

## CHOOSING AND USING A CREDIT CARD

A credit card is an important part of our American way of life. It provides consumers with a guaranteed payment in emergency situations, freedom from carrying large sums of cash, a record of purchases, and protection against poor quality merchandise or service. If used unwisely, it also can mean a life of debt, bill collectors, and poor credit references.

Consumer use of credit cards is increasing dramatically because of lower credit card interest fees, lower or no annual fees, and more businesses accepting cards for payment. A wide variety of cards and rates makes choosing a credit card difficult as well as time consuming. An understanding of credit card terms and options will help you make the best decision to meet your needs. You need to carefully comparison shop for a credit card. Over a lifetime, a poor credit card choice can be as expensive as a poor decision about purchasing a car or obtaining a home mortgage.

### TYPES OF CARDS

Bank cards such as Visa or MasterCard are all-purpose cards issued by more than 6,000 individual banks or other financial institutions such as credit unions. The cards look very similar but terms and conditions vary widely. Visa and MasterCard are large companies that provide the credit systems to banks that issue the cards. Banks set their own terms on annual fees, spending limits, minimum income requirements, and credit standards. Each bank establishes its own finance charges and may offer cardholders incentives or perks. Usually you have a choice of paying your bills in full with no interest or “revolving” a portion of the bal-

ance by paying at least a minimum amount plus finance charges. Visa and MasterCard are accepted by most businesses. The Discover Card is a bank card that offers a 1 percent cash-back rebate program, but it is accepted by fewer businesses.

Travel and entertainment cards, including American Express and Diners Club, have no preset spending limits but you are expected to pay your bill in full each month. Revolving credit is available on some plans. Card holders are provided with copies of their signed sales slips each month along with their statement. American Express cards are accepted at only one-third to one-half the businesses that accept Visa and MasterCard, and annual fees are considerably higher.

Department store cards or specialty store cards are often easier to obtain, but their finance fees are usually higher than other cards. Use is limited to purchases from the store that issues the card. Cardholders receive advance notice of sales and may be invited to private sale days.

Some gasoline (or oil) credit cards may require the holder to pay the entire balance in full every month, but many now offer revolving credit. Many gasoline companies have partnered with banks to issue all-purpose Visa or MasterCards.

### CHOOSING THE BEST CARD FOR YOU

To obtain the least expensive credit card, consider how you will use it. The most important consideration is whether you plan to pay your bill in full each month. If you do pay your bill each month, the annual fee and other fees will be most important. If you

expect to use a credit card to pay for purchases over time, the interest rate and the balance calculation method are important terms to consider. In either case, your costs will be affected by whether or not there is a grace period (a time without interest costs). Other considerations include how widely the card is accepted, how high the credit limit is, and what features or services are available.

**ANNUAL FEE.** Many credit cards charge a flat yearly fee, while others have none at all. The annual fee varies among issuers from zero to over \$75; the current average is \$17. To keep your business, many banks will waive the annual fee if you are a good credit customer and if you ask. If you pay your bill in full each month and do not have an annual fee, possessing a credit card offers you convenience as well as financial opportunities.

**INTEREST RATE OR ANNUAL PERCENTAGE RATE (APR).** These terms refer to the cost of credit. The annual percentage rate is disclosed to you when you apply for a credit card, and it is on each bill you receive. It is expressed as a yearly rate, such as 18 percent. If you divide the yearly rate by 12, you will get the monthly rate (1.5 percent). If you are like two-thirds of cardholders, who do not pay off the full balance each month, the interest rate is your most important financial consideration. To escalate costs even more, most issuers charge interest on the outstanding interest.

**Fixed interest rates.** A fixed rate means the interest rate is fixed until the issuer notifies the consumer otherwise. By federal law, card issuers must give consumers 15 days' notice before changing the interest rate on a credit card.

**Variable interest rates.** A variable rate changes when interest rates on other economic indicators (indexes) rise or fall. By law, the cardholder does not need to be informed about each change, because it is part of the original agreement on the application. The most commonly used index is the prime lending rate (the rate banks charge their best customers). Other indexes are tied to mortgage rates or commercial lending rates. Index rate changes will raise or lower the finance charge you pay on your account. The card issuer must tell you in the application which index is used, what additional amount is added to the index, and how often it is changed. Although credit card rates are

dropping, many card issuers are switching from fixed to variable interest rates, which are more difficult for consumers to track. The only way to tell if variable rates have changed is to check your monthly statement to see what the rate is and compare it to the previous month's rate. More than 60 percent of cards now have variable rates.

