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SELECTING A CREDIT CARD

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Consumers who want to save interest charges on large loans, such as a home mortgage or auto loan, usually comparison shop for the "best deal." Comparison shopping for a credit card is also an excellent practice because terms and conditions of the account can make a difference in how much consumers pay for the privilege of borrowing. Consumers are often amazed at some of the "hidden" costs of some credit cards. With information in this fact sheet, Utahns can compare credit card terms they have already accepted with offers received in the mail and/or over the telephone. The goal is to assist consumers in finding credit cards with terms best suited for their spending and repayment habits.

CREDIT CARD TERMS

The Federal Truth-in-Lending Act requires credit card issuers to display the costs of credit cards in an easy-to-read box format on most applications and solicitations. The Schumer Box that lists the costs of the card is named after the representative who led the legislation through Congress (see Table 1). Although the Schumer Box is helpful, complex interest computation methods and other factors make it challenging for consumers to compare credit card plans. Contained in the following pages are factors consumers may want to consider when selecting a credit card.

Table 1. Schumer Box

Annual Percentage Rate for Purchases	Grace Period for Purchases	Minimum Finance Charges	Balance Calculation Method for Purchases	Annual Fee	Transaction Fees for Cash Advances	Late Payment Fees
19.9% fixed rate	Not less than 25 days	$.50 when a finance charge at a periodic rate is charged	Average daily balance method (including new purchases)	$20 per year	2% with a minimum fee of $3	$10

ANNUAL PERCENTAGE RATE (APR)

The APR is a measure of the cost of credit that includes interest and may also include other charges. The APR is expressed as a yearly interest rate (e.g., 21.2%, 18.5%, 6.9%). In the Schumer Box (Table 1), the APR is 19.9%. The lower the APR, the better for the credit cardholder. The APR is advertised in solicitations and is disclosed to cardholders when the account is opened. It can also be found on each monthly bill. The APR can be somewhat misleading because it does not include the effect of monthly or daily compounding of finance charges, additional fees, or factors that eliminate the grace period, all of which can raise the actual cost to consumers.

The APR can be fixed or variable. A **fixed** rate remains constant until the credit card issuer gives written notice of a change. By Federal law, issuers must give consumers 15 days' notice before changing the interest rate on a credit card. A **variable** interest rate is subject to change depending on the index used by the credit card issuer. Some of the common indexes are the prime rate; the one-, three- or six-month Treasury bill rate; or the Federal Reserve discount rate. Most of these indexes can be found in the money or business section of major newspapers. The variable rate is calculated by adding a fixed percentage (i.e., 9.9%) to the index rate listed for the week specified. Rate changes will raise or lower the finance charge amount paid on accounts. If a credit card has a variable rate feature, ask the card issuer whether there is a minimum and maximum APR and how often and by how much the rate can change. When the prime rate is decreasing, the variable rate is the best choice, but if it is increasing, the more stable fixed rate is generally best. Make a selection based on the risk you are willing to take. A consumer who consistently pays the total balance owed each month will find the APR not as important as other factors.

The **periodic rate** is the interest rate the credit card issuer applies to the outstanding balance to calculate the finance charge for each billing period. The monthly periodic rate is determined by dividing the yearly APR by 12. For example, the monthly periodic rate on an APR of 21.9% is 1.825% (.219 ÷ 12 = .01825). Cardholders with an outstanding balance on their credit cards can *estimate* the monthly finance charge by multiplying the periodic rate times the balance. For example, the estimated finance charge on an outstanding balance of $3,000 at 1.825% is $54.75 ($3,000 x .01825 = $54.75). If the consumer makes a payment of $54.75, the interest due is paid but no money is left to apply toward the principal—this payment only covers the cost of monthly interest and the loan would never be paid off! If the consumer makes a payment of $60, then $5.25 is applied toward the principal. The result is that it will take the consumer over 11 years to pay off the $3,000 debt that would cost the consumer $8,082 ($3,000 + $5,082 interest).

