

Deflate Your Rate:

How to Lower Your Credit Card APR

By Bradley Dakake and the State PIRG Consumer Team

Survey conducted by Bradley Dakake, Consumer Advocate at MASSPIRG Education Fund, on behalf of the State Public Interest Research Groups. Special thanks to the volunteers who participated and to Deirdre Cummings, MASSPIRG Consumer Program Director; Ed Mierzwinski, the State PIRGs' National Consumer Program Director; and Alison Cassady, the State PIRGs' Research Director. Additional thanks to Liz Hitchcock, U.S. PIRG Communications Director; Joey Fink, Production Coordinator at U.S. PIRG; and the U.S. PIRG field team.

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*For more information, please visit www.pirg.org or the State PIRGs' credit card education website, <http://www.truthaboutcredit.org>.
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BACKGROUND

At the end of the year 2000, U.S. households were accruing interest on \$574 billion of revolving credit card debt,¹ or debt carried over to the next month rather than paid off entirely. The average household with a credit card balance carried revolving debt of nearly \$10,000.² A household making the minimum payments – commonly only 2 percent of the unpaid balance or \$20, whichever is greater – on this debt would pay nearly \$1,500 in interest just in the first year. Nationally, consumers pay interest of more than \$87 billion annually on this revolving debt.³ Cardholders paying only the minimum balance accumulate interest on top of interest, paying far more than their share to credit card companies.

An estimated 55-60 percent of Americans carry credit card balances. One recent study found that nearly half of those with balances made just the minimum payment in February 2002. This means that about one out of four cardholders in the USA now make only the minimum payments. In the same month, about 37 percent of Americans who could not pay off their balances paid less than half their outstanding balance, and only 13 percent of consumers with an outstanding balance could afford to pay more than half the balance.⁴

While American consumers accumulate more debt, between 1995 and 1999 the credit card industry's profits rose by 274 percent, from \$7.3 billion to \$20 billion. In addition to keeping interest rates high, the industry has increased its income from late payment fees and over-the-limit fees, among others. In 2000, fee income accounted for 25 percent of credit card companies' total income, and between 1995 and 1999, total fee income increased by 158 percent, from \$8.3 billion to \$21.4 billion.⁵

Further, the industry increased its bottom line (at the expense of consumers) by not passing along massive decreases in its own "cost of money" when the Federal Reserve reduced the prime rate. In the past year alone, the Fed has reduced the prime rate eleven times (from a high of 9.5 percent on May 17, 2000 to a low of 4.75 percent on December 12, 2001),⁶ yet average credit card rates have remained at or around a 14 percent annual percentage rate (APR). Many variable rate credit cards—cards with APRs that fluctuate with the prime rate—now have invoked "floor rates." Since early 2001, many variable rate card companies have refused to reduce their APRs as the prime rate fell, arguing that their contractual floors have been reached.⁷

In response to these shocking statistics and the lack of government action to protect consumers, the State PIRGs investigated whether consumers could fight back on their own against unfair and unreasonable credit card interest rates. *Deflate Your Rate* reports on our study and offers consumers ways to lower their credit card interest burden.

FINDINGS

A 1998 Federal Reserve survey of 2,000 credit cardholders found that 81 percent felt their annual percentage rate (APR) was too high.⁸ In January 2002, the State PIRGs conducted a survey to show one simple action consumers can take to lower their credit card interest rates and save themselves hundreds or even thousands of dollars.

Volunteers participating in the survey called their credit card company and asked for a lower APR. The results from a national spot survey of 50 consumers were the following:

- With one 5-minute phone call, 56 percent of consumers who called their credit card company lowered their APRs.
- Those who were successful reduced their APRs by an average of more than one-third, from an average of 16 percent to an average of 10.47 percent.
- Three consumers were able to reduce their APRs by 15 points.