**Teaser interest rates.** Some credit card issuers offer very low rates for six months to a year, then the rates increase dramatically. These "teaser" rates can be worth getting if they last for a year or you can easily move your balance to another low-rate card when the rate increases. Points to consider include the following: Will the issuer allow free balance transfers into the account from other credit cards? Are these transfers treated as cash advances that carry higher interest rates? If the application is not clear, call the company to clarify the plan.

**Tiered interest rates.** Tiered interest rates depend on the balance on the card. The higher the balance, the lower the interest rate. This system is designed to encourage holders to put all credit charges on one card and to use the card as much as possible. It may result in problem debt levels for the owner. Tiered rates may also be used if the bank thinks a holder is a high credit risk because of not paying bills on time or exceeding the credit limit. Interest rates on the unpaid balance may increase as much as 10 percent. Banks must notify cardholders in advance that their rates are going up.

If you carry a credit card balance from month to month, check your current rate of interest and try to secure a card with a lower rate. Cards with low rates usually have tough credit standards to meet. If you have a good credit history, charge a reasonable volume, and pay your bills on time, you will be eligible for a low rate.

**GRACE PERIOD.** The grace period refers to the number of days before a credit card company begins to charge interest on new purchases. This is generally 25 days. The countdown may start on the date of your purchase or the date the purchase was posted to your account. You will be charged interest on your new purchases immediately if you have not paid your credit card bill in full the previous month.

Credit cards offering **no grace period** are becoming more common. Interest starts

immediately on new purchases, whether or not you have paid your credit card bill in full the previous month.

A card with a **full grace period** (not very common) will give you the benefit of the grace period whether or not you paid off your balance in full the previous month.

If your credit card company allows a free period, the issuer must mail your bill at least 14 days before your payment is due to ensure that you have enough time to make your payment by the due date and during the grace period.

If you pay your balance in full each month, you will benefit from a typical or a full grace period. If you carry over a balance each month, you will benefit from a full grace period. A plan without a grace period or with a short grace period is of little benefit to consumers.

**BALANCE CALCULATION METHODS.** If your card plan has no grace period or you carry a balance from month to month, it is important to know how the card issuer will calculate your finance charge. The method used can make a big difference in the amount of money you owe, even if the interest rates are identical from one card to another.

- **Average daily balance.** To compute the balance due, the issuer totals the beginning balance for each day in the billing period and deducts any payment credited to your account that day. New purchases may or may not be added to the balance, depending on the plan. The resulting daily balances are added up for the billing cycle and the total divided by the number of days in the billing period to arrive at the average daily balance. Paying this bill early in the month will be an advantage because it lowers the average daily balance and results in a lower finance fee. This is the most common method used by card issuers.
- **Previous balance method.** The finance charge is calculated on the previous balance unless the bill is paid in full. This is a more expensive method for you.
- **Adjusted balance method.** The balance is calculated by subtracting the payments you have made from the previous balance. It is the least expensive plan for the consumer, but is rarely used by credit card companies.

- **Two-cycle average daily balance method.** This method eliminates the grace period on new purchases and retroactively charges interest for the previous month each time the account carries a balance. This is the least favorable method of determining a credit card balance.

**OTHER TRANSACTION FEES OR CHARGES.** Card issuers may charge extra fees for a cash advance, a late payment, or exceeding your credit limit. These fees may be high. For example, a late payment fee is generally about \$15. On a card balance of \$1,000, that is about 15 percent a year in addition to the interest charge.

Use the chart on the next page to comparison shop for the lowest cost credit card.

