CHAPTER SEVEN: CREDIT CONTROL

CREDIT CONTROL

*"When I started college I had 5 credit cards ...
I felt like I had expenses and I put those expenses
on my credit card. Trust me. I regretted it!"*

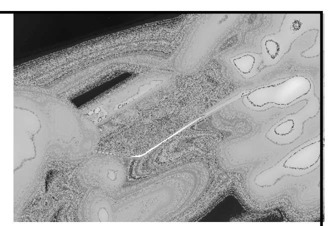
Crystal, Chicago Teacher

CRYSTAL'S CHARGES

Crystal was a typical young adult. She went to college with no emergency savings. Soon after she got to college, her car was broken into, and she had no funds to repair it. Like ¾ of young adults, Crystal had a credit card. She put the repairs on her credit card!

Unfortunately, Crystal did NOT realize how the interest or extra charges on her credit card would add up. Pretty soon Crystal was stuck in debt. Almost all of Crystal's payments went to her extra charges. Crystal could hardly make a dent in her debt!

HOW LONG WOULD IT TAKE TO PAY OFF CRYSTAL'S DEBT OF $500 WITH MINIMUM PAYMENTS OF $10?



TAKE A GUESS … YOU DO NOT NEED TO CALCULATE THE ANSWER!

OVER **7 YEARS**!

HOW COULD THAT BE?!

IF CRYSTAL HAD CHARGED $500 ON HER CREDIT CARD AND HAD AN 18% APR OR INTEREST RATE, PAYING THE MINIMUM OF $10 SHE WOULD PAY …

OVER **$350** EXTRA IN INTEREST!

I thought I was smart. I was going to pay the minimum balance and then I was going to pay the finance charges, but it adds up! If I would have kept doing that, I would have been paying those credit cards for like 5 years!

Crystal, Young Adult – Now Credit Card Debt Free!

Respond to these questions below. (See Page 53 and Video: Trouble with Credit)

1) Why did Crystal get into trouble with credit?
She did not have emergency savings; she put her expenses on her credit card; she thought she could just pay the minimum, etc.
2) What could Crystal have done differently?
Go to college with emergency savings; make a plan to spend less or earn more and pay off her debt more quickly, etc.

Almost half of young adults carry credit card debt and the average balance is $2,000! (Experian/Simmons, 2010)

If young adults would have been able to invest this $2,000 at age 20 instead of making credit card payments, they would have over $40,000 by age 65 (if they earned 7% APR).

Comparison of value of $2,000 in Credit Payments & $2,000 in Investments at Age 20 Held to Age 65 at 7% APR

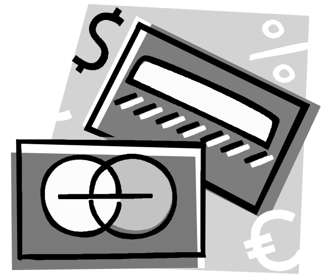
"Only get one [credit card]...definitely pay off the whole amount you put on there. Otherwise, the interest that they charge on that adds up to astronomical amounts."

Hannah, College Student

MAKING CREDIT WORK FOR YOU

CHAPTER SEVEN: CREDIT CONTROL

DEAR DICTIONARY: WHAT IS CREDIT REALLY?



Dear Dictionary,

Please help!!! I just got my first credit card offer and I can't understand what all these things mean! Thanks!

Confused

Dear Confused,

You are not alone – most credit card users do not understand the terms of their credit card! Check out the definitions listed below to learn more.

Dictionary

MOST PEOPLE DO NOT UNDERSTAND THE RULES OF THEIR CREDIT CARD! (GAO, 2007)

CREDIT CONTROL DEFINITIONS THAT MAKE *CENTS*

Credit: Buying a product or service NOW but agreeing to pay for it at some date in the future. (Mary pays for her new jacket with a credit card, but her payment is not due for two weeks.)

Borrower: Someone who gets money or buys something and agrees to pay for it in the future. (Mary was a borrower when she bought the jacket using a credit card.)

Lender: Someone who gives money to someone for them to borrow or to use to buy something if they agree to pay the money back in the future. (Mary's credit card company was her lender.)

