

Before You Choose a Credit Card

Offers for credit cards are everywhere. You receive them by mail, in your email inbox, at your bank and when you are shopping in your favorite store. Yet, have you ever really stopped to think what card and type are best for you?

A credit card is a handy, useful tool, but so is a chainsaw. What you may not know is that both are quite capable of inflicting great damage if you use them improperly!

Good advice for handling both tools: Choose the right tool for the job and always follow the safety instructions.

Below are a few things to consider before selecting a credit card:

- Spending Habits
- Interest Rates and Card Services
- The Credit Limit
- The Grace Period
- Fees and Penalties
- Rewards and Incentives

Important Information/Credit Terms	
Annual Percentage Rate for Purchases and Cash Advances	9.9%
Annual Fee	None
Grace Period on Purchases	25 days (min.)
Method of computing the Balance for Purchases	Average Daily Balance (including new purchases)
Minimum Finance Charge	None
Cash Advance Fee	None
Over the Credit Limit Fee	None
Late Payment Fee	5% of statement balance, up to a maximum of \$25.00
International Transactions	None
This credit disclosure information is accurate as of September 15, 2008. The terms of credit card accounts are subject to change and revision by Martinsville DuPont Credit Union. Information on any changes may be obtained by writing us at P.O. Box 2158, Martinsville, VA 24113, or calling us at (276) 632-1679 or (800) 475-MDCU.	

Spending Habits

How do you intend to use the card? Will you pay the entire balance at the end of every month? Do you anticipate carrying a balance from month-to-month? Will you use it to pay for everything, emergencies, or just certain purchases?

Honest answers to these questions will help you decide which type of card is right for you and which offers you receive will benefit you the most.

Interest Rates

There can be several interest rates associated with your credit card. The **purchase rate** is the interest rate you will pay on your purchases once you carry a balance past the **grace period**. The **balance transfer rate** may be different and applies to balances you transfer from other credit accounts onto this card (if you have them). The **cash advance rate** is often very high. It can be 20% or more. Avoid these fees; there are better ways to get your hands on cash. The **default rate** is the expensive rate credit companies will apply to your card if you are late on your payments and default on your obligation to pay the card.

Credit Limit

The credit limit is the maximum amount of money the credit issuer will let you borrow on your card. This limit will be determined by several factors including your credit score, the type of card you choose and your income. Be careful with credit limits. Maxing out credit cards can be a sign you are in trouble and will damage your credit score.

Grace Period

This is the amount of time you have to pay your credit card balance in full before the finance charges are applied to your balance. You will be given a certain number of days to pay off your balance: 21 days from the billing date and 28 days from the billing date. Grace periods disappear once you begin to carry a month-to-month balance and there is no grace period for cash advances. You'll learn more about the grace period when we discuss **finance charges**.

Fees & Penalties

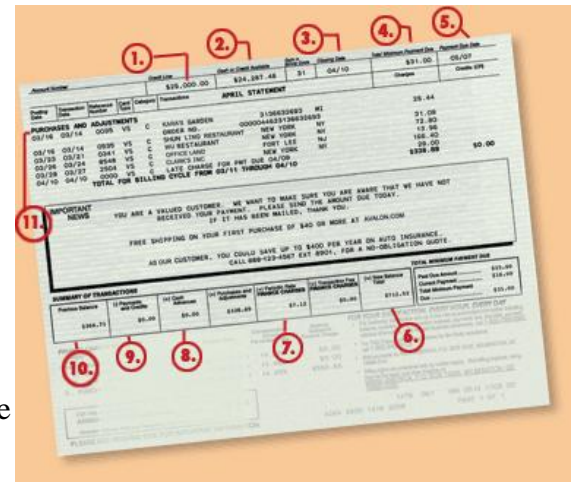
Always examine the application document carefully and be aware of any fees and what circumstances under which fees are applied.

