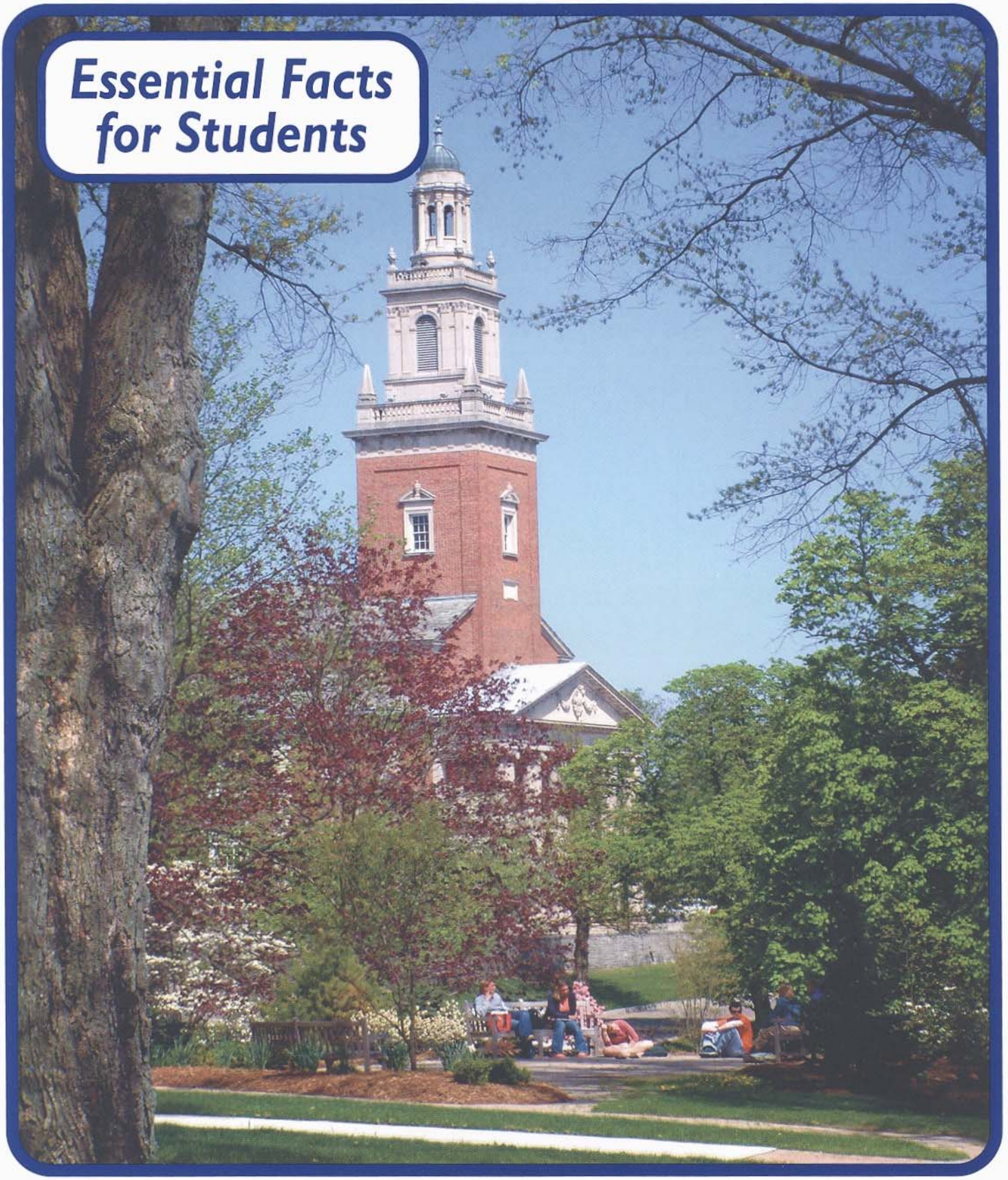
The ABCs of Credit Card Finance



Carol A. Carolan, Ph.D.

2008

HOW LONG AND HOW MUCH DO I HAVE TO PAY?

