**Annual percentage rate (APR) and equivalent annual**

**rate (EAR)**

Banks do not expect you always to have your calculator with you when you are trying to choose the best way of borrowing and the best provider.

By law, all lenders have to tell you the annual percentage rate (APR) or the equivalent annual rate (EAR) of borrowing from them. This is the true cost of borrowing that amount of money for that period of time. Knowing the APR or the EAR helps you to compare different lending products.

**The APR** is worked out using a complicated formula that you do not need to know at this stage, but which includes:

􀁺 the interest rate;

􀁺 the length of time for which you want the loan (known as the ‘term’); and

􀁺 any fees.

Fixed APR

The APR on a personal loan is ‘fixed’ – that is, it does not change over the life of the loan. To work out your monthly payments, the bank or building society will show you a table

Variable APR

If the interest rate on your borrowings can change, the APR is said to be ‘variable’.

Variable APR means that your interest payments can go up or down each month,

depending upon what interest rate is being charged at the time.

The type of borrowing that has a variable APR includes loans other than personal loans, credit cards and store cards. The reason why these have a variable interest rate is that the loan or debt may be outstanding for years and the lender is not prepared to fix the interest rate when it does not know for how long the debt will be owed.

EAR

EAR is the legal way in which interest rates have to be quoted for overdrafts. The

calculation includes:

􀁺 the lender’s interest rate;

􀁺 the way in which interest is calculated; and

􀁺 any fees.

The reason why the calculation is different for an overdraft from that for any other type of borrowing is that an overdraft is attached to a current account, which might

sometimes be in credit. In other words, the account holder might not always be using

their overdraft. A lender has to show the EAR for an overdraft so that the customer knows what the charge for the borrowing will be if they use their overdraft all of the

time.