

Unit 6: Credit, Credit Cards, Credit Histories

Read Chapter 6 in the text.

Read this unit including websites. You may want to take notes on the key points.

My son came home from school one day and declared, "Credit cards are evil." Of course I was very intrigued by this and asked him to tell me why. He explained how people use them too much and have to pay a lot of interest and they get in way over their heads, etc. I told him that some people do that, but other people use them wisely and credit cards can be good, it all depends on how you use them. So, if you are worried that I am going to tell you that credit cards are evil, relax. They aren't, but they have been the cause of a lot of financial problems for some people. As I told my son, it all depends on how you use them.

Unit 6:

Positive Aspects of Credit

There are some great things about credit:

Convenience - it is nice to just carry a credit card sometimes. It is convenient and easy to use.

Emergencies - you can fall back on credit in an emergency when you don't have the cash. If you were driving on a long road trip and had car trouble, a credit card can be a life saver.

Reservations - you need to have a credit card to rent a car and make hotel reservations.

Telephone/Online purchases - you also need a credit card to buy things over the phone or online (unless you can send a check later).

To consume earlier - if you don't have the money now, you can buy on credit and use the item sooner.

Fraud protection - if you carry cash and it is stolen you have no way of getting it back. If your credit card is stolen and used, you can work with the credit card company to have those charges taken off.

Float period - if your credit card has a grace period you can make a purchase and have a while before you need to pay for it.

Unit 6:

Negative Aspects of Credit

Of course, there are some negative aspects too:

Interest - credit comes at a price. If you paid cash for all items you would pay a lot less than when you buy things on credit and pay finance charges.

Fees - some people pay a lot in fees.

Add-ons - sometimes lenders require additional expenses such as credit life insurance or credit disability insurance. This can add even more to the cost of credit.

Overspending - this is one of the biggest problems of credit. With the convenience comes the ability to overspend - and many do.

Drazen Prelec and Duncan Simester, marketing professors at the Massachusetts Institute of Technology, Cambridge, Massachusetts did an experiment with a real-life, sealed-bid auction for valuable tickets to a Boston Celtics game. Half of the participants in the auction were informed that whoever won the bidding would have to pay for the tickets in cash within one day. The other half were told that the winning bidder would have to pay by credit card. Incredibly, the average credit card bid was roughly twice as large as the average cash bid. Simply because they were dealing with plastic, the money was devalued in some way.

Unit 6:

Credit Cards

There is a lot of information to learn about getting and using a credit card. Read the information at the following website:

[Credit:How to Establish, Protect, and Use It
\(http://ianrwww.unl.edu/pubs/homemgt/heg195.htm\)](http://ianrwww.unl.edu/pubs/homemgt/heg195.htm)

Many people will shop around for purchases and try to get the very best deal they can. Yet when they are looking for a credit card, they take the first one that comes along (like in the student center to get the free T-shirt). Credit cards can have very different terms and should be looked at carefully. Make sure you are getting the card that is right for you. One way to compare different cards is to look at the "Schumer's box". This is a table that will appear on every credit card offer with information such as APR, grace period, fee information, etc. The following website has good information about shopping around and it also has a Schumer's box example. Be sure to read the glossary too.

[Shop: The Credit Card You Pick Can Save You Money
\(http://www.federalreserve.gov/pubs/shop/\)](http://www.federalreserve.gov/pubs/shop/)

Comparing different credit cards is one of the options for the "You Pick" assignment. Follow the directions on the syllabus if you decide to compare credit cards for this assignment.

Some credit card companies are charging very high fees. There can be late fees, balance transfer fees, cash advance fees, annual fees, over the limit fees, etc. These fees are all in addition to interest charges! Be sure you understand what fees come with each credit card you look at. For example, if you were planning to transfer a large balance from an old card to a new one because it had a lower interest rate, find out if they have a balance transfer fee. Some cards have a 3% balance transfer fee. If the new card had that fee, you might lose a lot of the benefit of transferring. Only paying the minimum payment is a big problem for some people. When you pay only the minimum, you are mostly paying the finance charge. Very little goes on the principle. You can take forever to pay off the balance, especially if you keep adding to it. Here is an example:

If you had a credit card debt of \$3000 on a card with 18% interest and the minimum payment was 3% of the debt, it would take you 13 years and 6 months to pay off the \$3,000 and you would pay a total of \$5,625.32. If this same debt was on a card that only required 2% for the minimum

payment, it would take 29 years and 6 months to pay it off and you would pay a total of \$10,013.30!

