# Topic 1(d) Credit

## Different meanings of the word 'credit'

***What does the word 'credit' mean to you?*** _____

_____

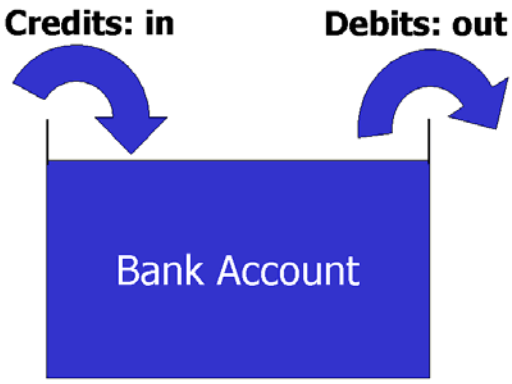
_____

In the language that banks use, 'credit' has two meanings:

1. Money put into a bank account
2. Money that is lent to a person

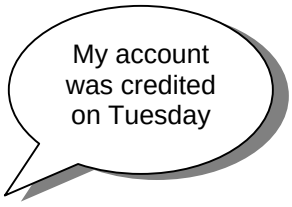
### Money put into an account

When you pay money into your bank or building society account the bank calls the amount a **credit**.




People can keep track of money going into and out of the account by looking at the account **statement**. The statement lists the amounts the bank has **credited** and **debited** and shows the total amount of money held in the account – the **balance**.

People use the word 'credit' in the following ways:

### Money lent to a person

'Credit' is also used to mean money that is lent to someone. For example, in shops you might see notices that say:



***Think about the adverts you have seen for goods sold by shops. Tick the boxes of the following items to show whether you think shops offer credit terms on them.***

| | Shops offer credit | Shops do not offer credit |
|---|---|---|
| Biscuits | ☐ | ☐ |
| Furniture | ☐ | ☐ |
| Washing machines | ☐ | ☐ |
| DVDs | ☐ | ☐ |
| Cars | ☐ | ☐ |

Shops tend to offer expensive items such as furniture, washing machines and cars on credit terms. By offering to lend customers the money, shops are encouraging people to purchase things they can't afford to buy with cash. Customers borrow the money, get the goods straight away and then pay the money back over a number of years.

### Different forms of credit

Credit is available in different forms. For example, credit agreements from shops, loans and overdrafts from banks, and credit cards from banks.

## Credit terms

People who take credit from a shop or a bank must pay the money back. They must also pay an extra amount for using the shop's or the bank's money. This extra amount includes the **interest** charged on the credit amount. The borrower may also pay **fees** to cover the shop's or the bank's **administration costs**.

***How old do people have to be to be able to get credit?***

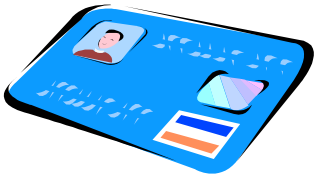
***ANSWER***: Most credit is only available to people aged 18 and over.

**Annual Percentage Rate (APR)**

All credit adverts, details and **agreements** must explain what interest and fees will be charged on the amount of money borrowed. This interest, including any additional charges, must be given as an **annual percentage rate**, for example 8% or 15%.

Organisations that offer credit must calculate the annual percentage rate (APR) according to rules set out in the **Consumer Credit Act**. Because all credit interest must be calculated in the same way, people wanting to borrow money can compare the APRs on different credit agreements. People can shop around for the lowest APR and so find the cheapest way to borrow the money.

## Credit cards

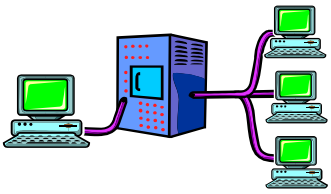


People use these plastic cards to 'buy now and pay later'. Some traders do not accept credit cards as a way of paying for goods and services. Those that do accept credit cards may set a minimum amount that can be paid by card, such as £5.

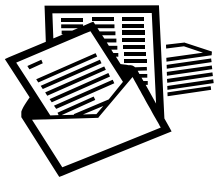
Visa and Mastercard are the two main types of credit card used in the UK. Let's see how paying by credit card works.

Kyle decides to buy a new mobile phone. It costs £120. He wants to pay using his Visa credit card. These are the steps involved:

1. Kyle checks that the shop accepts his type of credit card. The shop has a Visa sticker on the till showing that it does accept his type of card.
2. Kyle gives the shop assistant his credit card.
3. The shop assistant puts the card into a device that reads the **microchip** on the card. This chip tells the computer device details about Kyle's credit card.
4. The shop assistant uses the keypad to type in the amount that Kyle will pay for the mobile phone, £120.00.
5. Kyle uses the keypad to type in his personal identification number (**PIN**) to show that he wants to pay this amount on his credit card.
6. The card reader sends a message to the shop's bank requesting permission to accept this credit card as a way of paying the £120. The message is sent through a computer network.

