A Course in Credit Management for College Students

An Honors Thesis (HONRS 499)

By

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Abstract

Credit cards, quick and convenient, have grown tremendously in popularity and usage since their introduction in the 1920's. When used properly, credit cards can help consumers establish a good credit history and build a foundation for obtaining future loans for housing and automobiles. When misused, credit cards land consumers into an endless cycle of debt, ruining their ability to obtain a home, a car, or even a job. Society is also affected by high debt when hopeless debtors commit suicide to escape financial burdens. Many college students are learning this lesson the hard way, receiving an unexpected crash course in financial crisis management.

How can this problem be rectified? There is no real method to control other people’s financial choices and nor should there be. However, some solutions, including stricter credit card solicitation regulations and increased student educational programs, are offered as choices in this paper. In order to support these proposals, national credit card debt statistics are evaluated for trends. The relationship between students’ lack of credit savvy and the prevalence of students in debt is also analyzed. In addition, current state and university-level credit card solicitation regulations are examined for adequacy. An extensive credit management section offering tips on using credit wisely, understanding credit scores, and finding a legal way out of debt trouble is included.
Acknowledgements

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- Also, thank you to all of my family (especially Mom and Dad) and friends who supported me throughout my collegiate studies here Ball State University. I love you all!

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Introduction

As long as there is a disparity between items people wish to purchase and what they have available to spend on those items, there will always be consumer demand for credit cards. Credit cards give consumers a quick and convenient way to purchase items and services beyond their immediate financial means. Moreover, credit cards give financial institutions, insurance agents, and potential employers an objective way to gauge a consumer’s financial credibility and trustworthiness. Consumer financial credibility and trustworthiness are thus boiled down to one single number—a credit score. Late and/or missed payments decrease this credit score dramatically, negatively affect a consumer’s ability to buy a house, secure a loan, or even acquire a job. Timely payments, low balances, low debt-to-income ratios, and long-term relationships with credit card issuers increase credit scores.

A seemingly logical solution to avoiding credit card pitfalls would be to avoid credit cards completely. However many young people are finding a lack of a credit history is nearly as ruinous to their future financial opportunities as having a large amount of credit debt. Knowing that establishing a credit history is important to young people and that college and living expenses can often outweigh income, credit card issuers heavily market their products and services to this age group. Consequently, college students appear to be responding to these intensified credit card solicitation techniques. The average national undergrad credit card balance, according to student loan provider Nellie Mae in a 2001 study, is $2,327. Moreover, the same study indicates that combining credit card balances with education loans gives graduating students an average debt of $20,402 ("Undergraduate"). Aside from the obvious potential damage to these youths’ future opportunities, societal problems such as suicide also increase along with rising credit card debt (Corey). Yet, credit card issuers continue to send applications
and offer promotions to college students, and college students continue to acquire more and more credit card debt. Something must be done to slow the increasing tide of college credit card debt. One possible solution is to impose stricter solicitation guidelines on credit card issuers. Even with stricter solicitation regulations, improper credit card usage will probably still exist. Therefore, another solution needs to be investigated. This other solution involves offering more financial management courses to college students. Education is the most important factor in personal fiscal fitness.

**Credit Card Evolution**

Since the Babylonian times nearly 3,000 years ago, people have used credit as a means of acquiring items beyond their immediate financial means. In fact, the invention of writing owes itself to the Babylonian merchants’ need to record sales and payments on sales. Most Babylonian commercial loans were granted in pieces of silver at an interest rate equivalent to 20%, while agrarian loans were granted in barley and other like goods at an interest rate equivalent to 33% (Geerts). Debts incurred and payments made were recorded on clay tablets. It was the merchant’s responsibility to keep track of debt paid and owing, much in the way modern credit card companies must track payments and purchases. The Code of Hammurabi (the written law of Babylonia) governed collection regulations and sales contracts. For instance, a borrower could pledge his property or crop as security for a loan. The merchant lender could not seize the property for payment without warrant, lest he be fined. If the security crop failed to produce a harvest, “payment was deferred and no interest could be charged for a year (“The Code”).”

Through the years, credit loans continued to be granted with different types of collateral to secure the loans. However, the process of recording loans on clay tablets (and later paper) for small amounts of money became cumbersome and time-consuming. There had to be a more
convenient way to both obtain credit and record credit transactions. In 1920, the shopper’s plate, forerunner of today’s plastic credit card, was introduced (“Did You Know?”). Hotel chains, retail stores, and fuel stations typically used the shopper’s plate system. The shopper’s plate was a “buy now, pay later” card payment system ran entirely by the issuing establishment. For example, department stores such as Marshall Fields issued the cards to preferred customers, processed the transactions, and collected the subsequent payments. Third-party banks or collection agencies were not involved in the transactions. However, the consumer could not use the cards at other establishments, limiting the card’s wide-use capabilities.

After World War II, the economy bounced back from the Great Depression and the era of the traveling businessman was ushered in. In 1950, Frank McNamara and his partner Ralph Schneider created the Diners Club Card to cater to the traveling and entertainment needs of these businessmen. The card was the first third-party charge card that could be used at various establishments. Essentially, the Diners Club took the collection process out of the retailers’ hands for a small fee. The retail establishment processed the transaction, but no longer collected the payments themselves. Instead, the Diners Club paid the retailer—less a service fee—and then collected the payments from the card users. The card, along with the “just charge it” mentality, became immensely popular. Within two years, the Diners Club card became the first international charge card (“History”).

The success of the Diners Club drew other companies into the charge card business. In 1958, American Express, previously an express delivery business, launched its first charge card. Despite the Diners Club’s success, American Express was nevertheless hesitant to enter the charge card business at first because of possible competition with its successful money order and travelers cheque business. However, by the late 1960’s, American Express was reassured of its
decision after steady growth of both its charge card division and its travelers cheque division ("Our Story").

