A Guide to Credit Cards

and

A Glossary of Terms

True

Know Before You Go . . . To Choose or Use a Credit Card

or False?

Federal Reserve Bank of Boston

In July 2010, credit card rules will change. In the meantime, here is a guide to current rules, with information about the changes to come, to help you when you consider which credit card offer you might want to apply for or accept. Think carefully about your spending patterns when you are looking at an offer and what features might be important to you. Do you pay off your card in full each month? Do you really need cash advances? Do you want to own a card jointly or on your own? Do you want a card with a "cash back" feature, frequent flyer miles, gasoline discounts? Finally, consider how you pay—will the billing cycle match your pay dates, or might you run the risk of late payments? Do you want to authorize automatic withdrawals from another account, at the same or a different bank? What impact will that decision have on your finances? This brochure is written to help you make decisions that are right for YOU when you choose a card.

Know Before You Go...
To Choose or Use a Credit Card

True or False?

All credit card offers have the same terms.

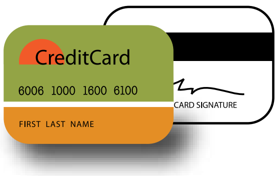
False: Credit card offers vary, depending on the bank involved and to whom the credit card is offered.[1] Be sure to read all of the terms and conditions carefully to see what you will be charged, not only for an annual percentage interest rate, "APR," but for such things as late, over-the-limit, and bounced check fees that can quickly add up. In addition, check to see if the card offers a grace period during which finance charges do not accrue if you make full payments every month. Also review any benefits the card may offer, *e.g.*, cash back bonus awards, miles, shopping points, and any associated annual fees for such benefits.

Interest rates are limited by my state's law.

False: Credit card interest rates are controlled by the state of the issuing bank, not the state you live in, so rates can vary widely.

All purchases and extensions of credit on a credit card are treated the same way.

False: Carefully review and understand the terms of your account for each transaction type before using your card; issuers generally apply different standards to purchases, cash advances and balance transfers. Each of these may carry different APRs. In addition, you may be given a grace period for purchases allowing you to avoid interest by paying your balance on time, in full each month. On the same account, however, interest may start to accrue immediately on cash advances. And if you decide to transfer a balance from another card, you may be charged a flat fee and interest until the balance is paid off.



I am married and therefore must have all joint cards with my spouse.

False: You can apply for an individual credit card, in your name alone, based on only your credit history. You alone are responsible for this card. You may authorize others to use your card, but you are still responsible for the debt.

Paying the minimum monthly balance on my credit card is the best way to manage my credit.

False: If you pay only the minimum monthly balance, it can take years to pay off your purchases, and with compounding interest, you may be paying for whatever you bought many times over. For example, if your minimum monthly payment is only two percent of the balance, and if you charged $2,000 on a credit card with an 18 percent Annual Percentage Rate, it would take about 30 years to pay it off with minimum payments. It would cost you about $5,000 in interest payments! Minimum payments recently changed to four percent with most card companies, and at that rate, you would pay the debt in 10 years and pay $1,000 in interest. While repaying the debt at four percent may seem burdensome, the higher repayment rate will save you thousands of dollars in interest payments in the long run.

Effective July 2010, card issuers will be required to provide: 1) a "warning" statement indicating that making only the minimum payment will increase the interest you will pay and the time it takes to repay the balance; 2) a hypothetical example of how long it would take to pay a specific balance in full if only minimum payments are made; and 3) a toll-free telephone number that you may call to obtain an estimate of the time it would take to repay your balance using minimum payments.

The card issuer may establish a toll-free number to provide customers with the actual number of months it will take the consumer to repay the balance instead of providing a hypothetical schedule in the periodic statement. In the alternative, the card issuer can forgo the three requirements listed above and provide an actual repayment disclosure in the monthly statement. (Regulation Z)

Once the credit card company has granted me a card with specific terms, including a rate of interest, it cannot change those terms for any reason.

False: Credit card companies are permitted by federal law to change your rates or terms with only 15-day written notice, so you need to read all the monthly inserts and notices you receive once you get a card. Credit card company agreements may provide a number of reasons that will enable them to increase your interest rate and charge you more for late fees, over-limit fees, and other charges. For example, some card agreements increase your rate if you are over-the-limit more than once in a specific time period or if you are late more than once.

Many card companies reserve the right to change your account terms for reasons they do not specify in their original offer with broad language like: "the terms of your account are subject to change" and "we may change the terms at any time for any reason."