Some of the common fees are:

- Annual Fee
- Late Payment Fee
- Over-the-Limit Fee
- Cash Advance Fee

Others fees can include:

- Using the Phone to Pay Your Bill on its Due Date
- Ordering Additional Copies of Your Statement
- A Returned Check Fee
- Balance Transfer Penalties



Rewards & Incentives

Many credit cards offer rewards programs that reward you for using your card. Incentives like **cash-back**, **airline miles**, **points you can use for discounts** are examples of some reward programs.

Types of Credit Cards

Standard Credit Card

This is the most common type of credit card. It allows you to carry a balance from month to month up to a certain credit limit. These are called **revolving balance** cards. Credit is used up as you spend with the card and becomes available again as you pay down the balance. A **finance charge** is applied to the balance on these cards as the balance is carried from month to month. You will be required to pay a **minimum payment** against the balance of this card on a certain due date. Failure to pay at least the minimum payment by the **payment due date** will result in a **late payment charge**, which will be applied to the balance on the card, too.

Charge Card

With a charge card, the entire balance accumulated during the month **must be paid in full** by the payment due date. These cards do not allow you to carry a balance from month-to-month. These cards typically do not have a finance charge associated with them because the entire balance must be paid in full. Late payments or failure to pay the entire balance will incur a fee, penalty, or cancellation of the card altogether.

Limited Purpose Cards

These cards can only be used at specific locations. They are used like credit cards with a finance charge on month-to-month balances, minimum payments and late fees. Cards only used at certain stores or gas stations are examples of limited purpose cards.

Secured Credit Cards

These cards can be an option for people with no prior credit history or with poor credit. Secured cards require a deposit to create a credit limit on the card. In essence, you are borrowing your own money. However, you may carry revolving balances from month-to-month depending on how much of your limit you use and your payment history. These cards can be useful to establish good credit, or to reinstate good credit after a blemish has occurred.

Pre-Paid Credit Cards

Much like secured cards, these credit cards establish a credit limit based on how much you “load” onto the card. Say you pre-pay \$1,000 on the card. You can now use the card up to the \$1,000 limit. If you need to increase your a limit, you can pre-pay more on the card to give it a higher spending power. As you use the balance, you can **reload** the card by pre-paying. This will bring the spending power back to whatever level you choose.

Types of Credit Card Fees

Annual Fee

This is a yearly fee charged for the convenience of carrying the card. Most credit cards do not have an annual fee but an annual fee is the most common for secured cards, charge cards and premium ones like “Gold” or “Platinum” cards that have added benefits and rewards programs.

Application Fee

When you apply for a card, sometimes you have to pay an application fee. Most cards do not have an application fee, but this cost can be common for secured credit cards. The application process for these cards can have several steps including credit checks and reference checking. These applications take more time and effort to complete by the credit card company, which is why the fee is charged.

Finance Charge

When there's a balance on a credit card, the interest that is carried to the next month beyond the grace period is a finance charge. Charge cards do not have a finance charge because the entire balance is required to be paid in full. Pre-paid cards do not have a finance charge because you are using money you have already loaded on the card. All other credit cards have a finance charge.

Balance Transfer Fee

A credit card that allows you to transfer a balance from another credit account onto the card may charge a balance transfer fee. These fees can typically be 1% to 4% of the amount transferred. The fee is charged only once, when the balance is first transferred and is more than the finance charge you will pay for carrying the balance from month-to-month. A **cash advance** is a type of balance transfer with a 1% to 4% fee.

Late Payment Fee

You must pay at least the minimum payment on your card by the payment due date or you will incur a late payment fee. Some card companies tier their late payment fees, meaning you might be charged \$15 as a late payment fee the first time you are late, \$25 the second time and \$35 each time thereafter. **Don't make late payments!** It is a waste of money paying these fees and it will severely damage your credit score!

