

## BORROWING OPTIONS: CREDIT CARDS

A credit card is issued by a lender that permits the user to make purchases on credit with payment due at a later date.

When you use a credit card, you are actually borrowing money from a revolving line of credit. The maximum total charges you are authorized to make (your credit limit) are set by the lender when you apply for the card and may be periodically adjusted. When you make a purchase using the card, the lender pays cash directly to the merchant. Thereafter, the lender bills you monthly for the amount charged, plus interest. You can pay the entire outstanding balance immediately or make payments until the balance is repaid. As you pay down the balance, you can charge it back up to your credit limit; hence the term revolving credit line.

### What is it?

You can also use most credit cards to obtain cash when you need it. This is referred to as a cash advance. Most credit card lenders offer a cash advance feature that allows you to obtain cash by presenting your credit card to a bank, credit union or other financial institution or by using the credit card at an ATM. The credit card lender repays the bank and bills you for the amount of the advance plus interest.

### Who can use credit cards?

A credit card can be used by its owner or authorized user. Cards are generally issued individually or jointly. They can also be issued to businesses. The name of the owner or authorized user is embossed on the front of the card.

Occasionally, you may read stories about children or pets that receive preapproved cards in the mail. Due to the aggressive manner in which cards are marketed today, these stories are likely true. However, it is not advisable to use a credit card that has been issued to your cat. It could be deemed a fraudulent act, especially if you have no intention of repaying your cat's debts.

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## What are the advantages of credit card borrowing?

### Nearly universal acceptance

Credit cards are accepted almost everywhere today, including supermarkets, doctors' offices and retail stores. Generally, merchants will accept all, or at least several, of the most commonly used cards. Accordingly, if you carry one or more major credit cards, you should have little trouble finding a merchant or bank to honor them.

### Very convenient to use

Credit card borrowing is very convenient. Credit cards can be easily carried in a wallet or pocketbook. As mentioned, credit cards are accepted nearly everywhere. Generally, the agreement with the lender is completed before you get the card. If you wish to make a purchase, you simply present the card to the merchant. The merchant can usually obtain electronic authorization (not necessary for smaller purchases) from your lender within a few seconds. If the purchase is made in person, you merely sign the credit card receipt. Mail order purchases, travel reservations and other such transactions can be completed over the phone by using a credit card. Indeed, modern technology has made credit card transactions nearly as quick and convenient as cash transactions.

### More secure than cash

Credit cards offer more security than cash. If your wallet or purse is stolen, your credit cards might be put to fraudulent use. However, there are some built-in protections provided by the credit card industry to minimize risk. You are asked to place your signature on a textured strip on the back of your card. Ideally, merchants will check the signature on the card to see if it matches the signature on the credit card receipt. Cards issued by your personal bank or credit union may include your photograph. Also, merchants can obtain electronic authorization for purchases. If the card has been lost or stolen, and you have notified the lender, authorization will be declined. Finally, in the case of lost or stolen cards, your liability for unauthorized purchases does not exceed \$50, provided that you have notified the lender in a timely manner. None of these protections are available with cash.

**Example(s):** You go on a trip carrying \$5,000 in cash. With \$5,000 in cash, you have \$5,000 worth of buying power. You lose your wallet. You lose \$5,000. If you go on a trip carrying a major credit card with a \$5,000 credit limit, then you have the same \$5,000 worth of buying power, with only a few exceptions (some merchants do not accept some cards). You lose your wallet. If the card is found and used illegally, the most you will have to pay is \$50. You have lost \$50 or less, not \$5,000. That is the security that credit cards provide.

### Can provide excellent source of short-term, no interest funding

Properly managed, credit cards give you the opportunity to capitalize on short-term, no-interest loans every month. Finance your groceries, gasoline, dry cleaning, entertainment and other regular monthly expenses using your credit card. When the bill arrives, pay the balance off in full. You will incur no interest charges and your money will have continued to earn interest in your bank account for an additional 30 days. If you select a card that has no annual fee, the cost of borrowing will be zero.