Your credit card company may even change your rate based on your late payment on a completely different debt, like on some other credit card you own, or on an auto loan. This is called "universal default." Any adverse financial information about you that hits your credit report could trigger universal default. Credit card companies may monitor your credit reports closely, so you need to be vigilant about all of your credit. (Regulation AA)

Effective July 2010, the 15-day notice requirement will be extended. Card issuers will be required to give 45-day written notice of any changes to account terms, including APR increases (penalty pricing) due to the borrower's delinquency or default. (Regulation Z)

In addition, the amended regulations place some restrictions on penalty pricing and prevent the "any time, any reason" repricing. Rate increases on new transactions during the first year after account opening will be prohibited. There are, however, several limited exceptions to the rate-increase prohibitions.[2]

If you pay only the minimum monthly balance, it can take years to pay off your purchases, and with compounding interest, you may be paying for whatever you bought many times over.

Regulation Z provides specific protections to cardholders when there is a billing error, unauthorized use (card is lost or stolen), or when you have a dispute with the merchant who accepted the card for payment.

I applied for and received a credit card with zero percent fixed APR on balance transfers for two years. I intend to transfer a balance from another card, and I will use the card for purchases as well. I can pay off my purchase balances in full each month and avoid any finance charges.

False: Card companies may choose how they apply the money you send, especially if you have accepted a zero percent offer for balance transfers but have another interest rate for new purchases going forward. Review your initial offer for terms like "we may apply payments and credits first to your balances with lower APRs before balances with higher APRs." Such terms allow the card issuer to apply your payment first to the balance carrying a zero percent APR, and you will have to pay interest on your purchase balance until your transferred balance is paid in full.

So, if you decide to take advantage of a zero percent offer on a balance transfer and carry a balance for a period of time, and if purchases will carry a higher APR, you may want to consider putting purchases on a separate card or using another means of payment.

Effective July 2010, if different APRs apply to different balances on an account (*e.g.*, purchases, balance transfers, cash advances), the card issuer must allocate payments in excess of the required minimum payment to the balances carrying the highest APR first or pro rata among all of the balances. (Regulation AA)

Opening a credit card account is a great way to establish a credit history that would be beneficial to obtaining other forms of credit in the future such as car loans or mortgages.

True: Financial institutions use credit reports provided by the three major credit bureaus (Experian, Transunion, Equifax) when making credit decisions. If you have no credit history upon which they can base your willingness and ability to repay your debts, financial institutions may hesitate to extend home or personal loans to you. A credit card from a major retailer or one of the major credit card issuers (MasterCard, Visa, Discover, American Express) is relatively easy to obtain. Just be sure to review all of the terms of your offer and be vigilant about paying your bills on time.

Warning: Too many open credit card accounts and too many applications can adversely affect your credit rating. In addition, maintaining high balances may also negatively affect your credit report and credit score.

I am more protected in credit card transactions than cash, check, or debit card transactions.

True: Federal Reserve Regulation Z, which implements the Truth-in-Lending Act, provides specific protections for consumers in credit card transactions when there is a billing error, unauthorized use (card is lost or stolen), or a purchase dispute. Regulation Z protections do not apply to cash, checks, or debit card transactions.

Billing Error

Regulation Z protects consumers in billing error[3] disputes with card issuers. If you find a billing error on your monthly statement, you must notify the creditor in writing within 60 days after the first bill showing the error was mailed. Just calling the creditor is not sufficient to preserve your rights under this regulation. Be sure to include your name and account number, the reason you believe there is an error, the date of the error, and the dollar amount.

The card issuer has to acknowledge your letter within 30 days or resolve the situation within that time. Or, the card issuer has up to 90 days to investigate and resolve your dispute. While waiting for the resolution, you are not required to pay the amount in question or any associated finance charges. (The card issuer cannot report you to the credit bureau as delinquent, and it cannot try to collect the disputed amount). You do have to pay other charges not in dispute and related finance charges.

If the card issuer determines that there was a billing error, it must correct the error and credit your account. If the card issuer determines that no error occurred, you must pay the amount owed and any finance charges that accrued. You must receive a written explanation of the reasons for the finding. You are entitled to documentation of the finding upon request.[4]

Lost or Stolen Card

If your credit card is lost or stolen, Regulation Z places a limitation on your liability: $50 maximum.[5]

Asserting Claims and Defenses

This protection will apply if you don't get what you ordered as the merchant promised. Regulation Z provides you with rights regarding resolution of disputes involving goods or services purchased with a credit card if:

1) You have made a good faith effort to resolve the dispute with the merchant,
2) The dollar amount in question is more than $50, and
3) The disputed transaction took place in the state where you live or within 100 miles of you.