Use the following chart to find your payoff time and total payoff amount for credit card balances ranging from $500 - $10,000 with APRs from 12% - 20%. Calculations are based on making a minimum monthly payment of 1% of the outstanding balance plus accrued monthly interest or a payment of $20, whichever is greater. This chart assumes discontinued use of your credit card and timely payments.

CARD BALANCE	12%		14%		16%		18%		20%	
	PAYOUT	YEARS	PAYOUT	YEARS	PAYOUT	YEARS	PAYOUT	YEARS	PAYOUT	YEARS
$500	$578	2.4	$595	2.5	$612	2.6	$631	2.7	$652	2.8
$1,000	$1,393	5.8	$1,500	6.3	$1,613	6.7	$1,731	7.0	$1,854	7.3
$2,000	$3,393	11.6	$3,667	12.0	$3,947	12.4	$4,231	12.8	$4,521	13.1
$3,000	$5,393	14.9	$5,835	15.4	$6,280	15.8	$6,731	16.2	$7,189	16.5
$4,000	$7,393	17.3	$8,002	17.8	$8,614	18.2	$9,231	18.5	$9,857	18.9
$6,000	$11,393	20.7	$12,337	21.2	$13,282	21.5	$14,231	21.9	$15,193	22.3
$8,000	$15,393	23.1	$16,672	23.5	$17,949	23.9	$19,231	24.3	$20,528	24.7
$10,000	$19,393	24.9	$21,007	25.3	$22,617	25.8	$24,231	26.1	$25,864	26.5

$10 EXTRA - PAY OFF YOUR BALANCE FASTER

The following chart illustrates how you can significantly reduce the time and total cost required to pay off your credit card debt. This is achieved by simply adding $10 to the minimum monthly payment described above. This chart assumes discontinued use of your credit card and timely payments.

CARD BALANCE	12%		14%		16%		18%		20%	
	PAYOUT	YEARS	PAYOUT	YEARS	PAYOUT	YEARS	PAYOUT	YEARS	PAYOUT	YEARS
$500	$550	1.6	$559	1.6	$569	1.6	$580	1.7	$591	1.7
$1,000	$1,222	3.4	$1,271	3.6	$1,321	3.7	$1,372	3.8	$1,423	3.8
$2,000	$2,819	6.8	$2,967	6.9	$3,117	7.0	$3,267	7.2	$3,418	7.3
$3,000	$4,533	9.2	$4,800	9.3	$5,068	9.4	$5,338	9.5	$5,607	9.6
$4,000	$6,311	11.0	$6,708	11.2	$7,106	11.3	$7,504	11.3	$7,904	11.5
$6,000	$9,976	13.8	$10,650	13.9	$11,326	14.1	$12,002	14.2	$12,679	14.3
$8,000	$13,726	15.9	$14,692	16.0	$15,659	16.2	$16,627	16.3	$17,596	16.3
$10,000	$17,562	17.6	$18,792	17.7	$20,060	17.8	$21,328	17.9	$22,596	18.0

THE ABCs OF CREDIT CARD FINANCE
ESSENTIAL FACTS FOR STUDENTS

Carol A. Carolan, Ph.D.

2008

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INTRODUCTION

Dear Student:

The following pages provide essential information that will help you wisely choose and responsibly use a credit card.

College students are a privileged group of individuals who are able to obtain a credit card without need of a prior credit history, employment, or a parent's cosignature. Most young adults gladly take advantage of this opportunity. After all, a credit card is a great financial tool. It can be more convenient than cash, it can be especially useful in emergencies, it allows one to establish a credit rating, and it offers valuable consumer protections under federal law.

At the same time, credit cards are a big responsibility. Young adults can face life-altering consequences if excessive credit card debt is accumulated during their college years simply because they didn't have the financial literacy skills to responsibly manage their accounts. Rather than building a positive credit history, irresponsible credit card use can result in a negative credit score, which will be a long-term financial liability as students graduate and embark on their adult lives. When burdened with excessive credit card debt, research has shown that GPAs can suffer, and feelings of depression may prevail. Some students even drop out of school or default on school loans.