Credit Card: A card that allows someone to buy something on credit (see above). (Mary pays for her new jacket with a credit card, but her payment is not due for two weeks.)

Interest: Money charged to a borrower by a lender for the use of the lender's money. (Mary's total balance on her credit card at the end of the month was $1,000. If Mary does not pay this by the due date, she will be charged $15 in interest this month.)

Interest Rate: The cost of borrowing money, usually shown as an annual percentage rate. (Mary's interest rate is listed as an **APR** of 18% or an 18% **annual percentage rate**. This means she would owe $18 on $100 borrowed for one year.)

Balance: The amount of money you still owe to the bank or lender. (If Mary paid $600 at the end of the month on the $1,000 she borrowed, her balance would be $400.)

Minimum Payment: The least amount of money you must pay towards your bill each month. (Mary has a minimum payment of 5% of her balance, but this cannot be less than $10.)

Grace Period: The time from when you are billed for something until the time when you have to pay for it or be charged interest. (Mary buys something on May 2nd but does not owe any money until May 22nd as she has a 20 day grace period.) ***The grace period ONLY applies if the previous month's balance was paid in full.***

WHAT SHOULD YOU DO BEFORE YOU GET A CARD?

What do other young adults recommend doing BEFORE you get a credit card?

#5

1) **Build EMERGENCY SAVINGS!** If you never spend more on your credit card than you have in your account, then you can always use some of your emergency funds to pay your bill if you get into trouble!

2) Open a **CHECKING ACCOUNT**. Practice keeping your checking account balanced and using a **DEBIT CARD** BEFORE getting a credit card. Successfully **BUDGET** your money for several months **BEFORE** getting a credit card.

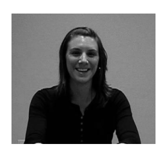
3) Learn about managing credit and building a positive credit record and also **CHECK your CREDIT RECORD BEFORE** getting a credit card. (see page 57)

4) Many cards may have varying interest rates or may not offer a grace period in certain circumstances. This can cost you big bucks! **Read the fine print of your credit card offer BEFORE you sign.**

5) **Make a commitment to PAY OFF YOUR BALANCE IN FULL EVERY MONTH BEFORE getting a credit card.** Make a commitment to use your credit card only for a set amount of purchases that fit into YOUR budget. When you reach this amount, put the card away!

"[At first] instead of using credit, ***use debit*** *because then you won't be as tempted to spend because you know that's your "real money" you're spending."*
Tanisha, Young Adult

"You really have to ***read the fine print*** *[with credit cards]...just know there are no freebies out there."*
Evan, Young Adult



"Only [buy on credit] when you absolutely have to, ***keep an emergency savings account*** *for unexpected expenses and [if you have debt] always pay more than the minimum."*
Debbie, Young Adult

WHAT IS A CREDIT RECORD ANYWAYS?

Credit Building Definitions

Credit Record: The history of your current & past borrowing and payment activities. This includes credit card payments, some utility bill payments, bankruptcies, etc. (Mary's credit record shows the credit cards that Mary has had, her auto loan payments, some utility payments & more. A **credit report** is a report detailing your credit record. This can be thought of like your transcript for credit. Your **credit history** refers to your past borrowing & payments.)

Credit Score: A number that represents the quality of your credit and payment history. Scores range from 300 to 850. Scores of 720 or more are considered the "best." Forty-percent of card holders have a score over 749 (www.fico.com). (Mary's credit score can be thought of as being like her GPA or grade point average for managing credit.)

WHO CARES ABOUT MY CREDIT SCORE?

1. Lenders – Any corporation that is considering lending you money – auto dealers (auto loan), mortgage broker (home loan) … even certain contracts such as rent etc.
2. Employers – many banks, large corporations, large hospitals, employers that will have you handle cash or finances will now ask you for permission to check your credit score.

   If you have a bad credit score and say no to this, how do you think this will impact your chances of getting the job in this competitive market?

FACT: MANY EMPLOYERS NOW ASK TO LOOK AT YOUR CREDIT SCORE! A BAD CREDIT SCORE COULD COST YOU A JOB!

