Credit Cards

and Your Credit Score

Me,
Myself,
My Money

CTCPA

Credit Cards *and Your Credit Score*

Learning Objectives

Lesson 1

Selecting a Credit Card: The Devil's in the Detail

- Identify and explain the costs and terms of using a credit card.
- Compare and contrast the costs and terms of different credit cards.

Lesson 2

The Cost of Credit: Behind the Numbers

- Calculate the finance charge and the monthly balance for a credit card purchase.
- Determine the interest paid and the total amount paid for a purchase made using a credit card.

Lesson 3

Credit Scores: What's the Score?

- Identify the factors used to determine a credit score.
- Identify ways to improve your credit score.
- Identify the benefits of a good credit score.

Learning Standards (grades 9-12)

Business

Connecticut Department of Education

Business and Finance Technology – Business Management
- Identify factors that affect the choice of credit, the cost of credit, and the legal aspects of using credit.

Cooperative Work Education
- Compare and contrast strategies for personal finance and risk management.

National Business Education Association

Economics & Personal Finance – Using Credit
- Identify methods of establishing and maintaining a good credit rating.
- Describe the risks and responsibilities associated with using credit.
- Determine advantages and disadvantages of credit.
- Define interest as a cost of credit and explain why it is charged.
- Analyze credit card features and their impact on personal financial planning.
- Explain the need for a sound credit rating.
- Compare and contrast the various aspects of credit cards.
- Explain credit ratings and credit reports and describe why they are important to consumers.
- Describe the relationship between a credit rating and the cost of credit.
- Identify the components listed on a credit report and explain how that information is used and how it is received by and reported from the credit reporting agencies.

Economics & Personal Finance – Personal Decision Making
- Differentiate between types of decisions and identify those for which a formal decision-making process should be used.

Computation – Credit Management
- Solve for interest using the formula I=PRT, where P=principal, R=interest rate, and T=time, and determine the finance charges.
- Calculate a credit card balance and finance charge using the unpaid balance method or the average-daily balance method.
- Calculate finance charges on credit card balances and cash advances.

Computation – Number Relationships and Operations
- Solve problems that involve whole numbers, decimals, and fractions, and use appropriate conversions.
- Solve problems that involve percents, ratios, averages, and proportions and use appropriate.

Selecting a Credit Card:
The Devil's in the Detail

Credit cards are issued by banks and other financial institutions and allow the cardholder to make purchases "on credit" up to a maximum amount called your credit limit. In addition, the cardholder can receive a cash advance with a credit card. A cash advance is similar to a loan.

When a purchase is made or a cash advance is acquired with a credit card, the cardholder will receive a monthly statement for the amount of the purchase or the cash advance. The cardholder can pay the entire amount in full or make a partial payment. If a partial payment is made, the card-holder is charged interest on the remaining balance.

Not all credit cards are the same. Before applying for a credit card, you should compare the terms and conditions of the card. For instance, you should compare the annual percentage rate, grace periods, finance charges, required minimum payments, annual fees, and other charges.

Annual Percentage Rate (APR)
The Annual Percentage Rate is the percent (interest rate) used to calculate the finance charge on the unpaid balance. Some credit cards offer low introductory APRs that increase after a period of time.

It is important to note that the APR on purchases and cash advances may differ. In addition, if you fail to pay by the due date or are late making another payment, such as a payment on another credit card or a car payment, the credit card company can increase the APR.

Finance Charge
Credit card companies charge interest (called a finance charge) on the unpaid credit card balance. The finance charge is based on the outstanding balance and the APR. The balance used to calculate the finance charge can be determined in a number of ways, so it's important to understand the method used. One commonly used method is the average daily balance. Finance charges can be avoided by paying the full amount by the due date.

Minimum Payment
Credit card companies require a minimum payment each month. The minimum payment is a stated amount, such as $10 or $20, or a percentage of the balance due.

Grace Period and Late Fees
The grace period is the number of days you have to pay the balance or the minimum amount due. If your payment is late, the credit card company will charge you a late fee. In addition, the credit card company can also increase your APR.

Other Fees
Credit cards also include annual fees for using the card, fees for cash advances, and fees for exceeding the credit limit.