In its 2006 nationwide survey, the Jump$tart Coalition reported that participating high school seniors scored 52.4% on personal financial basics. Although this is a slight improvement from 2004's average score of 52.3%, it is obvious that knowledge of this important information is still lacking. These results highlight the need to learn how credit cards work and to also learn how to responsibly manage your accounts.

Managing money, like many other things, is simply a learned skill than can be developed if we have the desire and determination to do so. And since having money seems to depend more on how well we manage it rather than on how well we earn it, money management is best learned early in life. Please take the necessary time to acquaint yourself with the information in this primer. Mistakes avoided today are sure to have a positive impact on your tomorrows.

Best Wishes,

Carol A. Carolan, Ph.D.

PLANNING A BUDGET

No educational material on credit card use would be complete without first stating the importance of planning a budget. By simply putting into writing your monthly income minus your monthly expenses, you take the first step in creating a realistic budget ... your own personal plan for spending and saving money. Begin the budget process by tracking your spending for a full month and writing down all expenditures, including small items such as gum, sodas, and snacks. If some costs will not occur on a monthly basis, average these expenditures to allow a monthly allocation so that the money will be available when needed. A sample budget form looks like this:

MONTHLY BUDGET

MONTHLY INCOME		ACADEMIC EXPENSES	
Allowance	$ _____	Tuition	$ _____
School Loan	$ _____	School Meal Plan	$ _____
Employment Salary	$ _____	Books/School Supplies	$ _____
Grants/Scholarships	$ _____	Loan Payments	$ _____
Interest from Savings	$ _____	Library Copy Cards	$ _____
Other	$ _____	Other	$ _____
TOTAL MONTHLY INCOME	$ _____	**TOTAL ACADEMIC EXPENSES**	$ _____

PERSONAL EXPENSES	
Rent	$ _____
Utilities	$ _____
Phone	$ _____
Internet/Cable	$ _____
Car Payment	$ _____
Food	$ _____
Clothing	$ _____
Transportation	$ _____
Movies	$ _____
Insurance	$ _____
Laundry	$ _____
Entertainment	$ _____
Gifts	$ _____
Spending Money	$ _____
Other	$ _____
TOTAL PERSONAL EXPENSES	$ _____

TOTAL INCOME	$ _____
TOTAL EXPENSES	$(_____)
AMOUNT LEFT OVER	_____

ESSENTIAL INFORMATION

When used and managed properly, credit cards offer us convenience, a sense of security, and allow us to build a healthy credit history. Irresponsible credit card use can result in excessive debt and can produce a poor credit score and become a long-term financial liability.

Basic information necessary to help you wisely choose and responsibly use a credit card can be grouped into two main categories:

1. A complete understanding of the costs of credit.
2. Behaviors that reflect financial literacy and personal responsibility.

CREDIT CARD COSTS

The following identifies the various costs and fees associated with credit card use. Some are evident and others are not so obvious. These costs apply equally to MasterCard, Visa, Discover and American Express cards.

Annual fees – Issuers may charge an annual fee for the privilege of using their card. It is becoming more common to find cards without annual fees and those who do assess this fee are often willing to waive it with a simple request from you!

Interest – Financial institutions charge card holders monthly interest on credit card balances. Interest rates are expressed as an Annual Percentage Rate (APR). The higher the APR, the more money you pay for the privilege of credit. APRs can be variable or fixed. A variable rate APR is based on a published index, like the prime interest rate, plus a few percentage points more, which is determined by the card issuer. The rate can change without notice when the index changes. A fixed APR can also change, but you must first be given 15 days notice. It is best to shop around for a card with a low interest rate.

Interest Calculation – Credit card issuers have a number of ways to calculate interest, the most common of which is the Average Daily Balance Method. This method works as follows:

- Charges and payments are calculated on a daily basis to determine how much is owed each day. The bank then adds these totals and divides by the number of days in the month. This figure reflects your average daily balance.
- To determine the "daily periodic rate," the bank's APR is divided by 365.
- The average daily balance is multiplied by the daily periodic rate and then multiplied by the number of days in the statement period to obtain monthly interest charges.