Some credit card issuers offer **tiered rates**. Tiered rates require large amounts be charged to take advantage of the lower interest rates. For example, the APR on charges up to $2,000 may be 18.9% while the rate on charges of $10,000 and above may be 13.4%. Be cautious about charging for unnecessary items just to get a lower interest rate or being tempted to pay less than you other-wise would on the same balance as if it were all at the higher rate. A lower rate on a higher balance can cost as much as a higher rate on a lower balance—so you are not better off financially.

If you have a credit card with a high interest rate, consider calling the bank to request a lower one. If your bank refuses, you have the option of changing to a credit card issuer offering a lower interest rate. There are several organizations that provide a list of banks that offer low-interest-rate/no-annual-fee cards (see Web Site Resources, page 7). A survey by Princeton Survey Research Associates that polled people who ordered a list of low-interest-rate credit cards found that one-fifth called their banks to ask for a lower rate. Of these people, nearly half (43%) got a lower rate simply by asking.

Consumers will have to decide whether having a local or out-of-state credit card issuer is important. Some prefer a local issuer because of the customer service provided by the financial institution.

GRACE PERIOD

A grace period is the time between the date a credit card was used to purchase an item and the date the APR (finance charges) will be charged on that purchase. The grace period is not the number of days a consumer has after receiving the bill to pay for it. Many credit card issuers offer a 20 to 25 day grace period while others offer none. The Schumer Box in Table 1 shows a 25-day grace period for this credit card account.

Many cardholders mistakenly believe that if a 25-day grace period is provided, all new purchases will be free of finance charges until after that 25-day period. Under most plans, the only time a cardholder's new purchases escape all finance charges is when *both* of the following conditions are met:

1. There is no unpaid balance left over from the previous billing cycle. That is, either the entire "new balance" on the last month's bill was zero, or, if that new balance was greater than zero, the cardholder paid it in full by the due date.
2. The new balance of purchases made during the

current billing cycle is paid in full by the current due date.

If the consumer does not pay the entire outstanding new balance due on the previous statement, any new purchases made in the current month will start accruing interest immediately. The consumer forfeits the grace period. If you have an outstanding balance on your credit card at the beginning of the new billing cycle, you will not benefit at all from the grace period. If your goal is to avoid paying finance charges, *you must pay off your credit card balance in full each month*.

FINANCE CHARGES AND BALANCE COMPUTATION METHOD FOR PURCHASES

If your credit card plan has no "free" or "grace" period, or if you expect to pay for purchases over time, it is important to know how the card issuer calculates the finance charge. The finance charge, or the dollar amount you pay to use credit, will vary depending upon the method the card issuer uses to figure the balance. The method used can make a difference in the amount of finance charges a consumer will pay—even when the APR is identical to that of another card issuer and the pattern of purchases and payments is the same. For consumers who never carry over a balance (always pay the balance in full), the finance charge computation method used by the credit card issuer is not as important as other factors.

There are two basic ways card issuers calculate balances on which finance charges are computed:

! ***Average Daily Balance (including new purchases or excluding new purchases).*** This method gives the cardholder credit for payment from the day the card issuer *receives* it. To compute the balance due, the card issuer first totals the beginning balance for each day in the billing period. Next, any payments credited to the account are deducted on the day received. New purchases may or may not be added to the balance, depending on the plan, but cash advances typically are added. The daily balances are summed for the billing cycle and the total is then divided by the number of days in the billing period. The result is the "average daily balance." Note the Schumer Box (Table 1) reveals the most commonly used average daily balance method (including new purchases).

! ***Two-Cycle Average Daily Balance (including new purchases or excluding new purchases).*** This balance is the sum of the average daily balances for two billing cycles. The first balance is for the *current* billing cycle, and is figured by adding the outstanding balance (excluding or including new purchases and deducting payments and credits) for each day in the billing cycle, and then dividing by the number of days in the cycle. The second balance is for the *preceding* billing cycle and is figured in the same way as the first balance. The two-cycle average daily balance is used primarily to backcharge interest on a previous balance on which consumers did not pay finance charges (because their balance was zero), but neither did they pay off the current balance due in full. The method affects consumers who *always* or *sometimes* carry over a balance.

