before selecting a credit card, it is important to understand credit card terms. You will want to compare the costs of similar cards to get the features you want and the best credit card value.

Annual percentage rate — The annual percentage rate, or APR, is the interest the card issuer charges on the unpaid balance of the credit cards.

Annual fees — Many credit card issuers charge annual membership fees; however, cards with no annual fees are available.

Grace period — The length of time you have to pay your bill before interest is charged on the purchases.

Finance charge — The total dollar amount paid to use a credit card, including interest costs, service charges, and transaction fees.

Transaction fees and other charges — Credit card issuers may charge other fees, such as for using the card to obtain a cash advance, failing to make a payment on time, or going over your credit limit. Carefully read the disclosure statement you receive when you apply for the card to see what service fees may be charged.

Schumer box — The detailed information described on the back of credit card applications.

Choosing the Best Interest Rate

Choosing a credit card with the lowest interest rate can save you money, if you carry a balance. The 2001 Survey of Consumer Finances by the Federal Reserve Board reported that 48 percent of families carry an outstanding balance on some type of credit card, and the median balance for these families was $1,900 on all cards. The Illinois Treasurer's Office reported that in 2004, households that had at least one credit card had an average of 7.6 cards.

Understanding the Finance Charge

If you expect to carry a balance on your credit card account, it is important to know how the card issuer will calculate your finance charge. The method used can make a big difference in how much finance charge you will pay, even when the APR is identical to that charged by another card issuer and the pattern of purchases and payments is the same.

- **Average Daily Balance —** Finance charges are based on the sum of the outstanding balances owed each day during the billing period, divided by the number of days in the period. The periodic rate (the APR divided by 12) is applied against that balance. However, the average daily balance can exclude new purchases, include new purchases with a grace period, or include new purchases with no grace period. How the average daily balance is calculated dramatically affects finance charges.
- **Adjusted balance —** Finance charges are computed by subtracting any payments you made and any credits you received during the present billing cycle from the balance you owed at the end of the previous billing cycle. New purchases are not included. You have until the end of the billing period to pay all or part of your balance, and you avoid interest charges on that portion. This method is usually most advantageous to cardholders.
- **Previous Balance –** Finance charges are figured on the balance you owe at the beginning of the billing cycle, without taking into account payments made during the current cycle.
- **Two-Cycle Balance —** This method uses the total of the average daily balances for two billing cycles even if you paid the balance off the previous month. To avoid finance charges, you must pay off your balance for at least two months in a row. Check with your credit card issuer for details.

Calculate the Finance Charges

Use the table below to compare the terms offered on three credit cards you now have or three offers you have gotten in the mail. Read the disclosure statement to find this information and then write it in the table below.

Average monthly balance you carry on card _______________ x the monthly periodic rate of _______________ = interest paid x 12 months = _______________ + annual fee of _______________ = Total yearly cost of _______________.

(If you get cash advances, pay late, or go over your credit limit, add these transaction fees to your total.)

Example: Average monthly balance of $1,500 x periodic rate of 1.6% ($1,500x.016) = interest paid $24.00 x 12 months = $288 + annual fee of $20 = Total yearly cost of $308

Issuer	APR	Grace period without balance	Grace period with balance	Annual fee	Minimum finance charge	Method of computing finance charge	Transaction fees
Any bank	19.2	25 days	None	$20.00	$3.75	Average daily balance	$10.00

The chart below compares different methods of figuring finance charges. In the example, the APR is 18% a year, or 1.5% a month. Using the various methods, the finance charge could be as little as $1.50 or as much as $6.00.

Finance Charge Method	APR	Previous Balance	New Purchases	Payment	Average Daily Balance	Finance Charges
Average Daily Balance (with new purchases)	18%	$400	$50 on 19th of month	$300 on 15th of month	$270	$4.05 *
Average Daily Balance (without new purchases)	18%	$400	$50 on 19th of month	$300 on 15th of month	$250	$3.75 **
Adjusted Balance	18%	$400	Not applicable	$300	Not applicable	$1.50 ***
Previous Balance	18%	$400	Not applicable	$300	Not applicable	$6.00 ****

* [($400 x 15 days) + ($100 x 3 days) + ($150 x 12 days)] divided by 30 days = $270 x 1.5% = $4.05
** [($400 x 15 days) + ($100 x 15 days)] divided by 30 days = $250 x 1.5% = $3.75
*** $400 - $300 = $100 x 1.5% = $1.50
**** $400 x 1.5% = $6.00

Deciding How Many Credit Cards You Need

A credit card has become a very common way for a family to pay for items it needs or wants. How many cards do you have?