Some issuers calculate interest charges based on the average daily balance of the last two billing cycles. This is called the Two-Cycle Average Daily Balance method. Because they can result in higher interest charges, it is best to avoid all two-cycle billing methods.

Cash Advances – These are cash loans you can get with your credit card, but they are not inexpensive. Cash advances typically have a one-time fee applied at the time the money is issued, are usually assessed higher APRs, and are granted no grace period. As a rule, cash advances are only for emergencies.

Convenience Checks – These are pre-printed checks linked to your credit card account that are mailed to your home. Although they are tempting to use, they are similar to cash advances and should be used only for emergencies. You typically pay an up-front fee, pay a higher APR, and there is no grace period. Destroy convenience checks before placing them in the trash.

Default Rates – Many issuers will raise your interest rate if you make late payments, miss payments, exceed your credit limit, etc. Some issuers even have a schedule of default rates that escalates according to the number of payments missed.

Low Interest Introductory Rates – These interest rates are usually time-limited, so it's important to know in advance when your interest will be bumped to a higher rate and how much it will increase. Introductory rates are typically raised to a significantly higher default rate if just one late payment is made.

Balance Transfers - Before you transfer your credit card balance from one issuer to another, be aware that balance transfers may have fees associated with them. Also be aware that the lower APR typically applies only to the transferred balance and not new purchases made on your account. The low APR is often time-limited.

Zero Percent Interest Rates – This is an introductory rate for purchases, balance transfers, or cash advances that is typically time-limited.

Late Fees – Credit card issuers charge a late fee when payments arrive after the due date. It is now common practice for issuers to charge a tiered fee based on the amount of your balance. These fees typically range from $15 to $39.

Over-Credit Limit Fees – Even though you've reached your credit limit, you will likely be allowed to make additional charges and will then be assessed an over limit fee. Most issuers charge a flat fee of $29 to $39. Some charge a tiered fee based on the amount of the balance.

Bounced Check Fees – If you bounce a credit card payment check, your credit card issuer will likely charge you a penalty fee of $29 to $39.

Currency Conversion Fees – Your credit card issuer will typically charge a currency conversion fee of 3% on foreign purchases.

Pay by Phone Fee – Some issuers will charge a $10 to $15 fee to make a payment by phone.

HOW TO WISELY CHOOSE & RESPONSIBLY USE A CREDIT CARD

Not all credit cards are equal since credit card issuers are free to offer the terms, services, conditions, and perks they desire. When choosing a credit card, it's best to look for:

- A Low Annual Percentage Rate (APR)
- No Annual Fee
- A Long Grace Period (at least 20 days). This is the length of time between the previous month's closing date and the next month's due date when you can avoid finance charges on new purchases if you pay your total new balance in full.
- Interest Calculated Using the Average Daily Balance Method
- Low Fees

Convenience Users – Convenience users pay their credit card balance in full each month and avoid paying interest on their credit card purchases. This benefit is attained because of the issuer's grace period, defined above. This method of credit card use is the most cost effective. You get to use the issuer's money to make purchases and have several weeks in which to pay them back free of interest charges! Convenience users still want a low APR just in case they can't pay their credit card statement in full some months. If you do not pay your balance completely one month, you will not be granted a grace period the following month and will pay interest on all of your credit card purchases. Convenience users especially want a long grace period ... at least 20 days.

"Revolvers" – These individuals keep a revolving balance on their account and pay interest on everything they purchase. They do not benefit from a grace period. Revolvers are especially looking for a card with a low APR to minimize the interest they must pay. They should avoid cards that use the two-cycle average daily balance method to calculate interest because this method can result in a higher interest charge. Issuers will only require a minimum payment each month, which is often based on 1% of the balance plus accrued interest or $20, whichever is greater. **ALWAYS PAY MORE THAN THE MINIMUM MONTHLY PAYMENT.** Paying just the minimum monthly payment is the most costly and least desirable form of payment for you.

