Credit – Student Guide

It may seem like a dream come true – show a card to a clerk at a store, and you can buy whatever you want. The reality, however, is that credit cards just allow you to put off until tomorrow the payments you should probably be making today. And there is a price for that convenience.

Credit cards have become an essential part of everyday life for most people. The important thing is how you manage them, so they don't control your financial future.

What is credit?

Credit is a way to purchase something you want or need without having the money on hand to cover the total purchase price. Banks and other companies issue the credit with the expectation of future payment, often with interest.

Credit usually takes one of two forms:

- Deferring payments in order to purchase a particularly expensive item or service, such as a house, car, education costs or home repairs; or
- Deferring payments for convenience, typically by using a credit card.

What do I need to know about credit cards?

In today's society, it's hard not to have a credit card. While cash payments are usually preferable, it's more and more common and convenient to simply scan your credit card to make a purchase and go.

Convenience aside, you may want to think carefully about whether to use a credit card at all. While credit cards allow you to pay for things later, depending on how long it takes you to pay your debt, you could pay much more than you owe because of the interest companies charge for the privilege of delaying your payments.

Before you get a credit card, be selective about which card you carry, and make sure you're familiar with these important features:

- **Annual fee** – a fee charged by the lending institution each year just for the privilege of having the card. Try to choose a card with no annual fee.
- **Balance** – the amount of money owed on a credit card. Think of this as being similar to the "principle" owed on a loan.
- **Cash advance or check writing fee** – extra charges you pay for using your card to get cash or to write a convenience check on the account.
- **Credit limit** – a preset limit for the balance the lender will allow you to incur.

- **Finance charges** – a blanket term covering any costs associated with the credit card. This includes the interest rate charged, as well as fees for having a balance over the preset limit or for using the credit card to get cash.
- **Grace period** – the period of time you can be late on a payment without being charged an extra fee.
- **Interest rate** – the percentage paid on unpaid balances. Beware of cards that offer a low initial interest rate or no initial interest rate, as the rate may rise significantly after a few months.
- **Late payment fee** – extra charges you pay making a payment after its due date. Avoid late payments, as the interest rate on your credit card may increase significantly if you are late paying your bill.
- **Over limit fee** – charges you pay for going over your credit card's preset limit.

What steps can I take to help manage how I use credit cards?

Credit cards can be very helpful when it comes to managing spending. But they can also lead to a financial nightmare if they're not used wisely. Here are a few pointers to follow:

Read the fine print. Unless you repay the entire balance immediately, fees and finance charges associated with the high interest rates many credit cards charge can continue to pile up and put you into greater debt.

Keep the number of credit cards you have to a minimum. It's best to only have one or two credit cards. Even unused cards with a zero balance will appear on your credit report. Plus, having large credit lines available can be tempting to use, causing you to spend more than you have budgeted.

Pay as much as you can each month on the credit card balance. Sometimes the minimum payment covers only slightly more than the interest charged each month. If you never lower the principle, you're really throwing away money every month you could be using to help achieve other financial goals.

Keep credit card balances low. This will help you minimize the impact of high interest rates. Keep responsible credit limits, and close accounts you're no longer using.

Credit history, credit report and credit score … what do they all mean?

In addition to the expenses associated with using credit cards, using them creates a trail of information known as a credit history. In other words, your credit history basically tracks your history of borrowing money and repaying debt.

Companies called credit bureaus take all the information that goes into your credit history to create a credit report and use it to assign each person a credit score. Your credit score is a measure of how reliable you are in paying off your debts. Things that factor into your credit score include:

- how much money you owe now and how much you've owed in the past;
- how many different institutions you owe money to;
- how regularly you make payments; and
- how much your payments are.

Who's using my credit report and credit score?

Banks and other companies look closely at your financial situation and credit history when making a decision whether or not to loan you money. A good or bad credit history can have a major impact on financial opportunities today and tomorrow. Without a good credit report, you may have fewer options for securing the funding needed for major purchases.

In addition to lenders, insurance companies sometimes look at your credit history to get an overall picture of how risky you may be to insure. And some employers even take your credit history into account when deciding if they want to hire you, because they may interpret your credit score as one measure of how trustworthy you are.

Because your credit report can impact so many things, it's a good idea to obtain a copy of your credit report annually or whenever you close a credit card account or pay off a loan. Report items that don't belong on your credit history or accounts that should be closed to the credit bureau to make sure they no longer appear on your record or adversely affect your credit score.

Ask yourself:
You've just graduated high school. You've never had a credit card, but you don't owe anyone money. Your credit score should be perfect, right? Not necessarily. Having no credit can sometimes be worse than having questionable credit. Because your credit history is a blank slate, you've yet to prove you can be trusted to repay a debt.

Should I worry about identity theft?

People love the convenience of credit cards, but they also make it easier for thieves to steal your identity and use your credit to make unauthorized purchases.

Be careful giving your credit card number to anyone, especially over the phone and online. Make sure you get the person's name you talked with on the phone in case there's a problem. Only use websites that have security measures to protect your privacy when making purchases online. And never give your personal identification number (PIN) to anyone.

Ask yourself:
You've just lost your wallet or purse. What might you have been carrying in it that could be used by thieves to impersonate you? What steps would you need to take to protect your identity?

Assignment

The following table helps demonstrate the true cost of obtaining credit. Let's assume you make purchases totaling $1,000 on a credit card with a 16% annual interest rate:

Purchases	Monthly payment	Annual interest rate (16%)	Months to pay off	Total cost
$1,000	$1,000	$0	1	$1,000
$1,000	$100	$81	11	$1,081
$1,000	$50	$171	24	$1,171
$1,000	$20	$659	83	$1,659

- *If you pay off the total balance on time, you pay no interest.*
- *If you make monthly payments of $100, your account will be paid off in 11 months.*
- *But if you pay only $50 a month, it will take two years to pay off the balance.*
- *And if you pay only the minimum monthly payment of $20, it will take 83 months – nearly seven years – to pay off the balance, resulting in a total payment of $1,659.*

This example also presumes you never use the card again after the initial $1,000 purchase.

Now, your teacher will discuss the consequences of putting off repaying your debts, especially if you have high interest rates. Also, what would happen if you make additional charges over time?

As you can see, every dollar you pay in interest on a credit card bill costs you the opportunity to use that dollar for something else. Avoid making hasty decisions that make cash management more difficult for you.

WBER-0510 (4/12)