Credit Basics, Scores and Cards
Practical Money Skills

Considering credit over cash? Credit cards can be a convenient and flexible form of payment, but they have to be used responsibly in order to make the most of your money. Though credit cards allow you to purchase items instantly without using cash, it's important to use your cards as carefully as you would handle your cash.

Before getting a credit card, first define your financial lifestyle and search for a card that fits with your situation and spending habits. After choosing a credit card, take time to understand its features and how it can affect your credit score.

Credit Basics

Credit cards provide security, convenience, and even rewards based on spending. However, if cardholders don't manage their cards carefully, they may find themselves facing unwanted consequences like a poor credit score or hidden fees.

Get to know credit cards with these 10 credit terms:

1. Annual Fee – The once-a-year cost of owning a credit card. Some credit card providers offer cards with no annual fees.
2. Annual Percentage Rate (APR) – The yearly interest rate charged on outstanding credit card balances.
3. Balance – An amount of money. In personal banking, balance refers to the amount of money in a savings or checking account. In credit, balance refers to the amount of money owed.
4. Credit Bureau – A reporting agency that collects information on consumer credit usage. There are currently three main credit bureaus in the United States: Equifax, Experian, and TransUnion. Learn more about credit bureaus at usa.gov.
5. Credit Line – The maximum dollar amount that can be charged on a specific credit card account.
6. Credit Rating – A financial institution's evaluation of an individual's ability to manage debt. It's crucial to have a good credit rating if you want to borrow money or apply for a credit card or loan. Learn how to maintain a strong credit score.
7. Grace Period – The period of time after a payment deadline when the borrower can pay back the borrowed money without incurring interest or a late fee.
8. Introductory Rate – An interest rate offered by credit card issuers in the initial stages of a loan. These rates are often set much lower than standard rates in order to attract new cardholders. Make sure you know how long the introductory rate will last and what the standard interest rate will be once the introductory period ends.
9. Minimum Payment – The minimum amount of money that you are required to pay on your credit card statement each month in order to keep the account in good standing.
10. Overdraft Protection – A banking service that allows you to link your checking account to your credit card, thereby protecting you from overdraft penalties or bounced checks in the case of insufficient funds.

<u>The True Cost of Credit Card Purchases</u>

If you don't pay off your credit card balance every month, the interest assessed on your account means you may be paying more than you expect. And if you spend beyond your means, the resulting interest and debt can become significant.

See how much extra you might pay on a $1,000 credit card purchase with varying interest rates:

Total Purchase Amount **This is the balance due on your credit card**	**$1,000**	**$1,000**	**$1,000**
Credit Card APR This is the annual interest rate on your credit card.	10%	15%	25%
Monthly Payment This includes paying just the minimum monthly payment, calculated in this example as $40.	$40	$40	$40
Number of Months to Pay Off Purchase Amount This is how long it will take you to pay off the entire balance.	29	31	36
Total Finance Charge This is the total amount of money you will pay just in interest.	$126	$207	$427
Total Cost This is the final amount you will pay for your purchase.	**$1,126**	**$1,207**	**$1,427**

Pros and Cons of Credit

To make the most of your credit cards and maintain a great credit score, it's essential to understand their pros and cons. Maximize the benefits and minimize unnecessary costs by learning about the advantages and disadvantages of credit.

Advantages

- Instant Purchasing Power – Credit can help with unexpected emergency expenses and give you the flexibility to pay them over time.
- Security – Lose cash, and it's gone. Lose a credit card, and it can be canceled with no harm done in most circumstances. Also, you need to be prompt about reporting a lost or stolen card to be protected against its unauthorized use.
- Record Keeping – Your credit card statement is an itemized list of your monthly expenditures, which can be helpful when it comes to budgeting.
- Convenience – Credit cards are more widely accepted as a form of payment than checks, and they're generally faster to use.
- Bill Consolidation – Bills can be paid automatically via credit card, consolidating several payments into a single sum.
- Rewards – Using a credit card with a rewards program may earn you benefits like free travel.

Disadvantages

The main disadvantage to credit card usage is the potential cost in interest and fees. Wise use of credit means understanding those costs and acting accordingly. Keep track of your spending to ensure that you can repay your credit card bill in full when it is due each month.

Building Credit

Understanding what credit is and how your credit score can be improved is a crucial step toward reaching your financial goals. Your credit score is a measure of factors that may affect your ability to repay credit. It's a complex formula that takes into account how you've repaid previous loans, any outstanding debt, and other financial history.

A credit score is dynamic and changes according to how much debt you accrue and how you manage your bills. To build credit wisely, learn how the Five C's of Credit – character, capital, capacity collateral and capacity — can affect your credit score and how you can use these five factors to strengthen your credit:

1. Character. A lender may decide whether you possess the honesty and reliability to repay debt based on your credit history. Lenders are likely to look at your credit use, bill payment, residential history, and how long you've worked at your current workplace.