Comparison of Finance Charge Computation Methods

Assume a consumer starts the first month with a zero balance and charges $1,000, of which the minimum amount due (listed on the statement) is paid. The next month, another $1,000 is charged and then the entire balance due is paid off. The same pattern is repeated three more times during the year. The stated interest rate on all cards is 19.8% APR. The yearly finance charge varies from $66.00 to $196.20. (See Table 2.)

If you do not understand how the balance on your account is computed, ask the card issuer. An explanation of how the balance was determined must appear on the billing statement the card issuer provides to you.

Table 2. Finance Charge Computation Methods

	Finance Charge
Average Daily Balance (excluding new purchases)	$ 66.00
Average Daily Balance (including new purchases)	$132.00
Two-Cycle Average Daily Balance (including new purchases)	$196.20
Two-Cycle Average Daily Balance (excluding new purchases)	$131.20

Source: Bankcard Holders of America, January 3, 1993. "Credit Cards: What You Don't Know Can Cost You."

ANNUAL FEES

Most credit card issuers charge annual membership or other participation fees. These fees range from $15 to $35 for most cards and from $50 and higher for some "premium" or "gold" cards. Some institutions still offer "no fee" cards, but these are less common than they used to be. Other institutions waive the fee for the first 12 months, but then bill the cardholder as soon as the second year begins. Still other issuers have a use fee (i.e., $1.75) for each month the card is *used*—meaning cardholders will pay $21 a year if the card is used monthly. The best deal for most consumers is a "no fee" card. Some credit card issuers will reduce or eliminate annual fees if cardholders indicate they plan to switch to another company's "no-fee" card. A change can be requested by phone. You also have the option of canceling the card within a stated period to avoid the annual fee. There may, however, be a cancellation fee.

TRANSACTION FEES FOR CASH ADVANCES

Many issuers charge cash advance fees, which typically amount to between 2% and 3% of the total cash advance. The fee may have a minimum amount, often $2, and a maximum amount, such as $10. Note the Schumer Box in Table 1 reveals the cash advance fee is 2% with a minimum fee of $3.00. The cash advance fee may be assessed for *each* cash advance taken. A consumer who is charged $5 for $20 in cash is paying a transaction fee equal to 25% of the amount borrowed. Using a credit card to obtain a cash loan is often the most expensive way for consumers to borrow money.

Some issuers charge higher interest rates on cash advances than for purchases. As an example, one card issuer offers a 7.9% APR on purchases made with the credit card, but charges a rate of 21.65% APR on cash advances. Issuers are not required to disclose the cash advance APR rate in solicitations or on applications. However, the information is usually provided in materials sent with the credit card to the applicant. A cash advance can also be obtained with a credit card at a bank or an automated teller machine (ATM) or by using checks linked to a credit card account.

Several card issuers offer cash advances with 25-day grace periods. The transaction fee they charge for the cash advance, however, may be more expensive than simply paying interest from the date of the advance. In addition, if the cash advance is not paid off in full when due, finance charges are accrued at the cash advance rate beginning on the first day of the new billing cycle until it is paid back. Below is an example of charges that could be imposed for a

$200 cash advance that is paid in full when the bill arrives:

Cash Advance Fee = $4 ($200 x .02 = $4)

Interest for one month = $3 (18% APR; $200 x .015 = $3)

Total cost of cash advance = $7 ($4 fee + $3 interest = $7)

In comparison, a $200 purchase with a credit card having a grace period would cost nothing if it is paid off promptly in full by the billing due date.