In order to compare credit card offers, you should refer to the "Schumer Box." Named after United States Senator Charles Schumer (New York), the Schumer Box contains all the terms and conditions of the credit card, including:

- Annual fee (if applicable)
- Annual Percentage Rate (APR) for purchases
- Other APRs (balance transfers, cash advances, default APRs)
- Grace periods
- Method used to calculate finance charges
- Minimum payments
- Other transaction fees (such as balance transfers, cash advances, late payments, going over the credit limit)

Presented below is a sample Schumer box.

Annual Percentage Rate (APR) for Purchases	2.9% introductory rate for purchases during the first six months of card membership. Then 13.99%.
Other APRs	Balance Transfers: 2.90% during the first six months of card membership on BT requests submitted with this application. Then 13.99%. Cash advance APR: 18.99%. APR of 25.99% for defaulted accounts.
Grace Period for Repayment of the Balance of Purchases	20 days for purchases, if full balance is paid by due date.
Method of Computing the Balance for Purchases	Average daily balance (including new purchases).
Annual Fee: NONE	Minimum Finance Charge: $.50

Other Fees: Late Payment Fee: $15 on balances less than $100, $29 on balances of $100 to $1,000, and $35 on balances greater than $1,000. Overlimit Fee: $35. Fee for Cash Advances: 3% of each transaction, $5 minimum and no maximum. Fee for Balance Transfers: 3% of each balance transfer, $5 minimum and $50 maximum.

Activity 1: Knowing the Numbers

Refer to the Schumer Box above, and answer the following questions.

1. What is the introductory APR and how long is it in effect?
2. What is the APR on purchases once the introductory rate expires?
3. What is the APR on cash advances?
4. What is the APR if you default on an account?
5. What is the grace period?
6. What is the fee for late payments?
7. What is the method for determining the balance for purchases?
8. What is the fee for exceeding the limit on the credit card?
9. What is the fee for cash advances?
10. What is the fee for balance transfers?

Activity 2: Alphabet Soup

Presented below are terms contained within a Schumer Box. Describe the meaning of each term.

Annual Percentage Rate	
Grace Period	
Finance Charge	
Minimum Payment	
Balance Calculation Method	
Annual Fees	
Transaction Fees for Cash Advances	
Late-Payment Fees	

Activity 3: Pick a Card!

Select two credit card offers and locate the Schumer Box for each offer. Using the information from the Schumer Box, complete the table below and determine the offer that is best for you.

	Credit Card Name:	**Credit Card Name:**
Annual Percentage Rates (APR)		
Introductory Offer		
On Purchases		
On Cash Advances		
On Balance Transfers		
Default Rate		
Grace Period		
Minimum Finance Charge		
Balance Calculation Method		
Minimum Payment		
Annual Fees		
Transaction Fees for Cash Advances		
Late-Payment Fees Other Fees		

The Cost of Credit:
Behind the Numbers

The cost of credit is the finance charge incurred on the unpaid balance. The finance charge is based on the APR and the outstanding balance. However, credit card companies can calculate the outstanding balance in a number of ways. For example, the outstanding balance can be an average daily balance of the amount due or the previous month's balance.

Activity 1: Balancing Act

Joe has a credit card, and his balance on March 31st was $300.

On April 6th he made a purchase and charged $200 to his credit card.

On April 16th, Joe made a payment of $400 to reduce his balance.

However, on April 21st, he charged another $1,000 to his credit card.

Joe's credit card company uses an APR of 24% on purchases and the average daily balance method to calculate finance charges.

1. What is average daily balance for April?

2. What is the monthly interest rate?

3. What is the finance charge for April?

Credit Card Tips

Some experts suggest spending no more than 15-20% of your income (after taxes) on credit purchases.

Credit card myth: Paying just the minimum balance each month is okay.

Tips for using credit cards wisely:

- Pay the balance in full at the end of each month.
- If you cannot pay the full amount, pay more than the minimum balance due.
- Prepare a budget and keep accurate records of purchases and payments.
- Negotiate with the bank for a lower interest rate, or transfer the balance to a credit card with a lower interest rate.
- Don't take on debt you cannot afford.
- Don't spend to your credit limit if you cannot afford to.
- Stop making purchases using credit – pay with cash!

