

# Section 1: How Credit Cards Work

We will discuss how credit cards work, important credit card terms, and choosing a credit card based on your needs.



## Key Takeaway



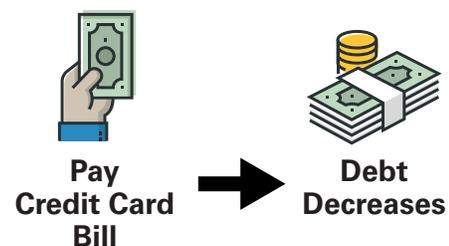
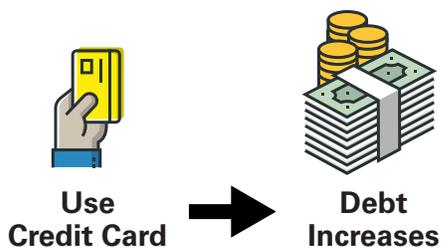
Know how credit cards work so you can more effectively shop around for one that meets your needs.

## What Is a Credit Card?

A credit card is a revolving line of credit. The balance on your card goes up when you make purchases. The balance on your card goes down when you make payments.

There is a limit on how much you can borrow on the card at one time. That is called your **credit limit**. It can also be called a credit line.

You must pay at least a portion of the bill every month, called the **minimum payment**.



### Important Financial Tool

A credit card can be an important financial tool because:

- Regularly paying your bill so the creditor receives your payment by the due date builds evidence that you are creditworthy.
  - The opposite is also true – if you do not pay the amount due so the creditor receives it by the due date, you can damage your credit history and decrease your credit scores.
- It can help you pay for emergency expenses when you cannot pay them in cash.
  - You do need to pay the credit card bill eventually though.
- It offers a convenient option for paying for purchases made online or by phone.
- You have the right to dispute erroneous credit card charges.
- You have the right to dispute certain charges for goods and services that weren't delivered as agreed.

### Cards That Are Not Credit Cards

There are other kinds of cards that may seem like credit cards, but they are not.

This includes:

- Charge cards
- Prepaid cards
- Debit cards

### Truth in Lending Disclosure

Credit card rates and fees can vary greatly from card to card, so understanding these terms can help you compare credit card offers.

Creditors must give prospective credit card customers a written disclosure containing important rate and fee information. This is called a Federal Truth in Lending Act or TILA disclosure. This is a helpful tool for comparing credit cards.



## Rates and Fees

The **annual percentage rate (APR)** is a percentage that tells you the **cost of borrowing money** on a yearly basis. Compare APRs when you shop for a credit card.

The APR charged for purchases may be different from the APR for **balance transfers**.

- Balance transfers are when you move some or all of the balance you owe on one credit card to another credit card.

The APR charged for purchases may also be different from the APR for **cash advances**.

- Using your credit card to get cash is a cash advance.
- Read your cardholder agreement to understand what else may be considered as a cash advance. For example, it likely includes using your credit card to:
  - Get cash from an automated teller machine (ATM) or in person from a provider of financial services
  - Borrow against your credit limit using a convenience or access check
  - Make a wire transfer
  - Purchase foreign currency

The creditor will likely also increase the rate on your credit card by a large amount if you do not pay your credit card bill on time. This is the **penalty APR**.

Interest rates can be **fixed** or **variable**. If your payment is late and triggers the penalty APR, get current on your payments as soon as possible. Then try to pay on time every month. Creditors must reduce the penalty rate if they receive on-time payments for six months.

- Fixed rate means the interest rate will not change until the creditor tells you in writing that it will change.
- Variable rate means the interest rate varies, usually based on an index. A variable rate will likely change more frequently than a fixed rate.

### Low Introductory APRs

A **teaser rate** is a low introductory APR that is offered for a limited time of at least six months. After the limited time, the rate will likely increase, perhaps significantly.

It's important to know when the teaser rate ends and what the new rate will be.

If you can't pay off the balance before the teaser rate ends, be prepared to pay what could be a much higher APR on your existing balance and future purchases.



## Try It: Learning About Credit Card Fees

Next to each fee, write the number of the definition that best describes it from the Definition List.

Fee	Matching Definition from Definition List Below (list the number of the definition)
Late fees	
Annual fees	
Cash advance fees	
Foreign transaction fees	
Balance transfer fees	
Credit-limit increase fees	
Over-the-limit fees	

### Definition List

Number	Definition
1	These fees are charged for transferring balances from one credit card to another credit card.
2	These fees are charged for using a credit card to get cash.
3	These fees are charged for not making payments on time.
4	This is a fee charged every year to use the credit card.
5	These fees are charged for making purchases using the credit card in a foreign currency.
6	These fees are charged for asking for and receiving an increase in your credit limit.
7	These fees are charged for borrowing more money than the creditor agreed in advance to lend to you (your credit limit).

