**Module 3:**

**Credit/Credit Score/Borrowing**

**Start with a Video: Here is a link;**

[**https://www.youtube.com/watch?v=h4Z5S8W96v0**](https://www.youtube.com/watch?v=h4Z5S8W96v0)

**Here is a link to an Infographic on Cash advances on the credit card:**

**http://www.fcac-acfc.gc.ca/Eng/forConsumers/topics/creditCards/Pages/infographic-cash-advances.aspx?WT.mc\_id=20160205-FebWeek1-RR-landpage-cc-info**

**Understanding Credit:**

**Many consumers use credit to help manage their personal finances. Credit can be a mortgage to buy a house, a loan to buy a car, a line of credit for larger purchases or a credit card to make everyday purchases more convenient. It's important to understand how different types of credit work, and how to use credit to build a strong personal credit history. This section provides information on how a credit card transaction works, credit card products, budgeting, and avoiding money mishaps. Understanding credit is the key to using it wisely and making it work for you.**

**Canadian Bankers Association is a great source for information on Credit and how to use credit wisely.**

Financial Consumer Agency of Canada provides a great resource on Credit Score and Credit Reports. Here is a link:

<http://www.fcac-acfc.gc.ca/eng/resources/publications/creditloans/pages/understa-comprend.aspx>

**Credit Cards:**

How well do you understand your credit card and the interest you pay on your card?

Did you know

If you carry a balance on your credit card, your interest charges will increase the cost of everything you buy.

On the other hand, if you pay off your balance in full each month and don’t use the card for cash advances or cash-like transactions, you won’t pay any interest.

Understanding your credit cards payment terms

**Interest-free grace period**

You can benefit from an interest-free period, also known as the grace period, when you make purchases with your credit card. **To do so, you must pay the balance in full by the current month’s due date.** The grace period on new purchases officially starts on the last date that is included in your monthly billing period.

The grace period on new purchases must be a minimum of 21 days as long as you pay the full balance by the current month’s deadline. The 21-day grace period on new purchases applies even if an outstanding balance has been carried forward from the previous month.

**The interest-free period does not apply to balance transfers or cash advances. With these transactions, interest is charged right away.**

**Example:**

John made a new purchase on May 5. His statement covers transactions he made between May 1 and May 31.

His statement shows the due date for his payment as June 21. This means that he will have a 21-day grace period from the last date included in the statement (May 31), provided that he pays the balance in full by June 21.

***Avoiding interest charges***

**You will never have to pay any interest if:**

1. you always pay the full amount owing on your credit card by the payment due date;

**AND**

2. you don’t use your credit card to take [**cash advances**](http://www.fcac-acfc.gc.ca/Eng/resources/Pages/Glossary-Glossair.aspx#C)or make [**cash-like transactions**](http://www.fcac-acfc.gc.ca/Eng/resources/Pages/Glossary-Glossair.aspx#C), such as a wire transfer or money order.

**How is the interest calculated on your purchases?**

If you don’t pay the amount owing on your credit card in full by the due date, you will pay interest, which increases the cost of everything you have charged to your card.

| **Transaction type** | **How interest is calculated** |
| --- | --- |
| **New purchases** *(purchases that appear on your monthly statement for the first time)* | You are not charged interest on the first monthly statement. |
| **Previous purchases** *(purchases that were listed on a previous statement where the full amount owing was not paid by the due date)* | You are charged interest back to the date you made these purchases **until you make a payment that covers the full amount of these purchases**. |
| [**Cash advances**](http://www.fcac-acfc.gc.ca/Eng/resources/Pages/Glossary-Glossair.aspx#C)**,**[**balance transfers**](http://www.fcac-acfc.gc.ca/Eng/resources/Pages/Glossary-Glossair.aspx#B)**and**[**“cash-like” transactions**](http://www.fcac-acfc.gc.ca/Eng/resources/Pages/Glossary-Glossair.aspx#C) | You are charged interest from the date you made the cash advance or balance transfer until the date you repay the total amount in full.  You don’t benefit from an interest-free period on these transactions. |

**Cash Advances?**

**The interest-free period does not apply to balance transfers or cash advances. With these transactions, interest is charged right away.**

**Payment history and credit score?**

**Minimum monthly payments**

The minimum monthly payment is the minimum amount you have to pay for a given month if you are carrying a balance on your credit card.

If you don’t pay the minimum amount by the due date, your credit score could be lowered. The lower score could reduce your chances of getting a loan in the future.

Your credit agreement will tell you how your minimum payment is calculated. A common method is either a flat dollar amount (usually $10) or a percentage of your outstanding balance, whichever is greater.

**Keep in mind that paying only the minimum amount you owe is very costly because interest will continue to grow.**

**Example:**

Amy has an outstanding balance of $2,000.00 on a credit card with an 18% interest rate. Her minimum payment is $10.00 or 2% of the balance, whichever is greater. Amy’s minimum payment would initially be $40.00 (2% of $2,000).

* If Amy makes only the minimum monthly payment of $40.00 every month, it would take her **30 years and 10 months**to pay off her balance in full AND she would end up paying**$4,931.11 in interest**.
* If Amy were to increase her monthly payment to $100.00, she would take only **two years** to pay off the balance in full and she would pay **$395.65 in interest**.

This example illustrates how expensive it can be to pay only the monthly minimum amount. Increasing the monthly payment by even a small amount can drastically shorten the length of time it will take you to pay off a credit card balance.

**How payments are applied to your balance**

If you do not pay off your balance in full, it’s important to understand how your credit card issuer will apply your payment against your balance. Federally regulated financial institutions, such as banks, must follow certain rules when applying your payment to your account.