LATE PAYMENT FEES

Late fees are typically charged when a cardholder fails to make at least the minimum monthly payment by the due date. Some issuers charge a flat late fee, for example, $10. Other issuers charge a fee that is a percentage of the minimum payment due (e.g., 2 to 5%). Note the Schumer Box in Table 1 reveals the late payment fee is $10. Some issuers allow cardholders 10 or 20 days to pay their bill after the due date before a late fee will be charged. Other issuers, however, charge late fees immediately after the due date. To avoid late fees, mail payments in plenty of time to arrive before the due date. If payments are made at the bank's branch or ATM, find out how long it takes payments to be processed. Some banks do not credit payments made at ATMs for several days.

OTHER FEES

In a review of credit card offers that were sent unsolicited to the authors, the following additional fees were discovered:

! Close-out account fee of $25 and written notice to close a credit card account.

! Inactivity fee of $15.

! Annual fee of $25 to cardholders who pay their bills in full each month.

! Application fee of $100 for the privilege of applying for the credit card.

! Missed payment fees that consist of increasing the lower advertised APR to the higher prime rate plus an additional 12.9%.

! Over credit-limit fees of $10 to $15.

! Surcharge fees consisting of additional charges on top of the APR. For example, one issuer tacks a 5.1% credit protection surcharge onto its 16.8% APR variable rate card if the cardholder does not have other accounts at that institution. The effective APR is 21.9% and there is no grace period.

! Debt consolidation and transfer fees. One of the credit card advertising pitches is "Transfer balances from your other bank, gasoline, and department store credit cards" to an issuer that offers a low interest rate. Generally the offer is good for a limited number of days or months. Loan consolidation is not a benefit to the cardholder unless it is for the same or shorter time period, or for the same or lower APR. Changing creditors to whom money is owed may incur a transfer fee. Cardholders who have consolidated several creditors into one loan may be tempted to incur more charges because it "seems like" they do not have as many creditors as before requesting payments.

CAUTION

The following caution is for credit cardholders that use a low interest rate offer to transfer a debt to a credit card that has an existing balance being charged at a higher rate of interest. Monthly payments made after the transfer may be credited to only the lower interest rate debt, not the higher rate debt.

As an example, assume you have a credit card account with Bank A at an 18% APR. You have another credit card account with Bank B at a 21% APR. Bank A wants to increase customer account balances to draw more interest—so the offer is made to consolidate your loans from other credit card companies at a low introductory rate of 5.9% APR for the first 6 months. The amount you bring into this account from credit card Bank B is credited to your Bank A credit card account. You now have one consolidated account at Bank A—but with two lines of debt—one that is charging 18% APR and the other that is charging 5.9% APR. When you make a payment, the amount goes toward the newly "consolidated" debt at 5.9% APR, not the higher 18% APR. The better policy would be, of course, for you to pay off the higher 18% APR debt first, and then apply the payments toward the lower 5.9% APR debt. If you find yourself in this situation and want to be sure your payments (as well as any dollars paid beyond the minimum payment) are applied to the higher APR, ask the institution for the appropriate procedure.

OTHER CONSIDERATIONS

Line of credit. A line of credit is the amount the card issuer will allow a cardholder to charge. It is listed on the notification or disclosure statement enclosed with a new card or renewal card and on the billing statement. Generally a line of credit large enough for emergencies and large purchases, but not so high as to encourage overuse of credit, is desired. Credit limits can usually be reduced or increased by contacting the creditor by phone. When a payment is made, the available line of credit may not reflect that payment for a certain period of time, such as 14 days.

Hours. Some cards do not have 24-hour, 7-day customer service. This may be a consideration if you cannot make calls during working hours or when traveling away from home.

Billing cycle. Will the credit cardholder allow you to change your billing cycle to be better timed with your pay day?

Incentive offers. Credit card companies often use rewards to entice consumers to use their cards. Examples of incentives offered include frequent-flier miles, discounts on new-car purchases, free gas, free golf clubs and guaranteed tee-off times at golf courses in Florida. Consider whether the "incentive" could be obtained at less cost for cash. For example, Smart Money reports that if you charge $8,500 a year on a credit card carrying an average balance of $1,500, you would earn enough frequent-flier miles to get a free domestic ticket in three years. But you would also be paying $265 in interest each year (17.65% APR), plus a total of $150 in annual fees. That means the "free" ticket would end up costing $945. For the same money, a consumer may be able to buy three round-trip tickets from New York to Los Angeles!