## Rewards

Some credit cards offer **rewards**, such as:

- Cash rebates
- Points that can be used to purchase other goods and services
- Airline miles that can be used to buy airplane tickets

Know what you need to do to qualify for rewards and maintain them. Think about whether the rewards will cause you to overspend.

Consider the credit card fees when you look at the credit card rewards.

Shop around since rewards and how you qualify for them vary from card to card.

## Other Important Terms

If your application for credit is approved, the creditor will set a **credit limit**. This is the maximum credit you can use. It may be called a credit line.

The **grace period** is the time between when your statement is issued and when your payment is due.

The **balance computation method** is how interest on your account is calculated.

- There are different methods. The average daily balance is one method. The cardholder agreement will explain which method is used.

Cards may offer different **customer service features**, such as the ability to pay your bills online.

Some credit cards may also offer you **additional features for free**, such as extending the warranty period on certain products you purchase using the card.

There may also be **additional products and services** you can choose, for a fee. These can include:

- "Payment protection" or "credit protection" to help you make payments if a specific hardship occurs, such as unemployment or hospitalization
- Programs that will monitor your credit reports for signs that a thief may be attempting to use your name to commit fraud

Before agreeing to pay a fee for an additional product or service, ask for a written summary of features and costs.

- Consider checking whether you can receive the offered product or service somewhere else for less money.
- Find out if you may already have it from another company.



## Try It: Choosing a Credit Card

Read the scenario and answer the question.

### Scenario: Siddharth Chooses a Credit Card

Siddharth is a self-employed web designer and is generally satisfied with how much he earns. He knows that his income is not steady. Some months he earns a lot, but then business slows down for a while and he earns much less.

Siddharth has a disability that affects his balance and mobility. He would find it convenient to shop online for things he needs. For example, a grocery delivery service now serves his neighborhood. He can select the groceries he wants on a website and pay online to have them delivered to his door.

He has decided to apply for a credit card and collected information on several cards. Now he wants to choose one.



**What should Siddharth consider?**



## Apply It: My Credit Card Comparison Chart

As you are shopping for a credit card, you can use this chart to compare different credit cards.

Comparison Item	Credit Card 1	Credit Card 2	Credit Card 3
Name of creditor/card			
Introductory APR and for how long			
APR after introductory period			
APR: Purchases			
APR: Cash advances			
APR: Balance transfers			
Penalty APR			
Annual fee			
Late fee			
Over-the-limit fee			
Cash advance fee			
Other fees, if any			
Grace period? How long?			
Are there rewards?			
My credit limit, if known			
Is it a secured card? Requirements?			
Other:			

## Unsecured and Secured Credit Cards

Banks and other financial institutions offer both **unsecured** and **secured credit cards** with varying credit limits and rates. Until now, we've been talking about unsecured cards.

A **secured credit card** requires collateral. You keep money (as collateral) in a dedicated deposit account at the financial institution issuing the card.

- The card is "secured" with that collateral.

If you pay at least the minimum payment regularly so the creditor receives it by the due date, you generally can improve your credit history and increase your credit scores.

A secured credit card is usually easier to qualify for than an unsecured card. Secured credit cards typically have lower credit limits than unsecured credit cards. Some people apply for secured credit cards if they are unable to get an unsecured card. A secured credit card can help them build or improve their credit history.



## Applying for a Credit Card

You can apply for a credit card, whether secured or unsecured:

- At banks, including in person, on the phone, online, or through the mail
- At retail stores
- Other places online, such as credit card comparison websites

You may also receive credit card offers in the mail. You may opt out of receiving certain mailed credit card offers by:

- Calling 1-888-5-OPTOUT (567-8688)
- Visiting [www.optoutprescreen.com](http://www.optoutprescreen.com)

### Key Terms in the Application Process

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**Credit Card Applicant:** Person applying for a credit card

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**Creditor:** The company that issues the card

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**Individual Credit:** When you apply for a credit card on your own, based on your own assets, income, ability to pay and credit history

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**Joint Credit:** When you apply for a credit card with another person, based on the assets, income, ability to pay, and credit history of both people

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**Authorized User:** Someone you allow to use your credit card account who has no responsibility to pay the bill.

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### Remember the Key Takeaway

Know how credit cards work so you can more effectively shop around for one that meets your needs.