



PREVENTIVE LAW SERIES  
**INTEREST RATES**



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### **WHAT IS INTEREST?**

Interest is the money a consumer pays IN ADDITION to the purchase price of an item in order to be allowed to make payments on the item over time. The interest rate on an item is a percentage of the price of the item. This is then added to the price of this item. Interest rates are found in any transaction which involves payment over time. The "principal" is the cost of the item. Interest is "compounded" when it is added to the principal of the balance. This in turn becomes the new amount from which interest is calculated during the next month, causing the debt to increasingly grow, even if you are making minimum payments.

The interest rate on a purchase is calculated according to a money/time ratio, and typically expressed as a yearly rate, or annual percentage rate (APR). For example, if Petty Officer Smith purchases a stereo for \$100 at a 10% interest rate per year compounded annually, he pays back \$110 if he pays in full by the end of one year. However, interest is most often compounded monthly, thereby costing much more money than if the interest was added to the principal only once a year.

### **HOW DOES A (SEEMINGLY) SMALL INTEREST RATE EQUAL BIG DOLLARS?**

Interest rates can be deceptive. Credit card interest is compounded MONTHLY. An APR of 18% equals an interest rate of 1.5% per month. Since the rate is compounded monthly, a consumer will pay *interest on the interest* generated the previous month. Petty Officer Smith's stereo purchased for \$100 and charged on a credit card at 18% interest would actually cost him \$119.58 if he paid at the end of 1 year!

### **IS THERE A MAXIMUM INTEREST RATE?**

Maximum interest rates vary according to state law. Many state laws exempt businesses from these caps for such parties as banks, pawnbrokers, and real estate brokers. Make sure that you understand how much interest you are paying, and how much it will cost BEFORE you sign any contract. Make sure you know how often interest is compounded, or added to the principal--the more times interest is compounded, the more it will cost you. If you do not understand the contract, bring it to a legal assistance attorney BEFORE you sign it.

### **READ THE FINE PRINT!**

The federal Truth-In-Lending Act requires that lenders disclose the interest rate to the consumer. 15 U.S.C. § 1601. A CAR DEALER MUST disclose the IDENTITY of the creditor, the ANNUAL PERCENTAGE RATE, the FINANCE CHARGE, the total NUMBER OF PAYMENTS, and any PENALTIES which may be assessed for late payments. If the CAR DEALER provides financing it must also itemize the amount financed and explain what each dollar is paying for. CREDIT CARD companies must disclose the APR and the METHOD by which they calculate interest. Both of these disclosures must be made clearly and conspicuously on the contract and not hidden among other language. A legal assistance attorney will help you understand the fine print.

If you are in the Military or are a spouse, the Military Lending Act applies and there is a 36% interest cap on certain types of loans such as payday loans, auto title loans, and tax refund anticipation loans. 10 U.S.C. § 987.

Be careful! Credit card companies often offer low APR FOR A SHORT TIME, such as 6 months, but then raise the rate after that. What they hope is that the cardholder will build up a large unpaid balance during the initial period before the company hits them with a higher interest after the promotional rate expires.

Car dealerships also often charge very high interest rates, which many customers do not realize they will be unable to afford. Have a legal assistance attorney review your contract and explain the interest rate to you. For example, an interest rate over 15% on a car is VERY HIGH.

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**RESOURCES:**

**Federal Trade Commission:** (877) FTC-HELP; [www.consumer.ftc.gov/features/feature-0009-military-families](http://www.consumer.ftc.gov/features/feature-0009-military-families)

- Consumer Information: [www.consumer.ftc.gov](http://www.consumer.ftc.gov); (877) FTC-HELP
- File a Consumer Complaint: [www.ftccomplaintassistant.gov](http://www.ftccomplaintassistant.gov)
- Federal Truth in Lending Act, 15 U.S.C. §§ 1601 et seq. (2012).

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