When are credit card purchases good?

- As a safe substitute for cash.
- When placing orders by phone or internet.
- As a means of identification.
- When accurate records are needed.

Warning Signs of Credit Card Problems

- You can only pay the minimum amount due on your credit cards.
- You have skipped credit card payments or have been late with payments.
- You receive past due notices and are charged late fees.
- Most of your credit cards are at the credit limit.
- You use cash advances on one credit card to pay balances on another card or pay bills.

Activity 2: The Cost of Credit

Abby goes on a back-to-school shopping spree using her new credit card and spends a total of $675. She receives her first credit card statement in September and decides to pay only the minimum amount due, which is $50.

Every month she receives a new statement and continues to pay only the minimum amount due.

Assume that Abby doesn't make any additional purchases, her credit card company charges an APR of 18%, and finance charges are based on the previous month's balance.

1. What is the monthly interest rate?
2. How is the monthly finance charge calculated?
3. What is the total amount Abby will actually pay?
4. What is the total amount of interest Abby will pay?

Statement Date	Previous Balance	New Charges	Finance Charges	Payments	New Balance
September	$0.00	$675.00	$0.00	$50.00	$625.00
October	$625.00				
November					
December					
January					
February					
March					
April					
May					
June					
July					
August					
September					
November					
December					
Total					

Activity 3: Interest Adds Up!

To celebrate the new year, Kristen went shopping and charged $1,000 on her new credit card.

Kristen receives her credit card statement at the end of every month and has decided to pay only the minimum amount due each month, which is $20.

Assume that Kristen doesn't make any additional purchases, her credit card company charges an APR of 21%, finance charges are based on the previous month's balance, and she receives her first statement in January.

Use an Excel spreadsheet to determine the following:

1. The number of years and months it will take Kristen to pay the balance.
2. The amount of interest Kristen will pay.
3. The total amount Kristen will actually pay for her purchases.

Credit Scores: What's the Score?

A credit score is a number that helps lenders determine how likely you are to make your payments on time. A credit score affects whether you can obtain credit and the interest rate on credit cards, auto loans, mortgages, and other loans and credit. The higher your credit score, the more likely you are to be approved for credit and pay a lower interest rate. Credit scores can even affect whether you'll be able to rent an apartment—without a good credit score, a landlord may turn down your application.

Your score is based on information in your credit report. The most widely used credit score is the FICO score, which was developed by the Fair Issac Corporation. Your FICO score is based on five factors:

1. Your payment history

Payment history is information about late payments. Late payments, bankruptcies, and other financial problems will hurt your credit score. A history of making payments on time will help your score. Your payment history is 35% of your FICO score.

2. The amounts you owe

This includes the amounts you owe on all your accounts, the number of accounts that have a balance, and how much of your credit you are using. The less you owe compared to the total credit you have, the better your score will be. This factor is 30% of your FICO score.

3. Your credit history

In general, a longer credit history will improve your FICO score. Your credit history is 15% of your FICO score.

4. New credit

New credit refers to the number of times you have applied for or opened new accounts, i.e., credit cards, and loans. If you continuously apply for credit, you will lower your score. If you apply for credit only when you need it, you will improve your credit score. This factor is 10% of your FICO score.

5. Other factors

The overall mix of credit you have, such as credit cards, retail accounts, auto loans and mortgages is also a factor. It's normal to have various types of credit cards and loans, so if you have a long history of good credit, your score will increase. This factor is 10% of your FICO score.

FICO scores range from 300 to 850 and there is no cutoff score for a "good" or "bad" score. However, most lenders consider a score of 750 or better to be "excellent." Scores around 700 are considered "good" while scores around 650 are considered "fair" and scores of 600 or lower are considered "poor."

You can obtain one free copy of your credit report a year. To request your credit report, contact the Annual Credit Report Request Service at www.annualcreditreport.com.

The three credit reporting agencies that compile credit reports are Equifax (www.equifax.com), Experian (www.experian.com), and TransUnion (www.transunion.com). If you find an error in your report, you can report the error to a credit reporting agency and the agency must investigate and respond to you within 30 days.

Activity 1: Increase Your Score

Lenders look at credit scores all the time and there are ways to improve your score.
Select from the list below the ways you can improve your score.

