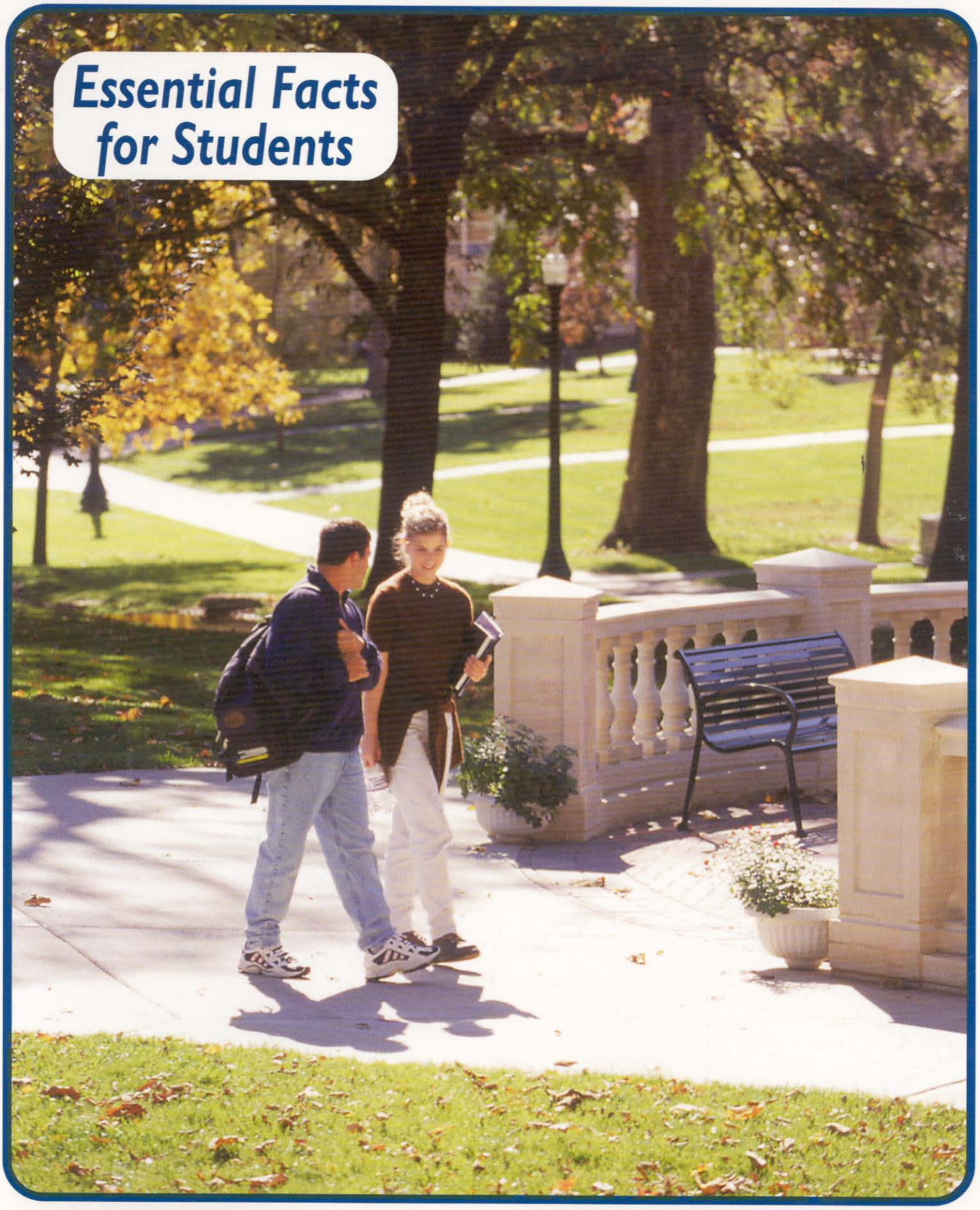
The ABCs of Credit Card Finance



Carol A. Carolan, Ph.D.

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 2% of the outstanding balance or a payment of $10, whichever is greater. This chart assumes discontinued use of your credit card.