Following suit, banks entered into the profitable credit lending business. In 1958, Bank of America launched its credit card, known as the BankAmericard. BankAmericard was the first revolving "credit card" accepted by merchants worldwide, making it fundamentally different from the Diners Club card and the American Express card. Although the terms charge card and credit card are used interchangeably, the two card types are distinctly different. Credit cards such as the BankAmericard allow the borrower to carry a balance from one billing cycle to the next. The price for that convenience manifests itself in the form of a finance charge or interest charge on the card's unpaid balance. Conversely, balances on charge cards such as the Diners Club card and the American Express card must be paid in full when the statement comes. Since unpaid balances on charge cards are not carried over from one billing cycle to the next, there are no annual percentage rates or periodic rates to be charged. Failure to pay the full amount of the charge card statement by the payment date will result in delinquency fees, a note in your credit report, and possible litigation, depending on the lateness of the payment. Credit cards allow greater flexibility to borrowers than that allowed by charge cards since payments on purchases could now be deferred until later dates in time.

The idea of revolving credit that could be paid in installments over several months became very popular. In 1966, Bank of America expanded its market and bankcard program outside of California by forming the BankAmericard Service Corporation. Banks across the United States joined this national bankcard program. Since costs were shared among the financial institutions, large banks as well as small banks could afford to join. Another national bankcard program would develop in 1966; The Interbank Card Association (which would later
be called Master Charge) formed with much the same purpose as the BankAmericard Service Corporation. Within three years, most U.S. banks were either in the BankAmericard Service Corporation or the Interbank Card Association ("About Visa: History"). Simultaneous participation in both networks was disallowed as competition was furious. In 1976, BankAmericard would become Visa and in 1980, Master Charge would become MasterCard. Neither company actually issues its own cards. MasterCard and Visa merely license their member banks to use their brand name on their cards. Brand name power is extremely important when it comes to credit and debit payment cards. Brand name marketing both reinforces a company's name throughout the market as well as delivers a message to customers. In the case of Visa and MasterCard, the message is one of reassurance of worldwide acceptance and financial trustworthiness.

In 1974, credit cards were given an additional function. French inventor, Roland Moreno, developed what is now referred to as "smart card" technology ("Smart Card Overview"). Mass storage capability combined with the convenience of cashless transactions makes smart cards an attractive choice. Smart cards are now being developed to fit on your keychain, increasing the card's convenience. Visa and MasterCard are devoting a lot of time, money, and research involving smart card technology and its potential uses. While slower to catch on in America than in Europe, smart cards are quickly becoming a preferred means of payment and information storage and represent the wave of the future in credit card technology

**Market Snapshot**

The credit card industry is a profitable one, dominated by a few major players. Currently, Visa International is the world's largest payment system, owned by nearly 21,000 financial institutions and circulating over 1 billion credit and other payment cards ("Visa International").
More than 3,700 transactions are processed every second by the Visa Network during its peak season (“About Visa USA”). MasterCard is the second largest payment system in the United States, owned by nearly 25,000 financial institutions from over 210 countries (“MasterCard Incorporated”). Discover Financial Services is also a major player with over 50 million card members and is accepted at more than 4 million merchants and cash access locations, making this business segment of Morgan Stanley the U.S.’s largest proprietary credit card network (“Corporate Overview”). American Express rounds out the 4 four largest credit card providers. While a world leader in financial services such as lending and consulting, American Express also enjoys the title of being the “world’s largest travel agency” (“Our Story”).

Visa and MasterCard do not issue cards to consumers; they lend their name to their member financial institutions. These financial institutions typically offer additional consumer lending services beyond credit cards such as mortgages, automobile financing, and credit insurance. These titans² of finance manage billions of dollars in assets as well as millions of cardholder accounts. Capital One Financial Corporation, for instance, currently has 47.2 million cardholders and manages $75.5 billion in total loans (“About Capital One”). The competition between these large institutions, as well much smaller ones, is intense. The fight for your credit account helps to explain why advertising campaigns and marketing techniques are so aggressive. Credit card solicitation aimed at young adults, in particular, is highly aggressive. In an attempt to understand why this demographic is subject to the lending industry’s strongest campaigns, the actual marketing strategies will be examined, as well as the young adults’ responses to them.

Credit Card Solicitation

You return back to your dorm or apartment after a long day of classes. You check your campus mailbox right away, anticipating a favorite monthly magazine or a package from your
family. Instead, you pull out a handful of envelopes imprinted with the words “Pre-Approved.” The contents discuss the benefits of this credit card. What sounds better than earning cash rewards while you purchase college textbooks? Maybe earning airfare miles toward your spring break trip sounds better. Rarely noticed is the inconspicuous print on the back of the application states that you would have to spend several thousand dollars to obtain enough of these “free” airfare miles to fly to Cancun.

Sometimes, though, the level of sales pressure rises. Credit card telemarketers sell credit cards as well as credit card services such as credit insurance and preferred user programs over the phone. Telemarketers retrieve your name and phone number from mailing lists supplied by credit bureaus. Having any type of loan or credit card can put you at risk for credit card telemarketing calls. Unlike credit card applications that arrive in the mail, telemarketers have a ready response to any doubts you might express regarding the card. Telemarketers establish two-way communication, a point in their favor as far as marketing techniques are concerned.

Credit card companies are showing up on campuses and universities across the U.S. Credit card company representatives set up tables in high traffic areas advertising everything from free T-shirts to coffee mugs to chances to win free MP3 players and airline tickets, all to establish early relationships with potential lifetime customers. Little do the students know that filling out credit card applications on a whim for free items lowers their credit scores. First, the inquiries of the credit card companies show up on credit reports. Secondly, if the student is approved for several cards, the debt-to-income ratio and the total debt available becomes higher, thus making the student less attractive to potential employers and loan officers.

Just why do universities allow credit card companies onto their campuses? Universities and student organizations receive money from the credit card companies to set up on-campus
tables. To participating student organizations, credit card companies give them a viable way to raise money. Some universities allow the credit card representatives only distribute applications and not collect them, and other universities allow the representatives distribute and collect the applications at the table.

Not all universities allow credit issuers onto school grounds. According to a report named “Graduating into Debt,” several colleges and universities\(^3\) in Maryland do not allow credit card marketing to students on their campuses. By not allowing the credit card vendors on campus, these universities face violating issues of free speech. Universities that do allow on-campus solicitation from credit card issuers cite the fact that they cannot simply pick and choose who is allowed on campus due to legal issues. That is, unless the policy is a blanket policy that does not allow any outside vendors onto campus grounds.

