

Chapter 6

**Using Credit Cards:
The Role of Open Credit**

Definitions and Examples of Credit

- **Credit** – receiving cash, goods, or services with an obligation to pay later.
 - ▶ Examples – auto loans or personal loans

- **Open credit** – credit that you can use and repay at your own pace so long as you pay the required minimum monthly payment.
 - ▶ Examples – Credit cards or department store credit cards

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Determining the Costs of Open Credit

- The balance owed
- Interest rates
- Balance calculation method
- Cash advance costs
- The grace period
- The annual fee
- Additional or penalty fees

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Interest Rates

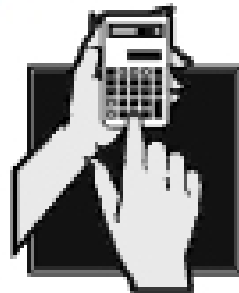
- Annual percentage rate (APR) – true simple interest rate paid over the life of the loan
- Teaser rates – introductory rates used to attract new customers, some as low as 2.9%
- Most credit cards compound interest

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Balance Calculation Methods

- Average daily balance – (most common)
 - Including new purchases
 - Excluding new purchases
 - Two-cycle
- Previous balance – (most expensive)
- Adjusted balance – (least expensive)



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Buying Money: The Cash Advance

- An extremely expensive way to borrow
- Interest begins immediately and may be at a higher rate than for purchases.
- Usually there is a "cash advance fee" of 2% to 4% of the amount advanced.
- Some cards require payment of the purchase balance before payment of the cash advance balance.

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The Grace Period

- Normally 20 to 25 days, excluding cash advances
- Doesn't apply if you carry a balance
- Beginning with no balance, you could avoid paying for a purchase for nearly 2 months
- Not all credit cards offer a grace period

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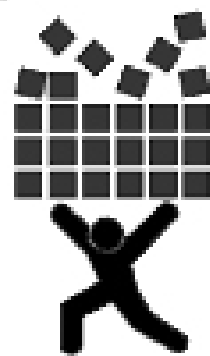
The Annual Fee

- Range from \$0 to \$100 (American Express charges \$300 for their Platinum card.)
- 70% of the 25 biggest card issuers don't charge an annual fee.
- Merchant's discount fee – charged to merchants, typically 1.5% to 5.0% of the purchase amount

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Additional Fees



- Cash advance fee
- Late fee
- Over-the-limit fee
- Penalty rates
- Be alert – “Important Notice of Change of Terms”
- The “Schumer” Box

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