

A Road Map to Avoiding Credit Card Hazards



Credit card companies are flooding us with card solicitations, deceiving us with misleading offer terms, and gouging us with higher-than-ever fees. As a result, consumers are sinking further into high-cost credit card debt.

What should you be on the lookout for?

How can you avoid being ripped off?

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As credit card companies intensify their marketing campaigns to boost profits, more and more glossy credit card offers are coming at us fast and furious. The average household receives eight credit card offers each month, and students, who often have no regular income, are encouraged several times a week by posters, flyers, and on-campus marketers to apply for credit cards.



At the same time, credit card companies are charging interest rates as high as 40% per year. Consumers are subject to a host of unfair and deceptive terms and conditions, saddled with enormous fees, and encouraged by credit card companies to make low minimum payments so that the companies can earn more money in the form of interest. As a result, the average credit card debt for Americans who

carry balances reached an all-time high of \$5,610 in 2000, an increase of one-third since 1995.

As consumers struggle, credit card companies such as Provident and First USA are making bigger profits than ever. Between 1995 and 1999, thanks in part to aggressive marketing and misleading practices, companies' profits nearly tripled, jumping from \$7.3 billion to \$20 billion.



Accident Ahead: 10 Credit Card Traps

1. More Late Fees

Credit card companies are reaping more profit from late fee income than ever before, for three reasons: (1) the average late fee more than doubled between 1992 and 2000, from \$12.53 to \$27.61, (2) companies have decreased the amount of time between when they mail a bill and when payment is due, and (3) nearly two-thirds of companies have eliminated leniency periods, (the time after a payment's due date before a late fee is assessed).

2. Higher Over-the-Limit Fees

In 2000, only one card charged a fee of less than \$20 to consumers who had exceeded their credit limits. The highest fee was \$35. In contrast, a 1995 survey found only one bank that charged a fee of \$20 or more. Many companies assess this fee to cardholders who exceed their limits by as little as \$1.

3. Hidden Transaction Fees

Fees for cash advances, balance transfers, and quasi-cash transactions like the purchase of lottery tickets significantly raise the cost of these transactions. But the terms governing these transactions are buried in the fine print where consumers can easily miss them.

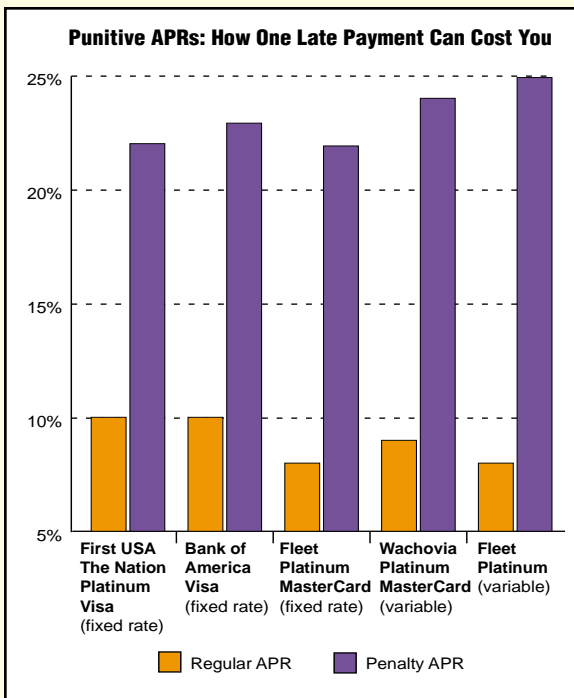
Currently, 55 to 60 million households (50-60% of all households in the United States) carry credit card balances. The average household carries a balance of \$7000 and pays more than \$1000 per year in interest and fees.

(Source: Stephen Brobeck, Consumer Federation of America)

Minimum fees, also stated only in the fine print, allow credit card companies to guarantee themselves high fee income regardless of the transaction amount. For example, if XCard has a transaction fee of 3% and a minimum of \$10, a cardholder who receives a \$50 cash advance will be charged the minimum, \$10, which amounts to an actual transaction fee of 20%.

4. Punitive Annual Percentage Rate (APR) Increases

The average penalty APR—a higher interest rate triggered by a late or missed payment—is nearly eight percentage points higher than the average regular (non-penalty, non-introductory) APR. In 1998, by contrast, penalty APRs were an average of 4.5 percentage points higher than regular APRs.



Fleet Platinum MasterCard (variable rate)*

Penalty APR is 16.91 percentage points higher than regular APR

	Regular APR (7.99%)	Penalty APR (24.90%)
Total Interest Paid:	\$466.73	\$3,314.87
Time to Pay Off Balance:	84 months	169 months

*calculations based on a balance of \$2000 and 3% monthly payments

5. Declining Grace Periods

While grace periods (the time during which a transaction does not accrue interest) historically were a full month long, they now average 23 days. Some cards have no grace periods at all.

6. Introductory APRs

Fifty-seven percent of card offers advertised a low introductory APR. The average introductory APR was 4.13% and lasted an average of 6.8 months. But credit card companies use low, short-term introductory APRs to mask regular APRs that are an average of 264% higher. These sharp rate increases are not prominently disclosed.