Minimum monthly payment. The minimum monthly payment is the lowest dollar amount that a cardholder is required to pay each month to the financial institution that issued the credit card. Generally the minimum monthly payment is equal to 2% of the new balance or $10, whichever is greater. Some statements refer to the minimum as the "Cardholder Amount Due," but that amount is not the total owed.

The lower the payment, the longer it will take for you to pay off the balance and the more finance charges you will pay. For example, a cardholder who makes a minimum payment of $80 on an outstanding balance of $4,000 at a 21% APR will take almost 10 years to pay off the loan. The cost of the interest is $5,592 with the cardholder paying a total of $9,592—almost twice the cost of the original loan. Obviously, making a minimum payment results in more finance charges being paid to the credit card issuer.

If a cardholder does not pay anything, or pays less than the minimum, late fees will be charged. The credit card issuer may also cancel the card. In addition, there may be a negative report sent to a credit bureau. That report could affect the cardholder's ability to obtain credit in the future.

Some cards allow the cardholder to skip a payment without a penalty especially at holiday times. Although this sounds like the issuer is providing a break to the cardholder, interest will be charged during this period and more in finance charges will be owed than before.

Rebates. Some credit card issuers offer yearly cash rebates to entice consumers to use their cards. The rebate may be computed as a percentage of total charges. The actual dollar amount of a rebate is generally very minimal and many cards have ended their rebate offers.

Toll Free Number. Some cards do not have a toll free customer service number. This may be a consideration for people who need frequent help reading their statements.

SUMMARY

As this Financial Fitness fact sheet has demonstrated, terms differ among credit card issuers, so shop around for the card that is best for your spending and repayment habits. Use the comparison chart (last page) to help you make a decision. Which credit card is best may depend on how you plan to use it. If you plan to pay bills in full each month, the size of the annual fee or other fees may be more important than the annual percentage rate and balance computation method. If, however, you expect to carry a balance monthly on your credit card purchases, the APR and the balance computation method are very important terms to consider. In either case, costs will be affected by whether or not the credit card issuer provides a grace period.

Once you have selected a credit card, keep abreast of changes that are announced either as enclosures with your bills or as a separate mailing. These announcements are not "junk" mail. Terms and conditions may change to the point that you decide it is time to shop for a different credit card.

CREDIT CARD RESOURCES ON THE INTERNET

Bank Rate Monitor (http://www.bankrate.com)

CardTrak (http://cardtrak.com)

Consumer Information Center
(http://www.pueblo.gsa.gov/cic_text/money/shop.txt)

Consumer Information Center
(http://www.pueblo.gsa.gov/cic_text/money/rscredit.txt)

Federal Reserve Board
(http://www.bog.frb.fed.us/pubs/shop)

USA Today
(http://banx.com/usatoday/cards/bq-cards.htm)

Internet sites listed may change or disappear over time; consumers may want to search for additional sites to learn more about credit card offers.

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COMPARISON SHOPPING FOR A CREDIT CARD

Terms	Credit Card Issuers		
	#1	#2	#3
1. Annual percentage rate (APR)			
2. Grace period for purchases			
3. Minimum finance charges			
4. Balance computation method used to determine finance charges			
5. Annual fees			
6. Transaction fee for cash advances			
7. Late payment fees			
8. Inactivity fees			
9. Over the limit fees			
10. Missed payment fees			
11. Fees if balance paid in full each month			
12. Surcharge fees			
13. Consolidation fees			
14. Additional fees (list) a. ____________ b. ____________ c. ____________	 ________ ________ ________	 ________ ________ ________	 ________ ________ ________
15. Other considerations. (list) a. ____________ b. ____________ c. ____________	 ________ ________ ________	 ________ ________ ________	 ________ ________ ________

These items are listed in the Schumer Box (See Table 1).