## SPECIAL TYPES OF CARDS TO CONSIDER

**REBATES.** Credit card issuers link up with manufacturers, airlines, oil companies, or other businesses to offer co-branded (jointly sponsored) cards. The company offers discounts or rebates for using the card; the bank hopes you will carry a balance so you will pay interest. If you pay your bill within the specified grace period and you charge a lot, you can get the rebate at no extra cost. Cards with rebates may be good for small business owners if they have many purchases that can be charged. Ask yourself the following questions:

- What is the annual fee and the grace period on this card?
- Will you charge enough to get the rebate? To earn a full rebate (\$500) from a computer company, the cardholder has to charge \$11,500. The average consumer puts \$2,500 on his card each year. It will take almost six years to earn this rebate. Even more has to be charged to earn a \$700 automobile rebate.
- Do you want the rebate product? Are you interested in a certain company's computer or automobile?
- Could you save more by buying another brand without the rebate? One oil company gives a 2 percent rebate on its gasoline, but if you are a person who spends an average of \$700 per year on gas, the rebate saves you only \$21 a year. A less expensive gasoline might be a better buy.

Use the following chart to comparison shop for the lowest cost credit card.

CREDIT CARD COSTS Comparison Chart				
	Credit Card Company			
	1	2	3	4
Annual percentage rate				
Teaser interest rate				
Fixed or variable interest rate				
Variable interest rate index				
Annual fee				
Grace period				
Balance calculation method				
Cash advance fee				
Late payment fee				
Credit limit				
Min. payment percentage				
Balance transfer option				
Rebate details				
Over-the-credit limit fee				
Other information (list)				
_____				
_____				
_____				
_____				

- Are you willing to take the risk that the company may change the rules for the advertised rebate? Frequent flier miles required for a free trip have increased.
- If you fall behind on your payments, is the interest rate on the rebate card reasonable?

**PREMIUM OR GOLD CARDS.** These cards generally mean higher credit limits, higher annual fees, and more perks, such as emergency medical and legal services for traveling cardholders, collision damage waiver insurance for a rental car when it is charged, and theft protection for merchandise purchased with the card. Formerly, prestige was associated with these cards because issuers often targeted applicants with incomes higher than \$35,000 and persons who had a high charge volume. Today, there are millions of “gold type” cardholders. Evaluate the benefits of these cards versus the cost. Many banks will raise the credit limit on a standard card if you ask. Most perks on premium cards are not frequently used. If a particular perk is important to you, evaluate the premium cards to find the best rate based on the annual fee, interest rate, and grace period.

**AFFINITY CARDS.** The card issuer donates a portion of the annual fee or transaction charges to a charity or an organization. The card bears the name or logo of the group, such as the Sierra Club or a university alumnae chapter. Although most banks will not reveal information on the amount donated to the charity, the usual amount is 0.25-0.50 percent of the charges or about \$12 on typical annual charges of \$2,500. Deductions through an affinity credit card plan are not tax deductible. Compare annual fees (often a fee is added after the no-fee first year), interest charges, and grace periods to see if the affinity card is competitive with other cards. Consider getting a credit card with no annual fee and donating the annual fee charged by the organization’s affinity card to the organization. Also, be aware that some affinity cards may not have an organization or charity behind them. Banks offer cards for groups such as skiers and book lovers.

**HOME EQUITY LOAN CARDS.** The cardholder agrees to use his or her home equity as collateral for this card in return for lower interest rates and interest that is tax deductible. This card provides a high-risk form of credit for users because the bank can

and will take the cardholder’s home if the debt cannot be paid. Several states disallow home equity loan cards because of the potential loss to cardholders.

**DEBIT CARDS.** These cards, which resemble credit cards but are not, provide access to funds in your bank or brokerage accounts. When you buy something with a debit card, the money is taken directly and immediately from your account. The debit card offers the convenience of a credit card at stores, hotels, or with telephone purchases but without the bills and the temptation to overspend. A debit card does not build a credit reference at the credit bureau or give you the advantage of a free loan during the grace period. It may have transaction fees assessed by the bank. Unlike a credit card, if you lose it or it is stolen, you could lose all the money in your account plus any line of credit linked to your account.

**SECURED CARDS.** This is a bank card backed by a deposit used as collateral in the bank that issues the card. Persons with no credit or bad credit can use this card to build or repair their credit. The deposit, usually ranging from \$500 to \$5,000, must remain in the bank while the card is in effect; the credit used cannot exceed the deposit amount. Be sure the card is issued by a bank and the deposit is held in a federally insured bank. Be wary of ads for “guaranteed” bank cards; acceptance by a credible institution is never guaranteed. Look for secured cards that will refund your application fee if you are not accepted, pay interest on the deposit, and offer you the opportunity to switch to an unsecured card after proving creditworthiness for a set period of time.