Example: If you had a credit card balance of $2,000, an 18% APR, stopped using your card, and made only the minimum monthly payment based on 1% of the outstanding balance plus accrued monthly interest or a payment of $20, whichever was greater, it would take 12.8 years to pay off your debt and your total payout would be $4,231.

When choosing a credit card, just remember to shop around and to ask questions. Don't be embarrassed to ask a representative to explain the contract so that you clearly understand the card's APR, how interest is calculated, whether or not there is an annual fee, the grace period, default fees, transaction fees, etc.

RATES & FEES AND THE SCHUMER BOX

Credit card issuers detail their basic rates and fees in a table called a "Schumer Box," named after Senator Chuck Schumer. This table makes it easier to compare credit card offers and facilitates your ability to choose the right card for your needs. A sample Schumer Box looks like this:

Annual Percentage Rate (APR) for Purchases	This rate only applies to purchases and can be a fixed rate or a variable rate.
Other APRs	The "Other APRs" box contains information on APRs for balance transfers, cash advances, convenience checks, and default rates. These rates can either be fixed or variable.
Grace Period for Repayment of Balances for Purchases	The grace period applies only to balances for purchases. You only receive a grace period if you pay your new balance in full each billing period by the due date.
Method of Computing the Balance for Purchases	Most issuers use the Average Daily Balance Method, including new purchases. Some issuers use the Two-Cycle Average Daily Balance Method.
Annual Fees	Many issuers do not charge an annual fee. Others may offer the first year with no annual fee with a charge thereafter.
Minimum Finance Charge	A minimum charge on any balance that remains unpaid. Usually, it only applies when the interest charge is less than the minimum charge.
Transaction Fee for Balance Transfers	An up-front fee assessed for making a balance transfer.
Transaction Fee for Cash Advances	An up-front fee assessed for requesting a cash advance. (The same fee typically applies to convenience checks.)
Late Payment Fee	A fee assessed when a payment is received by the issuer after the due date.
Over-the-Credit Limit Fee	A fee assessed when one goes over their credit limit and charged monthly until the account is brought under its limit.
International Transactions	A fee (usually 3%) assessed on each foreign currency purchase after it has been converted into U.S. dollars.

Further descriptions of the terms and conditions of a credit card offer are found beneath the Schumer Box. Be responsible and read these explanations so that you understand the credit card agreement to the best of your ability.

DOs AND DON'Ts ONCE YOU HAVE A CREDIT CARD

Once you have a credit card, follow these guidelines to avoid financial problems.

Limit yourself to one card. Having more than one card tempts you in ways you do not want to be tempted and is a prescription for trouble. If you do have more than one card, manage your accounts carefully.

Don't use your credit card for tuition and limit its use for school related expenses. Student loans are far more cost effective for tuition.

Differentiate between needs and wants. The convenience of plastic makes it easy to overspend.

Remember that credit cards are a convenience. Your socioeconomic status is not changed once you have a credit card. They do not allow you to purchase items you cannot afford.

Pay your credit card bill off fully each month. If you can't pay your credit card bill fully each month, **ALWAYS MAKE MORE THAN THE MINIMUM MONTHLY PAYMENT.**

Manage your credit card account like you manage your checking account. Be sure you have enough money to pay your credit card balance.

Don't skip payments, even if your issuer says you can. You will be charged full interest during this period and will end up owing more the following month.

Pay your bills on time. Avoid late fees and a poor credit rating.

Avoid exceeding your credit limit. Don't get charged over-limit fees or risk having your low APR replaced by a much higher default rate.

Avoid cash advances. Except in the most dire emergency, do not request a cash advance because of the fees you will be assessed. Ask your issuer to explain to you their application of payment when a cash advance exists on your account.

Avoid using convenience checks. The same precautions apply for convenience checks as for cash advances.

Be wary of introductory rates. Be sure to check the fees since it could end up costing you more money than if you had stayed with your original credit card issuer.

