

COMPARING CREDIT CARD FINANCE CHARGES, FEES, AND BENEFITS

Deciding if a particular credit card is right for you involves understanding what it costs and what it offers you in return.

To determine how much a credit card costs, you should understand how the finance charge is calculated, as well as what fees you might incur. Evaluating what a card offers involves assessing the benefits it makes available and the likelihood you'll use them.

What you pay versus what you get: Credit card finance charges

Put simply, the finance charge is the dollar cost of using credit. Most of the total finance charge may be the interest you pay on outstanding balances, but it also includes various fees you may incur.

Interest rates

The interest rate on a credit card, expressed as the annual percentage rate (APR), determines the amount you'll pay the card issuer for the privilege of borrowing money and carrying an outstanding balance. The card issuer establishes the APR and must disclose it to you on both the credit application and on the statement you receive each billing cycle (generally each month).

You're usually charged interest only if you carry an unpaid balance on your account from one billing cycle to the next. (Cash advances can be an exception to this rule. You may be charged interest on a cash advance from the moment you receive the money, even if you pay back the entire advance at the end of the billing cycle.) Interest on any unpaid balance is added to your outstanding balance each billing cycle.

You must be notified in writing at least 45 days prior to any change in the APR. The APR may only be changed if (1) the index on which the rate is based changes, (2) it is a promotional rate that has expired, (3) you have failed to comply with a hardship workout plan or (4) your account falls 60 days past due.

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The APR for a credit card may be either fixed or variable. A variable APR may change frequently, since it is often linked to a major economic index. To arrive at the APR, the issuer adds a certain number of percentage points (the margin) to the index. Your interest rate will vary as the index rate varies. If the issuer changes either a fixed or variable APR, you must be given an opportunity to either accept the new rate or cancel your credit card. Such cancellation cannot be considered a default on the account or trigger an immediate obligation to repay the account in full.

You may be charged different APRs at different times or for different portions of your total balance. Credit card issuers often offer a low interest rate for the first 3-12 months your account is open. Called the introductory or “teaser” rate, it’s designed to attract new cardholders. After the end of the introductory period, the interest rate increases to the issuer’s regular rate.

You may also be charged one interest rate for balances you’ve transferred to the card, a second rate for new purchases and a third (and generally higher) interest rate on cash advances. If you make a payment greater than your minimum monthly payment due, the credit card issuer must apply any amount above the minimum due to the portion of the balance with the highest APR.

Finally, you may be charged a higher “penalty” rate if you’re 60 days or more late in making your payments. If your rate is increased for this reason, you must be informed that the rate increase will be terminated (and the rate restored to what it was before the increase) once you have made timely minimum payments for six months.

When the issuer computes your finance charge, the card’s APR is converted to a periodic rate, which is the interest rate you’re charged for each billing cycle. For example, if the APR is 18% and you’re billed monthly, the periodic rate will be 1.5%, or 18% divided by 12 months. (Different APRs for different portions of your balance will result in different periodic rates applied to those portions.) Your finance charge for the billing cycle will be the outstanding balance multiplied by the periodic rate.

Calculating the outstanding balance

Credit card companies use various methods to calculate the outstanding balance used to determine your finance charge. The most common calculation methods are listed below, with the methods that result in the lowest finance charges listed first, followed by those that result in higher charges.

- **Adjusted balance:** The balance outstanding at the beginning of the billing cycle minus all payments and credits (e.g., for returned merchandise) made during that cycle. This method of calculation is often the most advantageous for consumers.
- **Average daily balance excluding new purchases:** The total of the outstanding balances for each day of the billing cycle divided by the total number of days in the cycle. Payments and credits made during the cycle are deducted and new purchases made during the cycle are not included.
- **Previous balance:** The beginning balance for the billing cycle. This balance doesn’t include new purchases made during the cycle, but it also isn’t reduced by any payments or credits made during that cycle.
- **Average daily balance including new purchases:** This method is similar to the average daily balance method described above, but new purchases made during the cycle are included when calculating the daily balances for the billing cycle.

If you look for cards that figure finance charges on adjusted balances or average daily balances that exclude new purchases, you’ll be getting the most favorable calculation

rate. If you always carry a large balance, though, you'll be paying a lot of interest no matter how the finance charge is calculated.

Credit card fees

While the interest you pay may be the largest portion of the finance charge associated with a credit card, it's not the only factor you should consider. Depending on the type of card you have, how you use it and your payment record, you may encounter other fees that will add to the total cost.

Annual fees

Many credit card issuers charge an annual membership or participation fee. This fee may be minimal for most cards, but it can be as high as several hundred dollars, particularly for some travel cards. You'll have to decide if the benefits offered by the card issuer are worth the annual fee you'll pay for them. If you incur no interest charges because you pay off your balance every month, the annual fee may be your only finance charge.

