CHAPTER 4

Hidden Costs of Credit (1/2)

Activity: Small group or partner

25 MINUTES

Materials: Course materials and the activity handout

Objective: The purpose of this activity is for students to examine the true cost of credit. Students will read a sample disclosure statement and understand the fees, limits, finance charges, grace periods, APRs, etc. associated with credit. Students will also evaluate the cost difference between making minimum monthly payments versus paying more than the minimum monthly amount.

STANDARD Credit and Debt Standard 1: Identify the costs and benefits of various types of credit.

- Explain how credit card grace periods, methods of interest calculation, and fees affect borrowing costs.
- Using a financial or online calculator, compare the total cost of reducing a $1,000 credit card balance to zero with minimum payments versus above-minimum payments.

Procedure

Hand out the student activity sheet and sample disclosure form. Assign students a group or partner to complete the activity.

Answers

Students should use the Sample Disclosure Form to answer questions 1–7.

1. This company can adjust the APR at any time and for any reason for failing to comply with the terms. This includes late payments, defaulting on the bill, not making minimum payments, or exceeding the credit limit.
2. There is no annual fee for this credit card.
3. The grace period is at least 20 days.
4. 11.99%, 14.99%, or 21.99% depending on review results.
5. $1,000 x 3% = $30.
6. $39
7. Your late charge will be $15, $29 or $39 depending on the balance of your credit card. Your APR will be reviewed and will probably increase.

Students will go to foundationsU.com and locate the "Debt Snowball" under "Tools." Enter the numbers for the two following scenarios to compare the total cost of reducing a $1,000 credit card balance to zero with minimum payments versus above-minimum payments.

(Note: the following scenarios do not use the Sample Disclosure Form.)

Scenario 1: Making Minimum Payments

» Total Debt (also called the *principal amount*): $1,000

» Interest Rate: 12.99%

» Minimum Payment: $30

8. Calculate the number of months it would take to pay off this debt.

   42 months

9. Calculate the total amount (principal and interest) needed to pay off this debt if you only make the minimum $30 per month payment.
   (# of months) × (monthly payment amount)

   42 (months) × 30 = $1,260

10. Calculate the total amount of interest that would be paid on this debt.
    (Total amount paid) – (principal)

    1,260 – 1,000 = $260

CHAPTER 4

Hidden Costs of Credit (2/2)

Scenario 2: Choosing to Pay More Than the Minimum Amount

» Total Debt: $1,000 » Interest Rate: 12.99% » Monthly Payment: $50

11. Calculate the number of months it would take to pay off this debt.

    23 months

12. Calculate the total amount (principal and interest) needed to pay off this debt if you pay $50 per month. *(# of months) × (monthly payment amount)*

    23 (months) × 50 = $1,150

13. Calculate the total amount of interest that would be paid on this debt. (*Total amount paid) – (principal)*

    1,150 – 1,000 = $150

14. Compare the total amount of interest paid in Scenario 1 to Scenario 2. Calculate the amount of money you would save by paying more than the minimum amount.

    260 – 150 = $110 saved

NAME: ______________________ DATE: ______________

Hidden Costs of Credit (1/3)

Directions

The following terms are found on credit card disclosure form. Work with a partner to locate the following information on the sample disclosure statement.

- **Annual Fee:** The fee a credit card company charges for the use of their credit card
- **Credit Limit:** The maximum amount of money the lender is willing to loan an applicant
- **Finance Charge:** The total cost of using credit including interest and fees
- **Origination Fee:** The charge for setting up a loan (often associated with home loans)
- **Loan Term:** The length of time you have to pay the loan. Remember, the longer the loan, the lower your monthly payment, the greater the interest paid.
- **Grace Period:** The length of time that the lender charges no interest on money borrowed when paying off your balance in full each month
- **Annual Percentage Rate:** The cost of the loan each year expressed as a percentage. All lenders are required by law to calculate APR the same way.
- **Introductory Rate:** Lower interest rate offered by credit card companies, usually for a short period of time, to entice you to sign up for credit with them. Eventually, the rate expires and a new "increased" rate takes effect.

Questions

Use the Sample Disclosure Form to answer questions 1–7.

1. Explain when this credit card company can adjust the APR.

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2. What is the annual fee for having this credit card?

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3. What is the grace period on this card?