**Tip:** Some cards offer benefits such as frequent flyer points or discounts on a new car. The more you use the card, the greater the benefit. If you use the card for all your purchases and pay it off promptly each month, you will earn the benefits at no cost (assuming that your card has no annual fee). The same applies for cards that contribute a portion of purchases to a charity or local schools.

## What are the disadvantages of credit card borrowing?

### Generally, the cost of credit card borrowing is high

If you carry a balance, credit card borrowing can be expensive. On average, credit card interest rates are steep. Many cards offer low introductory rates for the first six months, but raise the rate thereafter. Even many of the so-called low interest credit cards charge double-digit interest rates at a time when your bank offers only 3 percent on your savings account. Many cards charge as much as 21 percent. Many charge an additional annual fee, plus service charges for cash advances.

**Tip:** To keep your rates low, shop for your cards. Look for cards with no annual fee. Look for low rates, even if they are temporary. Transfer your balances to cards with lower rates. Call your bank and ask for a better rate or a waiver of the annual fee. Customer service representatives often have authority to offer you deals. You have to ask for them.

### It is easy to get in over your head

Credit card companies may offer consumers more credit than they can afford to repay. Many companies offer liberal credit lines and raise them automatically or upon request. Although interest rates are high, credit cards remain attractive to many borrowers because of their low required minimum monthly payment. Borrowers thus feel secure charging large amounts on their cards because they know they can make at least the minimum payment.

The problem is that the minimum monthly payment is what makes credit cards so burdensome for most borrowers. If you make the minimum monthly payments on a balance of \$1,000 with an interest rate of 18%, you could be making payments for almost 10 years (providing no new charges are incurred during that time). Many borrowers faced with exorbitant balances become hopeless and unrealistic about their ability to get out of debt. Many take cash advances from one card to make payments on another.

**Tip:** Never charge more than you reasonably believe you can pay off within three to four months. Pay off balances as soon as possible, even if you have to use your savings to do so. Your savings earn only about 3% in a savings account. Your credit cards may charge as much as 21% interest. If you use your savings to pay off your credit cards, you net an 18% gain. If you are already over your head in debt, remember it is only money. Don't let it jeopardize your health, your marriage, your friendships, your sanity or your life. Consult an attorney who specializes in debtor-creditor matters.

### Current rules

The current rules regarding credit card accounts became effective as of February 22, 2010 (except as noted otherwise). Among other things, the rules:

1. Require credit card companies to notify cardholders in writing at least 45 days prior to any change in the annual percentage rate (this rule became effective August 2009)
2. Prohibit credit card companies from extending credit to consumers under age 21 unless the consumer demonstrates the independent means of repaying the debt or has a cosigner over 21 capable of repaying the debt
3. Prohibit credit card companies from treating a payment as late for any purpose unless the credit card company provides a reasonable amount of time (21 days) for the consumer to make that payment

4. Require credit card companies to allocate payments exceeding the minimum payment to the portion of the balance with the highest interest rate first
5. Prohibit credit card companies from calculating interest using a method referred to as "two-cycle billing"
6. Prohibit credit card companies from charging a cardholder an over-the-limit fee unless the cardholder authorizes the credit card company to complete the transaction that causes the balance to go over the limit
7. Require credit card companies to disclose at account opening all interest rates that will apply to the account and prohibit increases in those rates, except in certain circumstances
8. Allow (as one of those circumstances) credit card companies to increase the interest rate on an existing balance only if the account is 60 days overdue, and require banks to reinstate the interest rate to what it had been before the increase once the cardholder has made timely minimum payments for six months
9. Require credit card companies to notify consumers in writing on each billing statement the number of months and the total cost (including principal and interest) involved in repaying the current balance if only the required minimum monthly payments are made

### Are there tax implications involved with credit card borrowing?

Interest on credit card debt is not deductible.

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