- ❒ Pay your bills on time.
- ❒ Keep your credit card balances low.
- ❒ Pay off debt and credit card balances.
- ❒ Move credit card balances from one card to another.
- ❒ Apply for and open new credit card accounts only when you need them.
- ❒ Check your credit report regularly and correct any errors.
- ❒ If you miss a payment, make the payment as soon as possible.
- ❒ Establish and maintain a long history of good credit.

Activity 2: What Can Your Score Do for You?

Your credit score is a number that helps lenders determine whether you will make your payments on time. In addition, your score can determine whether you get credit and how much you will pay for a credit card or a loan.

So, by improving your credit score, you can (check all that are true):

- ❒ Lower your interest rates.
- ❒ Receive better credit card offers.
- ❒ Speed up credit approvals.
- ❒ Receive better auto loans.
- ❒ Increase your chance of getting approved to rent an apartment.
- ❒ Receive a lower interest rate on mortgages.

Did you Know?

Students

- 76% of undergraduates have credit cards and the average undergrad has $2,200 in credit card debt.
- 21% of undergraduates with credit cards reported that they pay off all cards each month; 44% say they make more than the minimum payment but generally carry a balance; 11% say they make less than the minimum required payment each month.
- Undergraduates reported that the number one use of credit cards is for school supplies (paper, notebooks, etc.). The second most common usage of credit cards was a tie between textbooks and food.

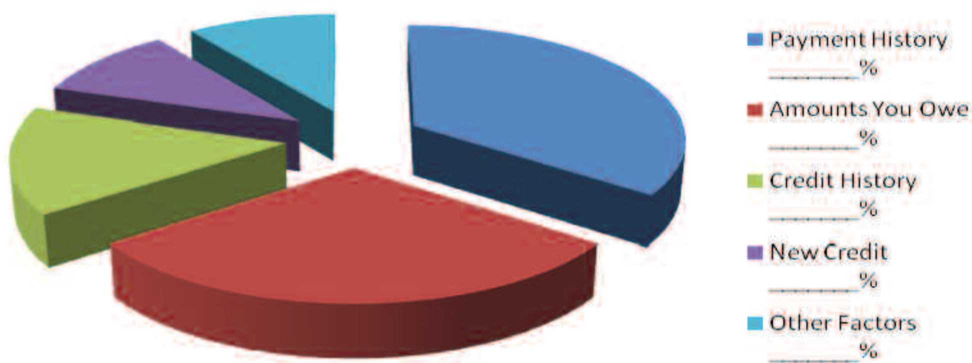
American Population

- The average young adult household now spends nearly 24 percent of its income on debt payments.
- Young Americans now have the second highest rate of bankruptcy, just after those aged 35 to 44.
- Total U.S. consumer revolving debt reached $976 billion in October 2008. About 98 percent of that debt was credit card debt.
- The total amount of consumer debt in the United States is nearly $2.6 trillion dollars, or $8,500 per person.
- It's estimated that Americans will carry $1 trillion in credit card debt by the year 2010, or $6,200 per person.
- The average late fee is $26 but can be as high as $39.

Activity 3: What's in a Number?

Your FICO score is based on five factors: your payment history, the amounts you owe, your credit history, new credit lines you apply for or open, and a mix of other financial and credit factors.

For each factor, indicate the percent it represents in your FICO score.



Activity 4: Know Your Score

Although there is no true definition of a "good" or "bad" FICO score, lenders consider some scores better than others.

Which FICO score is considered "excellent" ?
a. 750
b. 700
c. 650
d. 600

Which FICO score is considered "poor" ?
a. 750
b. 700
c. 650
d. 600

What is the highest FICO score? ____________

What is the lowest FICO score? ____________

Instructor's Solutions

Lesson 1, Activity 1: Knowing the Numbers

Refer to the Schumer Box above, and answer the following questions.