You may get offers in the mail asking if you want more credit cards. These offers often say that you are "pre-approved" for the card. They urge you to accept quickly "before the offer expires." Decide if you really need another credit card before you accept an offer.

You may be tempted to overspend if you have too many cards. You may find it more difficult to keep track of purchases you have made and how much money you have spent when you have several credit cards.

Creditors may also look at you as a poor credit risk because of the amount of credit you have available. Although you may not carry large balances, you have the potential to run up large amounts of debt. The more cards you have, the less eager creditors may be to give you more credit.

Choosing the Best Credit Card(s)

Terms differ among credit card issuers, so shop around for the card that is best for your spending and repayment habits. Which credit card is best may depend on how you plan to use it. If you plan to pay bills in full each month, the size of the annual fee or other fees may be more important than the annual percentage rate and balance computation method. If, however, you expect to carry a monthly balance on your credit card purchases, the APR and the balance computation method are very important terms to consider.

Once you have selected a credit card, keep abreast of changes that are announced either as enclosures with your bills or as a separate mailing. These announcements are not “junk” mail. Terms and conditions may change so much that you decide it is time to shop for a different credit card.

Deciding How Much Credit Is Too Much

Most of us use credit, yet too much credit can lead to problems. Worksheet 20 will help you decide if you are using too much credit.

Using the chart below, add all your debts, but do not count your mortgage or your rent. List all auto loans, school loans, and personal loans plus the credit card balances you usually carry from month to month. Next, enter your average monthly payment for each loan and the amount you usually pay each month on your credit card balances.

List of All Loans and Credit Cards	**Average Monthly Balance**	**Average Monthly Payment**
	$	$
	$	$
	$	$
	$	$
Total monthly debt payments	$	$

Find Your Debt-to-Income Ratio

Your debt-to-income ratio (DTI) is a number that determines whether you have enough income to meet your monthly financial obligations, including the mortgage payment, and still have enough money left to live on. You can use this calculation to find out if you have the capacity to take on a new loan. When applying for a mortgage, the Fannie Mae federal guideline standard states that your DTI should not exceed 36 percent.

Your monthly housing payment, comprised of your mortgage plus property tax and insurance, is added to your other monthly debts such as your credit cards, car loans, student loans, etc. To find your debt-to-income ratio, divide this sum by your gross monthly income.

As an example, if your mortgage payment is $1,000 and you have $500 per month in other debts, your debt load would be $1,500 per month. With a gross monthly income of $4,500, your DTI ratio would be 33 percent ($1,500/$4,500 = .33).

Find Your Debt Ratio

Your debt ratio is the percentage of your take-home pay that is used to pay your debts (do not include your mortgage or rent). To calculate your debt ratio, divide your total monthly debt payment by your monthly take-home pay.

Example: If your total monthly debt payment is $200 and your monthly take-home pay is $1,200, what is your debt ratio?

$200/$1,200 = 16.6%

1) What is your total monthly debt payment $______________

2) What is your monthly take-home pay? $______________

3) What is your debt ratio? ______________%

Look at Your Debt Ratio: How Are You Doing?

- 10 percent or less — Congratulations! You are in the safe limit and probably feel little debt pressure.
- 11 to 15 percent — You may feel some debt pressure and reduced financial flexibility. Be cautious about taking on more debt.
- 16 to 20 percent — You are probably hoping that no emergency arises. Start working on reducing your debt. Your debt-to-income ratio is considered fully extended.
- 21 to 25 percent — You are probably worrying. ALERT! It is time for a dramatic change. You may need help from a credit counselor.
- 26 percent or more — You definitely have more credit than you can handle. You need professional help immediately to reduce your debt.

Getting Rid of Credit Card Debt

To get rid of your debt, you need to plan how you want to do it. First, gather your credit card information and complete the chart below.

