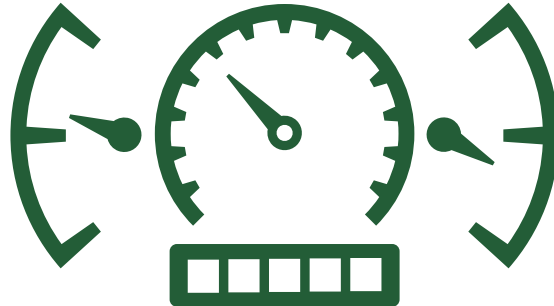


SECTION 5.2

THE CREDIT TRAP



TERMS

CREDIT TRAP: when something you purchase ends up costing more than the original price due to interest paid on credit card.

ELECTRONIC FUNDS TRANSFER ACT: debit card allows only 2 days to report fraudulent activity, before you are liable for up to \$500.

FAIR CREDIT BILLING ACT: protects information gathered by credit bureaus and removes liability for fraudulent transactions.

"Hey Steve, did you see my new seventy-two-inch Smart TV? It was only \$2,000," Billy bragged.

"Awesome! Can't wait to watch the big game on it," Steve replied enthusiastically. Then he asked, "By the way, how did you afford a new Smart TV?"

"It was easy. I used my credit card, and my credit company says I only have to pay forty dollars a month," Billy stated with a false sense of security.

Billy doesn't fully understand how the credit system works and is in jeopardy of falling victim to...the credit trap!

HOW DOES THE CREDIT TRAP HAPPEN?

The **CREDIT TRAP** occurs when something you purchased ends up costing more than the original price. The trap is set when you use other people's money with your credit card. The card is going to charge interest on your balance.



MONEY VEHICLE TIP:

Be aware: anytime you carry a balance on your credit card you will be charged interest!

Let's look at our friend Billy with his new TV. He went out and bought a \$2,000 TV with his credit card, making the balance he borrowed and the amount he still owes \$2,000. The interest rate on his credit card is at an annual rate of 15 percent. This means he will be charged \$25.00 every month, or \$300 for the year, if he doesn't pay off the \$2,000 balance. So that sweet new TV Billy bought doesn't end up costing \$2,000, after one year of the credit trap, the TV costs \$2,300! The scary part is that each month you do not pay off the amount, the credit trap deepens.

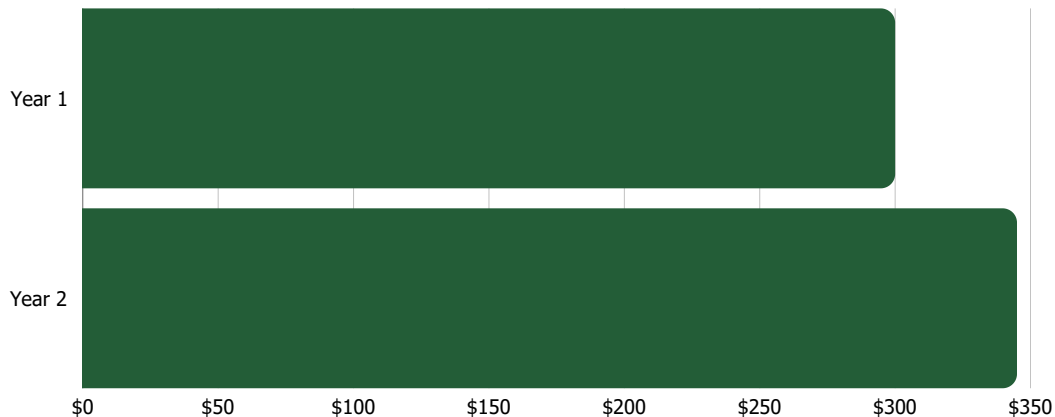
**THE CREDIT TRAP IS WHEN
SOMETHING YOU BOUGHT
ENDS UP COSTING MORE
THAN THE PURCHASE PRICE.**

The credit trap occurs when your purchase (new TV) ends up costing more than what was on the price tag. This means that compound interest (Chapter 2) is working against you to make a TV that was probably already out of your price range cost even more. The brutal reality is that the trap makes compound interest not a friend but an enemy, the 8th wonder of the world is now making YOU an employee.



Let's say Billy doesn't pay off his balance, and after a year he owes \$2,300, due to the interest the credit card company has charged him. Now, his 15 percent interest will be charged on the entire balance of \$2,300, making the trap get bigger, rising from \$300 in year one to \$345 in year two and widening the trap even bigger. -192-

INTEREST YEAR OVER YEAR



IF THE CREDIT CARD COMPANY IS LAYING A TRAP, CAN'T I JUST AVOID IT BY NOT USING ONE?

Yes and no. You can avoid using a credit card altogether, but you will be penalizing yourself by not building a good credit score. Your credit score will become a factor when you want to get a car loan, acquire a home mortgage, rent an apartment, attain insurance policies, set up your utilities, or even apply for a job! We will discuss the details of what makes up your credit score in future chapters, so for now, just understand that credit is something you will have to U.S.E. to your advantage.

Now that you know you need credit and see the trap that has been laid, how do you strategize a way around it? The first step to breaking away from the credit trap is understanding how it occurs. The next step is avoiding the trap altogether.