1. What is the introductory APR and how long is it in effect? **2.9%; 6 months**
2. What is the APR on purchases once the introductory rate expires? **13.99%**
3. What is the APR on cash advances? **18.99%**
4. What is the APR if you default on an account? **25.99%**
5. What is the grace period? **20 days**
6. What is the fee for late payments? **$15 on balances less than $100, $29 on balances of $100 to $1,000, and $35 on balances greater than $1,000**
7. What is the method for determining the balance for purchases? **Average daily balance**
8. What is the fee for exceeding the limit on the credit card? **$35**
9. What is the fee for cash advances? **3% of the amount, with a minimum of $5.00**
10. What is the fee for balance transfers? **3% of the amount transferred, with a $5 minimum and a $50 maximum**

Lesson 1, Activity 2: Alphabet Soup

Presented below are terms contained within a Schumer Box. Describe the meaning of each term.

Annual Percentage Rate	**Interest rate (%) used to calculate a finance charge on the unpaid balance.**
Grace Period	**Number of days until a payment is due.**
Minimum Finance Charge	**The cost of using credit; the interest charged on the unpaid balance.**
Minimum Payment	**The minimum amount due each month if you have an outstanding balance.**
Balance Calculation Method	**Method used to determine balance when calculating the finance charge.**
Annual Fees	**Yearly charge for owning the credit card.**
Transaction Fees for Cash Advances	**Fee charged for obtaining a cash advance.**
Late-Payment Fees	**Penalty or fee for payments not made by the due date.**

Lesson 1, Activity 3: Pick a Card!

Select two credit card offers and locate the Schumer Box for each offer. Using the information from the Schumer Box, complete the table below and determine the offer that is best for you. **Responses will vary.**

	Credit Card Name:	**Credit Card Name:**
Annual Percentage Rates (APR)		
Introductory Offer		
On Purchases		
On Cash Advances		
On Balance Transfers		
Default Rate		
Grace Period		
Minimum Finance Charge		
Balance Calculation Method		
Minimum Payment		
Annual Fees		
Transaction Fees for Cash Advances		
Late-Payment Fees		
Other Fees		

Lesson 2, Activity 1: Balancing Act

Joe has a credit card, and his balance on March 31st was $300.

On April 6th he made a purchase and charged $200 to his credit card.

On April 16th, Joe made a payment of $400 to reduce his balance.

However, on April 21st, he charged another $1,000 to his credit card.

Joe's credit card company uses an APR of 24% on purchases and the average daily balance method to calculate finance charges.

1. What is average daily balance for April? **$600**
2. What is the monthly interest rate? **2% (24% / 12 months)**
3. What is the finance charge for April? **$12.00 ($600.00 x 2%)**

Balance	Dates	# of Days Balance is Outstanding/ # of Days in April	Average Balance
$300 (1)	April 1 - 5	5	$50.00
$500 (2)	April 6 - 15	10	$166.67
$100 (3)	April 16- 20	5	$16.67
$1,100 (4)	April 21- 30	10	$366.67
			$600.00

(1) $300 balance on March 31
(2) $300 balance on March 31, plus $200 purchase on April 5
(3) $500 balance on April 15, less $400 payment on April 15
(4) $100 balance on April 16, plus $1,000 purchase on April 20

SOLUTIONS

Lesson 2, Activity 2: The Cost of Credit

Abby goes on a back-to-school shopping spree using her new credit card and spends a total of $675. She receives her first credit card statement in September and decides to pay only the minimum amount due, which is $50.

Every month she receives a new statement and continues to pay only the minimum amount due.

Assume that Abby doesn't make any additional purchases, her credit card company charges an APR of 18%, and finance charges are based on the previous month's balance.

1. What is the monthly interest rate? **18% / 12 months = 1.5% (APR / 12 months)**
2. How is the monthly finance charge calculated? **Monthly Interest Rate (1.5%) x Previous Balance**
3. What is the total amount Abby will actually pay? **$747.35**
4. What is the total amount of interest that Abby will pay? **$72.35**