Government officials are getting involved in the matter, as well. Louisiana and Arkansas have legislation acts limiting on-campus marketing. Several other states have seen bills as well, including California, Pennsylvania, and New Jersey (Corey). Many of the proposed bills also propose education programs regarding credit card usage. The tragic suicide of a college freshman attending the University of Central Oklahoma due to insurmountable credit card debt helped to bring the issue of credit card marketing strategies into the public spotlight (Corey). Meanwhile, television commercials showing frivolous credit card spending on college parties continue to air.

Some schools choose to sell their student lists to credit card issuers in addition to letting them bring their propaganda to campus. Towson University used to sell its student lists to MBNA and Salisbury University admits to currently selling student names, addresses, and telephone numbers to anyone who requests the information (Hystad and Heavner 9). Typically,
it had been the credit bureaus selling lists of consumer information gathered from credit reports to telemarketers. Now, even college students who have never applied for a card or taken out a loan receive solicitations from card issuers because they chose to receive a higher education.

Credit card applications are posted to the walls inside classrooms as well as placed inside bookstore bags. Most times that a student buys books or school supplies, a credit card application is waiting for them. Most times that a student sits in class and stares at the wall, a credit card application is waiting for them. Most times that a student opens their mailbox, a credit card application is waiting for them. College students simply cannot escape the marketing ploys of credit card issuers. Perhaps that is what is meant by “effective advertising.”

Courses in Credit Management

Understanding how credit cards work and how to read the fine print on credit card applications and cardholder agreements is important to building a positive credit history. Establishing credit early on in life is very important. However, establishing credit the correct way is more important.

Some colleges and universities offer credit management classes as a part of their freshman orientation programs. Towson University is one such university, although the classes are not mandatory. Other universities offer courses, but only as electives. Legislators in California, Pennsylvania, and New Jersey are pushing for bills that would require universities to educate students on credit matters and usage (Corey).

Is there a correlation between a lack of educational programs over credit management and rising student debts? New York Senator Charles Schumer believes there is a correlation. A recent study conducted by Nellie Mae shows that New York college students are carrying a total credit card debt of approximately $2 billion (“NY College Students”). Student loans are not
even included in this amount. Dividing the debt over New York’s 889,000 undergraduates yields an average of $2,250 per student, which is right in line with Nellie Mae’s findings on the nation’s average undergraduate credit card debt of $2,327 ("Undergraduate"). According to Schumer, “students get bombarded by credit card offers, but don’t realize they can carry hidden fees and interest rates that are very high” ("NY College Students").

The first step in fighting the increasing debt load college students carry would be to educate the students. The addition of a semester-long course in financial planning into college core curriculums would help greatly. Catching the incoming college students and giving them an early opportunity to enroll in these classes will give them the skills they would need.

The second step involves imposing stricter regulations on credit card companies through legislation. Credit card companies should not be completely regulated, but should be limited in the types of “gifts” they offer to students and the amount of credit card applications they send through the mail. Credit card companies send out applications in bulk without always looking carefully at each student’s income and the amount of debt they can reasonably handle over time. Credit card companies must consider how much debt a student can repay as well as the chances the student will actually apply for the card and not throw the application away.

By giving students the credit management skills and knowledge they need and monitoring on-campus solicitations, college students will have a firm path to walk on after graduation. Included in this paper is a section devoted strictly to proper credit management. Those students who are contemplating applying for a charge card and those who already have one should read over the tips. Some of them might surprise you.
Credit Management Tips

Understanding how credit works is the key to proper credit management for the individual. The following tips should help you make wise credit decisions and build a positive credit history.

Know Your Limits and Your Purpose

Before you apply for a credit or charge card, you should ask yourself the following question: why do I need a credit card and how do I expect to pay on the card? Will the card be used for emergencies only? Will the card be used for small, everyday purchases to establish or reestablish credit? Will the card be used to transfer an existing credit card balance from a high interest rate to a low interest rate?

The reason you apply for a credit or charge card often determines the type of card you should apply for, the maximum spending limit you should set, and the most acceptable annual percentage rate of interest. You should pay particular attention to your income and what level of debt you are looking to incur or have already incurred. Your debt-to-income ratio should be kept very low to ensure you can pay off that debt on a timely basis. The higher your debt-to-income ratio gets, the less likely you can pay off all of your debts and the less attractive you look to prospective lenders, landlords, and employers.

For example, if you intend on using your card for emergencies only, you probably would not want a card with an annual fee. Most charge cards have an annual fee to cover the cost of not charging a periodic finance charge on carryover balances, so a bank credit card would be preferable. The chances of having to use the card are hard to calculate, so incurring a cost year after year merely for the privilege of having the card would not make the most sense. Also, because emergency expenses have the possibility of being high, a low rate of interest
(somewhere around 15%) coupled with a moderate spending limit should give you enough flexibility to incur those expenses.

If you have a poor credit history or no credit history at all and want to establish credit by making small, frequent purchases and paying off the entire balance of the card each billing period, a credit card with a low credit limit would be the most beneficial. High credit limits signify high risk potential to lenders, which in turn mean higher interest rates and lower credit scores, so you want to try to set your limit relatively low to help avoid this lender interpretation. Also, low credit limits will deter you from taking on more debt than you can handle. You always want the lowest interest rate possible, but a lack of credit history or a poor credit history could mean the interest rate you will be able to obtain may be higher than what you would like it to be at first. By paying off your credit card balance on time every billing period, you will demonstrate creditworthiness and, after a period of time, may qualify for lower interest rates.

If you cannot obtain a regular unsecured credit card, you may need to apply for a secured card. Secured cards work like this: you deposit some money into a savings account with a participating bank. The financial institution with which you made your deposit will give you a Visa or MasterCard. What makes the card “secure” is that the money you deposit becomes collateral for the bank. Your credit limit will be 100% of your savings account deposit or some percentage above that (Curry). A deposit of $200 will allow you to charge up to $200 worth of goods or services. If you do not pay off the $200 balance on time, the financial institution can and will seize your savings account deposit.

For some people, secured credit cards can sometimes be the only means of obtaining credit. Annual fees and high interest rates are often higher than those found with unsecured credit cards. Also, you must meet certain eligibility requirements as set forth by the issuing
financial institution. You want to make sure the financial institution reports the card to the agencies as it will help you build creditworthiness faster. However, you do not want the bank to flag your card as a secured card. This flag may signal credit history problems and restrict your ability to rebuild credit (Curry). If you make timely payments on your secured card, you may qualify for an unsecured card after a period of time.