7. Low Minimum Payments

Low minimum monthly payments are designed to sound attractive to consumers, but they encourage cardholders to pay more in finance charges as the length of time required to pay off a balance increases significantly. Credit card companies have decreased minimum payments in recent years from the historic industry standard of 5% to a current standard of 2% to 3%.

Always Pay More than the Minimum: It Saves You Money

Beginning Balance	APR*	Monthly Payments	Total Interest Paid	Months to Pay Off Balance
\$2,000	15.04%	2%	\$2,205.63	169 (14 yrs.)
\$2,000	15.04%	5%	\$589.74	65 (5.5 yrs.)
\$2,000	15.04%	10%	\$269.31	36 (3 yrs.)

*the APR of 15.04% is the average non-introductory, non-penalty APR found in the State PIRGs' survey of 100 credit card offers. NOTE: Results based on \$20 minimum payment or the percent, whichever is greater.

8. "Fixed" APR

Despite their name, so-called "fixed" interest rates can be raised with as little as 15 days notice to cardholders.

9. "Bait and Switch" Credit Card Offers

Direct mail credit card offers generally advertise the premium card the bank has to offer, yet the fine print includes the caveat that the company can substitute a lower-grade, non-premium card if the applicant does not qualify for the premium card. The lower-grade card costs more and offers less attractive terms, facts which are rarely mentioned in the official disclosures of the offer.

10. Tiered Pricing

This new, anti-consumer practice is catching on quickly with credit card companies. In an offer, the company quotes a meaninglessly-wide range of possible APRs: Providian's Aria card, for example, quotes a range of 7.99% to 20.24%. The company then assigns an APR to each applicant once the card is issued, based on the applicant's credit history. Consumers are thus being denied the right to know the terms of a credit card before they accept an offer.



Consumers at the Wheel: Navigating Credit Card Offers

1. Shop around before accepting a credit card offer.

Terms and conditions vary widely, so it's important to compare offers—for example, regular APRs range from 7.99% to 30.25%. Key fees and terms to compare:

- **regular (non-introductory) APR:** look for APRs near or below 15.04%
- **grace period:** at least 25 days
- **late payment fee:** no higher than \$20
- **annual fee:** look for cards with no annual fee (most do not have annual fees)
- **penalty APR:** look for cards that don't assess penalty APRs, or if unavoidable, penalty APRs no higher than 20% and in place for a limited period of time only (for example, until two consecutive payments are made on time)

2. Read the fine print—disclosure charts and surrounding text—carefully and thoroughly before accepting a card. Many punitive fees are stated only in the fine print below the disclosure chart.

3. Carry only one or two major credit cards, and avoid using the full available credit line. Remember that credit card purchases are more expensive than cash or check purchases once interest and other fees are included. Use credit cards sparingly and wisely.

4. Pay off all balances in full every billing period, or pay as large a portion of the remaining balance as possible, making the largest payments toward the card with the highest interest rate. Always pay more than the minimum, if possible!

5. Reduce the number of direct mail credit card solicitations

you receive by calling 1-888-5-OPTOUT. This will remove your name from pre-screening lists at the three major credit bureaus.

6. Seek credit counseling as soon as financial problems arise. To locate a free or low-cost credit counseling agency near you, call 1-800-388-2227 or visit www.nfcc.org. For one-on-one counseling over the phone, call 1-800-680-DEBT, or visit www.myvesta.org on the Internet.

7. Check your credit reports at least once a year for errors. Correct any errors immediately. Consumers in CO, GA, MA, MD, NJ, and VT are entitled to one free report per bureau per year; consumers in other states may have to pay up to \$8 per report. To receive copies, call:

Equifax 1-800-685-1111
Experian 1-888-397-3742
TransUnion 1-800-888-4213

8. If you believe you are the victim of unfair interest rate charges, late fees or other penalties, or deceptive marketing, and the credit card company fails to address your complaint, file complaints with your state Attorney General's office and the national Office of the Comptroller of the Currency:

- **visit:** www.occ.treas.gov/customer.htm
- **call:** 1-800-613-6743, (M-F 9am-3:30pm CST)
- **e-mail:** Customer.Assistance@occ.treas.gov
- **fax:** 1-713-336-4301 or;
- **mail:** Customer Assistance Group
1301 McKinney Street, Suite 3710
Houston, Texas 77010

9. Use the credit calculator, available online at www.truthaboutcredit.org, to calculate how much you need to pay each month to pay off your balance within the time frame you've specified. The calculator can also tell you how long it will take to pay off your balance if you continue to pay the same amount each month.

10. Know your financial means and limitations, and don't spend beyond your means. Create a budget that takes into account your average credit card payments each month, and stick to it.



Road Signs: Terms You Should Know

Annual Percentage Rate (APR): The amount of interest assessed on an outstanding credit card balance. For billing purposes, the APR is usually divided into periodic (monthly or daily) rates. A variable APR, often referred to as "prime + x%," is tied to an economic market index such as the Prime Rate; thus it fluctuates with the economy. A fixed APR does not fluctuate with the market; rather, it is set by the credit card company. The company can change it at any time with as little as 15 days notice to cardholders.

