Consumer and Family Sciences

Department of Consumer Sciences and Retailing

To Your Credit: Fact Sheet 1

Choosing the Best Credit Card

EXPERT REVIEWED

Barbara R. Rowe, Extension Specialist

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http://web.aces.uiuc.edu/cfe/ccs/index.html

Many Americans are addicted to credit cards. The average household has at least four, and invitations to sign up for more arrive in the mail every day. However, shopping for the best credit value is more complicated than ever. Not all credit cards are alike. Before selecting a credit card, it is important to understand credit card terms and to compare the costs of similar cards to get the features and terms you want from your credit option. Each affects the cost of the credit you will be using.

Credit card terms

Annual percentage rate. The annual percentage rate, or APR, is the interest rate that the card issuer charges on the unpaid balance of the credit cards. Some cards have set rates; other cards have variable rates, where the amount of interest changes. The interest rate is noted on the disclosure statement that you receive when you apply for a card and again when you open the account. It also is noted on each bill you receive. If a credit card has an unbelievably low rate, it probably is an introductory rate, meaning that the rate is in effect for a short period of time -- six months to a year. After the introductory period is over, the rate will increase. If you carry a balance on your credit card, you will want to look for a credit card with a low rate. However, be careful that you do not obtain a low rate that is offset by a high annual fee.

Annual fees. Some credit card issuers charge annual membership fees. These fees range from $25 to $75 or more for premium cards, but cards with no annual fees are available. Lists of no-fee cards are available at many Web sites, including:

- Credit Card Menu by gromco, www.creditcardmenu.com
- Credit Card Catalog, www.creditcardcatalog.com
- All Credit Cards Online, www.allcreditonline.com

Costs and features

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

You will want to look at other factors besides costs when shopping for a credit card. For example: 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. You may be interested in an "affinity card," an all-purpose credit card that is sponsored by professional organizations, college alumni associations, and some members of the travel industry. An affinity card issuer donates a portion of the annual fees or transaction charges to the sponsoring organization, or allows you to qualify for free airline miles or other bonuses.

Grace period. This is the length of time you have to pay your bill before interest is charged on the purchases.

Some cards do not offer grace periods; finance charges begin from the date you use your card or from the date each credit card transaction is posted to your account. Most card issuers offer 25-day grace periods if the card was paid in full on time the month before.

Finance charge. The total dollar amount paid to use a credit card, including interest costs, service charges, and transaction fees.

Transaction fees and other charges. Credit card issuers may also charge other fees. For example, using the card to obtain a cash advance, failing to make a payment on time, or going over your credit limit all usually result in fees, some of them costly. Some issuers charge a flat monthly fee whether or not you use the card. Carefully read the disclosure statement you receive when you apply for the card to see what other service fees may be charged.

Calculating the finance charge

If you expect to carry a balance on your credit card account, it is important to know how the card issuer will calculate your finance charge. This charge will vary depending upon the method the card issuer uses to figure your balance. The method used can make a big difference in how much finance charge you will pay, even when the APR is identical to that charged by another card issuer and the pattern of purchases and payments is the same.

Average daily balance. This is the most common plan used by credit card issuers. Under this method, the sum of the outstanding balances owed each day during the billing period is divided by the number of days in the period. The periodic rate (the APR divided by 12) is applied against that balance.

However, the average daily balance can exclude new purchases, include new purchases with a grace period, or include new purchases with no grace period. How the average daily balance is calculated dramatically affects finance charges.

Two-cycle average daily balance. This method uses the total of the average daily balances for two billing cycles even if you paid the balance off the previous month. In effect, this method doubles the finance charge. To avoid finance charges, you must pay off your balance for at least two months.

Adjusted balance. Here the balance for finance charges is computed by subtracting any payments you made and any credits you received during the present billing cycle from the balance you owed at the end of the previous billing cycle. New purchases are not included, you have until the end of the billing period to pay part of your balance, and you avoid additional interest charges on the portion that you paid. This method is usually most advantageous to cardholders.

Previous balance. Finance charges are figured on the balance you owe at the beginning of the billing cycle without taking into account payments made during the current cycle.

Calculate finance charges

Average monthly balance you carry on card _______________ x the monthly periodic rate of ________________= interest paid x 12 months = ______________ + annual fee of ______________= Total yearly cost of ______________.

(If you get cash advances, pay late, or go over your credit limit, add these transaction fees to your total.)

Example: Average monthly balance of $1,500 x periodic rate of 1.6% ($1,500 x .016) = interest paid $24.00 x 12 months = $288 + annual fee of $20 = Total yearly cost of $308.

Use the table below to compare the terms offered on three credit cards you now have or three offers you have gotten in the mail.

Read the disclosure statement to find this information and then write it in the table below.

Issuer	APR	Grace period without balance	Grace period with balance	Annual fee	Min. finance charge	Computing finance charge	Transaction fees
Any Bank	19.2	25 days	None	$20.00	$3.75	Average daily balance	$10.00

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Credit Card Smarts Fact Sheets

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- Build a New Credit Record
- Check Your Credit Report
- Choose the Best Credit Card
- Choose the Best Credit Card Interest Rate
- Control Your Holiday Credit Card Debt
- Decide How Many Credit Cards You Need
- Decide How Much Credit Is Too Much
- Get Rid of Credit Card Debt
- Protect Your Credit Information
- Fair Credit Reporting Act Update

Supplementary Information

- Credit Card Terms
- Record Your Credit Card Information
- Review Your Credit Report

E-mail: sweedler@uiuc.edu