If you have good credit, but feel your interest rate is too high, you have four options. Option one is to continue paying the high interest rate. The second option is to request a decrease in your interest rate. Occasionally, if you are a long-time credit consumer and have demonstrated a history of making credit payments on time, card issuers may be willing to decrease your interest rate, but only if you ask. Point out that you have been a loyal customer of the company and would like to be recognized for that with a lower interest rate. The credit card issuer might refuse your request, but there is never any harm in asking. Your third option is to transfer the balance from your high interest rate card to a lower interest rate card. This option can be tricky, though. Many credit card companies advertise low balance transfer rates. These advertisements have a lot of fine print attached to them. Some of the low balance transfer rates are introductory, or “teaser,” rates that expire after a certain amount of time—typically 6 months to a year—and then increase dramatically. You want to avoid low introductory rates if you feel you cannot pay off the entire transferred balance within that time period. Also, read the fine print for any additional fees you may incur from either your old or new credit card issuer. The fees may outweigh the interest savings. Possible fees are discussed in greater detail in the “Read and Understand your Credit Terms and Conditions” section below.

The fourth option is to secure a loan from a bank or credit union and using this loan to pay off your credit card balance. Interest rates from a bank are likely to be more favorable,
rates will not skyrocket after a specified time period. Meanwhile, you can still build your credit history by paying the bank off in a timely fashion.

Say your current card has an interest rate of 18% per annum and a balance of $1,000. Your minimum payments are set as a percentage (2.5%) of your current balance, so your beginning minimum payments would be $25, decreasing each month. If you made no more purchases on that card and make the minimum payments each month, it would take you 153 months (almost 13 years) to pay off your debt completely. Amazingly, you will have spent $1,115.41 in compounded interest for the convenience of minimum payments!

If, instead, you were able to obtain a $1,000 loan from a bank at say 10%, and agreed to pay back the loan in monthly installments of $25, you would be saving a tremendous amount of money. To be exact, your $1,000 loan would be paid off in 49 months (just over 4 years) at a cost of $221.46 in interest. For roughly the same monthly payment, you could save $893.95 in interest through a bank loan as opposed to continuing payments on the high interest card, making the bank loan option an attractive one.

Read and Understand Your Credit Terms and Conditions

Credit card applications are legally binding contracts. The applicant’s signature constitutes an acceptance of the credit terms and conditions as set forth by the lender. Typical credit terms are annual rates of interest for purchases, balance transfers, cash advances and defaults, method of interest calculation, application and/or annual fees, grace periods for purchases, minimum finance charges for purchases, late payment fees, over-the-limit fees, cash advance fees, and balance transfer fees. In addition, information regarding fraud liability and how to handle billing inquiries and disputes is included. Credit card applications also disclose statutory laws regarding consumer credit for residents of that state. All terms not presented in
this initial application are then disclosed to you in the form of a full cardholder agreement after
you have signed up for the card. While the application discusses some of the key points, reading
the full cardholder agreement is imperative, no matter how long and tedious it may appear.
When an item or term is in dispute, the cardholder agreement is the document that will be
referenced, not the cursory application, although the signed application still binds you to the
terms of the cardholder agreement.

Interest rates are normally stated in terms of the “prime rate plus X percentage points”
(Quinn 214). The prime rate is the “rate at which banks will lend to their most-favored
customers” (“Current”). According to Bankrate.com, the Wall Street Journal publishes the most
“widely quoted measure of the prime rate” (“Current”). The prime rate does fluctuate, typically
with changes by the Federal Reserve Board. Credit card applications often disclose the most
current prime rate as of the publishing date of the application. However, as this rate does
change, you should monitor the prime rate periodically to make sure the interest rate on your
statement is correct and current. Interest rates are also typically given as an annual percentage
rate (APR). In order to find the monthly rate of interest, or periodic interest, divide the APR by
12 months.

Defaulting on any of your credit terms can subject you to a high “penalty interest rate.”
Making tardy payments or exceeding your credit limit also subjects you to late payment fees and
over-the-limit fees for each occurrence. Interest rates and fees on purchases can also differ from
those of cash advances and balance transfers. As mentioned earlier, if you plan on transferring
your balance from a high interest credit card to a low interest one, read the fine print in both your
existing credit card agreement and in the new credit card agreement/application. Often,
advertised low balance transfer rates are only introductory rates that skyrocket after the
introductory period has expired. Introductory balance transfer rates are good so long as you pay off the entire balance before the introductory period expires. Currently, card issuers are offering more fixed balance transfer rates of which you want to take advantage. One caveat: fixed rates are not guaranteed to stay the same forever. A fixed rate may stay the same only for the life of a certain amount or balance transferred over, while it may be slightly higher for another balance transferred over. Also, the rates for new purchases may be higher than your transfer rate, so make sure you know what your rates are, for how long the rates are good for, and what your other rates will be before transferring your balance.

If you are looking to transfer your credit card balance to another card, be wary of balance transfer fees and penalties. Sometimes, either the old issuer or the new issuer or both will charge a fee for transferring balances. This transfer fee may either be a percentage of the transferred balance or a flat fee. The old issuer may also charge an additional penalty fee for closing the account or for managing any existing money in the account. Find out how long it will take for the transfer to take place ("Transferring"). Make sure you are not paying on two balances at once or that you are not missing payments on the account that you thought was already closed.

Likewise, you want to know the specific fees and rates charged for cash advances. Never assume that the purchase rate and the cash advance rate are the same, as cash advance rates are typically higher than purchase rates. Also, know what your cash advance limit is so you do not exceed it; it often runs congruent with your card’s available credit limit, but not always.

There are three ways credit card companies and financial institutions calculate finance charges on unpaid balances. The average daily balance method is the most common method for calculating finance charges. The credit card company tracks all of your daily balances for a month and computes the average for each day—the average daily balance. The average daily
balance is then multiplied by the monthly interest rate to arrive at the monthly finance charge. The average daily balance can be calculated on a one-cycle billing or a two-cycle billing. One-cycle billings are charged only on the previous month’s unpaid balance. Two-cycle billings are charged on both the previous month’s and current month’s balance. For the consumer who carries a balance one month, but pays in full the next month, this method could cost them extra interest because of the previous month’s balance. For the consumer who carries a balance every month, this method probably will make little difference in the interest amount. Regardless of payment routines, one-cycle billings are more beneficial for the consumer than two-cycle billings.

