

Credit Cards

Most students have to borrow money at some point during their time at University. Credit Cards are one of the easiest and most common ways in which to do this. However for most students they will not necessarily be the most appropriate or cheapest way, in which to borrow money. This leaflet aims to give you a clearer understanding of how credit and credit cards work. It covers:

- Different types of credit cards and how they work
- The costs involved with credit
- Tips for getting the best deal? - The right card for you is one that charges you the smallest amount for the services you use.
- How to manage your credit card

WHAT IS A CREDIT CARD AND HOW DOES IT WORK?

There are basically three types of credit cards:

- **Bank Cards** - issued by banks (e.g. Visa, MasterCard)
- **Charge Cards** - such as American Express.
- **Store Cards** - issued by an individual shop or a chain of stores.

Unlike a debit card where you need money in a bank account to buy things, you don't have to have cash or a bank account to spend on a credit card.

- A credit card allows you to **borrow** money to buy goods and services and spread the payments out over a period of time.
- A bank or credit card company will set a **credit limit** for you; e.g. £1000, the maximum amount that you are allowed to spend.
- The credit card company will allow you to pay back the money you owe on your card in monthly instalments or, if you can afford it, you can pay off the whole thing when the bill comes in.
- If you are paying the amount off in instalments, your credit card provider will give you a minimum amount that you will have to pay each month, this is called the **minimum payment**. The minimum payment is a small percentage (usually between 2-5%) of your full balance.
- If you do not pay the balance in full each month you will be charged interest.

HOW MUCH DOES A CREDIT CARD COST?

The main things to consider when getting a credit card are:

- APR
- Interest Rates
- Late fees
- Over limit fees
- Annual fees

WHAT IS INTEREST AND APR?

Charging interest is how financial organisations make their money. If you do not pay off the full amount that you have borrowed within a certain period of time (normally 28 days), the credit card company will charge you a fee for borrowing the money, and this is called interest.

- The amount of interest that you pay differs between credit cards.
- The amount of interest that you will pay will be determined by the APR of the credit card. APR stands for Annual Percentage Rate and will be shown as a percentage, for example 14.9%.
- All lenders have to tell you what their APR is before you sign an agreement. It will vary from lender to lender. Generally, the lower the APR the better the deal for you, so shop around. The APR does not include annual charges or fees.
- Interest is charged at different rates for different services even if you are using the same card. The different rates will be explained in the terms and conditions given to you when you apply for the card.
- Many credit cards now have introductory rates of 0% interest for the first 6-9 months of owning your credit card. This allows you to make minimum payments without having to pay interest charges for a set period of time. However once this period finishes it is usually followed by a much higher interest rate.

MINIMUM PAYMENTS

Making only the minimum payment each month is a very expensive way to borrow in the long term. Suppose you have a debt of £1000 on your credit card and interest is charged at 18% per year. If you pay off the minimum each month, which for example is **3%** (or **£5** if this is less), then in the first month you would need to pay **3%** of **£1000 = £30**. **(Note that the minimum to pay on some cards can be different.)**

The **£30** would then be deducted from your next month's bill but interest calculated on a daily basis would be added on, which as a rough estimate would be **£20** or more. As you can see although you are paying off the debt you also have interest charges each month which means you are not paying off anything like as much as **£30**. In fact it would take you **13** years to pay off the whole balance and the total payments would amount to **£1772** which is **£772** more than you first owed.

The best way to use your credit card is as a convenient way of paying for things, **not** as a way to borrow money.

WHAT OTHER CHARGES WILL I HAVE TO PAY?

Annual Credit Card Fees

Some credit cards have a flat, yearly charge similar to a membership fee. Many companies offer "no annual fee" cards today but not all, so remember to consider this when you are choosing which one is right for you.

Late payment fees

If you do not pay your minimum payment on time, the credit card company will charge you a late payment fee, as well as the interest owed. This charge may be more than the amount you owe so be very careful to check what the charge is, and to ensure that all your payments are made on time. A good way of doing this is to set up a direct debit from your current account. You will also be charged if you go over your credit limit. Banks and credit card companies have different charges so contact your provider for details.

BANK CHARGES

On 5 April 2006, the Office of Fair Trading (OFT) concluded that steep charges for late payments on credit cards were "unjustifiable" and "legally unfair" in terms of the Unfair Terms in Consumer Contract Regulations. Unfair terms are legally unenforceable. The OFT stated that it would take court action against banks that charged late payment fees above their maximum charge of £12.

If charges exceeding £12 apply to your account, you may wish to write to your bank or credit company to provide them with an opportunity to voluntarily refund charges. Make sure you keep copies of the letters you send. If your bank refuses to give a refund, you should try writing again to your bank stating the terms of the Unfair Terms in Consumer Contract Regulations. If you don't get a response after 7 days, you should consider raising a small claims action for payment.

Alternatively you may wish to make a claim through the Financial Ombudsmen if you prefer not to go through the court system. For this you would have to go through the company's complaint procedure.

CAN I USE A CREDIT CARD TO MAKE CASH WITHDRAWALS?