This example doesn't even include new purchases. It would take even longer if you kept adding to it. Just paying a little extra each month, even \$10, can make a BIG difference. On a balance of \$6,300 with 22% interest, it would take you 23 years and 10 months to pay it off. You would pay a total of \$15,867. But if you added only \$10 extra a month, it would reduce the time to 3 years and 5 months. The total paid would be \$8,504. A little extra can make a big difference.

Read the information at the following website:

[Handling Credit Problems \(http://www.urbanext.uiuc.edu/thriftyliving/tl-creditproblems.html\)](http://www.urbanext.uiuc.edu/thriftyliving/tl-creditproblems.html)

Your credit card company or someone else may offer you consumer credit insurance. This may be life, disability, or involuntary unemployment insurance. If you die, become disabled, or become unemployed, this insurance may pay your credit card payment. It is generally not recommended. If you have life and disability insurance and an emergency savings fund, you most likely could do without this insurance. If you don't have these, it would most likely be better to put your money into those areas instead of buying the consumer credit insurance.

Unit 6:

Wise Use of Credit Cards

1. When you are shopping for a card, look for one with:
 - ✓ a grace period
 - ✓ no annual fee
 - ✓ a low interest rate
2. Set aside the money when you make the purchase. One great way to do that is to subtract the purchase price out of your check book when you make the purchase. When your credit card statement comes, make sure all the purchases have been recorded and subtracted out of your check register. Then write a check to pay the credit card. Don't subtract that check - all the purchases have already been subtracted.
3. Pay off the balance each month to avoid interest charges.
4. Pay all credit card bills on time to avoid fees and to protect your credit history.

Unit 6:

Credit Histories

A credit history can also be called a credit report or a credit record. It is a continuing record of your debt commitments and how well they have been honored. When you order your credit history you can see credit cards, loans, missed payments, available credit, and who has requested your credit file.

You may not have a credit history if you have not had credit yet. Even if you have had credit, you may not have a credit history if the place you got credit from did not report the credit to a credit bureau. If you ordered a credit history, look for potentially negative items, the number of open accounts, and the status of the accounts. These are things that lenders will look at. Also look to see if there are mistakes on your credit history. Each semester I have students that find false information on their history. If there are mistakes, you have a legal right to have them taken off. Follow the directions sent with your history to have them checked. You can also look at the following website for more information (this one is only for your information - no test questions will come from this site):

[Credit Histories and Records](http://www.federalreserve.gov/pubs/consumerhdbk/histories.htm)

(<http://www.federalreserve.gov/pubs/consumerhdbk/histories.htm>)

It is very important to have a good credit history and there may be more reasons than you know about. The following groups or individuals may request your credit history:

1. Lenders - you probably already knew this. It is very hard to get a loan of any kind if you have negative items on your credit history. Or, you may be able to get a loan, but you might have to pay a lot higher interest rate than someone with good credit. I have even heard of lenders that you already have credit with looking at your credit history. If you have defaulted on another loan, they may change the terms they have with you (such as higher interest). They worry if you have defaulted on one loan, you may default on theirs. The term for this is universal default.
2. Landlords - if you are trying to rent an apartment in a large complex the landlord may look at your credit history. If you have negative items on it, you may have trouble renting.
3. Insurance Companies - auto insurance companies will likely charge you higher premiums if you have bad credit. This may seem like a strange connection, but they have done studies and found that someone with risky credit is more likely to be a risky driver.
4. Employers - this may surprise you (along with the auto insurance). Some employers are looking at credit histories. There are two reasons for this. First, they may feel that you can't be responsible for their company's finances if you

can't be responsible for your own. Second, employees who have financial problems are less productive on the job.

As you can see, there are many reasons to protect your credit history. If you have already made some mistakes, the best thing to do is to be very careful in the future about making your payments on time and staying within the credit limits. Also, it is good to check your credit report at least once or twice a year. By doing this, you can look for mistakes and fraud. Often identity theft is first noticed on a credit report. It will not hurt your credit score to order a copy of your credit report. It only hurts when you are applying for a lot of credit. You can receive a free copy of your credit report once a year. Check the resource list for the website or phone number. Be careful to not misspell the website. If you do misspell it, you will likely go to a fraudulent website. Read the information at the following websites:

[A credit score can make -- or break -- a would-be borrower](http://www.bankrate.com/brm/news/pf/19981204.asp)
(<http://www.bankrate.com/brm/news/pf/19981204.asp>)

[Credit Fixes That Can Fix You](http://www.smartmoney.com/debt/advice/index.cfm?story=creditfixes)
(<http://www.smartmoney.com/debt/advice/index.cfm?story=creditfixes>)

Also, if you would like more information about credit histories, the FannieMae Foundation has a great booklet you can order for free. Call 1-800-599-5300 or look at [Order our FREE Guide on Credit.](http://www.creditguide.org) (<http://www.creditguide.org>)