If these three conditions are met, you may assert the claims and defenses you would normally have against the merchant, against the card issuer.

I received a credit card offer in the mail (zero percent on purchases for one year with a credit line of up to $5,000) that said due to my excellent credit history, I have been pre-approved for this special offer. If I apply, I am guaranteed to get this card at the stated rate.

False: Under federal law, card issuers may send you credit card solicitations that say you are "pre-approved," but the offer is not final until the credit card company checks your full credit history. And once they have done a credit check, the offer may change. While you must be made a "firm offer of credit" in order to be sent a pre-approval, you may not get the card at the rate provided in the initial mailing.

And even if you do get the rate that was promised in the pre-approval, that rate may change at any time. If you default on a payment, *i.e.*, you fail to pay on time, exceed the credit line, or make a payment that is not honored by the bank, the card issuer could increase the APR substantially.

In addition, you are not guaranteed the credit line amount originally offered. The amount of your initial credit line will be based on your credit profile at the time your account is opened. If you do not meet the card issuer's specific requirements, they may not extend credit to you at all.

Federal law requires that credit card companies make specific term disclosures in their credit card offers. You should use these terms to compare offers and determine the most appropriate card for you.

True: Regulation Z, which implements the Truth-in-Lending Act, requires that all credit card applications or solicitations contain certain items in a specific table format with headings, commonly referred to as the *Schumer Box*. Use terms such as APR, minimum finance charge, grace period, cash advance fee, balance transfer fee, late fee, and over-the-limit fee to determine which offer is most appropriate for you.

Be sure to review the terms outside of the Schumer Box as well. Sometimes the big differences between cards are in the fine print.

Understanding the terms of your credit card will soon be easier. Effective July 2010, card issuers will be required to adopt new disclosure formats that will make account solicitations and applications, account opening disclosures, and monthly statements more meaningful and easier to read. (Regulation Z)

The Truth-in-Lending Act requires that all credit card applications or solicitations contain certain items in a specific table format with headings, commonly referred to as the Schumer Box.

If I plan to carry a balance on my credit card, I should purchase credit protection insurance in case I am not able to make my payments.

False: Don't automatically assume that this product is right for you. Be sure to evaluate the terms carefully before purchasing this product.

Credit protection insurance is offered by credit card companies in the event that you cannot make your required payments. If, for example, you suffer job loss or short-term disability, must take unpaid family leave, or fulfill military obligations, the credit card company may either defer payments, finance charges, and late fees or make your minimum payments for you. The company may also offer this insurance in the event of marriage, adoption, divorce, or birth of a child. Before signing up for credit insurance, consider the following:

1) If you file an insurance claim, will you still be able to use your credit card? For instance, if you file a claim because of job loss, the credit card company may no longer extend credit to you because you have no income. However, if you file a claim because of a marriage, you may still be able to use the card.
2) Ask the credit card company to explain the insurance terms. For example, if the insurance covers hospitalization, is there a minimum hospitalization period required before the insurance is available? Does this coverage impact other medical insurance you may have or *vice versa*?
3) Is there is a monthly fee?
4) If the card company defers your payments, and you make a payment, your regular payment cycle is reinstated. Under what circumstances will you be required to make at least minimum payments again?
5) In the event of marriage, adoption, baby, or divorce, the card company will make two months minimum payments. Interest, however, will continue to accrue.
6) What documentation does the credit card company require before it accepts your claim?
7) Can you afford the insurance payments? The cost of credit protection insurance may fluctuate depending on your credit card balance. For instance, a

company's fee may be $0.85 for every $100 of your balance. If your balance is $5,000, then your monthly payment for the insurance would be $42.50. This amount would be in addition to you regular monthly payments.

I received blank checks in the mail from my credit card company. I can use these checks to pay off any of my debts, including balances on my other credit cards. The APR charged on the checks is lower than the purchase or balance transfer rate on my card, so I should definitely take advantage of this great deal to consolidate some of my debts.

