Shopping for a Credit Card

LESSON DESCRIPTION AND BACKGROUND

In 2007, nearly three-fourths of all U.S. families had at least one credit card. According to the Federal Reserve, 46 percent of families carried a balance on their cards. The median balance carried was $3,000. Americans are obviously in love with their credit cards, but they are not always well informed about them. They may not know that all credit cards are not created equal. The first part of this lesson emphasizes that credit cards differ from one another in terms of annual fees, annual percentage rates, grace periods, and credit limits. The second part shows students how to read a credit card statement so that they can see the real cost of charging goods and services.

Lesson 15 correlates with national standards for economics and personal finance as shown in Tables 1-2 in the introductory section of the publication.

ECONOMIC AND PERSONAL FINANCE CONCEPTS

- Annual fee
- Annual percentage rate (APR)
- Credit card
- Credit limit
- Grace period

OBJECTIVES

At the end of this lesson, the student will be able to:

- Describe differences among **credit cards**, including fees, **annual percentage rates**, **grace periods**, and **credit limits**.
- Read and understand a credit card statement.
- Evaluate the costs and benefits of using a credit card to purchase goods and services.

TIME REQUIRED

One 45-minute class period

MATERIALS

- A transparency of **Visual 15.1**
- A copy for each student of **Exercise 15.1** and **15.2** from the *Student Workbook*
- Optional: Credit card solicitation letters and/or information sheets that accompany credit card statements

ADDITIONAL RESOURCES

To download visuals, find related lessons, correlations to state standards, interactives, and more visit http://fffl.councilforeconed.org/9-12/lesson15.

PROCEDURE

1. Introduce the lesson's focus on credit cards. Ask:

a. How many of you have a credit card? ***(Answers will vary. If no students have credit cards, ask whether they know people who do have credit cards.)***

b. What do you buy with your credit card? ***(Answers may include such things as gas, clothing, CDs, small appliances, dinner at a restaurant, mail-order catalog purchases, and Internet purchases.)***

2. Give each student a copy of **Exercise 15.1** from the *Student Workbook*. Ask the students to read the exercise and answer the question at the end. When they have finished, discuss the answer:

a. What characteristics should you look for if you want to save money on a credit card? ***(The credit card should have a low fee or no annual fee, a low APR, and a long grace period.)***

3. Remind students that **Exercise 15.1** explains different ways to calculate credit card interest. It is important for cardholders to understand how their credit card company calculates interest. Display **Visual 15.1** on the overhead and discuss how the different methods provide different calculations of interest for the statement period, even when the transactions are the same.

4. When you have finished discussing **Visual 15.1**, ask:

a. Which method of calculating interest is more favorable to the card holder? ***(An adjusted balance method of calculation is more favorable to the cardholder.)***

b. Which method is more advantageous to the creditor? ***(The previous balance is more advantageous to the creditor. Note that the most popular method used by credit card companies is the average daily balance method.)***

5. Give each student a copy of **Exercise 15.2** from the *Student Workbook*. Ask the students to read the exercise and answer the questions at the end. Discuss the answers.

a. How much did Tim Gray charge on his credit card in the month of the statement? ***($30.63)***

b. What is the credit limit on this credit card? ***($7,500)***

c. How much of that credit was available at the time of this statement? ***($6,378)***

d. How does Tim's previous balance compare to the new balance shown on this statement? ***(The new balance is $50.55 higher than the previous balance.)***

e. Was Tim charged a finance charge this month? If so, what was the amount of the finance charge? ***(Yes. He was charged a finance charge of $19.92 this month.)***

f. What is the annual percentage rate for credit on this account? ***(21 percent)***

g. Looking at this statement, do you think Tim is handling his credit well? Why or why not? What would you recommend? ***(Tim is probably not handling his credit well. He is not paying off his monthly balance. In fact, his monthly balance is increasing. He is paying a relatively high APR. Tim should consider how he could quickly pay off the total balance of this card.)***

CLOSURE

Conclude the lesson by noting that most students in the class will use a credit card some time in their lives. Credit cards provide many advantages, including the efficiency with which payments can be made, the way they free people to carry relatively little cash, and their use in emergencies. However, card holders can get into trouble easily if they use credit cards carelessly. If credit card holders maintain high balances that are unsupported by current income, the finance charges they incur may absorb a growing proportion of each month's income. If that happens, it can set a vicious cycle in motion—sometimes leading to personal bankruptcy. Students should take great care not to let this happen to them. To protect themselves, they must, for starters, be well informed about the different characteristics of credit cards and the numbers found on a credit card statement.

ASSESSMENT

As a homework assignment, ask the students to bring to class credit card solicitation letters or the information sheets that accompany credit card statements. An alternative to collecting solicitation letters is to compare credit card offers online. One website, www.bankrate.com, could be useful for this purpose. Put the students into groups of three and have them compare the features of three different credit cards. They should use the chart on the next page to display the results of their comparisons. They also should answer the questions that follow the chart.

Credit Card Comparison Chart

	Card #1	Card #2	Card #3
APR (annual percentage rate): Is it fixed or variable?			
Penalty APR and trigger events when it is charged			
Annual fee			
Late fee			
Over-the-limit fee			
Transaction fees (balance transfers, cash advances, etc.)			
Grace period			
Method of computing account balance			
Rewards for use			

Questions:

1. What characteristics would you look for if you carried a balance and wanted to save money on a credit card? ***(Low APR, no annual fee, favorable method for computing interest.)***

2. What features would you look for if you planned to pay off your balance each month? ***(Long grace period, rewards for use, no annual fee.)***

3. Which card would your group choose? ***(Accept a variety of well-reasoned answers.)***

EXTENSION

Ask the students to interview an adult who uses a credit card. They should ask what uses the interviewee makes of his or her card and what the advantages and disadvantages are of using the card. Depending on the extent to which the adult is willing to share this information, she or he may also permit the student to look at a recent credit card statement or online form, to provide a real illustration of the use of credit cards.

Methods of Calculating Credit Card Interest

Assume: **APR 18 percent annually or .04931 percent daily (.0004931)**
Statement received on April 1 with the following information:

Previous balance as of March 1:	$600
Payment (on March 15):	$400
Purchase (on March 15):	$100
Days in the billing cycle:	30

1. Previous Balance Method:

The creditor would charge .0004931 times the previous balance of $600 times the number of days in the billing cycle (30). This would total $8.88. Your $400 payment on March 15 is ignored in calculating interest owed.

Previous balance method interest calculation = $600 x 30 x .0004931 = $8.88

2. Adjusted Balance Method:

You would be charged $2.96. That is: .0004931 times the adjusted balance ($200), which is the previous balance ($600) minus payments made ($400). This is multiplied by 30, the number of days in the billing cycle. This is the best deal for consumers, but it is rarely used by creditors.

Previous balance		**$600**
Payment	**-**	**$400**
Adjusted balance		**$200**

Adjusted balance method interest calculation = $200 x 30 x .0004931 = $2.96

3. Average Daily Balance (ADB) Method

Average Daily Balance Method (Including Newly-Billed Purchases): The creditor would charge you \$6.66. That is: .0004931 times the average daily balance, which was \$600 for the first half of the month and \$300 for the second half. Note that the average balance was \$450 for the month. Using this method effectively eliminates the grace period on new purchases. The only way to have a no-interest grace period is by paying the outstanding balance in full each month.

\$600 x 15 x .0004931 = \$4.44
\$300 x 15 x .0004931 = \$ 2.22
Interest charge for this method: \$6.66