

Topic: credit

Case Study: Lisa's Rewards

Do the benefits of a credit card ever justify the costs and risks?

Background

Lisa's dream has just come true. As a teenager growing up in Los Angeles, California, she has always dreamed of moving to New York City to pursue dancing and choreography in musical theater, and she just got notification that she was accepted to New York University's dance program with a generous scholarship. She is thrilled to be able to see this dream become a reality, although both she and her parents are a little saddened by the large distance that will be between them. The family can afford to visit Lisa once per year and to pay for Lisa to come back to L.A. for either the holiday break or the summer break, but not both.

Lisa has always been a pretty good kid—she's responsible, maintained a solid A– average through high school, and has even managed to save about \$2,000 to help pay for living expenses during college by working a part-time job at GameSpot. She does have a weakness for video games, so most of her paycheck goes to support that addiction; luckily, the employee discount helps her stretch her game dollars farther.

Lisa is planning to open a checking account with the money she has saved, and is thinking of getting a part-time job in New York to help pay living expenses to offset the need for loans. She will not do so, however, until at least midterms of the first semester have passed, so she knows how much time her academic coursework and additional dance practice will require. If she's doing well and has enough free time, she plans to

Case Study: Lisa's Rewards

work 10 hours per week and estimates that she can earn at least \$10 per hour since she has experience.

All in all, Lisa is really happy and her family is very supportive of their daughter. Still, she wishes New York were just a little closer to L.A. so she could visit home a bit more often.

Dilemma

One day in July, as Lisa was nostalgically packing up her childhood belongings and leafing through her high school yearbook, a piece of mail arrived that offered a solution. OrangeJet Airlines, which runs frequent and relatively inexpensive flights between Los Angeles and New York City, seemed to be offering her a credit card. Lisa was confused, because she didn't think OrangeJet was a credit card company, but the letter also said something about Visa, which she recognized as a brand of cards, and also had the name of a bank that she didn't recognize. She hadn't been planning to get a credit card because she heard that it's easy to fall into huge debt, but she also had heard something about "building credit" in school.

This letter seemed like a too-good-to-be-true offer: for an annual fee of \$100, which wouldn't be charged the first year, Lisa could earn points on all of her purchases toward free flights. If she used the card to buy flights, then the points would rack up really quickly, with points being multiplied by 5. By Lisa's calculation, if she used the card for most purchases and to buy her annual flights home, she'd be able to take at least one and possibly two extra flights for Thanksgiving or Spring Break during her college career, for free. The big catch was that, because she is under 21 and would not have a steady income stream, so she needed her parents to co-sign the card. She knew her parents were secretly not thrilled that she would be 3,000 miles away, so she rushed to show them the deal.

Lisa's parents were a bit more hesitant; they were by no means financial experts, but all the numbers Lisa showed them struck them as high (the APR was 21.6%, the late fee was \$25, and the default APR was 33%), and the promise of free airline flights just seemed too good to be true. They encouraged Lisa to get a simple checking account with a debit card to avoid debt, the temptations of overspending, and high interest, but Lisa promised them that she could be disciplined with the card, would not spend

money she didn't have, and would pay the bill on time every month. Lisa's parents visited their local bank, where they had been loyal customers for over 20 years, and asked what the bank could offer if Lisa really wanted a credit card. The bank offered a starter card that would be co-signed between them and Lisa; they would be responsible if Lisa didn't pay, and they would be alerted of any transaction over \$100. The card also had a tight limit of \$500 to start, which would rise to \$1,000 after one year of timely payments. It had no annual fee and an APR of 11.2%. But, of course, it didn't offer points towards airfare.

Recommendations

You are Lisa's parents. How would you advise Lisa to proceed? What factors would you consider when deciding between the OrangeJet card and any other options? What other options would you consider? Think about the advantages and disadvantages of different options and how you would prioritize different criteria for weighing them; you should also consider whether there are other card options that might be better than either of the two presented here.

What else would you want to know to make a better recommendation?

Terms

- Annual fee
- Bank
- Checking account
- Co-sign
- Credit Card Accountability, Responsibility and Disclosure (CARD) Act of 2009
- Credit limit
- Credit report
- Credit score
- Debit card
- Finance charges
- Grace period
- Identity theft
- Interest (APR)
- Minimum payment
- Six C's of credit
- Truth in Lending Act of 1968
- Variable APR

Resources

What the Credit Card Reform Law Means to You

A description of new consumer rights under the CARD Act of 2009.

<http://www.creditcards.com/credit-card-news/help/what-the-new-credit-card-rules-mean-6000.php>

AnnualCreditReport.com

This central site allows you to request a free credit file disclosure, commonly called a credit report, once every 12 months from each of the nationwide consumer credit reporting companies: Equifax, Experian, and TransUnion.

<https://www.annualcreditreport.com/cra/index.jsp>

How to Read a Credit Card Statement

This interactive site offers a sample credit card statement with helpful pop-up bubbles that define key credit card terms. This can be helpful in the decision as to whether to get a card and what card to get, because being familiar with credit card terminology and forms can help inform that choice. It could also be helpful to Lisa later on, should she choose to apply for a card, to ensure she fully understands all of the terms and rules, what she is being charged for, and what her obligations are.

<http://www.aie.org/managing-your-money/credit-cards/How-to-Read-a-Credit-Card-Statement.cfm>

6 Things to Consider Before Choosing a Credit Card

A good source of basic information about credit card terminology and bases for comparison between cards. Be aware that this source partners with the credit card industry; part of its goal is to match consumers with cards, so its advice should be taken with that context in mind.

<http://www.creditcards.com/credit-card-news/help/6-consider-before-choosing-picking-credit-card-6000.php>

Credit Cards

Resources from the Federal Reserve Bank on credit cards, including a link to an interactive guide to the summary information required by law to be included in a credit card offer. Click on "Learn More About Your Offer" for the guide.

<http://www.federalreserve.gov/creditcard/#>

A Tool for Selecting the Best Cash-Back Credit Card

A link to a tool for analyzing whether rewards cards are worth it, given annual fees and other costs, under various spending scenarios.

<http://bucks.blogs.nytimes.com/2012/06/21/a-tool-for-selecting-the-best-cash-back-credit-card/>

Occupational Outlook Handbook: Dancers and Choreographers

Average income for dancers and choreographers, as estimated by the Bureau of Labor Statistics.

<http://www.bls.gov/ooh/Entertainment-and-Sports/Dancers-and-choreographers.htm>