False: Credit card checks may be appropriate for some borrowers but not others. Before using the checks issued by your credit card company, consider the following:

1) You cannot use these checks to pay off credit cards in your wallet that are issued by the same credit card company.
2) The debts you pay off with these checks will be added to your credit card balance. If you carry a balance from month to month, the card company can apply your payments to the balance that carries the lowest APR first. So, your balances carrying higher APRs will stay on your card longer and continue to accrue interest at those higher rates, costing you even more money. If you go over your credit limit, you will also be charged over-the-limit fees.
3) You may be charged a fee for use of these checks.
4) A high balance on one credit card may adversely affect your credit rating. For this reason, be careful not to consolidate too much credit onto one card.

Currently, card issuers are not required to provide cost disclosures with these checks; the issuer can just refer the borrower to their original account agreements. Effective July 2010, card issuers will be required to disclose key terms such as introductory rates and their expiration dates, rates that will apply after introductory rates expire, fees, and grace periods(or lack thereof), in a summary table on the front of the page containing the checks. (Regulation Z)

My poor credit history will prevent me from getting a credit card.

False: There is a variety of credit cards developed for individuals with differing levels of credit problems. Most of these are subprime cards, often promoted as *credit builder* or *credit repair* cards.

These cards may provide you with an opportunity to rebuild or repair your credit, but they could be expensive. Because a borrower with credit history problems poses additional risk to the creditor, subprime credit cards can carry higher interest rates and fees. The fees alone, such as annual membership, account set-up, and the usual over-the-limit, late payment, and cash advance fees, can eat up over half of your credit line. So your purchasing power could be more limited than you expected. Some card issuers will require that you open and maintain a bank account balance for up to the offered credit limit as collateral.

A subprime credit card offer will be labeled as such.

False: Credit card issuers do not indicate in their disclosures that a card is subprime. Be sure to carefully evaluate the cost and terms associated with each offer you receive to determine which one is best for you before you apply for any given card. Once your application is approved, the subprime credit card issuer may assess your new card with many fees associated with setting up the account. These fees could add up to hundreds of dollars before you even use your card. Your buying power with this card will be limited until you pay these initial charges and free up your promised credit limit.

> Effective July 2010, card issuers will be prohibited from financing security deposits and fees that together exceed 50 percent of available credit in the first year. The new rule also limits security deposits and fees charged when you open an account to a maximum of 25 percent of your initial available credit. Any additional amounts have to be spread evenly over five or more billing cycles. (Regulation AA)

Endnotes

[1] Those with higher credit scores may be offered more favorable terms.

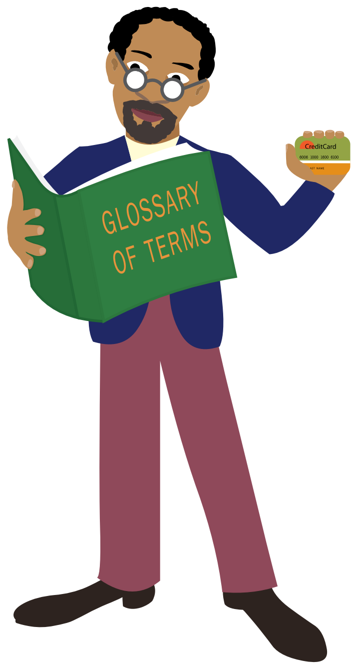
[2] Exceptions include the following: 1) Card issuers can offer a discounted rate that expires after a specified time period, as long as the new rate is disclosed at account opening; 2) Card issuers can offer a variable rate that is tied to an index outside of the issuer's control; 3) Card issuers can increase rates for new transactions (not during the first year) as long they give 45-day advance notice; and 4) Card issuers can increase the rate that applies to outstanding balances if the account is over 30 days delinquent.

[3] Billing error is broadly defined in Regulation Z to include computational errors as well as billing for property or services not accepted or delivered as agreed upon.

[4] Note that billing error instructions must be provided on the back of every credit card monthly statement.

[5] MasterCard and Visa have a zero dollar liability for lost or stolen credit cards.

Glossary of Terms You Should Know



Annual Fee: Some card issuers assess this flat fee each year for use of the credit card.

Annual Percentage Rate (APR): The APR provides the true cost of credit expressed as one number that enables you to compare different credit cards. Card issuers may use different APRs to compute the finance charges on outstanding balances for purchases, cash advances, and balance transfers.

Average Daily Balance: Card issuers look at your average daily balance to calculate the finance charges on your account. The average daily balance is calculated by adding the daily balances over a period of time (billing cycle) and dividing by the total number of days in that period.