Credit Card	Account Number	Amount Owed	Minimum Payment	Interest Rate

Which debt will you pay first? Choose strategies to help get rid of your debt. Once you have a plan, you are on the way to reducing your debt.

Choose Strategies to Cut Your Debts as Soon as Possible

Study your list of debts. Then look over the following strategies to reduce debt. Make a repayment plan using one or more of these ideas.

- **Pay high-rate cards first —** At higher interest rates, more of your monthly payments go toward finance charges. Quickly paying off balances on your credit cards with high rates can free up cash to pay other bills.

OR

- **Pay off cards with the smallest balances first —** Paying off cards with small balances gives you extra money to pay on the bigger balances.
- **Stop making new charges —** If you have to, cut up your cards, hide them, lock them in a drawer, or freeze them in water in a plastic bag.
- **Stay flexible —** The key to sticking to your credit card debt repayment plan is to stay flexible. If you find that you set unrealistic spending limits in the beginning, revise your spending plan the next month.

- **Get a cheaper credit card —** Find one or two low-rate cards and cancel all the others. Switching from a high-rate credit card to a low-rate card can easily save you $200 or more a year.
- **"Power Pay" your accounts —** Calculate using "Power Pay," a computer program available from the Cooperative Extension Service.

Checking Your Credit Report

Credit enables consumers to buy millions of dollars worth of goods every day. It gives you the ability to finance real estate and "big-ticket" consumer durables. You can get credit precisely because credit grantors can identify which consumers are likely to pay their bills. They do so by obtaining the payment histories of individuals from credit reporting agencies. Credit reporting agencies collect and report personal credit histories and debt repayment practices to their subscribers — mostly businesses and banks.

There are three major credit-reporting agencies: Equifax, TransUnion, and Experian. These agencies cover all 50 states, are highly computerized, and have millions of files and millions of subscribers paying a monthly fee for this information. Credit bureaus are smaller versions of credit-reporting agencies, usually operating within a single state or multi-county area.

Credit-reporting agencies do not make the decision to grant credit; only the lender can do that. Different lenders may make different decisions based on the same information. What is different is the importance they give to specific factors — for example, how long you have lived at the same address, what you do for a living, how much you earn, how much you owe, how promptly you pay your debts, and how long you have used a credit card.

Review Your Credit Report

Order a copy of your credit report from one of the three main credit-reporting agencies using a form similar to the "Credit Report Request" that appears later in this chapter or by phone or e-mail. The cost varies from nothing to about $10, depending on the company and your situation.

If you have been turned down because of negative credit information within the last 60 days, the report should be free. You can also get a free credit report if you are unemployed, getting public assistance, or a victim of identity theft.

You have the right under federal law to request your credit report and to ask the credit-reporting agency to correct any incomplete or inaccurate information at no charge.

A federal law that took effect in late 2004 entitles consumers to one free report each year from each of the three nationwide credit-reporting agencies. To order your free report, do not contact the companies individually. They are only providing free annual credit reports through one central Web site, toll-free telephone number, and mailing address.

To order, go to www.annualcreditreport.com, call 877-322-8228, or complete the Annual Credit Report Request Form and mail it to: Annual Credit Report Request Service, P.O. Box 105281, Atlanta, GA 30348-5281. You can also print the request form from www.ftc.gov/credit.

Credit Report Request

Date: ________________________

Please send a copy of my credit report.

Following is the information you will need:

Full name, including Sr., Jr., III (print): ________________________________

Social Security number: ____

Birth date: ____

Spouse's full name, if married: ______________________________________

Spouse's Social Security number: ____________________________________

Spouse's birth date: ____

Current address: ____

____

____

Previous address(es) in the last five years:

____

____

____

____

Signature

Check one:

_______ Payment enclosed.

_______ Because of information obtained from my credit file, I have been denied credit within the past 60 days.

_______ I am a victim of identity theft, on welfare, or unemployed.

Credit-Reporting Agencies

Equifax
Information Service Center
PO Box 740241
Atlanta, GA 30374-0241
1-800-685-1111 or 1-800-997-2493
http://www.equifax.com

TransUnion
Consumer Disclosure Center
PO Box 1000
Chester, PA 19022
1-800-888-4213 or 1-800-916-8800
http://www.transunion.com

Experian
Consumer Assistance Center
PO Box 2104
Allen, TX 75013-2104
1-888-397-3742
http://www.experian.com

Fixing a Poor Credit Rating

You do not have to be a spendthrift to reach "debt overload." Job loss, unexpected medical bills, divorce, or money management mistakes can all cause problems with credit. Losing control of your debts is easier than regaining it. Here are steps you can take to re-establish your credit no matter what the reason for your credit problems.