7. The shop's bank asks permission from Kyle's bank to go ahead with this **transaction**.
8. Kyle's bank gives permission. This is called an **authorisation**.
9. The shop's bank sends the card reader a message saying that the transaction has been authorised. The bank gives the card reader an **authorisation code** so that this transaction can be matched with the permission received from Kyle's bank.
10. The card reader prints out a receipt for Kyle that shows the amount he has spent on his card and the authorisation code.
11. The shop sends its bank details of this transaction.
12. The shop's bank credits the shop's bank account with £120.
13. The shop's bank asks Kyle's bank for £120. Kyle's bank pays this amount.
14. Kyle's bank puts this transaction on Kyle's credit card statement.
15. Kyle decides to pay back half of the £120 this month and the other half next month. He sends his bank a cheque for £60. Next month he will pay £60 plus the interest his bank has charged on this £60.



***Suppose Kyle pays back the full £120 when he receives his credit card statement. Will his bank charge him interest?***

***ANSWER***: Kyle will not have to pay any interest if he pays back the full balance of his credit card when he receives the statement.

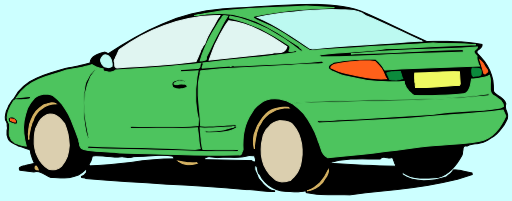
## Review questions

1. In the language of banks, which of the following are meanings of the word 'credit'?
   a. Money put into a bank account
   b. Money lent to someone
   c. Money taken out of a bank account
2. What is the name of the document that lists all the credits and debits on a bank account?
3. What does APR stand for?
4. Are all APRs calculated in the same way?
5. Credit cards charge interest on which amount of money?
   a. The full amount of the transaction.
   b. The amount of money that the cardholder borrows (ie the amount he/she does not pay back by the deadline).

## Case study

Jo is 19 years old and has a full-time job. She is buying her first car from a local garage. She wants to borrow the money and pay it back over three years.

She investigates the credit available from the garage and the credit available from her bank. She compares APRs and decides that taking credit from the garage will be cheaper.



## Learning activities

### Internet

1. Find out more about credit agreements and APR by going to www.tradingstandards.gov.uk. Select 'for schools', then 'Ask CEdRIC'. Click on 'Key Stage 4' and then on 'Personal finance'. There is a straightforward explanation of how credit works here.
2. Go to www.moneyfacts.co.uk and find out the lowest and highest APRs on their best buy credit cards offering standard rates on purchases.
3. Go to www.chipandpin.co.uk to find out more about how credit cards work.
4. Use the Internet to find information about
   a. a high street store card;
   b. a bank or building society credit card;
   c. credit terms available from an electrical or furniture retailer.

   Draw up a table showing how the maximum that can be borrowed and the APR for each form of credit.

### Group

1. Collect leaflets about the credit cards available from shops, banks, building societies and the Post Office. Find the APR that is quoted for each card. Which is most expensive and which is cheapest?

### Individual

1. Look at your bank account statement and identify which entries are credits. If you do not have a bank account, ask family members if they will show you their account statements.

# Key points for Credit

- In the language of banks 'credit' has two meanings:
  - money put into a bank account;
  - money that is lent to a person.
- Banks call money put into a bank account a credit. These credits are listed on the bank account statement.
- People can take out credit agreements in shops to buy expensive items like furniture. This is a way of borrowing money.
- Credit is available in different forms including credit agreements, loans, overdrafts and credit cards.
- As well as paying back the money, borrowers pay interest and fees.
- The cost (interest rates plus charges) of credit must be quoted as an annual percentage rate (APR).
- The Consumer Credit Act sets out rules for calculating the APR.
- APRs make it easy for people to compare the costs of borrowing money from different places.
- People need to be 18 years old or more to take out most forms of credit.
- Credit cards let people buy now and pay later.
- Cardholders use a personal identification number (PIN) to tell the shop's card reader that they want to make the transaction.
- Credit cardholders can choose to repay all the money they have borrowed by the date given on their card statement. Then they pay no interest.
- If credit cardholders do not repay all of the money by the deadline they pay interest on the amount that they are still borrowing.
- If people want to borrow money, it is a good idea for them to shop around for the best credit deal.