Balance Computation Method: This refers to the method the card issuer uses to determine the balance for purchases on which the finance charge is computed. Examples include average daily balance and two-cycle average daily balance.

Billing Cycle: The billing cycle is the interval between the days or dates of the periodic statements. The usual billing cycle is between 20 and 30 days. It cannot exceed three months.

Cash Advance: The cash advance option enables you to borrow cash using your credit card. The cash advance limit may only be a small percentage of your credit limit. Cash advances usually carry higher finance charges than purchases or balance transfers. Typically, they do not have grace periods for repayment. Finance charges begin to accrue the day of the cash advance transaction. A cash advance fee may also be charged for this extension of credit that comes in the form of cash.

Cash Line: This is the amount available for cash advances.

Change-in-Terms Notice: Card issuers are required to give 15-day advanced written notice of any changes in terms on the credit card account. Exception: no advance notice is required if a rate increase is due to default or delinquency.

Effective July 2010, creditors will be required to give 45-day written notice. The notice will include any increases triggered by default or delinquency.

Charge Card: A charge card is similar to a credit card except that balances must be paid in full at the end of each billing cycle.

Credit: Credit enables you to defer payment of debt or to incur debt and defer its payment; buy now, pay later.

Credit Card: This is usually a plastic card that may be used repeatedly to borrow money or buy products and services, and pay for them at a later date. Credit cards are issued by banks, savings and loan institutions, retail stores, and other businesses.

Credit Report: This report contains detailed information on your credit history. The report includes identifying information and details about your credit accounts, loans, bankruptcies, late payments, and recent credit inquiries. Prospective creditors will obtain these reports, with your permission, to evaluate your creditworthiness. Every year you should order a free copy of your credit report and review it for accuracy.

Credit Score: Your credit score is a measure of the risk you pose to someone who wants to lend you money. It is calculated using a standardized formula. Late payments and poor credit card usage can damage your credit score. Lenders use your credit score to determine what interest rate to charge. The better your credit score, the better the rate you can get from a card issuer.

Default Rate: This is the APR that will apply to your balance in the event that you default. For example, if you make one late payment or exceed your credit limit, these actions may trigger a higher APR on your account. (See Penalty APR).

Effective APR: The effective APR is disclosed on the periodic statement. It reflects the cost of interest and certain other finance charges imposed during the statement period.

> Effective July 2010, card issuers will no longer be required to disclose the effective APR, as the term was found to be confusing to consumers. In place of the effective APR, card issuers will be required to disclose interest and fee totals for the month and the year-to-date as a means of informing consumers of the cost of their credit.

Finance Charge: This is cost the of credit expressed as a dollar amount.

Fixed Rate: The fixed rate is a predetermined interest rate that does not change during the entire loan term.

> Effective July 2010, creditors will only be allowed to advertise an open-end account as a "fixed" rate account if the advertisement provides a specific fixed rate period and the rate will not increase during that period. If no time period is specified, the creditor can only use the term "fixed" if the rate will not increase while the plan is open.

Foreign Transaction Fee: This is a fee that card issuers often assess for purchases made overseas.

Grace Period: The grace period is the date by which or the period within which any credit extended for purchases may be repaid without incurring a finance charge. If no grace period is provided, that fact must be disclosed. If the length of the grace period varies, the card issuer may disclose the range of days, the minimum number of days, or the average number of days in the grace period, if the disclosure is identified as a range, minimum, or average. If you do not pay off your balance in full each month, you will not be able to take advantage of the grace period; finance charges will continue to accrue on your balance.

Late Fee: This is a flat fee that the card issuer will charge you if you do not make the minimum payment by the required due date. The fee amount must

The cost of credit protection insurance may fluctuate depending on your credit card balance. For instance, a company's fee may be $0.85 for every $100 of your balance.

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be disclosed to you when you open your account. In addition to disclosing the required due date for your credit card bill, many card issuers include a cut-off time by which you must pay to avoid a late fee.

> Effective July 2010, the cut-off time for receipt of mailed payments must be reasonable; 5:00 P.M. or later is considered reasonable under the new regulation. In addition, when mailed payments are not accepted on the due date because it falls on a weekend or holiday, card issuers must consider payments received on the next business day to be timely.

Minimum Monthly Payment: This is the smallest amount you can pay each month on your credit card balance to avoid a late fee. The minimum monthly payment is based on your account balance. These days the required minimum monthly payment is between two and four percent of your balance. Most of the minimum monthly payment covers interest and little if no principal.