Don't use one credit card to pay another. If you only have one card, you won't be put in this dilemma. But if you do have multiple cards, this is a cardinal rule. Use savings, responsibly borrow from family or friends or talk to your bank and ask for help, but **NEVER USE ONE CREDIT CARD TO PAY ANOTHER.**

Don't rise to the occasion when your issuer gives you an increased credit limit. Keep within your budget; this is not carte blanche to spend more.

Mail your check as soon as you receive your statement. If you keep a revolving balance, the earlier your issuer receives your payment, the lower your average daily balance. This will reduce the amount you pay in interest.

Keep your credit card receipts. You should keep your credit card receipts so that you can verify the accuracy of the charges listed on your monthly statement. This audit is critical for detecting potential fraud or mathematical errors. When the audit is complete, keep your important receipts in a secure place and destroy all others.

Immediately notify your issuer if you move. More than one young adult has paid late fees needlessly because they failed to advise their credit card issuer that they moved and did not receive their credit card bill in time.

Immediately notify your issuer if your credit card is lost or stolen. If you report the loss before your card is used, you're not liable for unauthorized charges. If you report the loss after the card has been used, you may be liable for up to $50. You are not liable if your account number, but not the card itself, was used illegally.

THERE IS ALWAYS A SOLUTION

If you are having difficulty paying your credit card bill, the worst thing you can do is ignore the problem. First, stop using your card. Next, call your issuer and advise them of your problem. They may be able to offer you a time-limited alternative payment plan. Obviously, you should work to reduce expenses and increase monthly income. Also, it is best to pay down high APR accounts before low APR accounts.

If your problem persists, you may want to contact a credit counselor for help. Credit counseling firms typically negotiate with your creditors for better interest rates on your various credit card accounts. Once you're on an acceptable repayment plan, you make one monthly payment to the firm and they, in turn, pay your creditors. The National Foundation for Credit Counseling can be located at www.nfcc.org or (800) 388-2227.

If you are stressed out about credit card debt, don't hesitate to talk with a school advisor, counselor, parent, or psychologist. Remember, there is always a solution to this problem.

CREDIT REPORTS & CREDIT SCORES

Credit Report - A collection of information obtained from your creditors reflecting the extent of your credit and payment history. Think of it as your "credit report card." Lenders use this information to determine if they will loan you money and at what rate. Experts recommend that you check the accuracy of your credit reports once a year.

The three major credit-reporting agencies are: Equifax (800-685-1111), Experian (888-397-3742), and Trans Union (800-888-4213). You can obtain a free annual credit report at www.annualcreditreport.com or by calling 877-322-8228.

Negative information can stay on your credit report for seven years, unless there is a bankruptcy, which remains for ten years.

Credit Score - A numeric value that is applied to your credit history by a credit-reporting agency or a lending institution. The most well know scoring system is called the FICO score. Ranging from 300 to 850, the higher the number the better the score.

Your score is based on several factors. The variable that is most heavily weighted is whether or not you pay your bills on time. Also considered is the amount owed on all your accounts and the number of credit cards held and their balances. The number of years one has credit is also considered, as is one's quest for new credit. Applying for many cards, even if they maintain a zero balance, is considered undesirable.

CONSEQUENCES OF IRRESPONSIBLE CREDIT CARD USE

Your credit history and credit score are extremely important. They speak volumes about your character. Lenders consider individuals with a high credit score to be low-risk, desirable customers who are worthy of the lowest interest rates. If you have a low credit score, you may face some or all of these negative consequences:

- You may be denied credit.
- If granted credit, you will likely pay high interest rates. This can be quite costly when purchasing a home, car, appliances, electronics, etc.
- You could have difficulty renting an apartment.
- Employers have access to your credit score and you can be denied employment because of a poor credit history.
- Graduate schools may reject your application for admission.
- You will likely pay higher insurance premiums.
- You may have to pay a large deposit for a cell phone.

IDENTITY THEFT

Identity theft is a crime in which an impostor steals personal information, such as a social security, driver's license, bank account or credit card number, in order to impersonate someone else. The information can be used to obtain credit, merchandise, and services in the name of the victim, or to provide the thief with false credentials.