Find Out Where You Stand

- First, admit you are in trouble.
- Second, develop a current financial statement.
- Third, contact at least one credit-reporting agency to get a copy of your latest credit report.

Make a Plan

When you get your report, check for mistakes. If there are errors, write the credit-reporting agency. State the error and ask for an investigation. The credit-reporting agency legally has 30 days to investigate and correct the information. If the negative information included in your report is accurate, only the passage of time can assure its removal. Generally, negative information stays on a report for seven years. Bankruptcy information stays on a report for 10 years. If there is an unresolved dispute with a creditor, you have the right to explain in a statement that will go on your credit report.

Some agencies advertise they can repair a bad credit report. Watch out! The only person who can repair your credit report is you!

Talk to current lenders about working out a plan that will make it easier to pay your debts. Contact them as soon as you run into financial problems. If you have paid your bills regularly in the past, most creditors will want to work with you. Most creditors would rather get a partial payment every month than take you to court or force you to file for bankruptcy. If you need help working out a repayment plan with creditors, the National Foundation for Credit Counseling can help. The nationwide assistance number is 800-313-2227. In Indiana, contact the Consumer Credit Counseling Service, 800-432-0420. Both organizations can give you the phone number for the office nearest you.

While you are repaying your debts, do not take on any more!

Starting Over

You are ready to start over once you have paid off your debts. First, make sure your credit record is up-to-date. Check that the payments you are making on time are reported to credit-reporting agencies.

Another way to show that you are creditworthy is to responsibly use a secured credit card. A secured card looks like and can be used just like a regular credit card. To get a secured credit card, you must deposit money into a savings account as collateral. Generally, the credit limit on the secured card will be 50 percent to 100 percent of the money you deposit. You should earn interest on the money deposited, although a secured card may have an application fee as well as an annual service charge. You will pay interest on any unpaid balances. If you fall behind on your payments, the credit card company can take what you owe out of the savings account.

To apply for a secured credit card, check with your local bank or credit union. When you get the card, be sure the bank or credit union reports your use of the card to credit bureaus to prove you can pay your bills on time.

Once you start using credit again, be sure to manage it well. Learn how to shop for credit and how to read credit contracts. When used wisely, credit is a tool that can help you realize your financial goals.

Adapted from *Fixing a Poor Credit Rating* by Barbara R. Rowe, Purdue Extension, Consumer and Family Sciences, 1997.

Credit Card Action Box

- Calculate your debt ratio.
- Review all your credit cards and their terms.
- Obtain, review, and correct (if necessary) your credit report.

Worksheet 20: How Healthy Is Your Credit?

Read each statement. Place a check in front of those statements that apply to you.

	Credit Habits
	1. Using credit for items that used to be purchased with cash.
	2. Getting a loan to pay existing debt.
	3. Charging more each month than you make in payments.
	4. Making only the minimum required payment.
	5. Juggling rent or mortgage and other large bills to pay debts.
	6. Rotating bills: paying half one month and half the next.
	7. Using a checking account overdraft feature to pay bills.
	8. Using credit card advances to pay living expenses.
	9. Writing post-dated checks.
	10. Taking out a new loan before an old one is repaid, such as a second or third mortgage or more than one debt-consolidation loan.
	11. Being chronically overdrawn at the bank.
	12. Borrowing frequently from friends and relatives to make ends meet.
	13. Using savings to pay bills that used to be paid by cash or check.
	14. Depending on overtime or moonlighting to make ends meet.
	15. Borrowing against life insurance with little chance of repayment.
	16. Being at or near maximum credit limits.
	17. Being chronically late paying bills.
	18. Increasing the percentage of take-home pay spent on consumer debt.
	19. Having late penalties assessed on outstanding obligations.
	20. Receiving calls or overdue notices from creditors.
	21. Receiving threats of repossession or legal actions.
	22. Accumulating negative information on your credit report.
	23. Being denied credit due to negative remarks on a credit report.
	24. Hiding credit-card statements and bills from others.
	25. Worrying excessively about money and financial distress.

