



Financial Literacy

Participant Handbook

Credit basics



Module 6 - Credit Basics

HANDOUT 6-1

Types of credit

Type of credit	Lender	Uses	Conditions
Revolving credit			
Credit Cards (secured and unsecured – NOT prepaid)	Financial institution	To make purchases, pay bills, make reservations, rent products, buy online	Has a credit limit amount with a minimum payment required. Interest rates vary. There may be extra fees and benefits.
Department store card	Retail store	To make purchases at that store only.	Has a credit limit amount with a minimum payment required. Higher interest charges (28%) than a regular credit card (19%).
Overdraft protection	Financial institution	Connected to your bank account. Protects against small cash shortages and NSF fees.	Fees for use plus interest costs.
Line of credit	Financial institution	To making purchases.	Has a credit limit amount with a minimum payment required. Interest rates are often low.
Installment credit or loans			
Pay Day loans	Private businesses	Short term cash needs.	Amount based on income. Term no longer than 1 month. High fees.
Buy Now Pay Later loans	Retail stores	Buy higher cost household items, such as furniture.	Pay in full by due date in one lump sum or instalments. Set up fees may apply. If the loan is not paid in full by the due date, high interest fees apply and go back to the date of purchase.
Rent-to-own	Retail stores	Buy higher cost household items and pay in instalments.	Terms and conditions vary widely. Fees can double the amount paid beyond the original cost of the item.
Consumer loan	Financial institution	Make large purchases (car, renovations, computer).	Receive a lump sum with a set interest rate and repayment schedule. Interest rates vary.
Mortgage	Financial institution	Buy house or other property.	Requires a down payment of 5-20%. Receive a lump sum with a set repayment schedule over many years (20-35). Terms of the agreement set for 1-5 years. Interest rates can be fixed or variable.
Student loan	Government	Pay for education (tuition, books, living expenses).	Low interest rates. Repayment begins after student leaves school. Amount depends on financial need.

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HANDOUT 6-2

Credit card features

Annual fee: A yearly fee you pay for the use of a credit card

- › Fees vary. Not all cards have fees.
- › Cards with fees usually have some benefit, such as lower interest rates, reward programs, or higher credit limits

Annual Percentage Rate (APR): The interest you owe on the amount not repaid in full by the due date

- › Different credit card types have different APRs. It is important to compare them.
- › If you do not pay your balance in full each month, you are charged interest from the moment you buy something.

Credit limit: The maximum amount you can borrow on your credit card

Grace period: The amount of time you have to pay the balance on the card before you are charged interest

- › Grace periods start on the date listed on your credit card bill. They must be at least 21 days.
- › If you pay in full each month by the due date, you will never be charged interest.

Minimum payment: The smallest amount you must repay, usually 2% to 10% of your balance owed

- › If you only pay the minimum, the interest compounds. That can make the actual cost of your debt very high.

Rewards programs: Allow you to collect points or air miles every time you use your card. You redeem them later for goods, services, or travel.

Insurance and other benefits: Some cards come with insurance for rental cars, travel, and life insurance. Some have balance protector insurance that will pay off the balance on your card if you lose your job or die.

Cash Advance: Allows you to borrow cash from your credit card. There is usually no grace period. That means interest charges begin from the time of the advance. They often have a higher interest rate.

TIP: Prepaid cards are not a form of credit: These cards charge fees for you to access your own money loaded onto the card.

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HANDOUT 6-2, continued

Choosing a credit card

Step 1 – Know your wants and needs

What will you be using your credit card for? Will you use it mostly for large purchases, or will you use it more often? Knowing how you will use the card can help you narrow down which options are best for you.

Step 2 – Do your research

Take the time to look into the different features and services you can get. Some cards have no annual fees. Others have low interest rates. Some have rewards programs that could help you save money. Choose the card that will meet your needs for the lowest cost.

Step 3 – Shop around

Once you know which features are important to you, compare cards offered through different financial institutions. The cost for features may vary between cards, such as annual fees and interest rates.

The Financial Consumer Agency of Canada (FCAC) has a Credit Card Selector Tool on its website. Use it to help you select the best card for you. <http://www.fcac-acfc.gc.ca/eng/consumers/ITools/Credit-Cards/default.asp>

Step 4 – Read the fine print

Before you sign any credit card agreement, read it with care. Make sure you are getting what you think you are getting. Check for hidden costs. Ask questions if there is something you do not understand. This is your money!

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HANDOUT 6-3

The cost of credit

How interest is calculated on a credit card: an example

- › The Visa interest rate is 20% annually.
- › The balance owing on this card is \$1000.
- › Monthly interest charges are the balance, multiplied by 20%, and divided by 12 months.

$$\text{\$1000} \times .2/12 = \text{\$16.67 interest per month}$$

- › If you pay the 2% minimum payment of \$20, you will only be paying \$3.33 toward the \$1000 balance. The rest will go to pay the interest..

$$\text{\$1000} + \text{\$16.67} - \text{\$20} = \text{\$996.67}$$

Here is what happens if you make only the minimum payment for three months:

	Payment	To interest	To principle	Balance
1st month	\$20.00	\$16.67	\$3.33	\$996.67
2nd month	\$19.93	\$16.61	\$3.32	\$993.35
3rd month	\$19.87	\$16.55	\$3.32	\$990.03

- › If you only pay the minimum payment of 2% toward your debt each month, it will take you more than **26 years** to pay off the debt. This will **cost over \$3000** in interest!