Returned Check Fee

Should you pay your bill by mail using a check and the check is returned to the credit card company because there wasn't enough money in your checking account to cover the payment, you will receive this fee. Getting hit with this fee is also a waste of money.

Finance Charges

The **finance charge** on your credit card can be a very important factor in determining which card is the best for you. The finance charge is quoted as the **Annual Percentage Rate (APR)** associated with carrying balances on this card. Different credit cards can have different rates, so look closely. You could save hundreds and even thousands of dollars by selecting a card with lower finance charges.

If you plan to pay your entire balance off on your card at the end of every billing cycle, you won't incur finance charges. Then APR doesn't really matter since you will receive a finance charge.

If, however, you might be carrying a balance over from the previous month, the APR of your finance charge can be a big factor. Be careful!

The finance charge on your credit card will kick in and begin accumulating interest on your balance and your purchases once your **grace period** has expired. Remember, the grace period is the amount of time you have to pay off your entire balance before the finance charge kicks in. Let's take a closer look below.

For example, your **billing cycle**, or **statement cycle**, ends on the first of the month and your **grace period** is 21 days from your billing date; knowing these factors establishes your **payment due date**.

Now let's say you created a \$500 balance of purchases by your billing date. The credit card company will send a bill showing your balance and your payment due date, which is the 22nd of the month (1st of the month plus 21 day grace period). You will not incur finance charges on the \$500 balance during your grace period, nor will you incur finance charges on any purchases you make during the grace period.

When the payment due date arrives on the 22nd, you must pay or have already paid the entire \$500 billed balance to avoid the finance charge.

If you pay the entire \$500 balance, no finance charge will be applied, even to purchases after the 1st. However, if you pay only the minimum payment or any amount less than the entire \$500, finance charges will begin to accumulate. The entire balance on your card, including new purchases made after the payment due date, will also incur finance charges.

Basically, if you do not pay off the entire balance, your grace period is gone.

The **minimum payment due** is a percentage of your billed balance and can vary from credit card to credit card, so be sure to determine how that is calculated before you choose a card. Typically, a **minimum payment** is 1% or 2% of the balance with a minimum payment of \$15, whichever is more.

For example, if your billed balance is \$500 and your minimum payment is 1% of the balance, that would be $.01 \times 500 = \$5.00$.

However, a minimum of \$15 would be required for this payment. If your balance was \$2,000, then 1% would be \$20 and that would be your minimum payment.

Caution: Paying only the minimum payment will make finance charges accumulate.

Because **finance charge APRs** vary from credit card to credit card, it can make a big difference to your wallet, so be sure to look closely at what those APRs are when you choose a card. Obviously, the lower the APR, the lower the finance charges, and the less costly one card will be over another.

Let's compare:

Card A has a finance charge APR of 9.9%.

Card B has a finance charge APR of 16.9%.

If you plan on carrying a \$2,000 balance on your card then:

Card A will have an annual interest cost of:

$$9.9\% \text{ of } \$2,000 = .099 \times \$2,000 = \$198/\text{year}$$

Card B will have an annual interest cost of:

$$16.9\% \text{ of } \$2,000 = .169 \times \$2,000 = \$338/\text{year}$$

The additional \$140 in interest charged by **Card B** has no benefit to you at all. It is the same \$2,000 balance over the same amount of time.

Why pay that much more for the same thing?

Now, You Try:

You have a credit card from **OMG Bank** with an **APR** of 19.5% and a 2% minimum monthly payment requirement.

You accumulate a balance of \$3,150 and then stop using the card.

1. What is the annual interest on this balance?
2. What would be the 1st month's minimum monthly payment? (*Assume the grace period is over and interest is due on the entire \$3,150.*)

Finance Charges on Balance Transfers

A **balance transfer** occurs when you transfer a balance from another credit account onto this credit card, presumably to take advantage of a lower APR. However, **balance transfer fees** should be taken into account when determining if a balance transfer onto this card is a savings and therefore a good idea.