Count the number of credit habits you checked, then calculate your "credit health" according to the following scale:

1-2	You probably have healthy credit.
3-5	Your credit health is threatened. You need to make an effort to improve your credit habits.
6 or more	Your credit health is unhealthy! Make changes now, so your credit is not ruined.

Source: *Saving on a Shoestring* by Barbara O'Neil, CFP, 1995, page 125-127

Focus on Financial Management

Resources

Unit 6: Focus on Credit Cards

1) American Consumer Credit Counseling, Inc.
130 Rumford Avenue, Suite 202
Newton, MA 02466-1316
800-769-3571
http://www.consumercredit.com/cardstats.htm

2) Garman, E T, and Forgue R. E.
Personal Finance, 2000
Boston, MA: Houghton Mifflin Co

3) Johnson, A. C.
The Financial Checkup, 2000
Providence, UT: Watkins Printing

4) National Foundation for Consumer Credit
8611 2nd Avenue
Silver Spring, MD 20910
800-388-2227
http://www.nfcc.org

5) Power Pay
http://extension.usu.edu/cooperative/powerpay/
Dean Miner
(801) 851-8469
powerpay@ext.usu.edu

6) *Selecting a Credit Card, MontGuide Fact Sheet #199802*
Human Resources
Montana State University Extension Service
Bonzeman, MT 59717, (406) 994-1752
http://www.montana.edu/wwwpb/pubs/mt9802.html

7) *Shopping for Credit: Comparing Credit Costs*, CFS-617
Purdue University Cooperative Extension Service
West Lafayette, IN 47907
888-EXT-INFO

8) *To Your Credit fact sheets 1-10*, 2001
Purdue University Cooperative Extension Service
West Lafayette, IN 47907
888-EXT-INFO
http://www.ces.purdue.edu/extmedia/cfs.htm#1

Materials available in the *Focus on Financial Management* series

Focus on Financial Management Workbook, CFS-727 ($25)

This printed workbook contains eight chapters designed to help middle-income adults increase their financial management knowledge. It is designed either for self-directed study or for participants who enroll in a *Focus on Financial Management* program. The workbook contains 24 worksheets to help participants conduct self-assessments and compile appropriate records.

Focus on Financial Management Coordinator's Guide, CFS-726 ($75)

This package contains the Coordinator's Guide and Workbook in print and on a CD so that a coordinator can present the eight 2½-hour sessions. The program coordinator is expected to organize and present the sessions and provide materials to the participants. The CD is available separately (CD-CFS-726) for $50.

Order online at www.extension.purdue.edu/store
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or by telephone to (765) 494-6794 or 888-EXT-INFO (398-4636)
or by fax to (765) 496-1540
or by postal mail to:

Purdue Extension • The Education Store
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West Lafayette, IN 47907-2094

The following individual chapters of the workbook are available free online.

- CFS-727-1-W, Unit 1: Focus on Getting Organized
  www.extension.purdue.edu/extmedia/CFS/CFS-727-1-W.pdf
- CFS-727-2-W, Unit 2: Focus on Money Personalities
  www.extension.purdue.edu/extmedia/CFS/CFS-727-2-W.pdf
- CFS-727-3-W, Unit 3: Focus on Your Net Worth
  www.extension.purdue.edu/extmedia/CFS/CFS-727-3-W.pdf
- CFS-727-4-W, Unit 4: Focus on Risk Management
  www.extension.purdue.edu/extmedia/CFS/CFS-727-4-W.pdf
- CFS-727-5-W, Unit 5: Focus on Savings and Investments
  www.extension.purdue.edu/extmedia/CFS/CFS-727-5-W.pdf
- CFS-727-6-W, Unit 6: Focus on Credit Cards
  www.extension.purdue.edu/extmedia/CFS/CFS-727-6-W.pdf
- CFS-727-7-W, Unit 7: Focus on Life's Challenges
  www.extension.purdue.edu/extmedia/CFS/CFS-727-7-W.pdf
- CFS-727-8-W, Unit 8: Focus on Retirement
  www.extension.purdue.edu/extmedia/CFS/CFS-727-8-W.pdf

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