

# Credit Card IQ

## A Guide for Teenagers



A credit card may look like a simple piece of plastic. However, there's a complex system behind how a credit card actually works. Before applying for a credit card, it's important that you understand how it works and how to use it wisely. It's good to learn about credit cards while you are still young so you don't find yourself in debt as an adult. Cedar Point Federal Credit Union is providing this packet as a resource to help teenagers make wise spending decisions and raise their "Credit Card IQ." Before making any decisions about opening a credit card, speak to your parent or guardian for their advice and guidance.

### Credit

Let's start by learning what the word "credit" actually means. Basically, credit is an agreement to purchase a good or service with the promise to pay for it later. When you use a credit card, you are essentially taking out a loan to pay for your purchase and agreeing to pay back that loan with interest. You can only use your credit card up to a specified amount, known as your line of credit. Each month, you will receive a bill for the purchases you've made. If you are unable to pay the entire balance due, you will be charged interest for your remaining balance. You may also be charged annual fees or late payment fees depending on the terms of your credit card. It's important to read and understand all the fine print before opening a credit card.

### Interest

You cannot borrow money for free. You will need to pay interest. Interest is a charge for the privilege of borrowing money, typically expressed as a percentage rate such as an annual percentage rate (APR). Your interest rate can vary depending on the type of card you use and your credit score. Simple math will tell you how much you will pay. Let's say you have a credit card that has an APR of 18%. That means that you will be charged 18% of your balance for the privilege of borrowing money. For example:

- If your interest rate is 15% and you carry a \$500 balance, you would owe roughly \$75 in interest after a year.
- If your interest rate is 20% and you carry a \$1,000 balance, you would owe roughly \$200 in interest after a year.

### Debit Cards

Keep in mind that a credit card and a debit card are two different things. They may look similar, but a debit card does not extend credit. A debit card withdraws money directly from your bank account at the time of the purchase. With a debit card, you can only spend money that you have available in your checking account. Debit cards do not have interest rates attached. However, if you spend more money than you have in your account, you may be charged overdraft fees.

## Minimum Payments

When you receive a credit card bill, you will be offered a minimum payment. This is the smallest amount of money you are allowed to pay toward your credit card bill that month. Paying the minimum amount will keep your account in good standing, but allows interest charges to add up over time. It can be easy to get into the habit of paying only the minimum payment and not the entire balance owed. However, that method can lead to significant debt. Depending on how high your balance is, it could take months or years to pay off a credit card if you are only paying the minimum payment. It's best to only purchase what you can afford and pay the balance in full every month.

## Cash Back and Rewards

Some credit cards offer benefits. For example, you could receive 5% cash back on all of your purchases. That means that for every \$100 dollars you spend, you get \$5 back. This is enticing to many people because it seems like you will make money by using the credit card. However, keep in mind that any cash back you receive will essentially be cancelled out you are charged interest. You must completely pay off your credit card balance every month to really take full advantage of these rewards.

## Pros and Cons of Credit Cards

Using a credit card has its advantages and disadvantages. You must weigh the pros and cons before deciding if a credit card is right for you. Think about your personal finances and spending habits to add additional pros and cons to the chart below. Ask your parent or guardian about their experience using credit cards. Hearing about an adult's financial experiences can help you make smart decisions about your own finances.

### PROS

- Allows you to make a big purchase and pay over time
- Convenience
- Rewards
- Improves your credit score if used responsibly
- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_

### CONS

- Can lead to overspending and/or debt
- Interest Rates
- Fees
- Damages your credit score if used irresponsibly
- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_

Now that you have a basic understanding of credit cards, continue on to the next page to test your Credit Card IQ!

# Credit Card IQ Quiz

Define the following terms:

Minimum payment – \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

Credit – \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

Interest – \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

Answer the following questions:

What does APR stand for?

What is the difference between a credit card and a debit card?

What can you do at your age to begin preparing for the responsibility of a credit card?

Ask a family member or friend about their experience with credit cards? What did you learn from him or her?