If you are paying 9% currently on another credit account and you are offered a 5.9% balance transfer rate, it may be tempting to select this card.

After all, paying 5.9% instead of 9% is always better. However, if there is a **balance transfer fee** of 4% to do the transfer then you'd pay 4% upfront at the beginning of the year and another 5.9% during the year.

Add these two and you get an effective annual APR of 9.9% which is more than the 9% you started with! The 4% fee is just a 1-time fee but it is still 4%!

For Example:

Your balance is \$2,500.

Originally, you were paying 9%.

$$9\% \text{ of } \$2,500 = .09 \times \$2,500 = \$225/\text{year to carry the } \$2,500 \text{ balance}$$

$$5.9\% \text{ of } \$2,500 = .059 \times \$2,500 = \$147.50/\text{year for the same } \$2,500 \text{ balance}$$

However, if you paid: 4% of \$2,500 as a balance transfer fee, then:

$$4\% \text{ of } 2,500 = .04 \times 2,500 = \$100 \text{ balance transfer fee}$$

At the end of one year you would have paid: \$100 transfer fee, plus a \$147.50 finance charge for a total of **\$247.50** instead of **\$225**.

You should have left the balance right where it was!

Now, You Try:

You have a credit card from **OMG Bank** with an **APR** of 19.5% and a 2% minimum monthly payment requirement. Balance transfers will cost you 3% of each balance transferred as a balance transfer fee.

You transfer a balance of \$1,150 onto the card on the 1st day of your billing cycle. You make purchases totaling \$1,000 during the month and then transfer another \$2,000 balance onto the card just before your billing date.

1. What is the balance you owe on the card when you receive your statement?
(You can assume no interest will be charged on the \$1,000 of purchases for the month.)

2. What is the amount of balance transfer fees you've accumulated?
3. What would be the 1st month's minimum monthly payment?

Rewards & Incentives Programs

Credit card companies entice you to get their cards by offering you rewards for spending money on their accounts. These rewards can be valuable. They can also be a waste of money depending on what the rewards are and how you shop.

Cash Back

Credit cards that offer you a certain amount of cash back when you use them are called **cash back credit cards**. These are the most useful of the rewards programs because everybody can use money back in their bank accounts. Typically 1% of your entire spending will be rewarded to you at year's end with this type of program.

If you spend a total of \$12,000 in a calendar year, you would receive 1% of that or \$120 in a check or a gift card from your credit card company. Sometimes, the option to use the \$120 reward as a credit on your next statement may be offered instead of actually receiving the cash.

Careful though, the **fine print** in some of these rewards programs **limit** the amount of cash back you can receive and also limit the types of charges that qualify for the reward. So, if gas purchases are excluded from the rewards program and the majority of your spending on the card is for gas, then you can expect little to no reward at the end of the year.

Airline Miles

Another popular rewards program is **airline miles**. Typically these rewards programs reward you one mile for each \$1 spent on your card. You accumulate miles and bank them towards the purchase of a future airline ticket. The airlines have seats designated for rewards promotions and it takes a certain number of miles to redeem for a free airline ticket.

If it takes 25,000 to 50,000 miles to get a round trip ticket within the U.S., you will need that much spent on your rewards card to save those miles. Reward miles required for a seat rise depending on your destination and the length of time before your trip. Seats to Europe or Asia can be 50,000 miles or more! Even domestic travel can require 25,000 to 50,000 miles if you want a ticket within 30 days.

Familiarize yourself with the requirements of the airline rewards before you choose an airline miles rewards program. Finally, if you don't fly, are afraid to fly, or have no intention of taking a trip, airline miles rewards may just be a waste for you.

More Things to Consider

If a reward program limits your use of rewards to a certain vendor or store, be sure you shop there! What good is a reward if you can't spend it?

Cost of Rewards

Is there a fee for belonging to a rewards program? If the credit card company charges you \$200 to belong to a 1% cash back program and you are not likely to receive more than \$200 in a cash back reward, then the cost of belonging is more than the ultimate reward itself.

