

Transcript

When to Use Credit vs Debit

Credit and Debit: two very different cards Alright, let's talk about credit and debit cards. Both are used in place of cash to pay for things you buy. Both are convenient and accepted almost everywhere.

Both are made of plastic and probably, yeah, in your wallet right now. And both offer some kinds of fraud protection and security, especially when compared to cash, right. But do you really know the advantages and disadvantages of each? Or what makes them different from each other? Do you?

Well, there's actually a lot separating the two. Yeah. Let's start by taking a look at your daily routine, shall we? Okay, this is fun. Say you're out and about and you stop for a cup of coffee. Latte, my fave. Because you like to treat yourself, right? You get to the register, pull out your wallet, and the cashier asks you: "Credit or debit?"

Here's the thing: It's a question we hear almost every day, but don't really think about that much. What's the difference between the two? Which one should we use, and when? And most importantly, why is it so important to know the difference?

All great questions, and the best way to answer them is to take a look at the pros and cons associated with each. But first let's clearly define each type of card. A debit card is a payment method that's linked to your bank account. So the money you spend comes right out of your own personal checking or savings account. Easy breezy.

A credit card is also a payment method, but instead of tapping into your own money, your purchase is paid for temporarily using someone else's money — like the bank or card issuer. This, of course, comes at a price: interest.

Okay, now for the pros and cons. Let's start with debit. After you swipe that debit card, money is automatically taken out of your account. In this way it's a lot like using cash, except more convenient since you don't have to carry cash. Any of it. Plus, it's also great for keeping track of what you spend, because, if you're enrolled in online banking, you can review your transactions online or you can always check your balance at the ATM.

Oh, and speaking of ATMs, let's say you need some paper money. Well, your debit card is usually combined with your ATM card, meaning, if you have the money in your account, you can usually get cash wherever you can find an ATM — which these days is pretty much everywhere. But remember, to avoid those ATM fees, be sure to use your own bank's ATM. Another plus is that many stores allow you to take cash out at the register. Yeah. All you need to do is use your PIN.

But what if you leave your card at the register, or it falls out of your pocket somewhere along the way? Can anyone just pick it up and start making cash withdrawals too? Well, thanks to your PIN number, most likely they can't. Your PIN is an identification code that adds a layer of security making it difficult for anyone to access your money. It's important to safeguard your PIN to keep your money safe — so don't give it to anyone. And in those cases where, let's say someone gets hold of your debit card and uses it for something where your PIN isn't required?

Well luckily, most banks have some kind of fraud protection policy in place that can help protect you if this happens. And here's one more benefit of your debit card: You don't pay interest on your purchases like you would with a credit card. So your latte may be overpriced, but as long as you have the sufficient funds in your account, you only pay the price that's listed. Making your debit card a great way to avoid the interest that can come with buying on credit.

So, those are the pros. Debit is convenient, secure, interest-free and some people find it easier to keep to a budget.

Now let's talk about a few cons. First, your card can be declined. This happens when you don't have enough cash in your account to cover your purchase. Getting declined happens sometimes, even to the best of us. And while not being able to complete a purchase can be frustrating, it does protect you from spending the money you don't currently have. Do keep in mind that some banks allow customers to overdraw their checking accounts, for a fee. If you think this might be a useful feature for you, check with your bank to find out their specific policies.

Okay, now let's rewind a little bit and talk about credit cards. Some people think of credit cards as working kind of like short-term loans, because essentially you're borrowing money from a bank or card issuer to pay for your purchase. And when it's that time to settle up, if you've carried a balance from one billing cycle to the next you'll most likely have to pay interest.

In addition to being useful for making everyday purchases, a credit card can really come in handy in emergency situations when you're short on cash. So, let's say you find yourself stranded on the side of the road because a big old pothole just took out a couple tires, a credit card is a good thing to use for a tow and new rubber.

The thing to remember is, you'll have to pay for it later. And speaking of paying, when you pay your credit card bills on time, guess what? Good things happen to your credit overall. In fact, if you pay your bills on time, stay within your credit limit and pay more than the minimum balance on your card, you could improve how your credit is evaluated. That's huge! And that might qualify you for lower interest rates on loans and credit cards.

Which is great news if you're looking to take out a mortgage or something like an auto loan in the future. Lots of credit cards come with extra perks, too, like grace periods that allow you to make purchases without interest as long as your balance is paid in full each month. Or rewards points that can be used for all sorts of things, like airline miles or hotel stays. Some cards even offer cash back every month.

In fact, if you already carry a credit card, you might be missing out on features you don't even know about. Things like travel insurance. Or purchase protection — that's a great one. That can really come in handy when you're buying a big-ticket item like a brand new washing machine or a cool laptop. In fact, when something goes wrong with a purchase, a call to your credit card company can make the difference between you fighting to get your purchase refunded or replaced on your own and having the power of a big company on your side to help you out, which is nice.

Fraud protection is another big benefit of a credit card. So say someone gets hold of your card and uses it, you might not be liable for what they buy with your good name. This is true of debit cards as well, but the policies might be different. So as you can see, there are clearly many benefits to using credit cards.

But there are some potential downsides as well. And those typically come about when you don't use your card responsibly. Like when you miss a payment. You'll be hit with late fees, and your annual percentage rate, or APR, can also rise. Even worse, it can have a negative effect on your credit. You should also be careful about going over your credit card's limit, because if you do, you'll likely pay for it in fees. Another thing to look out for is overspending. Some cards give you pretty high spending limits, and without discipline you can end up spending your way into a place where you may not want to be — unnecessary debt. And that's a hole that can be hard to climb out of.

So credit or debit? The choice is yours. And that's what we're really taking about here — making a smart decision — and understanding the pros and cons that come with each. So the next time you're standing at that register, you'll know that whichever card you decide to use, you'll be using the one that's right for you. It's the kind of knowledge that helps you sleep better at night. Unlike that extra large latte you just bought yourself.