> Effective, July 2010, card issuers must provide (1) a "warning" statement indicating that making only the minimum payment will increase the interest the consumer pays and the time it takes to repay the consumer's balance; (2) a hypothetical example of how long it would take to pay a specific balance in full if only minimum payments are made; and (3) a toll-free telephone number that consumers may call to obtain an estimate of the time it would take to repay their actual account balance using minimum payments.

Open-End Credit: Commonly referred to as revolving credit, open-end credit is consumer credit extended by a creditor under a plan in which:

1) The creditor reasonably contemplates that the cardholder will make repeated transactions;
2) The creditor may impose a finance charge from time to time on an outstanding unpaid balance; and
3) The amount of credit that may be extended to the consumer during the term of the plan (up to any limit set by the creditor) is generally made available to the extent that any outstanding balance is repaid.

Over-the-Limit Fee: This is a flat fee that card issuers will charge if your balance (which includes purchases, balance transfers, cash advances, fees, and interest) goes over your credit limit.

Penalty APR: Beginning in July 2010, card issuers will be required to use the term "penalty APR" in place of "default rate." In table format (the Schumer Box), they will disclose the rate, the specific actions that trigger the penalty APR (such as late payment), the rate that will apply, and the duration of that rate if it will expire or, if applicable, the fact that the rate is indefinite.

Periodic Rate: This is the finance charge rate that may be imposed by a creditor on a balance for a day, week, month, or other subdivision of a year.

Periodic Statement: The card issuer is required to provide this statement which shows all of your account activity for the billing cycle. Typically, you will receive the periodic statement each month.

Regulation AA: The Federal Reserve's Regulation AA in part prohibits unfair or deceptive acts or practices in violation of the Federal Trade Commission Act. Recently, the Federal Reserve Board amended the regulation to prohibit unfair or deceptive acts or practices by banks in connection with credit card accounts. The new rules are effective July 1, 2010.

Regulation Z: The Federal Reserve's Regulation Z implements the consumer credit protections of the Truth-in-Lending Act. The regulation prescribes uniform methods of computing the cost of credit, disclosure of credit terms, and procedures for resolving errors on certain credit card accounts. Regulation Z applies only to consumer credit, not business or commercial credit. The Federal Reserve Board recently amended Regulation Z to improve the effectiveness of the disclosures that creditors provide to consumers for credit card accounts. The new rules are effective July 1, 2010.

Schumer Box: Regulation Z requires that card issuers disclose certain terms and costs of the card in a standardized table known as the Schumer Box. The Schumer Box is named for the New York Congressman responsible for the legislation intended to help consumers focus on the important terms of their credit card agreements.

Secured Credit Card: This is a credit card that is linked to a savings account; the funds can be claimed by the issuing credit card company should the cardholder fail to make payments.

Subprime Credit Card: Card issuers generally offer these cards to consumers with low credit scores or credit problems. Subprime credit cards often have substantial fees associated with opening the accounts, higher interest rates and possibly a required security deposit. They also tend to have low credit limits.

Teaser Rates: These are low rates that lenders offer for a limited period of time to make their products more attractive. For example, card issuers offer qualified borrowers cards with an introductory zero percent APR. At the end of the specified period, the card will revert to a higher variable APR.

Two-Cycle Billing: Some card issuers use this method to calculate interest on credit card accounts. When a consumer pays the entire account balance one month but does not do so the following month, the card issuer calculates interest charged for the second month using the account balance for the days in the previous billing cycle as well as the current cycle. For example, you have an average daily balance in January of $2,000. You pay off the balance in full. In February, your average daily balance is $1,000. You only pay $500 at the end of the billing cycle. A lender using the two-cycle billing method will calculate the interest you will pay not on the outstanding balance of $500, but rather on the average daily balance of both January and February.

> Effective July 2010, card issuers will be prohibited from using this method.

Truth-in-Lending Act: See Regulation Z.

Universal Default: Some card issuers practice universal default whereby they will automatically raise the rate on your card if you default with another lender.

Variable Rate: Most credit cards have variable interest rates—rates that can move up and down. The variable rate is usually tied to an index such as the prime interest rate.

To order this brochure, call the Federal Reserve Bank of Boston's publications line at (800) 409-1333 or visit **http://www.bos.frb.org/consumer**

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