You can withdraw money with your credit card. Banks and credit card companies will charge a handling charge or fee of about 1.5% of the amount you take out, with a minimum charge of £1.50. For example, if you took out £200 from the cash machine you would be charged a £3

handling fee. If you need to draw money out on a regular basis, it is advisable to draw out larger amounts less often however it is not advisable to use a credit card in this manner if you can help it.

BALANCE TRANSFERS

Card issuers sometimes offer you a lower rate of interest if you swap your balance from your existing card onto one of their cards. This is called a balance transfer. You should be aware that some credit card companies charge a one-off balance transfer fee, so the interest rate may not be the only cost to consider. If you transfer a balance to a new card or cards think about whether you still need the old credit card. If not, cut the old card in two, return it to the credit card company and tell them to close the account.

Things to consider about balance transfers:

- How long the introductory lower rate of interest lasts.
- What the interest rate is after the special offer ends.
- How other terms and conditions, such as credit limits, payment dates, interest calculation, fees and charges etc., compare with your present card.

HINTS AND TIPS

- If you want to borrow, check that your credit card is the most effective way for what you want to buy. Is it something that you want to pay off quickly or over a longer period of time? Check that there is no other more appropriate forms of credit.
- A credit card can give your finances flexibility but long-term, credit card debt can be more expensive compared to the alternatives, such as a personal loan or overdraft.
- For major purchases plan your budget carefully.
- If you believe you have more credit than you can resist, talk to your credit card company and ask them to reduce your limit.
- Credit is not "free money"!
- Shop around, use comparison websites but be careful of introductory rates and always read the small print
- If you no longer want or need your old card, remember to cancel that card with your old credit card company and close the account.
- Most credit card companies offer the ability to have an additional cardholder (s) on an account, say for a partner or family member. However, remember that it is the main account holder who has signed the credit agreement with the credit card company and is therefore legally responsible for paying off the spending of all cardholders on the account.
- DO NOT use your credit card as a means of buying goods and enjoying a lifestyle that is beyond your means.
- ALWAYS be aware of all of your Credit Card fees

- Making minimum payments is one of the most common mistakes you can make. If you pay more than what is required each month, you will save lots of money on interest and get to debt-free goals sooner.

WHAT ARE THE PROS AND CONS OF CREDIT CARDS?

Advantages

Using a credit card can be a useful way of making purchases and has a number of advantages. For example:

- You don't need to carry huge amounts of cash around
- You can buy items over the Internet.
- You can make purchases abroad without having to worry about local currency (However there is likely to be charges for this).
- You can spread the cost of a large payment over several months.
- A credit card is useful in an emergency, for example, an unexpected repair to your house or car.
- There is additional security, for example Purchase cover (Insurance covering your purchase for a set number of days against theft or damage) and Fraud guarantee (This guarantees you against any fraud on your card.)
- For purchases over £100, the Credit Card company becomes jointly liable for any purchase giving added security on goods.

Disadvantages

Although credit cards can be a convenient way of shopping, remember that you are effectively borrowing money. It is like taking out a short-term loan. Credit cards can:

- Lead to lots of debt that you could find difficult to repay.
- Incur charges if you make late payments or exceed your credit limit.
- Damage your credit rating if you continually make late payments or miss them altogether. This may make it difficult to get things like a mortgage in the future.
- Cost you more and take you longer to pay off than the alternatives, particularly if you only ever make the minimum repayment. If you need to borrow money, look at low-interest loans as an alternative to a credit card.
- Make it difficult to manage your finances if you have more cards than you need. There is no limit to the number of credit cards that you can have, therefore it is very easy for debt to get out of control.

To help minimise the risks you must always be honest and responsible when completing an application form. If you are not honest you could be charged with defrauding the card company and risk prosecution. You may also end up with a very high credit limit that will encourage you or tempt you into spending more.

HOW DO I MANAGE MY CREDIT CARD?

Each month, your bank or credit card company will send you a statement, either by post or via email. This gives details of all your recent transactions (purchases) and what you need to pay (minimum payment). It also details any interest charges that you may have.

Always check every transaction on the statement to ensure that they are legitimate and made by you.

If you spot a mistake on your statement, a charge for something that you did not buy, or an item that wasn't delivered as agreed, or you do not recognise a transaction that is listed, contact your card company immediately. If you report an item that you do not recognise then the credit card company will put it into dispute. Putting an item into dispute means that your bank or Credit Card Company will investigate the purchase on your behalf.

CREDIT CARD DEBT

If you find yourself getting into financial difficulties with your credit card(s) then contact the Advice Centre. We can offer advice and assistance with dealing with credit card debts and negotiating with creditors etc. For more info on debts see our "Debt" leaflet.

FURTHER INFORMATION

www.moneysupermarket.com www.choosingandusing.com
www.moneyextra.com

Comparison websites allow you to view credit card terms and conditions and offers, and choose the one that suits you best. Check out

www.cardwatch.org.uk
information about credit card fraud.

www.moneymadeclear.fsa.gov.uk
Shopping for credit, OFT and FSA consumer information