Signs That You May Be an Identity Theft Victim

- You receive a credit card or a statement for an account you did not request.
- You don't receive your statement, signaling that a change of address may have occurred.
- Unauthorized charges appear on your statement.
- You're denied credit for no apparent reason.
- Debt collectors contact you regarding goods, services or credit that you didn't purchase or initiate.

How to Minimize the Risk

- Only give out personal information if you initiated the contact.
- Try to use an alternate form of identification other than your social security number.
- Keep your social security card at home and don't print this number on checks.
- Limit the number of cards and identifying information you carry in your wallet.
- Obtain a photo ID credit card.
- Know your billing cycles and when statements should arrive in the mail.
- Secure your important credit card receipts and shred all others.
- Don't leave mail in your mailbox and use the post office for outgoing mail.
- Use creative passwords ... avoid the last four digits of your social security number.
- Limit online purchases to secure websites protected with an encryption system.
- Keep personal information in a safe place in your home.
- View your credit reports from each of the credit reporting agencies once a year.
- Place virus protection software on your computer and update it regularly.

If You are a Victim of Identity Theft

- Contact the three major credit-reporting agencies and ask them to place a "fraud alert" on your file so that creditors know to contact you before opening new accounts.
- Order a copy of your credit report from all three agencies.
- Review the reports and contact the fraud department for creditors who show a false or tampered account. Close the account(s) and follow up with a letter.
- File a police report and ask for a hard copy.
- Contact the Federal Trade Commission (FTC), which maintains the Identity Theft Data Clearinghouse and provides important information to identity theft victims. They can be reached at www.consumer.gov/idtheft or (877)-IDTHEFT.

FOR MORE INFORMATION ON CREDIT CARDS

To learn more about credit cards, check out the web. Here are a few sites:

www.Students.UseCreditWisely.com (Citibank's educational website that includes an interactive budget builder tool)

www.bankrate.com (A financial calculator, bankcard rates)

www.mymoney.gov (Federal Government's website on money management)

www.ftc.gov/idtheft (National resource for identity theft)

www.jumpstart.org (Dedicated to the personal financial literacy of young adults)

www.aba.com/consumer+connection (American Bankers Association's consumer site)

www.equifax.com, www.experian.com, www.tuc.com (Credit reporting agencies)

www.annualcreditreport.com (Request your free annual credit report)

www.truthaboutcredit.org (A project of the state Public Interest Research Groups)

GLOSSARY OF IMPORTANT TERMS

Amount Due – Some issuers use this term synonymously with "minimum monthly payment."

Annual Fee – A one-time yearly charge similar to a membership fee.

Annual Percentage Rate (APR) – A measure of the cost of credit, expressed as a yearly percentage. Most credit card plans apply different APRs for different types of credit. For example, one APR will be applied to purchases, while typically higher APRs are applied to cash advances.

Cash Advance – A cash loan from your credit card. Cash advances typically have a one-time fee applied, are assessed higher APRs, and are granted no grace period.

Convenience Check – Pre-printed checks linked to one's credit card account. Convenience checks typically have a one-time fee applied, are assessed higher APRs, and are granted no grace period.

Daily Periodic Rate – Represents 1/365th of your APR. It is used to calculate monthly interest charges.

Debit Card - A card that resembles a credit card that is linked to a checking or savings account. Funds are withdrawn immediately from the linked account with each purchase.

Default Rate – A high APR triggered by missed or late payments, charging over one's credit limit, bouncing a payment check, etc.

Due Date – The date your payment is due.

Finance Charge – The total cost of using your credit card, including interest charges and other fees.

Grace Period – The length of time between the previous month's closing date and the next month's due date when you can avoid finance charges on new purchases if you pay your total new balance in full. Grace periods typically do not apply to cash advances or convenience checks.

Introductory Rate – A low APR which is typically time-limited.

Late Fee – A fee that is assessed if your payment is received past its due date. Many credit card programs increase the APR if you have one or more late payments within a specified time period.