WHAT WOULD YOU WANT TO KNOW AS A LENDER?

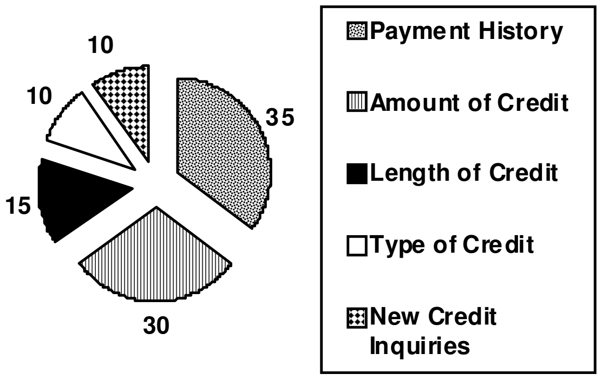
How do credit reporting agencies decide what your credit score will be? How do lenders choose to whom they will give a loan? Let's find out.

FLIP FLOP! Let's pretend that YOU are the lender…

1. **What if you were lending the other half of your group $1,000?** (Fake money of course!)
2. **What you would want to know about the other people before you lend them your $1,000? (List your top 3 ?s below.)**

WHAT MAKES UP YOUR CREDIT SCORE?

The chart below lists the things that credit reporting agencies think about when figuring out your credit score. It also shows how important each item is. (For example, “payment history” is the largest section of the chart at 35%. This means that “payment history” is the most important factor or item in setting your credit score.) A list of what each item like “payment history” means is included to the right.



PAYMENT HISTORY = a record of previous credit payments including bill payments, credit card payments, etc. (Bankruptcies, delinquencies, accounts not paid or late payments will hurt your credit score.)

AMOUNT OF CREDIT = the amount that you owe as a percentage of your credit limit (pg. 60) (Owing too much or “maxing out” your cards hurts you.)

LENGTH OF CREDIT = a record of how long you have had your accounts open (Having a short credit history will hurt your score.)

TYPE OF CREDIT = a listing of the types of credit you have – loans, credit cards, etc. (Having a positive record of managing credit card and loan payments helps you.)

NEW INQUIRIES = a record of new inquiries or applications for credit (Having too many applications for credit can hurt your score.)

HOW DO I BUILD A GOOD SCORE?

1) **Pay your bills on time as agreed every month.** Once you have any type of credit, be sure to pay your bills on time EVERY month. Be sure to at least pay the **minimum on time as agreed**. *When you use a utility or service and pay for it later, this is credit! Some companies report these payments, and they could impact your record. PAY ALL YOUR BILLS ON TIME!*

2) **Once you decide that you are ready for a credit card, pay off the balance in full (or the total amount you charged) each month.** Once you do NOT pay the balance in FULL (for most cards), you will owe interest on ANY card purchases you make until your balance is zero.

3) **Do NOT MAX OUT your credit cards!** Keep charges to ideally **less than 30%** of your **credit limit.** This may help to improve your credit score.

4) **Keep the number of cards that you have small.** Having too many cards or applications for credit may be too hard to manage and may hurt your score.

5) **Check your credit record** at least once a year for free at www.annualcreditreport.com. If you find an error on your record or think someone else may have put bills in your name, see page 63 for help.

6) **If you do not have credit, think about if or when you should obtain credit.** Be sure to weigh the costs of any fees, risks or requirements with any benefits.

7) **Obtain a checking account and keep it balanced.** This shows that you keep financial commitments.

8) **Establish a savings account and save often to show discipline.** Emergency savings may also be used to help pay off your credit charges if you get in a pinch!

WHAT SHOULD I DO IF I GO INTO DEBT?

1) **Work with your lender, credit card company, utility, etc.**

   When many students realize that they will not be able to pay a bill, they panic. They are afraid to contact the company that they owe money to and try to ignore the problem. This is the worst thing that you can do.

   If you contact the company, you will often find that they will help you to arrange a payment plan. You will still need to pay your debt of course, but this can help you to avoid missing payments which will cost you more money in fees and may hurt your credit record (costing you even more money in the future through higher interest).

