



AMBD Article

CREDIT CARD 101: UNDERSTANDING INTEREST CHARGES

A credit card is a flexible and useful tool, either as a means of payment or as an alternative source of funds at times of emergencies. While credit cardholders can reap benefits from its usage, it is very important that users understand how to utilise credit cards responsibly. This also includes understanding how interest on credit cards is applied and calculated. This article aims to provide users with guidance on how to make good use of your credit card, and to better manage its usage.

Disclaimer

The examples in this article are for illustration purposes only.

Credit cardholders are encouraged to check with their respective financial institution on how interest rates on credit cards are calculated. For example, some financial institutions may charge interest on credit cardholders on a daily rate.

**Note: For credit cards issued by Islamic banks, the term “interest charge” is represented as “administration fee”.*

Transactors vs. Revolvers: The Different Types of Credit Cardholders

Transactors

Transactors tend to pay their credit card bills in full. They are therefore perceived to have a lower level of credit risk, overall.

For example: Hussein bought groceries worth B\$250.00 using his credit card, but pays the balance in full when the bill comes.

Revolvers

Revolvers carry an outstanding balance from month to month. They are generally perceived to have a higher risk of defaulting, especially when they accumulate a significant amount of unpaid balances. Therefore, revolvers need to ensure that they pay their outstanding balances on time and be extra wary of compounding interest and late payments fees.

For example: Siti bought a new computer costing B\$1,200.00 using her credit card, but only pays the minimum amount due when the bill comes.

Act Responsibly: Avoid the Consequences of Late Repayments!

1. **Lowering your chances of getting a new loan**

Credit Bureau, Autoriti Monetari Brunei Darussalam (CB, AMBD) collects, compiles and consolidates both banking and non-banking (such as utilities) information to generate an individual/ company's credit score and subsequently, the credit report for the individual/ company. With these tools, financial institutions are able to make credit assessments on an individual's loan application. Credit cardholders with irregular repayments will be seen as high risk, and this may lead to financial institutions being less inclined to grant them new credit facilities.

2. **Understanding "Compounding Interests"**

Compounding interest refers to the interest on top of the initially charged interest which individuals are required to pay on top of the outstanding amount from their credit facility. Furthermore, a late fee is usually incurred for payments made after the due date.

For example: Abu bought a new laptop costing B\$1,000.00 using his credit card. Assuming he does not make any repayments at all and the interest charge stands at 1.5% per month and his late payment fee is fixed at \$40.00 per month, the amount he is due to pay will be as follows:

SCENARIO: NO REPAYMENTS MADE				
Month	Opening Balance	Interests @ 1.5%	Late Payment Fee	Amount Outstanding
January	B\$ 1,000.00	B\$ 15.00	B\$ 40.00	B\$ 1,055.00
February	B\$ 1,055.00	B\$ 15.83	B\$ 40.00	B\$ 1,110.83
March	B\$ 1,110.83	B\$ 16.66	B\$ 40.00	B\$ 1,167.49
April	B\$ 1,167.49	B\$ 17.51	B\$ 40.00	B\$ 1,225.00
May	B\$ 1,225.00	B\$ 18.37	B\$ 40.00	B\$ 1,283.37
June	B\$ 1,283.37	B\$ 19.25	B\$ 40.00	B\$ 1,342.63
July	B\$ 1,342.63	B\$ 20.14	B\$ 40.00	B\$ 1,402.76
August	B\$ 1,402.76	B\$ 21.04	B\$ 40.00	B\$ 1,463.81
September	B\$ 1,463.81	B\$ 21.96	B\$ 40.00	B\$ 1,525.76
October	B\$ 1,525.76	B\$ 22.89	B\$ 40.00	B\$ 1,588.65
November	B\$ 1,588.65	B\$ 23.83	B\$ 40.00	B\$ 1,652.48
December	B\$ 1,652.48	B\$ 24.79	B\$ 40.00	B\$ 1,717.27
Total		B\$ 237.27	B\$ 480.00	-

After a year, Abu's total accumulative outstanding credit card balance will have shot up from B\$1,000.00 to B\$1717.27 – almost double the amount he initially owes. Therefore, it is important to make your repayments to avoid these unnecessary charges. You will also be saving your money!

Financial Tips to Better Manage Your Credit Cards

1. Budgeting and self-control

Use your credit cards wisely, preferably only for emergency purposes. Track your credit card spending against your financial capacity. Budgeting and knowing your needs and wants will help you from overspending.

2. Know your due date

Keep track of your repayment due dates and ensure monthly obligations are paid on time to avoid unnecessary additional charges. Any outstanding balance including interests that are not cleared by the due date will be compounded in the next payment statement.

3. Pay above the minimum amount due on a timely basis

Following the above example with Abu, the table below shows the difference should he pay the minimum amount due (8%) or above the minimum amount due (15%).

Assuming Abu only pays the minimum payment on monthly basis, he would clear his debt in **24 months**, summing to a total of **B\$1,305.88**.

On the other hand, assuming that Abu pays 15% of the outstanding amount, he would clear his debt in **16 months**, with total payment of **B\$1,160.24**.

Scenario	Paying 8% of the monthly outstanding	Paying 15% of the monthly outstanding
Initial Debt	B\$ 1,000	
Interest rate on outstanding amount	1.5% per month	
Time taken to pay off outstanding	2 years or 24 months	1.3 years or 16 months
Total amount paid eventually	B\$ 1,305.88	B\$ 1,160.24

This example shows that paying above the minimum amount due means would lead to clear of debt quicker and also at a lower total amount.

4. Pay your credit card bills in full and on time once you receive your bill

A normal billing cycle is usually 28 to 31 days, with a grace period between the end of a billing cycle and the payment due date. As such, when the opportunity arises, pay your credit card in full before the end of the grace period as it will prevent you from incurring any interest charges.

5. Take note of charges incurred using the cash advance facility

Credit cardholders are also advised to be extra wary on utilizing the cash advance facility on their credit card as interest charges are incurred instantly after withdrawal. Charges using this facility are often incurred on a daily rate, causing outstanding balance to accumulate very quickly.

Did You Know?!

1. You can leverage on your bank's 0% interest installments plan

Some financial institutions allow credit card balances to be converted into monthly installment plans of 6, 12, 18 or 24 months with a one-time processing fee, and 0% interest charge on installment.

For example, Abu uses his credit card to purchase a new computer worth B\$1,000.00. After converting the repayment to 12 monthly installments, he only needs to pay B\$83.33 per month after paying the processing fee.

2. Payment convenience

Utilizing internet banking or mobile banking apps can give you the convenience to track your credit card balance, and make repayments on time. Credit cardholders should also take advantage of the direct debit facilities available to avoid missing your payment schedule.

Bottom Line

There is absolutely nothing wrong with owning a credit card as it acts as an alternative emergency source of fund aside from cash savings. However, it is important that credit cards are used responsibly. If you are interested in signing up for a credit card, ensure that you speak to a sales representative of your preferred financial institution to understand information such as credit card payment due dates, fees and charges that you might incur, as well as penalties for non-payment.

For more information, please contact the Financial Consumer Issues of AMBD at fci-edu@ambd.gov.bn and follow AMBD's Instagram @autoriti_monetari.

Autoriti Monetari Brunei Darussalam

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