Keep in mind that the credit card issuer can charge different interest rates for different types of transactions. For example, for purchases, your interest rate could be 18%, but for cash advances and balance transfers, it might be 21%. Check your credit card agreement or disclosure statement, because these interest rates must be outlined in the agreement or statement. If they are not, contact FCAC to review your agreement.

Credit card issuers can apply the **minimum payment** any way they want. However, if you pay more than the minimum amount, your credit card issuer has to apply the amount over the minimum payment in one of two ways:

1. to the part of your balance with the highest interest rate, and then in descending order to the rest of your balance (next highest interest rate to lowest), or
2. proportionally to all interest rate categories of the balance.

Try FCAC’s [**Credit Card Payment Calculator**](http://www.fcac-acfc.gc.ca/Eng/resources/toolsCalculators/Pages/CreditCa-OutilsIn.aspx)to see how increasing your payment will help you be debt-free sooner.

**Example:**

Let’s say you are carrying a $2,000 balance that includes $1,500.00 of purchases and $500.00 of cash advances. If you make a payment of $700.00 in addition to the minimum payment, your payment could be applied as follows:

| **Method one: Highest interest rate to the lowest** | | | |
| --- | --- | --- | --- |
| **Type of transaction** | **Interest rate** | **Portion of balance** | **Amount applied to each transaction type** |
| **Cash advances** | 21% | $500.00 | $500.00 |
| **Purchases** | 18% | $1,500.00 | $200.00 |

Using method one, your $700.00 payment (over the minimum payment required) would pay off all of the cash advances, which have a higher interest rate. The remaining portion of the payment ($200.00) would be applied to the portion of the balance with the lower interest rate (purchases).

| **Method two: Payment applied proportionally** | | | |
| --- | --- | --- | --- |
| **Type of transaction** | **Interest rate** | **Portion of balance** | **Amount applied to each transaction type** |
| **Cash advances** | 21% | $500.00 (25%) | $175.00 (25% of payment) |
| **Purchases** | 18% | $1,500.00 (75%) | $525.00 (75% of payment) |

Using method two, 25% of your payment ($175.00) would be applied to the cash advances, because cash advances account for only 25% of the balance. The other 75% of your payment ($525.00) would go toward the purchases, because they account for 75% of the balance. This means that you will continue to pay interest on $325 of cash advances at the higher interest rate.

**Why is it important to pay on time even if it’s the minimum required payment?**

The minimum monthly payment is the minimum amount you have to pay for a given month if you are carrying a balance on your credit card.

If you don’t pay the minimum amount by the due date, your credit score could be lowered. The lower score could reduce your chances of getting a loan in the future.

Your credit agreement will tell you how your minimum payment is calculated. A common method is either a flat dollar amount (usually $10) or a percentage of your outstanding balance, whichever is greater.

**Keep in mind that paying only the minimum amount you owe is very costly because interest will continue to grow.**

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***What happens if you make a late payment?***

It’s important to pay your credit card bill on time. If you don’t pay by the due date indicated on your statement, **you’ll be charged interest on the entire amount you owe until you pay it in full.**

Late payments could also result in:

* penalties, such as an increase in your interest rate
* **damage to your credit score**
* your card being cancelled by your issuer.

**Borrowing on your credit card**

It’s never a good idea to borrow money from your credit card. Why?

High interest rate and it’s charged from day 1. This should be your last resort.

**Understanding your credit Report and credit score**

**What is a credit report?**

Your credit report is a summary of your credit history. If you have ever used a credit card, taken out a personal loan, or used a “buy now, pay later” offer, you have a credit history.

Your credit report is created when you borrow money or apply for credit for the first time. Lenders send information about your accounts to the credit reporting agencies. Your credit report also includes personal information that is available in public records, such as a bankruptcy.

Your credit report contains factual information about your credit cards and loans, such as:

* when you opened your account
* how much you owe
* whether you make your payments on time
* whether you miss payments
* whether you go over your credit limit.

Mobile phone and Internet accounts may be reported, even though they are not credit accounts.

Chequing and savings accounts that have been closed “for cause,” due to money owing or fraud committed by the account holder, can also be included.

**What is a credit score?**

A credit score is a three-digit number that is calculated using a mathematical formula based on the information in your credit report. You get points for actions that demonstrate to lenders that you can use credit responsibly. You lose points for things that show you have difficulty managing credit. To find out what counts toward your credit score,

In Canada, credit scores range from 300 to 900 points. The best score is 900 points.

Lenders and credit reporting agencies produce credit scores under different brand names, such as Beacon, Empirica and FICO®.

Your score will change over time as your credit report is updated.

Businesses use your credit report and score to see how risky it would be for them to lend you money. It is up to each lender to decide on the lowest score you can have and still borrow money from them. Lenders may also use your score to set your interest rate and credit limit. If you have a high credit score, you may be able to get a lower interest rate on loans, which can save you a lot of money over time.

While they are very important, credit scores are usually not the only thing a lender will look at. Often, they will also consider other factors, such as your income, job or any assets you own.

**Why might the credit score I receive be different from one a lender is using**?

A credit score you order for yourself may not be the same as a score produced for a lender.

This can happen even if they are created at the same time using the same information in your credit report because there are different types of credit scores that are designed to meet the needs of lenders.

A lender may put more weight on certain information depending on the reason it is calculating your score. For example, it may want to assess your risk of becoming bankrupt or determine whether you qualify for a mortgage.

Your own credit score should still be in the same range as a score created for a lender.