How interest is calculated on a loan: an example

- › This is a \$1000 loan at 12% interest, to be paid over a two year period.
- › Equal monthly instalment payments would be \$47.07
- › Each month, as the balance goes down, you pay less interest and therefore more toward the principal.

	Payment	To interest	To principle	Balance
1st month	\$47.09	\$10.00	\$37.09	\$962.91
2nd month	\$47.09	\$9.63	\$37.46	\$925.46
3rd month	\$47.09	\$9.25	\$37.84	\$887.62

The full payment schedule would include 24 payments. The total interest cost would be \$130.16

The online calculators used to calculate these payments are included in the resources handout for this module.

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HANDOUT 6-3, continued

Comparing the cost of credit

Payment Method	Cost of item	Sales Tax at 12%	Interest and fees	Total cost of item
Cash	\$1000	\$120	0	\$1120.00
Buy Now, Pay in 1 Year – pay balance in full on time (no interest)	\$1000	\$120	\$50 set up fee	\$1170.00
Buy Now, Pay in 1 Year – pay balance in full but one week late (28% interest from date of purchase)	\$1000	\$120	\$50 set up fee \$373.09 interest	\$1543.09
Buy Now, Pay in 1 Year – begin to make \$100/month payments after due date	\$1000	\$120	\$50 set up fee \$765.52	\$1935.52
Credit card – pay in full by due date	\$1000	\$120	0	\$1120.00
Credit card – make minimum payment only at 20% interest	\$1000	\$120	\$3083.97 interest over 26 years 4 months	\$4083.97
Rent to own – weekly rental fee and buy out at end of contract	\$1000	\$3.60 /week	\$30.00 /week rental fee plus tax \$100 buy out at end of contract	\$1747.20

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HANDOUT 6-4

Managing credit

- › Only use as much credit as you can afford to pay back.
- › Do not treat credit like free money – it can be very expensive money.
- › Shop around for the lowest interest rate.
- › Understand your agreement. Make sure you know the payment deadlines and the penalties for late payments.
- › Avoid “maxing-out” or using all your available credit.
- › Figure out the total price you are paying when you use credit. How much will it cost with interest?
- › Read your credit card statements. Make sure the charges and purchases listed are correct. If they are not correct, call your credit card company right away.
- › Mark your payment deadlines on a calendar. Allow a few days for processing time before the due dates.
- › Pay your full balance by the due date every month if you can.
- › Do not miss payments. If you cannot pay the full amount, always make at least the minimum payment.
- › Tell your creditor if you cannot make a payment on time. Many lenders will be willing to help you manage your payments if you ask them.
- › Use pre-authorized payments if possible. These are automatic payments that go to paying off your loan.

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ACTIVITY SHEET 6-5

Goal-setting

Example:

Goal: Get a lower interest rate on my credit card	When? December 2011
Tasks: <ul style="list-style-type: none"> › Read through my statement to confirm my current interest rate. › Locate the customer service number for my card. › Call customer service and ask for a lower rate. 	End of this week Next Monday Next Monday
1. Goal:	
Tasks:	When?
2. Goal:	
Tasks:	When?

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HANDOUT 6-6

Resources

Financial Consumer Agency of Canada www.fcac-acfc.gc.ca

This website offers interactive tools such as a Credit Card Selection Tool and Credit Card Payment Calculator. There are many helpful resources on credit card features.

Can Learn www.canlearn.ca

This site has information about student loans, grants, and scholarships from the government of Canada.

National Student Loans Services Centre <https://nslsc.canlearn.ca>

If you have received a Canada or Integrated Student Loan, then this website is for you. The National Student Loans Service Centre gives you information and details about your student loan.

Canadian Mortgage and Housing Corporation www.cmhc-schl.gc.ca

This website has information about housing and mortgage insurance in Canada.

TD Personal Loan Calculator www.tdcanadatrust.com/lending/tools/loan_calc.jsp

This calculator helps you figure out a repayment schedule for a loan based on the loan balance, interest rate, and length of the loan.

MasterCard www.mastercard.com/canada/

This website provides cardholder information and resources for understanding credit card terms and conditions.

Visa www.visa.ca

This site provides cardholder information and resources for understanding credit card terms and conditions.

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HANDOUT 6-7

Glossary

annual fee: A fee charged once a year by many credit card companies

collateral: Items of value that are promised to the lender in the event the borrower does not repay the credit, acts as a form of security for the loan, may be seized and sold if the repayment agreement is not followed

credit: The ability to borrow money or receive items or services now while paying for them later.

credit card: A card issued by a financial institution that lets you buy things and pay for them later. The credit card company pays the seller. You repay the credit card company monthly.

creditor: A person or company that lends money or sells you goods that you pay for later

debt: Money that you owe

grace period: The amount of time you have to pay a credit card balance before you are charged interest

interest: The amount paid by a borrower to a lender for the use of money

line of credit: A type of pre-approved loan that allows you to borrow money when you need it, up to a maximum amount

loan: Money that you have borrowed and have to repay on a set schedule, with interest

mortgage: A loan to buy property. If the loan is not repaid on time, the lender can take possession of the property.

overdraft: A shortage in a bank account caused by taking out more money than you had in the account. Banks will sometimes allow good customers to make overdrafts for a short time, but they charge fees and interest for the service.

payday loan: A small, short-term loan from a lender with high interest rates

prepaid card: A card you pay cash for in advance. The balance goes down as you make purchases or withdrawals.

principal: The money invested or loaned, not counting the interest