Another method of calculating finance charges is the adjusted balance method. The finance charge is calculated by taking previous month’s balance, adding new charges, deducting payments, and multiplying the monthly interest rate by the adjusted amount. This method is not commonly used.

A third method is the previous balance method. Finance charges are computed by multiplying the monthly interest rate by the previous month’s balance. If your card issuer uses the previous balance method of calculating finance charges, you could pay a finance charge in October even if you have paid off that month’s balance. You would be paying a finance charge based on September’s balance. The difference in finance charges is demonstrated in Table 1 and Table 2. Assumptions are that the annual percentage rate is 21.00% (1.75% periodic) and that one-cycle billing (including new purchases) is used by the credit card issuer. Also assumed is that the billing statement covers the month of November, or 30 days. Payment was made November 15 (on time) and one purchase was made on November 26. The previous month’s balance is $1,000.
Table 1: Finance Charge Calculations based on Increasing Balances

<table>
<thead>
<tr>
<th>Method of Calculating Finance Charges</th>
<th>Adjusted Balance</th>
<th>Average Daily Balance</th>
<th>Previous Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Previous Balance</td>
<td>$1000.00</td>
<td>$1000.00</td>
<td>$1000.00</td>
</tr>
<tr>
<td>Less Payments/Credits</td>
<td>($50.00)</td>
<td>($50.00)</td>
<td>($50.00)</td>
</tr>
<tr>
<td>Plus Purchases/Advances</td>
<td>$150.00</td>
<td>$150.00</td>
<td>$150.00</td>
</tr>
<tr>
<td>Plus Finance Charges</td>
<td>$19.25</td>
<td>$17.47</td>
<td>$17.50</td>
</tr>
<tr>
<td>New Balance</td>
<td>$1119.25</td>
<td>$1117.47</td>
<td>$1117.50</td>
</tr>
</tbody>
</table>

Table 1 on the previous page shows that the previous balance method favors those consumers who have an increasing account balance while the adjusted balance method favors the credit card issuer. Table 2 shows how the adjusted balance method favors the consumer who has a generally decreasing account balance and how the previous balance method favors the credit card issuer. Assumptions are kept the same for comparison purposes.

Table 2: Finance Charge Calculations based on Decreasing Balances

<table>
<thead>
<tr>
<th>Method of Calculating Finance Charges</th>
<th>Adjusted Balance</th>
<th>Average Daily Balance</th>
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</tr>
<tr>
<td>Less Payments/Credits</td>
<td>($150.00)</td>
<td>($150.00)</td>
<td>($150.00)</td>
</tr>
<tr>
<td>Plus Purchases/Advances</td>
<td>$50.00</td>
<td>$50.00</td>
<td>$50.00</td>
</tr>
<tr>
<td>Plus Finance Charges</td>
<td>$15.75</td>
<td>$16.25</td>
<td>$17.50</td>
</tr>
<tr>
<td>New Balance</td>
<td>$915.75</td>
<td>$916.25</td>
<td>$917.50</td>
</tr>
</tbody>
</table>
As can be seen from the previous two tables, the three different methods create different results depending on your payment routines and on your monthly account balance. What appears to be a small difference between finance charge calculations based can be magnified greatly over higher balances and over time.

One other important disclosure found in many credit card applications and all cardholder agreements is how to handle unauthorized use of your card, defective goods purchased with your card, and billing errors made on the part of the credit issuer or merchant. Unauthorized use of your card can occur if someone steals your card or if someone obtains your number to run up fraudulent charges in your name. Always notify your card issuer immediately if either of these events occurs. If you are in possession of your card, but suspect someone is in possession of its number, then you are not liable for any of the purchases made as long as it can be proven that you did not make the purchases yourself. If you notify your card issuer that your card is stolen before any fraudulent purchases are made, you are not liable for any of the purchases. If fraudulent purchases are made on the card before you report the card theft, you are normally liable for only $50. However, some credit card companies will waive this small fee. By being careful of whom you give your personal information to and by keeping your cards secure, you will be able to better avoid having to go through this trouble in the first place.

If you purchase goods with your credit card and those goods are received damaged or defective, you may not be liable for those purchases. You must first meet certain requirements as set forth by the card issuer, however. In order to preserve your rights, you must make your claim in writing to the credit card issuer. Also, send any evidence that you collected to show you tried to resolve the dispute with the merchant. Until the issue is resolved, you are allowed to withhold payment for that particular transaction only. You must still pay on other purchases
made. Also, the credit issuer cannot report you as delinquent, but they may file a note on your credit report that states the transaction is in dispute. If the card issuer sides with you, the charge will be removed from your statement, as well as any related finance charges. If the card issuer does not side with you, then they may report you as delinquent, turn your account over to a debt collection agency, or sue you for the unpaid amount.

The Fair Credit Billing Act (FCBA) of 1974 is a federal law that governs the legal handling of credit card billing errors. Billing errors can be defined as anything from mathematical miscalculations of your balance, unrecorded payments and/or credits, incorrectly billed purchases and/or interest, and a failure on behalf the card issuer to mail you your statement at least 20 days before the due date. As in the case of receiving defective goods, you must make your claim of any billing errors in writing in order to preserve your rights. The claim should be made immediately. You do not have to pay an item while it is in dispute, and the card issuer cannot report you as delinquent for as long as the problem is being investigated. If the card issuer sides with you, the disputed charge and related finance charges should be removed from your statement. If the card issuer does not side with you, you must either pay the disputed amount, including any late payment fees or you must risk being reported as delinquent or being sued by the card issuer. In the latter case, you have the additional option to file a letter with the credit reporting agencies citing your side of the story.

Some applications contain more information than others regarding certain credit terms. Some applications have more “fine print” than others. Being familiar with the previous credit terms is especially important, however. These terms and conditions have an impact on what card will be most beneficial to you in the long run.
Review and Understand Your Credit Report

Your credit report is similar to a school report card. Your credit report contains personal information about you, as well as the bases for how lenders view your creditworthiness. Therefore, it is crucial that you review your credit report periodically, especially if there is a loan or employment opportunity in the foreseeable future. Credit report mistakes do happen and can take some time to straighten out with lenders and/or financial institutions. In addition, your credit report, much like a report card, can show you what areas of your credit profile you need to work on to increase your credit score.