## COSTS OF PAYING MINIMUM PAYMENTS

A credit card may be an expensive form of credit. Card issuers may only require a minimum payment of 2 to 5 percent of the outstanding balance each month. A \$2,500 balance could mean you would pay only \$50 a month. However, at 18.5 percent APR and a 2 percent minimum payment, it would take 30 years to pay off the balance and cost you close to \$2,000 in interest. That means that everything you charged cost you almost double the price. Your overall goal should be to



pay off your balance and keep it paid off. Then, if your credit card does not have an annual fee and does have a grace period, you will have free service.

## PROTECTION OFFERED ON CARDS

The federal Fair Credit Billing Act protects consumers from many kinds of potential credit card abuse. It provides greater protection for persons using credit cards instead of cash or checks.

**SENDING THROUGH THE MAIL.** Credit card issuers are prohibited from sending a card you did not request. They are allowed to renew or substitute a card without a request. You may be solicited for a card by mail or by phone; only if you say yes will one be sent to you.

**PROMPT CREDIT FOR PAYMENT.** Your account must be credited with your credit card payment on the day the issuer receives it, unless the payment is not made according to the creditor's requirements or the delay in crediting will not result in a charge. Be sure

to send payments to the correct address. If you lose your payment envelope, check the billing statement for the address for payments.

**ERRORS ON YOUR BILL.** Specific rules are in place for correcting billing errors. The card issuer will send you a statement describing these rules when you open an account, and after that, once a year. You must notify card issuers in writing within 60 days after the first bill with the error was mailed to you. Therefore, it is important to keep receipts and to promptly compare them to bills. State your name, account number, amount of the error, and why you believe it is an error. The card issuer has 90 days or two billing cycles to correct the error or explain why the bill is correct. During the investigation, you do not have to pay the amount that is in question.

**UNAUTHORIZED CHARGES.** If your card is lost, stolen, or otherwise used without your permission, you can be liable for up to \$50 per card. If you report the loss before the card is used, you are not responsible for any unauthorized charges. Keep a list of your credit card numbers and toll-free company



numbers so you can report lost cards immediately. For more protection, follow up your phone call with a letter to the card issuer. State your card number, when your card was missing, and the date you called the issuer.

**DISPUTES ABOUT MERCHANDISE OR SERVICE.** If you have a problem with a service or product that you have charged, your first step is to contact the seller and try to resolve the problem. If that is unsuccessful and your card is a bank card, a travel or entertainment card, or another card not issued by the seller of the problem product or service, you may withhold payment only if the purchase exceeded \$50 and occurred in your home state or within 100 miles of your billing address.

**REFUNDS OF CREDIT BALANCES.** If you return merchandise or pay more than is owed, you may carry the credit balance on your account or request a refund if the amount exceeds \$1. Send your request in writing to the card issuer. Your refund must be sent within seven days of the time the card issuer receives your request.

## REMINDERS FOR CHOOSING AND USING CREDIT CARDS

1. Shop carefully for the credit card that has terms that are best for you.
2. Understand the terms of the credit plan before you accept the card.

3. Save copies of charge slips and compare charges when your bill arrives.
4. Pay bills promptly and pay as much of the bill as possible. Always pay more than the minimum.
5. Keep a record of account numbers and issuers' telephone numbers. (There is a chart on page 6 that will help you keep track of your credit card numbers. Keep copies of this form in a safe place.)
6. Draw a line through blank spaces above the total when you sign receipts. Retain and rip up carbons.
7. Read your mail from the bank. If your credit card rate goes up, switch to a lower rate card. In Maryland, you can pay off your debt at the old interest rate if you notify the bank in writing and stop using the card.
8. Treat your credit card as money.
9. Be careful about giving credit card information over the phone.
10. Establish a good credit history by using your card responsibly.

Credit card interest rates are down, and often there are no annual fees. On the negative side, grace periods are being shortened, balance calculations are favoring issuers, and extra fees are being added. It's financially important to choose and use your credit cards carefully.

### Choosing and Using a Credit Card

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