If you're offered a card with no annual fee, read the fine print. In some cases, the annual fee is waived only for your first year of membership or if you charge a substantial amount. You may be able to negotiate your annual fee on an individual basis. If you call the credit card issuer, it may lower your annual fee to keep your account.

Transaction fees

The credit card issuer may charge you separate fees for a wide variety of transactions. These fees must be set forth in the cardholder agreement you receive when your application for the card is accepted. Here are some of the most common transaction fees:

- **Cash advance fees:** These fees are usually several percentage points of the amount advanced, or a minimum amount, whichever is greater.
- **Balance transfer fees:** If you transfer another account's balance to your credit card, the issuer may charge you a fee equivalent to several percentage points of the transferred balance, up to a certain maximum amount.
- **Foreign currency surcharge:** If you make a purchase in a foreign currency, some card issuers will charge you a percentage of the purchase price as a fee to process the transaction.
- **Duplication and replacement fees:** You may be charged separate fees for duplicate billing statements, photocopies of transaction slips and/or replacements of lost cards.
- **Closed account fees:** A credit card issuer may charge you to close your account, particularly if you do so before a minimum stated time has passed.

Penalty fees

If your credit card payment posts to your account after the due date specified on your billing statement (which must be on the same date each month), you'll probably be charged a late payment fee. (If the due date falls on a weekend or holiday, your payment must be credited without penalty on the next business day.) Generally, this fee will be a fixed amount, but the amount may vary depending on the size of your balance (larger balances generate larger late fees). If you're late making a monthly payment more than once within a specified time (usually 12 months), the late payment fee may become higher still.

Credit card issuers are prohibited from authorizing a transaction that will cause your balance to go over your credit limit unless you authorize the transaction—opt in-orally, electronically or in writing. If you exceed the credit limit on your card, you'll be charged

an over-the-limit fee. This fee is for a predetermined fixed amount. You may be charged an over-the-limit fee only once for each billing cycle, and may not be charged this fee again in a subsequent billing cycle unless you again obtain an additional extension beyond your credit limit.

All finance charges generally must be paid by the due date for the billing period in which they're added to your account. If they aren't, they become part of the new outstanding balance used to calculate the finance charge for the next billing cycle.

Caution: Failure to make at least the required minimum payment by the due date for each billing cycle can result in your account becoming delinquent. Not only will this increase your costs, but it may also blemish your credit history.

Credit card benefits

By far, the largest benefit offered by a credit card is convenient and flexible borrowing power. But all credit cards offer that, so what other benefits might you look for? Additional credit card benefits usually take the form of rewards or services.

Reward

A card issuer may "reward" you for using your card by offering credit toward merchandise or services, or cash back. Travel cards may give you frequent flier miles you can exchange for free airline tickets or hotel accommodations. Cobranded cards offer discounts on purchases you make from merchants who have entered into partnership agreements with the card issuer. Issuers of affinity cards "donate" a small percentage of your outstanding balance to a nonprofit organization affiliated with the card. Some card issuers credit your account (consequently reducing your outstanding balance) with "cash back" for using the card.

While these rewards can be attractive, you usually have to spend a lot to get a little. Frequent flier miles might pay for your daughter's next spring break on a tropical beach, but you'll have to travel extensively before she can even get out of town. Discounts with merchant partners on a co-branded card might help you save money, but only if you shop frequently with those merchants anyway. Your direct donation to your favorite charity might give the charity more than it would receive from a small percentage of your credit card use, and you'll get to claim the direct donation as a deduction on your tax return.

The rewards offered by credit card issuers aren't free, either. In most cases, their cost to the issuer is covered by higher finance charges. You'll need to determine if the value of the rewards you expect to receive exceeds the additional interest and fees you may need to pay to get them.

Other services

Most issuers of credit cards offer certain services you may find useful. Some services are "free" (although the cost of providing them may be reflected in the card's interest rate and fee structure), while other options may be provided for additional fees. Among the common services offered are the following:

- A toll-free customer service telephone number. Representatives may be available 24 hours a day, 7 days a week.
- Online account management. Card issuer web sites allow you to review your statements and make payments over the Internet.

- Itemized periodic statements. These statements can help you track your expenses. Some card issuers also provide annual transaction reports that can help you identify tax-deductible expenses.
- Credit insurance. If you're unemployed and/or disabled, this insurance covers your minimum monthly payments.
- Recourse against merchants for unsatisfactory purchases. In some circumstances, your credit card issuer may help you resolve a dispute with a merchant or reverse a charge for defective or undelivered merchandise.
- Travel assistance. Travel card issuers may help you make airline and hotel reservations, provide free travelers checks and check cashing services, or offer travel insurance. Some even admit you to VIP lounges at airport terminals.

When you evaluate a credit card offer, the most important factors to consider are usually the APR and the fee structure. Be particularly careful to avoid letting the glitter of additional services, especially those you may rarely use, blind you to their hidden costs.

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