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4. What is the APR for this credit card?

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5. How much will it cost, in fees, to transfer a $1,000 balance to this card?

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6. What is the charge if you exceed your credit limit?

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7. What will your charge be if your payment is late, and how will it affect your APR?

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Hidden Costs of Credit (2/3)

Questions (Continued)

Go to foundationsU.com and locate the "Debt Snowball" under "Tools." Enter the numbers for the two following scenarios to compare the total cost of reducing a $1,000 credit card balance to zero with minimum payments versus above-minimum payments.

(Note: the following scenarios do not use the Sample Disclosure Form.)

Scenario 1: Making Minimum Payments

- Total Debt (also called the *principal amount*): $1,000
- Interest Rate: 12.99%
- Minimum Payment: $30

8 Calculate the number of months it would take to pay off this debt.

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9 Calculate the total amount (principal and interest) needed to pay off this debt if you only make the minimum $30 per month payment. *(# of months) × (monthly payment amount)*

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10 Calculate the total amount of interest that would be paid on this debt. (*Total amount paid) – (principal)*

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Scenario 2: Choosing to Pay More Than the Minimum Amount

- Total Debt: $1,000
- Interest Rate: 12.99%
- Monthly Payment: $50

11 Calculate the number of months it would take to pay off this debt.

____

12 Calculate the total amount (principal and interest) needed to pay off this debt if you pay $50 per month. *(# of months) × (monthly payment amount)*

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13 Calculate the total amount of interest that would be paid on this debt. (*Total amount paid) – (principal)*

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14 Compare the total amount of interest paid in Scenario 1 to Scenario 2. Calculate the amount of money you would save by paying more than the minimum amount.

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Hidden Costs of Credit (3/3)

Sample Disclosure Form

Annual Percentage Rate (APR) for purchases	A 0% fixed APR until the first day of the billing cycle. After that, **11.99%** fixed, **14.99%** fixed, or **21.99%** fixed, depending on our review of your application and credit history (a).
Other APRs	Balance Transfer APR: 0% fixed APR until the first day of the billing cycle. After that, 11.99% fixed, 14.99% fixed, or 21.99% fixed, depending on our review of your application and credit history. Cash Advance APR: 25.24% variable Default APR: Up to 34.24% variable. See explanation below (b).
Variable rate information	The following APRs may vary monthly based on the Prime Rate (c): Cash Advance APR: The Prime Rate plus 16.99%. Default APR: The Prime Rate plus up to 24.99%.
Grace period for repayment of purchase balances	At least 20 days.
Method for computing the balance for purchases	Average daily balance method (including new purchases).
Annual fee	None
Minimum finance charge	$1.00
Transaction fee for balance transfers	3% of the amount of each transaction, but not less than $5.00 nor more than $99.00.
Transaction fee for cash advances	3% of the amount of each transaction, but not less than $10.00
Late payment fee	$15.00 on balances up to, but not including, $100; $29.00 on balances of $100.00 up to, but not including, $250.00; and $39.00 on balances of $250.00 and over.
Over-the-Limit fee	$39.00
International transactions	3% of the U.S. dollar amount of the transaction, whether originally made in U.S. dollars or converted from a foreign currency.

(a) Rates, fees, and terms may change: We reserve the right to change the account terms (including the APRs) at any time for any reason, in addition to APR increases that may occur for failure to comply with the terms of your account. For example, we may change the terms based on information in your credit report, such as the number of other credit card accounts you have and their balances. The APRs for this offer are not guaranteed; APRs may change to higher APRs, fixed APRs may change to variable APRs, or variable APRs may change to fixed APRs. Any changes will be in accordance with your account agreement.

(b) Your APRs may increase if you default under any Card Member Agreement you have with us for any of the following reasons: We do not receive at least the minimum payment due by the date and time due; you exceed your credit line on this account if applicable; or you make a payment to us that is not honored by your bank. Your APRs may increase as of the first day of the billing cycle in which the default occurs. We may consider the following factors to determine the default rate: the length of time your account has been open; the existence, seriousness and timing of defaults; other indications of your account usage and performance; and information about your other relationships with us or any of our related companies.

(c) The "Prime Rate" is the highest prime rate published in the Money Rates column of *The Wall Street Journal* two business days before the closing date on the statement for each billing period.