Minimum Monthly Payment – The smallest payment you can make and still be in good standing. It is the most expensive way to pay your credit card bills.

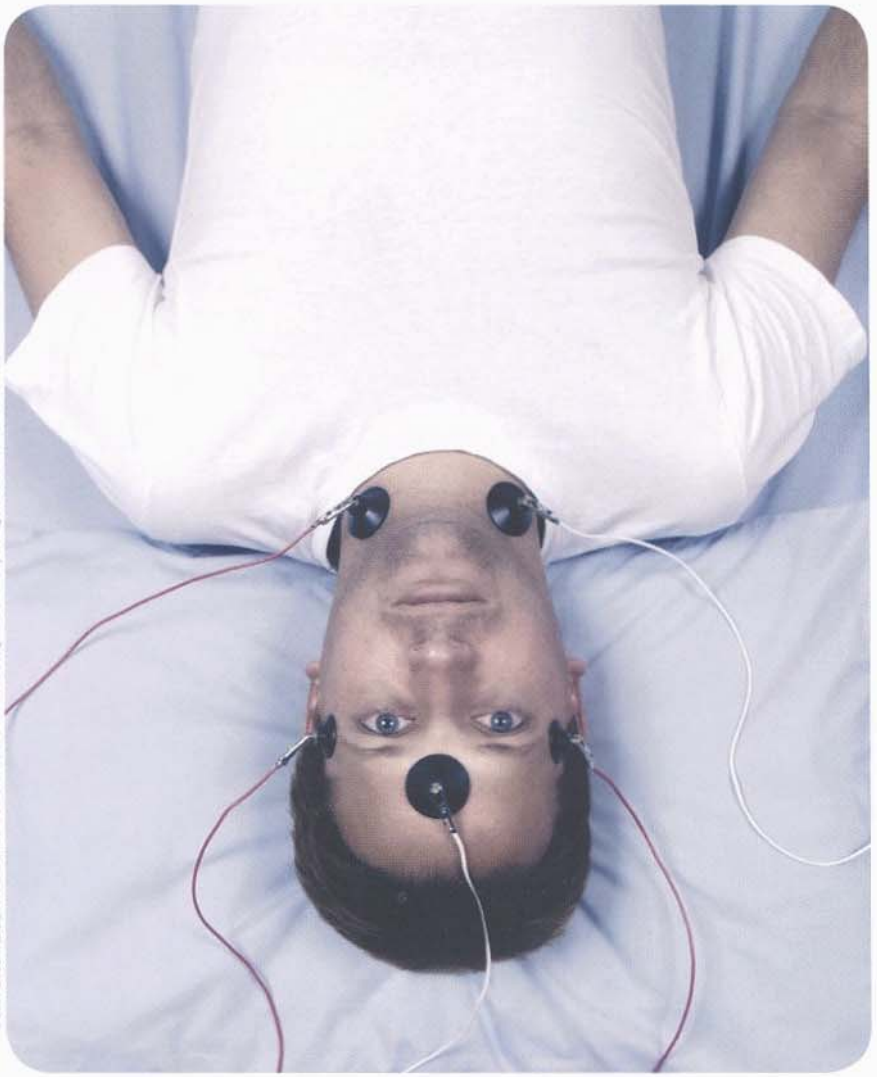
New Balance – The total amount owed, after new charges and credits have been calculated.

Over Credit Limit Fee – A fee paid if you charge over your approved credit limit.

Prepaid Card - A card having a set monetary value which is reduced by each purchase.

Previous (Outstanding) Balance – The amount you owed last month.

Transaction Fee – A charge for various credit activities, such as using an ATM machine, getting a cash advance, or using a courtesy check.



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A website

designed to help

make credit work

for you,

not against you.

It includes tips

on budgeting,

saving and

avoiding credit pitfalls.

Because the more

you know

about credit now,

the less painful

your financial future

will be.

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Prepare now for a STRONG Financial Future!

April is....

"California Financial Literacy Month"

www.dfi.ca.gov

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