CARD BALANCE	12%		14%		16%		18%		20%	
	PAYOUT	YEARS	PAYOUT	YEARS	PAYOUT	YEARS	PAYOUT	YEARS	PAYOUT	YEARS
$500	$696	5.8	$754	6.3	$829	6.9	$931	7.8	$1,084	9.1
$1,000	$1,696	11.6	$1,954	13.3	$2,329	15.6	$2,931	19.3	$4,083	26.3
$2,000	$3,696	17.3	$4,354	20.2	$5,329	24.3	$6,931	30.8	$10,083	43.7
$3,000	$5,696	20.6	$6,754	24.1	$8,329	29.2	$10,931	37.5	$16,083	50+
$4,000	$7,696	23.0	$9,154	27.0	$11,329	32.8	$14,931	42.3	$22,083	50+
$6,000	$11,696	26.4	$13,954	31.0	$17,329	37.9	$22,931	49.0	$34,083	50+
$8,000	$15,696	28.8	$18,754	33.9	$23,329	41.5	$30,931	50+	$46,083	50+
$10,000	$19,696	30.6	$23,554	36.1	$29,329	44.2	$38,931	50+	$58,083	50+

$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.

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	$1,292	4.8	$1,363	5.1	$1,445	5.3	$1,540	5.7	$1,653	6.1
$2,000	$2,889	8.2	$3,136	8.8	$3,439	9.6	$3,818	10.5	$4,311	11.7
$3,000	$4,602	10.6	$5,081	11.5	$5,688	12.7	$6,483	14.2	$7,581	16.3
$4,000	$6,380	12.4	$7,124	13.7	$8,088	15.2	$9,392	17.3	$11,272	20.1
$6,000	$10,046	15.3	$11,380	16.9	$13,160	19.1	$15,670	22.0	$19,509	26.3
$8,000	$13,795	17.3	$15,770	19.3	$18,453	22.0	$22,334	25.8	$28,504	31.3
$10,000	$17,596	19.0	$20,241	21.3	$23,882	24.4	$29,243	28.8	$38,002	35.5

CENTER FOR STUDENT CREDIT CARD EDUCATION, INC. CSCCE

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INTRODUCTION

Dear Students:

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 2004 nationwide survey, the Jump$tart Coalition reported that participating high school seniors scored 52.3% on personal financial basics. Although this is a slight improvement from 2002's average score of 50.2%, it is obvious that knowledge of this important information is still lacking. These results highlight the need for students to learn how credit cards work and to also learn how to responsibly manage their 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,

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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

Allowance	$_____
School Loan	$_____
Employment Salary	$_____
Grants/Scholarships	$_____
Interest from Savings	$_____
Other	$_____
TOTAL MONTHLY INCOME	$_____

ACADEMIC EXPENSES

Tuition	$_____
School Meal Plan	$_____
Books/School Supplies	$_____
Loan Payments	$_____
Library Copy Cards	$_____
Other	$_____
TOTAL ACADEMIC EXPENSES	$_____

PERSONAL EXPENSES

Rent	$_____
Utilities	$_____
Phone	$_____
Credit Card Payment(s)	$_____
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 use a credit card can be grouped into two main categories:

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

CREDIT CARD COSTS

The following identifies the numerous 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 – Banks 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 typically are happy 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. 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 (and the most consumer friendly) 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 "monthly periodic interest rate," the bank's APR is divided by 12.
- The average daily balance is multiplied by the monthly periodic interest rate to determine your interest charges for the month.

Some banks 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.

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, unless it is a dire emergency, cash advances should be avoided.

Courtesy Checks – These are very similar to cash advances and also should be avoided. Credit card issuers will sometimes mail you courtesy checks, which can be tempting to use. Just like cash advances, however, you usually pay an up-front fee, pay a higher APR, and will not have a grace period.

Low Interest Teaser 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. Teaser rates are typically raised to a significantly higher penalty rate if one or two late payments are made.

Balance Transfers - Before you transfer your credit card balance from one issuer to another, be aware that balance transfers often 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 usually time-limited.