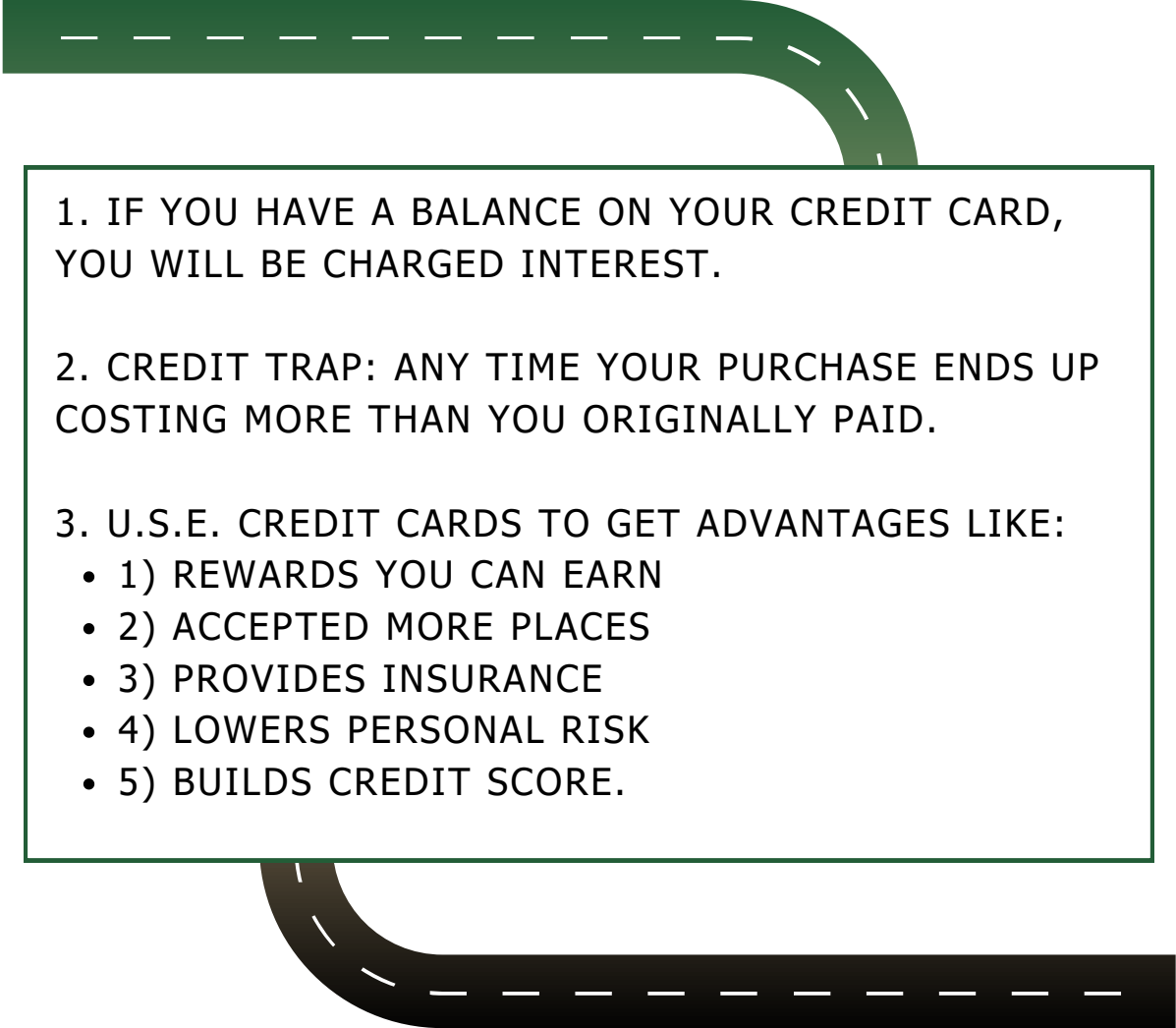
- **ELECTRONIC FUNDS TRANSFER ACT:** Debit card allows only 2 days to report fraudulent activity, before you are liable for up to \$500.
- **FAIR CREDIT BILLING ACT:** Protects information gathered by credit bureaus and removes liability for fraudulent transactions.

Remember the quote from Albert Einstein in Chapter 2 'Those who understand it get paid it and those who do not, pay it'. This concept touches on the second part of that Einstein quote about how those who don't understand compound interest end up paying it. Albert never used a credit card, but he saw the importance of the concept and how it could—and would—be exploited.

Standing at the register and thinking about which card to insert into the payment device, understand when you swipe your credit card that the credit trap has been laid.

SECTION 5.2

RECAP

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1. IF YOU HAVE A BALANCE ON YOUR CREDIT CARD, YOU WILL BE CHARGED INTEREST.
 2. CREDIT TRAP: ANY TIME YOUR PURCHASE ENDS UP COSTING MORE THAN YOU ORIGINALLY PAID.
 3. U.S.E. CREDIT CARDS TO GET ADVANTAGES LIKE:
 - 1) REWARDS YOU CAN EARN
 - 2) ACCEPTED MORE PLACES
 - 3) PROVIDES INSURANCE
 - 4) LOWERS PERSONAL RISK
 - 5) BUILDS CREDIT SCORE.