

M110 SECTION 9.3 CONSUMER LOANS

Using a credit card is basically receiving a loan from the credit card company. Thus, a *finance charge* will be charged to the consumer in the form of an annual fee or interest charges. When do you get charged this *finance charge*? As long as you pay the bill in full by the due date you do not pay a finance charge – otherwise finance charges are added. How and when this finance charge is calculated is not exactly simple.

UNPAID BALANCE METHOD (OPEN-ENDED CREDIT)

With this method, the interest is based on the previous month's balance.

1. Start with Unpaid Balance
2. Calculate and Add on Interest (Finance Charge) on Unpaid Balance
3. Add on any purchases
4. Subtract off any payments or returns
5. This is the Current Month's Unpaid Balance
6. Calculate the Finance Charge for next month on this Unpaid Balance

EXAMPLE The annual interest rate on your credit card is 18% and your unpaid balance at the beginning of last month was \$600. Since then, you purchased ski boots for \$130 and sent in a payment of \$170.

- a. What is the Unpaid Balance this month?
- b. What is the next month's finance charge?

AVERAGE DAILY BALANCE METHOD (OPEN-ENDED CREDIT)

The most complicated and the most common method is the *average daily balance method*. Throughout a month you may make payments toward paying off your debt, while at the same time be making purchases with your card thus increasing your debt. So from day to day your balance owed is changing. The finance charge is calculated from the *average of these varying day to day balances*.

Let us see how the finance charge is actually calculated.

EXAMPLE:

You begin the month of April with an unpaid balance of \$240. The annual interest rate of your credit card is 18%. A payment of \$60 was made on April 11th, a purchase of \$24 was made on April 18th, and \$12 was charged on April 23rd. Find the finance charge on the May bill.

Days	Number of Days	Balance	Number of days x Balance
Total			

Now, find the Average Daily Balance:

$$\text{Average Daily Balance} = \frac{\text{sum of the total amounts owed each day of the month}}{\text{number of days in the billing period}} = \frac{\quad}{\quad} = \quad$$

Then use this amount as the principal and use the simple interest formula to obtain the finance charge. Remember that you are thinking about *days in that particular month* when it comes to time.

$$I = P \cdot r \cdot t$$

EXAMPLE: You begin the month of July with a balance of \$1024. Purchases of \$315 were made on July 7, and \$410 was charged on July 22. A payment of \$400 was made on July 15. The annual interest rate on the card is 14.4%. Find the finance charge on the August 1 bill.

Days	Number of Days	Balance	Number of days x Balance
Total			

Average Daily Balance = $\frac{\text{sum of the total amounts owed each day of the month}}{\text{number of days in the billing period}}$ = _____ =

Finance Charge:

EXAMPLE: On May 1, a credit card account had a balance of \$189. Purchases of \$213 were made on May 5, and \$102 was charged on May 21. A payment of \$150 was made on May 25. The interest on the average daily balance is 1.5% per month. Find the finance charge on the June 1 bill.
(Make a chart!!!)