

# CHAPTER 7

Section 7-3  
Computing the  
Costs of Credit

# COMPUTING INTEREST ON CREDIT

- **Finance charges-interest and fees paid on credit charges**
  - **Fixed interest rate-does not change from month to month**
    - Can be changed with 30 days written notice
    - Card holder can refuse increase
    - Company can close account
    - Balance paid off at old rate, but no new charges allowed
  - **Variable Interest Rate**
    - Interest rate can change at any time without notice
    - Rate rise depended upon general interest rate increases
- **Credit Card statement should disclose daily and annual rate of interest**
- **Use variable rate credit cards sparingly, these can create balances that are difficult to pay**
- **Credit cards with fixed rates are a better choice if you must carry a balance from month to month**

# METHODS OF COMPUTING INTEREST

- **Adjusted Balance Method**
  - Interest calculated based on the amount owed after you pay your bill each month
  - Charges made during month are added to balance at the beginning of the period
  - Payment is subtracted to get the adjusted balance-then interest is calculated on the new balance
- **Previous Balance Method**
  - Interest is calculated on the outstanding balance from the previous billing cycle
- **Average Daily Balance Method**
  - An adjusted balance is computed for each day of the month
  - Interest is calculated on the average daily balance (balance for all days added and then divided by the number of days)

# CREDIT CARD TERMINOLOGY

- **Minimum Payment**
  - Amount required to be paid each month
  - Usually 3 to 5 percent of balance owed
  - Payment includes principal and interest
  - Minimum payment can be increased at any time
- **Credit Limit**-a set limit on the amount that can be charged on the card
- **Penalties and Fees**-paid based on agreement violation
  - **Penalty**-a fee charged for violating a term of the credit agreement
  - **Late payments**: Payment doesn't arrive on time--can cause an interest rate to rise
  - **Over-the-limit fee**-charge for exceeding your approved credit limit
  - **Cancellation fee**-charged if you close an account before a stated time

# CREDIT POLICES

## ■ Interest Rate Increases

- Rates rise if credit card company believes you are a risk
  - If you miss a payment
  - Pay late
- Notice of rate increase usually given
- Happens when there is too much outstanding credit (amount owed)

## ■ Lowered Credit Limit

- Card issuer reduce your credit limit
- Can happen at anytime
- Happens when you are believed to be a greater risk than other credit card holders
- Could lower your over all credit score

# CREDIT CHOICES

## ■ Special Offers

### ■ Introductory rate-temporary interest rate on new accounts

- Last 6 months to a year
- Rates replaced with either a fixed or variable rate
- Purpose is to get you to switch to a new card

### ■ Balance Transfer

- Moving a balance from one credit card account to another
- Transaction fees may be high on these transfers

## ■ Easy Access Credit

- Access checks provided by credit card that allow you to borrow against your credit card account without swiping your credit card
- Similar to cash advances
- Can be used to pay bills or make purchases
- Quickly obtained, but can have high fees or hidden costs

# CREDIT CHOICES

## ■ Instant Credit offer

- Offer at a store when you are making a purchase
- Discount or incentive to sign up for store's credit card on the spot

## ■ Online Credit Approval

- Complete credit applications online for credit card/mortgage loans
- Require sensitive personal data
- Avoid credit offers that come by email or in pop-up ads
- Only apply for online credit when you initiate the contact

# CREDIT CARD STATEMENT

- **Statement that shows charges, payments, interest, fees and new balance**
  - **Keep an envelope or folder for your credit card receipts**
  - **Compare charges listed to sales receipts**
  - **Verify payments**
  - **Verify credits (returned items)**
  - **Verify fees (make sure these should be charged per credit card agreement)**
  - **Verify interest and amount owed are correct**



# GOOD CREDIT PRACTICES

- **Make payments on time to avoid late fees**
  - Late payments can increase interest rates
  - Impact credit score (lower it)
- **Pay the full amount owed on your credit card statement to avoid paying interest charges**
  - Allows benefits of credit without expense
- **Know your credit card billing cycle**
- **Keep track of balances to help keep your debts in check**
- **Unwise use of credit can lead to overspending.**