



Credit cards: convenient tools that should be used with *caution*

Credit cards are a convenient payment method—but they can get you in trouble if you're not careful.

A *credit card* is a tool that allows you to pay for a purchase with money that you borrow from a financial institution. When you get a credit card, you enter into a legal agreement with the financial institution that you'll pay back the amount of money you've borrowed within a certain timeframe.

How it works¹

Your credit card will have a **spending limit** that's set by the financial institution. If you pay back the full amount you owe (the balance) before the end of the monthly billing period, you generally won't have to pay any interest on the money you've borrowed.

If you **don't** pay the full amount, you'll be charged interest on each purchase from the day it was made. If you **miss** a payment or are **unable** to pay the minimum, you may also be charged a fee on top of the interest. Your interest will continue to build until you pay the full balance.

You can also use a credit card to get cash with what's called a **cash advance**. The interest on a cash advance is often higher than the interest you pay on normal purchases, and it's typically charged on a daily basis, beginning when you take the cash—so make sure you check your cash advance terms with the credit card company before you use this option.

How you use a credit card can affect your credit rating

If you pay off your balance each month, having a credit card can be a great way to establish or improve your credit rating. If you **don't** make your payments on time, not only will you owe fees on top of the interest, you may **damage** your credit rating. To keep your credit rating strong, you need to make at least the minimum payment required each month.²



Key terms



Fees—Some credit cards have additional fees, such as an **annual fee** for simply having the card. This fee is similar to a membership fee and is typically charged **one once a year** for as long as you're a cardholder.



Rewards—credit cards offer you cash or points that can be applied toward benefits such as travel or merchandise. Many financial institutions will use rewards as a way to **incentivize** consumers to choose their credit cards.



APR—The interest rate on your credit card is also referred to as the APR, or **annual percentage rate**. If you purchase something using a credit card and fail to pay off the balance by the due date, you'll be charged interest at that rate. You'll want to make note of any change to your credit card's APR, as that will affect the amount of interest you'll pay on outstanding balances.



Finance charges or late fees—If you're late making a payment or if you only pay part of the balance, you may be **charged** an additional fee. You may also incur a charge for a balance transfer.



Credit limit—This is the **predetermined** limit that you can charge to your credit card. If you establish a track record of responsible usage and timely payments, the financial institution may increase your credit limit. If you exceed the credit limit, you may be penalized.

Is a credit card for me?

Credit cards are easy to use, can be safer than carrying cash, and sometimes offer consumer protection on certain purchases. At the same time, they may carry high interest rates and additional fees. The convenience of credit cards can lead some users into a debt spiral.

So if you're considering a credit card—or you already have one—make sure you use it **with caution**. Remember that if you don't pay the full balance, the interest you owe will continue to build until you pay the balance, effectively increasing the price of your purchase. Making a large purchase today thinking you'll have the money for it next month can lead you down a slippery slope to growing debt.

Consider starting **small**. Purchase small items with your credit card and pay off the full balance every month. This will allow you to build your credit score and establish good credit card habits.



1 "How Does a Credit Card Work? Here's an Easy-to-Understand Guide and Credit Card Definition," Credit Card Insider, 5/4/20, <https://www.creditcardinsider.com/blog/how-does-a-credit-card-work/>. **2** "How to Build Credit With Credit Cards: The Definitive Guide," Credit Card Insider, 6/16/20, <https://www.creditcardinsider.com/learn/definitive-guide-how-to-build-credit-with-credit-cards/#:~:text=The%20most%20important%20thing%20you,minimum%20required%20amount%20each%20month.&text=This%20can%20help%20you%20both,interest%20completely%20with%20most%20cards>.

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