Penalty APR: A much higher, punitive interest rate that credit card companies may apply to cardholders who have exceeded their credit limits, made one or more late payments, or are otherwise in "bad standing." Penalty APRs are, on average, about 52% higher than regular APRs.

Credit Limit (or Line): The maximum, cumulative amount of money a consumer may borrow from a credit card company. Credit limits are set based on a consumer's credit history; however, this does not necessarily mean that the limit is one that the consumer can afford.

"Pre-Approved": This term is misleading and does not mean that a consumer is guaranteed to receive the card for which s/he has applied, or any card at all. It merely means that the consumer was chosen to receive the offer because s/he met some initial criteria of creditworthiness.

Grace Period: The time during which a transaction does not accrue interest. Grace periods range from 0-30 days, with an average of 23 days, and they often apply only to purchases, not cash advances or other transactions. On most cards, grace periods only apply if the previous month's balance is paid in full and on time.

Transaction Fee: Cardholders are nearly always assessed additional fees for transactions other than purchases (such as cash

advances). The fee is usually a percentage of the transaction, but a minimum fee may apply. Transaction fees may or may not be capped.

Quasi-Cash Transaction: A transaction similar to cash, such as the purchase of lottery tickets or betting chips. These are usually subject to transaction fees.

Cash Advance: An immediate cash loan from a consumer's credit card account. Cash advances may carry a higher APR than purchases, and often are assessed transaction fees. Grace periods may not apply to cash advances.

Balance Transfer: At a cardholder's request, credit card company A will pay the balance the cardholder has with company B, and the balance will then be put onto the cardholder's account with company A. Consumers usually transfer balances when applying for a new card, to take advantage of low introductory APRs. Balance transfers usually incur transaction fees.

Schumer Box/Disclosure Chart: The disclosure chart contains the most important information of the offer (although not all important information is included in it). By law, the disclosure chart must contain:

1. the actual APR (that is, what the APR will be once the introductory period ends)
2. the formula for the APR, if the rate is variable
3. the length of the grace period
4. the amount of the annual fee, if any
5. the minimum finance charge
6. any transaction fees (for example, fees for cash advances)
7. the method of computing the purchase balance for each billing period
8. late payment fees, and default or delinquency fees
9. over-the-limit fees

Methods of Computing Balances: Methods used vary widely and have a significant effect on the cost of credit. There are three main methods:

1. **Average Daily Balance.** This is the most common computation method.

The outstanding balances for each day in the billing cycle are added, and this total is divided by the number of days in the billing cycle. New purchases may or may not be added, depending on the terms of the card. If the terms state that new purchases are included, purchases made during the billing cycle will raise a cardholder's balance and may increase the finance charge. Once the average daily balance is calculated, interest is assessed each day at the daily rate, which is the annual percentage rate divided by 365.

2. Adjusted Balance. Payments or credits that are received during the current billing period are subtracted from the balance at the beginning of the billing cycle. New purchases are not included in the calculations. For example, if a cardholder's beginning balance was \$2000, and s/he made a payment of \$500 during the billing period, s/he would only be charged interest on the remaining \$1500. This is generally the most consumer-friendly computation method.

3. Two-Cycle Balance. To obtain this balance, credit card companies add together the average daily balances for the current and the previous billing cycles. The average daily balances for the current billing period may or may not include new purchases. The two-cycle balance method is the least consumer-friendly method of balance computation.

Secured Credit Card: This type of credit card is linked to a bank account, allowing a credit card company to deduct payment if the cardholder fails to pay. To obtain a secured card, a consumer must deposit an amount of money equal to the credit limit of the card into a bank account. This account is separate from any other accounts the consumer may have.

Debit Card: Debit cards are not credit cards; rather, they deduct money directly from the cardholder's bank account whenever a transaction is made with the card. Consumer protections guaranteed by law to credit card users often do not apply when a debit card is used.



School Zone: College Students and Credit Cards

Having saturated the working adult population with credit card offers, credit card companies are now banking on a new market: college students. Under regular credit criteria, many students would not be able to get a card because they have no credit history and little or no income. But the market for young people is valuable, as industry research shows that young consumers remain loyal to their first cards as they get older. Nellie Mae, the student loan agency, found that 78% of college students had credit cards in 2000. Credit card companies have moved on campus to lure college students into obtaining cards. Their aggressive marketing, coupled with students' lack of financial

experience or education, leads many students into serious debt.

Warning Signals

- Undergraduates with credit cards carried an average balance of \$2,748 in 2000. (Source: Nellie Mae)
- Half of all college students with credit cards don't pay their balances in full every month.
- 58% of college students reported seeing on-campus credit card marketing tables for two or more days within a one month period at the beginning of the semester.
- On a test of personal finance skills administered to high school seniors, students averaged a score of 57%, an F on any grading scale. Only 5% of the seniors scored a C or better. (Source: Jump Start, www.jumpstart.org)



**"Children, dogs,
cats, and moose
are getting
credit cards."**

Alan Greenspan,
Federal Reserve Chairman,
in a 1999 address to the
Senate Banking Committee

www.truthaboutcredit.org

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