There are multiple ways to obtain a credit report. Under the Fair Credit Reporting Act (FCRA) of 1971, if your application for a credit card, job, or loan is turned down due to information supplied by a credit reporting agency or bureau, you have the right to request a free copy of your credit report. You will know what credit bureau to contact because the rejection notice must list the name and address of the credit bureau they used if the rejection was due to information supplied by that agency. However, your request for the free credit report must be made within 60 days of your rejection notice ("Credit"). You also have the right to a free credit report once per year if you live in Colorado, Georgia, Massachusetts, Maryland, New Jersey, or Vermont. If you are the victim of identity theft or fraud, on welfare, or unemployed and actively seeking work, you have the right to a free credit report anytime (Quinn 234).

Otherwise, you may have to pay for your credit report (see FACT Act below for exceptions to this rule). The typical price of a credit report from one of the credit bureaus—Equifax, Experian, or TransUnion—is not more than $9. However, it is a good idea to obtain a copy from all three major credit reporting agencies. All three credit bureaus offer 3-in-1 credit reports. The price for these reports generally ranges from $30-$40, depending on if you order the basic comparison
of all three bureaus, or if you order any custom debt analyses and financial planning tools. The 3-in-1 reports are useful because all three agencies might share the same mistake or might have entirely different information. You will not know beforehand which bureau your potential lender/employer/landlord will use, so it is important to know what is on all three reports. If you find a mistake in all three reports, you should report the mistake to each bureau (in writing) individually as the bureaus might not share the corrections with one another. If the bureau with which you mailed your complaint cannot verify the disputed item within a reasonable amount of time (about 25 days), the item should be deleted. If it does verify the disputed items within that time, you should write to the bureau again to explain why the item is erroneous, include documentation on why the item is inaccurate, and ask for a correction. After clearing up the item with one bureau, make sure to clear up the items with the other two bureaus. Corrected credit reports must then be sent to any credit lender who received a credit report “in the past 6 months and any employer who received it within the past two years” (Quinn 236).

While paying $9 is a small price to pay for peace of mind in knowing how potential lenders and employers view your creditworthiness, the Federal Trade Commission (FTC) issued a ruling on December 4, 2003 ("Fair Credit") that provides for free annual credit reports for consumers under the Fair and Accurate Credit Transactions (FACT) Act and FCRA. The ruling requires that the three major credit bureaus make available to consumers, upon request, one free copy of their credit report during a 12-month period. The free credit reports are not available to all American consumers at the same time, though. Beginning December 1, 2004, residents living on the west coast can make their request for a free credit report. Residents living in the northeastern states will be able to make their requests beginning on September 1, 2005. Figure 1 on the following page shows the exact availability for the free credit report requests.
Free credit report availability

Figure 1: Rollout Dates by Region for Free Credit Reports

With the availability of free credit reports thanks to the FACT Act, there is little reason not to request at least one copy annually. If you have never looked at a credit report before, though, you might be confused as to how to interpret the report. Credit reports are really not that hard to decipher, however.

Credit reports have four main sections—identifying information, credit history, public records, and credit inquiries. The identifying information section will contain your name, home address, phone number, and social security number. Some reports may include current and previous employers as well as previous home addresses in this section.

The credit history section contains information regarding how much credit has been extended to you, how much debt you have incurred, any late or missed payments, payment amounts on installment loans, how long you have had the loan or credit card, and the names of
the companies that have extended credit to you. This information only appears if the company reports information to the credit bureaus. Some smaller department stores, banks, and credit unions as well as most utility companies do not file reports with credit reporting agencies. However, if one of these institutions turns your account over to a debt collection agency that does report with the credit bureaus, your delinquency will show up on your credit report.

The public records section contains items such as tax liens and court judgments that have been levied against you. This section also includes bankruptcy filings. While liens, judgments and general credit card information remain on your credit report for up to seven years, certain types of bankruptcies remain on your credit report for ten years. Bankruptcy should be an all-else failed move to start over because you will feel the negative ramifications of it for a long time.

The credit report’s last section deals with credit inquiries. Inquiries occur every time you or someone else requests a copy of your credit report. The credit report copy you obtain for yourself is a soft inquiry. Soft inquiries do not show up on the credit report. When prospective lenders or employers request a copy of your credit report, they are usually making what is known as a hard inquiry. Hard inquiries do remain on the credit report, however. Lenders may interpret a large number of hard inquiries in a short period of time as meaning that you are desperately seeking credit and could be a credit risk. An exception to this interpretation is if you are shopping for mortgage rates. Lenders and scorers know the importance of getting the lowest possible mortgage rate and will often overlook the inquiries as long as they are made in a condensed amount of time (Yochim).

Once you have your credit report in hand, it is now time to interpret your overall credit score. Your credit score is a single number that lenders use to objectively determine your
creditworthiness. Fair Isaac Corporation (FICO), founded in 1959 to help companies combat fraud, invented a formula to determine a person’s credit risk. This formula and resulting score, called a FICO score, became the standard measure of credit risk (“Company”). The FICO score is still the same score most scorers use today. Your FICO credit score can be between 300 and 850. A score above 700 is considered average. The higher the score, the better your chances are at getting that loan, job, or apartment you have been seeking. Chances are good that the three major credit bureaus do not have exactly the same information about you and do not report the same FICO score to lenders and employers. Therefore, it is a wise decision to find out what all three bureaus have to say about your credit score.

Your FICO credit score can be affected by the five following key factors, listed in order of importance:

- **Payment history**—paying your bills on time can raise your score significantly while missing or making late payments can have just the opposite effect.

- **Total debts owed**—compare your total debt to two different figures: your available credit and your income. If your debt is almost as high as your available credit, you are considered a credit risk and your score will drop. Similarly, the closer your debt amount is to your income, the less likely it appears that you can take on and pay off added debt, and your score will decrease.

- **Length of credit history**—the longer your established credit history is, the higher your score will be. This is, of course, providing you use your card regularly.