Be sure a reward program is right for you and actually does reward you!

Picking the Right Card

When you decide to pick a credit card, remember the following tips:

- **Spending Habits**

How are you going to use the card? If you are going to pay the balance in full, then the interest rate doesn't really matter.

Choose a card with no annual fee and a longer grace period so you have longer to pay before you incur finance charges. Look for a card that pays you rewards for using it.

If you are going to carry a balance, the APR of the finance charge is your biggest concern. If you will use this card for most of your spending, look for a card with a generous credit limit and a relevant rewards program.

- **Interest Rate**

Find a card with a reasonable APR finance charge should you need to carry a balance. Be sure to examine the grace period so you know how much time you will have to pay your card before you incur a finance charge.

Be sure to examine the documents that come with the card to determine how the minimum monthly payment is calculated and see what the balance transfer fee is, if any, should you wish to transfer a balance onto the card.



- **Credit Limit**

Having too high of a credit limit can hurt your credit score. Having too low a limit and constantly maxing out your card will also hurt your credit score. Try to find the right amount and use it wisely.

- **Fees and Penalties**

Read the fine print. Find out what fees the lender charges, what services they include and under what circumstances. Try not to pay extra for a card with a rewards program. Many cards offer them for free so shop around.

Be aware of time limits, like how long before a payment is considered late and the charges that coincide with those limits.

Answer Key

Now, You Try: (From Page 6)

You have a credit card from **OMG Bank** with an **APR** of 19.5% and a 2% minimum monthly payment requirement.

You accumulate a balance of \$3,150 and then stop using the card.

1. What is the annual interest on this balance?

$$19.5\% \text{ of } \$3,150 = .195 \times \$3,150 = \$614.25$$

2. What would be the 1st month's minimum monthly payment?
(Assume the grace period is over and interest is due on the entire \$3,150.)

$$.195 \times \$3,150 = \$614.25 \quad \$614.25 / 12 = \$51.19 \text{ monthly interest}$$

$$\$3,150 + \$51.19 = \$3,201.19$$

$$2\% \text{ of } \$3,201.19 = .02 \times 3,201.19 = \$64.02$$

Now, You Try: (From Page 7)

You have a credit card from **OMG Bank** with an **APR** of 19.5% and a 2% minimum monthly payment requirement. Balance transfers will cost you 3% of each balance transferred as a balance transfer fee.

You transfer a balance of \$1,150 onto the card on the 1st day of your billing cycle.

You make purchases totaling \$1,000 during the month and then transfer another \$2,000 balance onto the card just before your billing date.

1. What is the balance you owe on the card when you receive your statement?
(You can assume no interest will be charged on the \$1,000 of purchases for the month.)

3% balance transfer fee on \$1,150

$$.03 \times \$1,150 = \mathbf{\$34.50}$$

1 month's interest on \$1,150 @ 19.5%

$$.195 \times \$1,150 = \$224.25 \quad \$224.25 / 12 = \mathbf{\$18.69}$$

3% balance transfer fee on \$2,000

$$.03 \times \$2,000 = \mathbf{\$60.00}$$

	\$1,150.00
	\$ 34.50
	\$ 18.69
	\$1,000.00
	\$2,000.00
+	\$ 60.00
<hr/>	

\$4,263.19 Statement Balance

2. What is the amount of balance transfer fees you accumulated?

$$3\% \text{ of } \$1,150 = \mathbf{\$34.50} + 3\% \text{ of } \$2,000 = \mathbf{\$60.00}$$

$$\mathbf{\$34.50} + \mathbf{\$60.00} = \mathbf{\$94.50}$$

3. What would be the 1st month's minimum monthly payment?

$$2\% \text{ of } \$4,263.19 = .02 \times \$4,263.19 = \mathbf{\$85.26}$$