Zero Interest Rates – This is a teaser rate for purchases or cash advances. Some issuers will actually give you a 0% APR for a limited period of time.

Late Fees – Credit card issuers charge a late fee when payments arrive after a due date. It has been common practice to charge a flat fee of $29, although many banks are now in the process of raising this fee to $35 and higher. Rather than a flat late fee, some banks charge a tiered fee based on the amount of the balance.

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 banks charge a flat fee of $29 or more in over limit penalties.

Penalty Rates – Many banks will raise their interest rate if you make late payments or miss payments. Some issuers even have a schedule of penalty rates that escalates according to the number of payments missed.

Bounced Check Fees – If you bounce a credit card payment check, your credit card issuer will likely charge you a penalty fee of $20 to $29 or higher.

Lost Card Replacement Fees – Some banks may charge customers a fee of $5 to $10 for lost or stolen credit cards if it occurs more than once or twice.

Currency Conversion Fees – Visa and MasterCard and your credit card issuer frequently add extra charges and fees when you use your card outside the U.S.

HOW TO CHOOSE THE BEST CREDIT CARD FOR YOUR NEEDS

Most individuals are looking for the same basic features when choosing a credit card ... a low interest rate, a long grace period and no annual fee. As previously documented, there are a number of charges that can be assessed when you use a credit card. And since credit card issuers are free to create their own product, including charges and benefits, all credit cards are not created equally. Therefore, it is important to shop around for the package that best suits your needs. To start, you should determine whether you plan to keep a revolving balance on your credit card or if you plan to be a convenience user who will pay off your balance each month.

Convenience Users – Convenience users pay their credit card balance in full each month and thereby avoid paying interest on their credit card purchases. This benefit is attained because of the bank's **grace period,** which is the length of time after the receipt of your statement to your payment due date when no interest is charged. This method of credit card use is the most cost effective. You get to use the bank's money to make purchases and have several weeks in which to pay them back free of interest charges! If you plan to be a convenience user, still look for the lowest APR, just in case you won't be able to pay your statement in full some months, and also look for a long grace period, like 25 days. 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. Of course, look for a card with no annual fee.

Revolving Balance – Individuals who keep a revolving balance on their accounts pay interest on everything they purchase and don't get to take advantage of a grace period. First, and foremost, look for a card with a low APR and, of course, no annual fee. Avoid cards that use the two-cycle billing method to calculate interest, (which results in higher interest to you) and instead, choose a bank that applies the average daily balance method described earlier. Banks will only require a minimum payment each month, which is often based on 2% of the balance. By all means, if you simply cannot pay off your balance in full each month, **ALWAYS PAY MORE THAN THE MINIMUM MONTHLY PAYMENT**. Paying just the minimum monthly payment is the most costly and the least desirable form of payment for you.

For example, if you had $2,000 of credit card debt, an 18% APR, stopped using your card, and made only the minimum monthly payment based on 2% of your outstanding balance, it would take 30.8 years to pay off your debt and your total payout would be $6,931.

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 credit card contract so that you clearly understand what interest you will be charged, how long a low teaser interest rate will be in effect, how interest is calculated, whether or not there is an

annual membership fee, the length of a grace period, what happens to your interest rate if you should have one late payment, the penalty charges for late payments, over-limit fees, the expenses involved with a cash advance, etc.

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.

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 otherwise could not 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 bank 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 penalty rate.

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

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

Beware of teaser rates. They may 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 bank 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 the bank 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 bank errors. Once you have validated the charges, destroy your receipts so that others cannot gain access to them.

Immediately notify your bank 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 promptly.

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.

Call your bank and ask for help. They may be willing to offer you a time-limited alternative payment plan. 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.

You can also call (800) 388-2227 to locate a credit counselor in your area.

Those of you who are very stressed out about credit card debt should not hesitate to speak to a school advisor, counselor, a parent or a psychologist. Remember, there is always a solution to this problem.

