CHOOSING CREDIT CARDS

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INTRODUCTION

Chances are you have received offers in the mail asking you to open credit card accounts. The offers often say you are "pre-approved" for the card, with a line of credit already set aside for your use. They urge you to accept quickly, before the offer expires. Before you accept a credit card offer, understand the card's credit terms and compare costs of similar cards to get the features you want.

Credit card offers may seem attractive, but remember a credit card is a form of borrowing that always carries a "finance charge" -- for the convenience of borrowing -- and often other charges also.

TERMS

Understanding credit card agreement terms will help you decide which card to get. Before selecting a credit card, learn which terms and conditions apply. Each affects the overall cost of the credit you will be using. Consider and compare the following terms.

Annual Percentage Rate (APR) - The APR is disclosed when you apply for a card, again when you open the account, and it is noted on each bill you receive. It is a measure of the cost of credit, expressed as a yearly rate. The card issuer must also disclose the *periodic rate* -- that is, the rate the card issuer applies to your outstanding account balance each billing period.

Some credit card plans allow the card issuer to change the annual percentage rate on your account when interest rates or other economic indicators (called indexes) change. These plans are commonly called "variable rate" plans. Rate changes raise or lower the amount of the finance charge you pay on your account. If a credit card has a variable rate feature, the card issuer must tell you the rate may vary and how the rate is determined, including which index is used and what amount (the "margin") is added to the index to determine your new rate. You must also be told how much and how often your rate may change. Even if you have a "fixed rate" card, the lender may, depending on the terms of your agreement, be able to change the rate from time to time, although it must give you notice before doing so.

Grace Period - A grace period -- also called a free period -- allows you to avoid the finance charge by paying your current balance in full before the "due date" shown on your statement. Knowing whether a credit card plan gives you a grace period is especially important if you plan to pay your account in full each month. If there is no grace period, the card issuer will impose a finance charge from the date you use your card or from the date each transaction is posted to your account. If your credit card plan allows a grace period, the card issuer must mail your bill at least 14 days before payment is due to ensure you have time to make your payment by the due date.

Annual Fees - Many credit card issuers charge annual membership or other participation fees.

Transaction Fees and Other Charges - A credit card may also involve other costs. For example, some cards carry a fee when you use them for a cash advance, when you fail to pay on time, or when you exceed your credit limit. Some require a monthly fee whether or not you use them.

BALANCE COMPUTATION METHOD FOR THE FINANCE CHARGE

If your plan has no grace period, or if you plan to pay for purchases over time, it is important to know how the card issuer will calculate your finance charge. The charge will vary depending on the method the card issuer uses to figure your balance. The lender must disclose to you the method it uses to calculate your balance and finance charge. The method used can make a difference in the finance charge you pay -- even when the APR is identical to that charged by another card and the pattern of purchases and payments is the same. Your credit card company may use virtually any balance computation method but it must describe it to you in depth in the credit card agreement, and certain advertising materials. Federal regulations define several different balance computation methods that a credit card company is permitted to identify by name and describe in less depth in its disclosure materials. These include:

Average Daily Balance (including or excluding new purchases) - The average daily balance method gives you credit for your payment from the day the card issuer receives it. To compute the balance due, the card issuer totals the beginning balance for each day in the billing period and deducts any payments credited to your account that day. New purchases may or may not be added to the balance, depending on the plan, but cash advances are typically added. The resulting daily balances are totaled for the billing cycle and the total is then divided by the number of days in the billing period to arrive at the “average daily balance.” This is the most common method used.

Adjusted Balance - This balance is computed by subtracting the payments you made and any credits you received during the present billing period from the balance you owed at the end of the previous billing period. New purchases that you made during the billing period are not included. Under the adjusted balance method, you have until the end of the billing cycle to pay part of your balance to avoid the interest charges on that portion. Some creditors exclude prior, unpaid finance charges from the previous balance. The adjusted balance method is usually the most advantageous to card users.

Previous Balance – The balance is simply the amount you owed at the end of the last billing period. Purchases made during the new billing period do not affect your balance but neither do payments that you make or credits you receive.

Two-cycle average daily balance including new purchases – This balance is the sum of the average daily balance for two billing cycles. The first balance is for the current billing cycle, and is figured by adding the outstanding balance (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 billing cycle. The second balance is for the preceding billing cycle.

Two-cycle average daily balance 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 new purchases and deducting payments and credits) for each day in the billing cycle, and then dividing by the number of days in the billing cycle. The second balance is for the preceding billing cycle.

COSTS AND FEATURES

Credit terms differ among card issuers, so shop around for the card that is best for you. Which one is best may depend on how you use it. If you plan to pay bills in full each month, the size of the annual fee or other fees, and not the periodic and annual percentage rate, may be more important. If you expect to use credit cards to pay for purchases over time, the APR and the balance computation method are important terms to consider. In either case, keep in mind that your costs will be affected by whether or not there is a grace period.

When shopping for a credit card, you will probably want to look at other factors besides costs -- such as whether the credit limit is high enough to meet your needs, how widely the card is accepted, and what services and features are available under the plan.

***This handout is general in nature. It is not a substitute for legal advice from an attorney regarding individual situations. (August 2021)**

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https://aflegalassistance.law.af.mil