The most effective way to strengthen your credit reliability is to make payments on time. Many credit card companies offer free, automatic alerts to help you keep track of your balances, payment due dates, payment history and purchase activity.

2. Capital. A lender will want to know if you have valuable assets such as real estate, personal property, investments or savings with which to repay debt if income is unavailable.

Learn the best ways to save for your goals in order to gain these valuable assets and potentially boost your credit score.

3. Capacity. This refers to your ability to pay off debt. Lenders will look to see if you have been working regularly in an occupation that is likely to provide enough income to support your credit use. They may look at your salary, check whether you have pre-existing loans or debts, and assess whether you have family members who depend on your earnings.

4. Collateral. A lender may require you to put up some form of collateral — a property or asset — for certain types of loans like auto loans. When you take out a car loan the vehicle you buy is typically used as collateral for the loan.

5. Conditions. This refers to the condition of the economy and how it may affect your ability to repay the loan.

To ensure you aren't taking on more than you are capable of paying off, follow the 20-10 Rule. This rule of thumb suggests you avoid borrowing more than 20 percent of your annual net income on all your loans (not including mortgage loans), and that payments on those loans do not exceed 10 percent of your monthly net income.

Credit Scores

When you apply for credit, lenders determine your credit risk by examining your credit scores, also known as FICO® scores. Each of the three main credit bureaus — Experian, TransUnion, and Equifax — keeps credit information about you that is used to calculate your FICO scores. This includes your payment history, the amount of money you owe, the length of your credit history and the number of recently opened credit accounts.

Your FICO scores help lenders determine the credit risk associated with loaning you money. Scores range from 300 to 850. The higher your score, the lower your perceived risk to a lender.

10 Ways to Keep Your Credit Score Strong

1. Complete credit applications carefully and accurately.
2. Use your credit cards responsibly — don't let them reach their limit or spend beyond your means.
3. Choose your credit cards wisely and make sure you understand all of the terms and features.
4. Attempt to pay your credit card balance in full each month, but at least make the minimum payment by the due date.
5. Always pay bills on time.
6. If you have problems paying your bills, contact your creditors. In many cases, they will work with you to figure out a payment plan.
7. If you move, let your creditors know your new address as soon as possible to avoid losing bills or receiving them late.
8. If your credit card is lost or stolen, report it to the issuer immediately.
9. Check your credit reports periodically for inaccuracies and immediately report errors to resolve any issues.
10. Establish a consistent work history.

Use a Secured Credit Card Account

If you're opening your first credit card account or you're trying to rebuild a damaged credit score, a secured credit card account is one of your best options. The main advantage of a secured credit card is that you cannot use it to spend outside your means. You are required to make an initial deposit to open a secured card, and after that you will only be able to spend up to 100 percent of that deposit amount. For example, if you put $500 in the account, you can charge up to $500 on your secured card.

If you consistently make your payments on time, it could be possible to transform your secured card into an unsecured card from a credit card issuer, boosting your credit score. Unsecured cards don't require an initial deposit to open, and it is possible to charge more than you can pay off. For this reason, secured cards are the best option until you're certain you will always spend within your means and pay off your balance on time.

Credit Resources

Now that you understand what credit is and how to improve your credit score, make sure you create financially smart habits by requesting your free credit report annually. Keep track of your score and review it for inaccuracies with these tips.

Request Your Free Credit Report Once Every 12 Months

Consumers are entitled to a free copy of their credit report every 12 months from each of the three major credit bureaus: Equifax, Experian and TransUnion. Visit www.annualcreditreport.com to request your credit report online, by phone, or through the mail. To get a free estimate of your credit score, visit FICO Estimator.

Review Your Credit Report

Over 13 million people a year find inaccuracies on their credit reports — payments mistakenly labeled as late, accounts that should have been closed, other people's debt information and more. Report mistakes right away, as errors could lower your credit score and cost you money.

You are responsible for ensuring your report is correct. If you find an issue:

- Check the last page of your report for instructions for claim disputes.
- Contact the credit bureau and report the error immediately.
- Put it in writing — if the issue remains unresolved, provide a letter of explanation and request that it become part of your report.

Credit Bureau Contact Information

Check your credit report for accuracy for free through the three major credit bureaus by accessing your report at www.annualcreditreport.com or by contacting the bureaus directly:

Equifax
Report Order: 1-800-685-1111
Fraud Hotline: 1-888-766-0008
www.equifax.com

Experian
Report Order: 1-888-397-3742
Fraud Hotline: 1-888-397-3742
www.experian.com