- **Amount of new credit**—a multitude of new accounts can decrease your score as it demonstrates too much desperation to gain credit.

- **Types of credit**—credit cards, retail accounts, and installment loans are all types of credit that are considered. Examples of installment loans are student loans, car loans, and home mortgages. Installment loans can help increase your score. Too many different types of credit can give the perception of credit risk, though. While it is good to mix an installment loan with a few wisely managed credit cards, take care to not take on too much debt.
Your credit report can give a lot of insight to both you and your potential lenders or employers. Your report allows you to see yourself through the eyes of others. However, errors on your credit report can severely damage your chances for work and/or credit. Take the time to request a copy of your credit report, review it carefully, and report any erroneous data immediately to the credit bureaus. Contact information for the three major credit reporting agencies is given in Appendix A.

**Beware of Credit Card and Identity Theft Schemes**

Incidences of fraud and theft are increasing as more people and more people make credit card transactions. In fact, identity theft is the fastest growing crime in America, claiming millions of victims each year. The FTC organized a national complaint clearinghouse to record consumer complaints regarding identity theft. Data summarized in a FTC report shows that between January 2002 and December 2002, the FTC processed 218,714 reports. Of these reports, 161,819 (74%) were filed by identity theft victims. The remaining 56,895 (26%) were from consumers concerned about identity theft and fraud ("Information"). The FTC does acknowledge that not all victims of identity theft actually file a report, so the actual numbers could be far more troubling.

College students, in particular, incur a great amount of risk. Not only are college students heavily targeted by credit card issuers, they are also more likely to conduct online transactions as well as use their social security number for identification purposes on campus. Criminals snoop around trashcans, hack into company databases, make phony telemarketing calls, and intercept your mail in order to steal your personal information, good name, identity, and good name. Even some companies that proclaim to sell credit card fraud guards and protection are really fraudulent companies scamming their way into your pockets.
With so many criminals waiting to prey on their next victims, you may be wondering how you can protect yourself. While you cannot completely safeguard yourself from fraudulent acts, you can take steps to help deter credit and identity thieves. The following is a list of preventive measures against credit card fraud ("Protection Basics"):

- Never disclose your personal identification number (PIN) or write it down—memorize it.
- Sign your card as soon as you receive it in the mail
- Report lost or stolen cards credit cards and debit cards immediately.
- Make sure you get your card back after a purchase. A good trick to use is to keep your wallet in your hand until the transaction is complete.
- Check sales receipts for accuracy before signing them and always reconcile your billing statement with your receipts.
- Make a comprehensive list of all your cards and their numbers and store it in a safe place. Reporting theft of your cards will be much easier and quicker this way.
- Always shred credit card applications and statements before disposing of them.
- Do not give your account number over the phone unless you initiated the call.
- Notify the Post Office immediately if you change your address.
- Make sure your mailbox is secure, and promptly remove delivered mail.
- Call the Post Office immediately if you are not receiving your mail.
- If you are told of a forwarding order placed on your mail without your knowledge, go to the Post Office to check the signature and cancel the order.
- When using an automatic teller machine (ATM), always observe your surroundings. Only use ATMs that are well lit and always have your card ready to use.
- Do online shopping only on sites that use data encryption techniques to safeguard your personal information. Look for a padlock at the bottom left-hand of your computer screen, uniform resource locators (URLs) that begin with "https://", and/or the words "secure sockets layer (SSL)". These items help identify cryptographically secure sights where only you and the merchant can view your information. Always log out of your account and exit your web browser for added security.
Identity thieves can steal your identity, run up a huge debt in your name, and then move to their next victim before you even begin to suspect anything is amiss. One common identity theft scheme involves your mailbox. Identity thieves sneak your credit card applications out of your mailbox and fill out the application in your name. Do not think you will catch it when the statement shows up at your house the next month. Identity thieves will change the mailing address, so you can have a past due account for some time and not know it until the creditors begin calling you. The importance of promptly removing mail from your mailbox, checking over your credit card periodically, and reporting fraudulent transactions in your name to the credit issuer and the three major credit bureaus as soon as you suspect fraud comes into play here. Paranoia is a good thing in this case. You may not be 100% safe from credit scams, but being vigilant is a good way to deter fraud and save your credit reputation.

Communicate with Your Credit Lenders if you Are Having Trouble Making Payments

If you are having problems paying your bills on time, contact your creditors immediately. Many borrowers do not realize that they have some bargaining power when it comes to how much they must pay their creditors. Creditors are sometimes willing to work with you to set up a payment plan or settle the debt for somewhat less than the full amount. After all, it does cost them a fee to hire a debt collector to collect your money. Creditors will generally their money in a timely manner from you than to go through a “middleman” debt collector. Your first step should be to offer your creditor a specific payment plan. Monthly payment amounts as well as the duration of the payments should be given. A budget of your income and your other living expenses will be helpful, as well. If you are deep in debt, you can try to offer your creditors a settlement. An example might be an offer to pay $0.75 on every dollar owed. The worst the creditor can do is say “no.” If the creditor does not accept a debt settlement plan, then go ahead
and try to set up monthly payments you can handle. Just be sure to stick with making these monthly payments.

Seeking help from nonprofit credit counselors is helpful. Nonprofit counselors can help you set up a budget and spending plan as well as help negotiate with your creditors for smaller payments. Some creditors actually prefer to work with consumers only through credit counselors. Nonprofit counselors charge a modest fee for their services and are a wonderful resource for those struggling to make their current credit card payments.

Contacting a lawyer is probably not the best means to straighten out your financial woes. In reality, the money you spend to retain the attorney will probably exceed any savings you might earn, especially if the attorney charges a percentage fee of what you owe.

Do seek legal advice if you are considering bankruptcy as a means out of debt. Certain debts are not discharged with bankruptcy filings. You will want to be certain of which debts are and are not to see if bankruptcy really is the best way to pay off your creditors. A Chapter 13 bankruptcy is slightly more forgiving than a Chapter 7 bankruptcy. Chapter 13 bankruptcies allow you to keep your property while you pay on a court-ordered payment plan. Chapter 13 bankruptcies can also be wiped off of your credit report after 7 years. Chapter 7 bankruptcies, on the other hand, can stay on your credit report for 10 years. Chapter 7 bankruptcies may require you to give up some of your personal property to pay off your creditors (Quinn 243). Any bankruptcy should be considered only after other legal means have been exhausted and only after proper counsel.

