APPENDIX B

Consumer Information About Taking on a New Credit Card

This handout is also available on this handbook's companion website,www.consumerlaw.org/fprc

EIGHT THINGS TO THINK ABOUT BEFORE YOU TAKE A NEW CARD

More than eight billion credit card offers are mailed to consumers each year. Most of us get several offers for new credit cards every week. In addition, credit cards are advertised everywhere. We see advertisements on television, the Internet, at sporting events, in restaurants, and increasingly on college campuses and even in high schools.

In the past, you rarely got new credit card offers if you had credit problems. Lenders reviewed credit reports and chose not to offer credit to consumers they considered bad risks. More recently, lenders buy huge mailing lists and offer credit to everyone on the list without an individual evaluation of their credit history. They offer credit cards to anyone with an adequate credit score, whether or not you can afford the credit or are already over-extended.

Credit card offers can be very enticing. Nearly every offer promises some special benefit with a new card. In some cases, the offer is for a low rate. In others, no annual fee is promised. Still others advertise free goods or services, low minimum payments, frequent flyer miles, cash back, special member privileges, and contributions to schools or favorite charities. These offers, however, never discuss the downside of a new card or the potential risks.

1. **Avoid accepting too many offers.** There is rarely a good reason to carry more than one or two credit cards. You should be very selective about choosing cards that are best for you. Having too much credit can lead to bad decisions and unmanageable debts. Opening too many new credit card accounts can also lower your credit score.

2. **Beware of subprime credit cards.** Instead of turning you down because of bad credit, some lenders will offer you subprime credit cards. These cards generally come with very high interest rates, other expensive fees, and low credit limits. You may also be charged for unnecessary products such as "credit protection." Some lenders will actually issue cards with low credit limits, and then add so many fees that you cannot charge any purchases to the card because you will already be maxed out when you receive it! Other lenders use subprime credit cards as a trick to revive old debts from other credit card companies. They buy up your old debts, and then offer you a new credit card. When the account is opened, the new lender slaps the old debt on the new credit card account.

3. **Watch out for bait-and-switch offers.** Some credit card lenders will send you an offer advertising an attractive, low-interest credit card with a high limit, but include—in the fine print—the statement that the lender can substitute a less attractive, more expensive card if you do not qualify. The substituted card often has a higher interest rate, more expensive fees, and/or a lower credit limit.

4. **Look carefully at the interest rate.** You should always know the interest rate on your cards and should try to keep the rate as low as possible. It is often hard to do this, because the terms are so confusing and sometimes misleading. Credit card lenders usually have several interest rates for a credit card. They also constantly change their rates. Some important terms to understand are:
   - ***APR.*** This is the interest rate expressed as an annual figure. Most cards have different APRs for purchases versus cash advances versus balance transfers and other types of transactions.
   - ***Variable rates.*** Most credit cards use variable rates, which change with the rise or fall of a common index rate (an example of a variable rate might be "U.S. Prime Rate plus 5%"). If your rate is variable, you need to understand when and how it may change. Variable interest rates can be very confusing. And even "fixed" rates can be variable—your credit card lender usually has the right to change your interest rate with just 15 days' notice.
   - ***"Teaser" rates.*** A teaser rate is an artificially low initial rate that lasts only for a limited time, such as six months or less. After that, the rate automatically goes up. If you build up a balance while a teaser rate is in effect, you will end up repaying the debt at a much higher permanent rate.
   - ***Penalty rates.*** Many credit card contracts, including those that advertise low permanent rates, provide in the small print that your interest rate increases if you make even a single late payment. Some lenders will increase your rate even if you are never late on their credit card, but are late with a payment to any other creditor or if your credit score drops too low. The penalty rate may be on top of late charges or other fees. You should review your contract to see if such terms apply. If you are having financial problems, late charges and penalty interest rates will put you further into debt. Even if you are not having financial problems, these terms are important if you make a late payment by accident.

