<u>Interest – How it Works</u>

What it is: Annual percentage rate (APR) is the yearly percent of interest you pay on your credit card. If your monthly interest is 2% then your APR is 24%. There are also variable rate credit cards with interest rates tied to an index such as the U.S. prime rate. The blender then charges an additional margin to you to determine the consumer's credit card APR. If your credit card is not variable then it is consider a fixed rate credit card. A fixed rate does not mean that the interest rate will never change, but the issuer generally must notify you before the change occurs, and in most circumstances can apply the higher rate only to purchases and other transactions you make after you get the notice. (source: CFPB).

How it works: The lenders use a formula to determine how much you owe each month.

APR / 365 days = *DPR Daily Periodic rate*

(DPR x days in billing period) x Balance Subject to Interest Rate = *Interest charged*

This may sound relatively simple but often times there are different interest rates for different transaction types such as:

<u>Introductory APR</u> – is a lower promotional rate for at least 6 months. If the interest rate is a variable APR then your introductory rate could change if the underlying index changes during the 6 months.

<u>Purchase APR</u> **–** applies to purchases

<u>Cash Advance APR</u> – the cost to borrow money from a credit company is higher than the amount for regular purchases.

*<u>Penalty APR</u>***-** usually the highest APR. It may be applied to certain balances if you violate the card terms and conditions like failing to make payments on time.

Why it matters: Annual percentage rate only applies to credit card balances, if you pay your credit card in full each month then you incur no interest cost. The period between the end of a billing cycle and the date your payment is due is referred to as a "grace period." Card issuers that provide a grace period must establish procedures to assure that bills are mailed or delivered at least 21 days before they are due.

Who should care? Not shopping around could be more expensive than you think. For example, let's say you have a $3,000 balance and can afford to pay $100 every month. If you have a credit card that charges an 18 percent annual percentage rate, or APR, you would pay $1,015 in interest and fees over the 41 months it would take to repay that debt. But if you had a card with a 15 percent APR, you would pay $783, and pay the debt off three months sooner. (source: CFPB)

Read the credit card agreement carefully and be cautious of low teaser rates. Many "teaser" interest rates increase dramatically after the introductory period and many include a balance transfer fee for transferring balancing from another credit card account.

For more information

- Consumer Financial Protection Bureau http://www.consumerfinance.gov/blog/how-do-i-shop-for-a-credit-card/
- Federal Trade Commission at http://www.consumer.ftc.gov/articles/0131-credit-card-interest-rate-reduction-scams
- Iowa State University Extension and Outreach Money Blogs tips http://blogs.extension.iastate.edu/moneytips/
- Iowa State University Extension and Outreach website at www.extension.iastate.edu/humansciences/