2) **Make a plan to pay off your debt.**

   Pay off as much as you can each month, but be SURE that you at least make your minimum payments and make these ON TIME! Avoid making any additional purchases on credit unless you can pay off the balance in full.

HOW DO PAYMENTS MAKE A DIFFERENCE?

Payment amounts can make a huge difference in the total interest you pay.

For example, let's say you purchase $500 worth of textbooks and school supplies on your credit card. Your credit card has a 16.5% interest rate and lets you make minimum payments of $10.

How long do you think it would take you to pay off your $500 balance (in years) and how much interest would you pay with the monthly payments listed below?

(You do not need to calculate this amount just take your best guess.)

1) Minimum monthly payment of $10:
   Time to Pay Off ___7 Years & 4 Months___
   Interest paid ________$376__________
2) A larger monthly payment of $25:
   Time to Pay Off _______2 YEARS______
   Interest paid ______$92____________
3) A larger monthly payment of $100
   Time to Pay Off _______6 MONTHS______
   Interest paid ______$22_____________

CRYSTAL IS NOW CREDIT CARD DEBT FREE!

I tell everyone I know... just one credit card and that's just for emergencies and to build your credit.

CREDIT CARD UPDATE!

Credit Card Accountability Responsibility and Disclosure Act of 2009

Contains a number of increased consumer protections including:

- Requires advanced notice for any increase in the annual percentage rate of interest for an existing or open consumer credit plan (ex. a credit card).

- Limits certain fees and charges such as allowing consumers to stop creditors from completing an over the limit purchase or transaction. (Contact your credit card company to learn more.)

- Stops credit card companies from providing a credit card to an individual under 21 unless they have completed a written application, including specific requirements such as:

    - Individuals under 21 must have a co-signer unless they have sufficient income. Students will receive a credit limit that is determined as a portion or percent of their income.

    - Individuals under 21 must have cosigner approval or okay before getting an increased credit limit.

    - Gifts or other items cannot be given to people under 21 in return for credit applications.

CREDIT LIMIT = the most a credit card user can spend or borrow on a given credit card.

COSIGNER = someone other than the borrower that assumes liability or responsibility for a loan or line of credit – actions will impact the credit of BOTH the borrower AND the cosigner

Tips for building credit with these new rules:

- Remember, other loans, such as student loans, can start to build your credit record once you start repayment.

- **<u>Be very cautious in considering having an adult over 21 cosign for your credit card</u>. The use of this card and line of credit will impact BOTH of your credit records.**

- Consider limited part-time employment to generate additional funds <u>if you can manage it with your studies</u>. Handled well, part-time employment can help you build emergency savings, provide a buffer in your budget, build your work experience, build up savings that can be a buffer in management credit payments, etc.

DISCUSS: WHAT ARE BENEFITS AND/OR CONCERNS FROM THESE NEW RULES REGARDING CREDIT CARDS FOR YOUNG ADULTS?

CREDIT JEOPARDY: IT ADDS UP!

- Question: If you just pay the minimum on your credit card bill, you usually must pay **interest** on the amount that is due and that you have not paid.

- Question: If you miss your credit card payment and do not pay even the minimum payment, you will be charged an extra fee and this will hurt your credit **score.**

- Question: Mary's car just broke down she knows that she will not be able to pay her full balance on her utility bill. She want to just ignore the bill and hope the whole thing goes away, but she remembers that she should always **contact** the company if she can't make a payment.

- Question: Your payments of your utility bill, your auto loan and your credit card may all show up on your **credit record.**

I got my first credit card my freshmen year of college. I had some trouble getting a credit card because I didn't have a credit history so I got denied for some of them, but ***my purpose for getting a credit card was to build my credit history.***

Terri, College Student with Excellent Credit (Now)

REMEMBER: AN **EMERGENCY SAVINGS ACCOUNT** CAN HELP YOU TO STAY OUT OF DEBT. IF YOU NEVER SPEND MORE ON YOUR CREDIT CARD THAN YOU HAVE IN YOUR ACCOUNT, THEN YOU CAN ALWAYS USE SOME OF YOUR EMERGENCY FUNDS TO PAY YOUR BILL IF YOU GET INTO TROUBLE!