DEBIT CARDS (pay now) v. CREDIT CARDS (pay later)

Let's take a look at each.

Pay Now: Debit Cards

A ***debit card*** (also known as a check card) looks like a credit card but is an alternative payment method to cash and checks. When you make a purchase with a debit card, the funds are ***immediately withdrawn*** from your bank account and transferred into the account of the store or business where you completed the transaction. Because a debit card links directly to your bank account, you can spend only what you have in your account.

While this helps keep you out of debt, you need to monitor debit card purchases closely and stick to your budget so you don't overdraw your checking account. If you use your debit card to buy something that costs more than the amount of money in your account, the charge may be rejected or, if you have overdraft protection, you may be charged an overdraft fee.

Benefits of debit cards:

• They allow you to make the same kinds of purchases as you do with credit cards so you don't need to carry cash.
• Most provide the same type of "zero liability" protection as credit cards.
• There is no APR or interest rate charged.
• There are no monthly payments or debt accrued.

Things to watch for:

• If you overdraw your account, you will be charged a fee for each transaction.
• If you withdraw money from an ATM machine that's not part of your financial institution's ATM network, you could incur fees on both sides – from your bank or credit union and the other institution that operates the ATM.

Pay Later: Credit Cards

A ***credit card*** entitles you to make purchases based on your promise to pay for these purchases at a later date. The card issuer grants you a line of credit, which is a promise from the card issuer to you that they will loan you any amount of money up to the credit limit on the account. You can use that credit to purchase goods, pay bills or obtain cash advances (like using an ATM). So no money is immediately deducted from your checking account. New laws from the credit CARD Act of 2009 place strict limitations on issuing cards to consumers under 21. If you fall in that age group, you have to have a co-signer or show proof of sufficient income to repay the debt.

Each month, the card issuer sends you an account statement that lists all of your purchases and the total amount you have purchased using the card that month. All credit cards issue you credit which you must pay back at an annual percentage rate set by the credit card company. The total amount is called your balance. When ***you pay the full amount*** of the balance, the card issuer charges you ***no interest for this service***. If you ***do not pay the full amount***, the balance on your card account becomes a loan to you from the card issuer and ***you begin paying interest on this loan*** in ADDITION to the balance you already owe. Essentially you are paying for the fact that you are in debt.

Benefits of credit cards:

• They let you buy items in stores, online, on the phone or through a mail order catalog without using cash. Or buying items that are expensive in one purchase like a new laptop
• They help you to establish credit history if you use them wisely.
• Enable you to purchase airline tickets, reserve hotel rooms and rent cars – all transactions that can be difficult to do using cash. Many debit cards cannot be used for this
• Provide access to cash advances in case of emergency.
• Depending on the credit card issuer, their rewards program may provide points with each purchase that can be used to receive free airline miles, merchandise or cash back on purchases.

Things to watch for:

• Credit cards make impulse buying easier, which can throw off your budget and increase your level of debt.
• Items charged cost more (cost of item + interest) **unless you pay the balance in full each month.**
• **Late payments** may incur fees, increase interest rate and negatively impact your credit rating.
• If you don't monitor spending carefully, your **purchases can push you over the credit limit**, resulting in an additional fee. This could also increase your interest rate and lower your credit score.
• While cash advances can be helpful in emergencies (using your credit card at the ATM), these incur a very high interest charge.

Key Terms

• **Annual fee** – This is a fee that some, but not all, credit card issuers charge to use their credit card.

• **Annual percentage rate (APR)** – Also known as interest rate, it is the percentage used to compute the finance charges on an outstanding balance.

• **Available credit** – The amount of unused credit available on your credit card account.

• **Cash advance transaction finance charge** – Most credit cards let you obtain a cash advance from your account, but there is a dollar limit and you may be charged an additional fee for this transaction. Plus, interest rates charged for cash advances are often higher than the rates for purchases.

• **Cardholder agreement** – This document details the terms and conditions of your credit card account. It will include your APR, any applicable annual fee, penalties and other costs associated with the use of the card.

• **Credit line (or credit limit)** – The maximum amount you are allowed to carry as a balance on the card. The amount of your credit limit is determined by your income, your credit score and your payment history (on-time payments)

• **Finance charge** – Based on the interest rate, this is the amount of interest you pay on the outstanding balance.

• **Grace period** – The period of time between the billing statement date and the date full payment must be received before interest is charged on your account balance and new purchases.

• **Introductory rates** – The APR offered by a credit card company as a promotional offer, which can vary from a few months to a year. The rate is then adjusted to the standard APR.

• **Late payment fee** – Amount charged if your payment is received after the billing due date.

• **Minimum monthly payment** – The amount due based on the percentage of the outstanding balance, or a minimum fixed amount.

• **Overdraft** – When you write a check or make a withdrawal from your checking account that leaves you with a balance below zero. If you sign up for overdraft protection, your bank will cover the transaction but will likely charge you an overdraft fee to do so.