If you are struggling to keep up with utility bills, credit card bills, rent, and educational loans, you are not alone. People across the world seek credit counseling everyday. Yes, you are signaling a need for help, but that is nothing to be ashamed of. Credit debt is definitely not
something you should ignore. The more you ignore your creditors, the more reluctant you will
grow to answer your telephone or your front door. The more you ignore your creditors, the
worse your credit report looks and the worse your chances are of getting a good job with which
to pay off those creditors. Do not wait until credit debt overtakes your day-to-day life. Do not
be afraid to seek help!

**Conclusion**

Credit cards have had a profound effect on commerce as well as how humans fit into their
society. Credit cards have given consumers the power to prove their creditworthiness as well as
the power to extend their financial means and buying power. Credit cards have grown along
with electronic commerce, allowing people the convenience to purchase items from the comfort
of their own house as well as the convenience of returning those items with ease.

While yielding positive benefits such as convenience and worldwide acceptance, credit
cards are not purely benign. Increasing credit card usage has uncovered some alarming trends
such as identity theft and fraud. Another such trend is the focus of this paper: college student
debt. The studies examined in this paper support the need for stricter credit card solicitation
regulations as well as more credit management courses in the education system. It is often said
that today’s youth is tomorrow’s future. These young people should not be accosted by billion
dollar credit card companies as they walk to their classes. These young people should be given
the proper tools with which to make wise decisions regarding, but not limited to, credit. After
all, education is perhaps the most important factor in wise personal financial management.
Notes

1 Smart cards are either embedded with a microprocessor and a memory chip or just a memory chip. Memory chip smart cards function similarly to prepaid phone cards and meal cards. Information can be preloaded into the memory chip. This information can only be used in a limited number of predefined functions. With prepaid phone cards, for example, you can purchase a phone card, and the memory chip will be loaded with the amount for which you purchased it. As you use the card to make phone calls, the balance stored in the memory chip will decrease. Depending on what type of phone card you purchased, you have a choice of what to do with the card when the balance is decreased to zero. If you purchased a prepaid, disposable single use phone card, then you can just throw it away. If the phone card is reloadable, you can take the card back to the retailer or a special kiosk to put more money back on the card to use again. Memory chip smart cards are commonly used on university campuses as a quick and convenient means to pay for textbooks, meals, and other educational expenses. The University of Michigan has used smart cards since 1995 as a means for identification and for making purchases. The “MCards” can be used at 345 locations on campus and 85 locations off campus (Lazarony). Other universities across America have also taken similar steps in adding more functionality to the smart cards.

Microprocessor/memory chip smart cards represent the future in smart card technology. The microprocessor gives the smart card added security. Smart card microprocessors are programmable and can add, delete, and manipulate data that is not limited to stored values of cash. Data such as health insurance, medical records, club member discounts, and phone numbers can all be stored on these cards, thus eliminating the need to carry a handful of cards in your wallet. Whereas memory chip smart cards can be used by anyone in possession of the card and are therefore subject to theft, microprocessor/memory chip smart cards offer an added level of security, making the data on the card subject to the cryptography and security measures built-in to the card reader (“What is a Smart Card?”)

2 Six of the world’s largest financial services groups/bank card issuers are Citigroup, Inc., J.P. Morgan Chase, Bank of America Corporation, Wachovia Corporation, Wells Fargo and Company, and Capital One Financial Corporation (www.hoovers.com)

3 These campuses include Bowie State University, Coppin State College, University of Maryland, Baltimore County, and University of Maryland Eastern Shore (Hystad and Heavner 8).

4 Some requirements include having a job with a specified minimum income, an address and phone number that can be verified and no recent bankruptcies (Quinn 224).

5 The grace period is the period of time in which you can pay off your card balance without incurring a finance charge. Cards without a grace period mean that for every single purchase you make, you are charged interest for that purchase. Many credit issuers offer 25-day grace periods. If you pay off your entire balance before the end of the grace period, you will not incur any interest, regardless of the amount of purchases you made. However, grace periods do not usually apply for cash advances and new purchases if you carry a balance from month to month.

31.
6 Some statutory disclosures focus on marital status and the ability to apply for credit independent of the spouse and others focus on credit discrimination. The state for which the particular law governs should be listed in bold print.

7 An alternative lending rate is the London Interbank Offered Rate (LIBOR). LIBOR is similar to the U.S. prime rate, but whereas the prime rate is the rate at which banks would lend each other reserves overnight, LIBOR is the rate for which banks will lend to each other in the London Eurodollar market for specific maturities of 3 months, 6 months, or 1 year (Block and Hirt 605).

8 A typical requirements are that you have made a good faith effort to return or exchange the goods with the merchant. Also, the defective goods must be worth more than $50 and must have been purchased either within your home state or within 100 miles of your home mailing address (Quinn 230).

9 Items to include in the claim letter are your name and contact information, why you feel an error was made, the amount of the error, and the date of the error. If your card issuer does not receive your claim letter within 60 days of the statement mailing date, then you have no legal recourse. If your card issuer does receive your claim letter within the 60 days, they must acknowledge your letter within 30 days of receiving it and resolve the issue within 90 days (Quinn 229). As a safety precaution, always save all credit card receipts until your statement comes and reconcile them together so you may note any discrepancies. Also, if you do file a claim letter, be sure to mail the letter by registered mail to the billing inquiry address and not the remittance address. Keep a copy of the letter for your own records.
Appendix A

Contact information for the three major credit bureaus:

Equifax Credit Information Services, Inc.
P.O. Box 740241
Atlanta, GA 30374
To request a credit report: 1-800-685-1111
To report fraud: 1-800-525-6285
http://www.equifax.com

Experian (formerly TRW)
National Consumer Assistance Center
P.O. Box 2002
Allen, TX 75013
To request a credit report: 1-888-397-3742
To report fraud: 1-888-397-3742
http://www.experian.com

TransUnion, LLC
Consumer Disclosure Center
P.O. Box 1000
Chester, PA 19022
To request a credit report: 1-800-888-4213
To report fraud: 1-800-916-8800
http://www.transunion.com
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