5. **Fees, fees, fees.** Other terms of credit may be just as important as interest rates. Credit card companies now impose a number of different fees—late payment fees, fees for exceeding a credit limit, annual fees, membership fees, cash advance fees, balance transfer fees, even fees for buying lottery tickets with a card—and keep raising these fees every year. These fees significantly increase the cost of a credit card, so that a card that appears cheaper with a low APR could end up being much more expensive.

6. **Look for the grace period.** Most credit cards offer a "grace period" or "free ride period," the amount of time in which you can pay off purchases without incurring finance charges (cash advances usually do not have a grace period). Without a grace period, finance charges begin accruing immediately, and a low rate may actually be higher than it looks. If you intend to pay off the balance in full each month, the terms of the grace period are especially important. Many credit cards have reduced their grace period. They have also reduced the time between when they send a bill

and when the payment is due, increasing the risk that you will go past the grace period and pay both interest charges and a late fee.

7. **Always read both the disclosures and the credit contract.** You will find disclosures about the terms of a credit card offer in a box, usually on the reverse side of or accompanying the credit card application. Review these carefully. If the disclosure box is on the reverse side of the application, make a copy before you return it to the lender. However, the law does not require that all relevant information be disclosed in this box. For this reason, you must also read your credit contract, which comes with the card. If you do not understand these terms, call the lender for an explanation.

8. **If you do take a credit card and discover terms you do not like: Cancel!** You can always cancel any credit card at any time. Although you will be responsible for any balance due at the time of cancellation, you should not keep using a card after you discover that its terms are unfavorable. You should also cancel the card if the lender changes the terms of your agreement and you do not like the new terms. Otherwise, you will be stuck with the new (and probably unfavorable) terms.

Avoiding Credit Card Problems

Credit card debts can spiral out of control. Here are some ways to protect yourself from getting in over your head.

Do not use credit cards to finance an unaffordable lifestyle. If you are constantly using your card without the ability to pay the resulting bill in full each month, consider whether you are using your cards to make an unreasonable budget plan work. No one can live forever by borrowing without a plan to pay off the resulting debts.

If you get into financial trouble, do not make it worse by using credit cards to make ends meet. Finance charges and other fees will add to your debt burden. However, using a credit card in a period of financial difficulty is preferable to taking out a home equity loan and putting your home on the line.

Do not get hooked on minimum payments. If you pay only the minimum, chances are that you will not be paying down your debt, or that you will be paying it off very slowly. For example, a $1,000 balance with an 18% annual percentage rate will take nearly 20 years to pay off if you make a minimum payment of 2% of the monthly balance. Also, lenders reserve the right to increase the minimum payment at their option. This means that you can budget for a $50 minimum payment only to find out that the new minimum payment of $100 applies.

Do not run up the balance in reliance on a temporary "teaser" interest rate. Money borrowed during a temporary rate period of 6% is likely to be paid back at a much higher permanent rate of 15% or more.

If you can afford to do so consistently with your budget plan, make your credit card payments on time. Avoid late payment charges and penalty rates if you can do so without endangering your ability to keep up with higher priority debts. Bad problems get worse fast when you have a new higher interest rate and late charge to pay during a time of financial difficulty. Many lenders will waive a late payment charge or default rates of interest one time only. It is worth calling to ask for a waiver if you make a late payment accidentally or with a good excuse.

Avoid the special services, programs, and goods which credit card lenders offer to bill to their cards. Most of the special services such as credit card fraud protection plans, credit record protection, travel clubs, life insurance, and other similar offers are a bad deal or are overpriced.

Beware of unsolicited increases by a credit card lender to your credit card limit. Some lenders increase your credit limit even when you have not asked for more credit. Do not assume that this means that the lender thinks you can afford more credit. Lenders generally increase the limit for consumers that they think will carry a bigger balance and pay more interest.

Avoid cashed check loans. Another credit offer to avoid takes the form of a check mailed to your home, usually by your credit card lender. When you cash the check, you not only accept high interest rate credit, but also get stuck with a big balance on a new account right from the start.