CREDIT REPORTS & CREDIT SCORES

A **credit report** is a collection of information obtained from your creditors reflecting the extent of your credit as well as your payment history on all your accounts. It's like a report card, which reflects how you've handled your bills. The three major 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 by calling 877-322-8228. Lenders buy these reports and use the data to determine whether or not they will grant you credit, and at what rate. Positive information can stay on your report indefinitely. Negative information can stay for seven years, unless there is a bankruptcy, which will remain on your report for ten years.

Your **credit score** is a numeric value that is given to you by a lending institution or a credit-reporting agency. The score is calculated from your credit history and helps lenders determine what level of risk they will assume if they lend to you. Although there are several scoring methods, the FICO score is the most common. (The three national credit bureaus have their own version of the FICO score, each with their own assigned names.) No matter which computer-programmed credit scoring system is used, the higher the number, the better the score. First and foremost, issuers of a credit score will want to know if you pay your bills on time. They'll also look to see how many credit cards you have, how many of your accounts have balances, how high are the balances, and how many inquiries there are on your credit report. Every time you request a new credit card or transfer your balance from one card to another, an inquiry is placed on your report. Lots of inquiries tend to be looked down upon by lenders as statistics show that individuals who have recently applied for lots of credit are less likely to pay their bills on time.

CONSEQUENCES OF IRRESPONSIBLE CREDIT CARD USE

Irresponsible credit card use can result in serious consequences. You may be denied credit in the future or, if you are granted credit, you may be forced to pay higher interest rates. You are likely to find it difficult to rent an apartment, purchase a car or obtain a cell phone. Even insurance costs more for those with a poor credit rating. Debt is increasingly being scrutinized during the recruitment process and potential employers may reject you because of a poor credit rating. Dreams of a postgraduate education can also go unfulfilled as more graduate schools are rejecting applicants due to a bad credit history.

Your credit score and credit report speak volumes about your character. Many (if not all) of your future financial transactions will be impacted by this information, and the benefits of wise credit management cannot be over emphasized. As examples, a good credit score will give you access to low interest loans (home, auto, consumer electronics, etc.) and will help you when you're applying for a job or graduate school.

FOR MORE INFORMATION ON CREDIT CARDS

To learn more about managing your credit card account, check out the web. There are numerous Internet sites to teach you different aspects of this topic. Here are just a few:

www.Students.UseCreditWisely.com (Citibank's Educational website)

www.bankrate.com (Includes a financial calculator, bankcard rates.)

www.ftc.gov/bcp/online/edcams/credit/index.html (File a complaint; Federal Trade Commission's list of consumer credit card publications.)

www.cardweb.com (The U.S. Payment Card Information Network; provides the latest happenings in the world of credit.)

www.consumer-action.org (Credit card surveys, credit card fraud.)

www.aba.com/consumer+connection/young_adults_main_page.htm (The American Bankers Association site for young adults.)

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 banks 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. Many banks increase the APR if a payment is late.

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.

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 period of time (often 25 days) during which you can pay your credit card bill without incurring finance charges. A grace period usually only applies if you pay your balance in full each month. If you carry a revolving balance, it does not apply. Grace periods also do not apply to cash advances and courtesy checks. Under these circumstances, interest will usually begin accruing the day the transaction takes place.

Late Fee – A fee that is assessed if your payment is received past its due date. Some credit card programs may also increase the APR if you have more than one late payment 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.

Monthly Periodic Rate – Represents one-twelfth of your APR. It is the rate at which interest is assessed during the monthly billing period.

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

Over Credit Limit Fee – A fine that is assessed if you charge more than your approved credit limit.

Penalty Rate – This represents an increase in your APR which is triggered by events such as late payments and over-limit charges.

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.

Use this page to list important credit card information. **Then place the booklet in a safe place.** In case your card is lost or stolen, you will have all necessary information available to report to your credit card issuer.

If you notify the issuer before a stolen card has been used, you will not be liable for unauthorized charges. If you notify the issuer of a theft after the card has been used, you may be liable to pay up to $50 per card for the charges. You are not liable for any amount if only your account number was used illegally (i.e., your card, itself, was not stolen).

IMPORTANT INFORMATION

CREDIT CARD NAME	BANKING INSTITUTION	ACCOUNT NUMBER	24-HOUR CUSTOMER SERVICE NUMBER