Statement Date	Previous Balance	New Charges	Finance Charges	Payments	New Balance
September	$0.00	$675.00	$0.00	$50.00	$625.00
October	$625.00	$0.00	$9.38	$50.00	$584.38
November	$584.38	$0.00	$8.77	$50.00	$543.15
December	$543.14	$0.00	$8.15	$50.00	$501.30
January	$501.29	$0.00	$7.52	$50.00	$458.82
February	$458.81	$0.00	$6.88	$50.00	$415.70
March	$415.69	$0.00	$6.24	$50.00	$371.94
April	$371.92	$0.00	$5.58	$50.00	$327.52
May	$327.50	$0.00	$4.91	$50.00	$282.43
June	$282.42	$0.00	$4.24	$50.00	$236.67
July	$236.65	$0.00	$3.55	$50.00	$190.22
August	$190.20	$0.00	$2.85	$50.00	$143.07
September	$143.05	$0.00	$2.15	$50.00	$95.22
November	$95.20	$0.00	$1.43	$50.00	$46.63
December	$46.63	$0.00	$0.70	$47.33	-
Total			$72.35	$747.33	

Lesson 2, Activity 3: Interest Adds Up!

To celebrate the new year, Kristen went shopping and charged $1,000 on her new credit card.

Kristen receives her credit card statement at the end of every month and has decided to pay only the minimum amount due each month, which is $20.

Assume that Kristen doesn't make any additional purchases, her credit card company charges an APR of 21%, finance charges are based on the previous month's balance, and she receives her first statement in January.

Use an Excel spreadsheet to determine the following:

1. The number of years and months it will take Kristen to pay the balance. **9 years, and 6 months (114 payments required)**
2. The amount of interest Kristen will pay. **$1,266.22**
3. The total amount Kristen will actually pay for her purchases. **$2,266.22**

Lesson 3, Activity 1: Increase Your Score

Lenders look at credit scores all the time and there are ways to improve your score.
Select from the list below the ways you can improve your score.

- ☑ Pay your bills on time.
- ☑ Keep your credit card balances low.
- ☑ Pay off debt and credit card balances.
- ☐ Move credit card balances from one card to another.
- ☑ Apply for and open new credit card accounts only when you need them.
- ☑ Check your credit report regularly and correct any errors.
- ☑ If you miss a payment, make the payment as soon as possible.
- ☑ Establish and maintain a long history of good credit.

Lesson 3, Activity 2: What Can Your Score Do for You?

Your credit score is a number that helps lenders determine whether you will make your payments on time. In addition, your score can determine whether you get credit and how much you will pay for a credit card or a loan.

So, by improving your credit score, you can: (Check all that are true.)

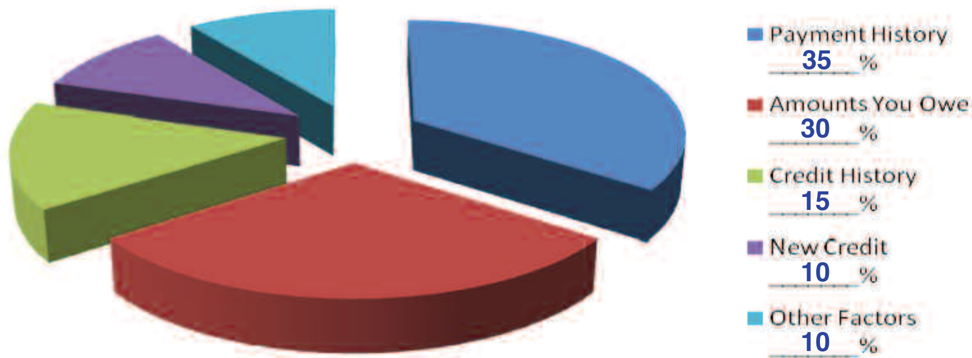
- ☑ Lower your interest rates.
- ☑ Receive better credit card offers.
- ☑ Speed up credit approvals.
- ☑ Receive better auto loans.
- ☑ Increase your chance of getting approved to rent an apartment.
- ☑ Receive a lower interest rate on mortgages.

Solutions

Lesson 3, Activity 3: What's in a Number?

Your FICO score is based on five factors: your payment history, the amounts you owe, your credit history, new credit lines you apply for or open, and a mix of other financial and credit factors.

For each factor, indicate the percent it represents in your FICO score.



Lesson 3, Activity 4: Know Your Score

Although there is no true definition of a "good" or "bad" FICO score, lenders consider some scores better than others.

Which FICO score is considered "excellent" ?
a. 750

Which FICO score is considered "poor" ?
d. 600

What is the highest FICO score? **850**

What is the lowest FICO score? **300**