The survey results also showed a correlation between the cardholder's credit history and the likelihood of receiving a reduction in the APR. Factors affecting the caller's success rate were:

- Length of time with a particular card (longer is better)
- Credit limit on that card (a higher limit is better)
- Unpaid balance-to-limit ratio on that card – how “maxed out” the cardholder is (a lower balance, making a lower ratio, is better)
- Unpaid balance-to-limit ratio on all cards (a lower balance is better)
- Number of times an individual missed or paid late on a loan or a card other than the one for which they were calling (fewer is better)

CONSUMERS COULD SAVE THOUSANDS OF DOLLARS IN REDUCED INTEREST PAYMENTS

By extrapolating from the survey results, we can show that tremendous national savings are possible if cardholders paid lower APR rates. A household with a \$10,000 credit card balance paying only 2 percent of the unpaid balance each month could save up to \$550 in interest in the first year with an APR cut by one-third. Over the lifetime of the debt, this family could save up to \$10,658 in interest and finish paying off the debt 148 months (12.3 years) earlier with this lower APR rate.

Increasing the size of the monthly payment also has a dramatic effect on reducing the total interest paid.⁹ At a 16 percent APR on a \$10,000 balance, a consumer paying 2 percent of the balance each month would make \$17,750 in interest payments over the lifetime of the debt. If, instead, that consumer budgeted to pay 10 percent of the balance

each month rather than the minimum 2 percent, the accrued interest would be only \$1,464 over the lifetime of the debt. Similarly, with a 10.47 percent APR on a \$10,000 balance, the consumer would pay \$7,092 in accrued interest with 2 percent minimum payments, but only \$927 in accrued interest with 10 percent monthly payments.

Some consumers surveyed achieved significant savings by lowering their APR rates. A cardholder from New Mexico was able to lower her APR by 53 percent, from a very high penalty rate of 31.12 percent to 14.65 percent. Her credit card company assessed a penalty rate after she missed a payment six months before completing this survey. For six months, she did not notice that each month she was being charged the penalty rate on her credit card balance. It was not until she completed this survey that she realized her APR had more than doubled six months prior. After completing the survey, she stated, “I bet they would have kept on charging me the penalty rate if I hadn’t called.” On a balance of \$2,900, she could save up to \$11,144 over the lifetime of her debt if she paid only 3 percent of the balance each month.¹⁰

Another cardholder from Colorado was able to completely eliminate his APR for six months. On a balance of nearly \$2,700, he went from 14.99 percent to 0 percent for six months. With a free, brief phone conversation, he saved himself \$196 over the next six months even if he pays only the 2 percent of the balance each month. Of course, his savings increase dramatically if he pays more than the minimum.

Not all consumers will be as successful in lowering their credit card APR. However, there are other options. During one consumer’s survey, the customer representative said to him, “I cannot offer you a lower rate, but I’m a consumer too. You should switch to another company with a lower rate and then switch back to get our lower introductory APR.”

Other customer representatives were not so forthcoming. Two volunteers were told they could not receive a lower APR because their credit card had a “fixed” rate. However, “fixed rate” only means that the card’s APR does not fluctuate like a variable rate card with the rise and fall of the prime rate. The credit card company determines the interest on a fixed rate card. The company can, of course, change the rate at any time so long as they give the consumer fifteen days notice.

CARDHOLDERS WITH THE HIGHEST BALANCES MAY NOT SEE THE SAME RESULTS

As noted earlier, the *average* household maintains \$10,000 in credit card debt. However, the median household debt is much lower than the average debt, which is skewed by a minority of households with extraordinarily high credit card debt. More typical, or median¹¹, households are likely to have revolving debts between \$2-5,000.¹² Because consumers with the higher balances may be less likely to convince their credit card companies to lower their APR, we also calculated the potential savings from a lower APR rate for households that maintain \$5,000 or \$2,000 in credit card debt.

Table 1. Individual Savings from Lowered APR Rate on \$5,000 Balance

Starting Balance	Interest Rate Reduction	Consumer's Monthly Payment (whichever is greater)	Individual Savings From Lower APR		
			# of Monthly Payments Eliminated	First Year Interest Reduced	Lifetime Interest Reduced
\$ 5,000	From 16% to 10.47%	25% of unpaid balance or \$20	1	\$ 94	\$ 98
		10% of unpaid balance or \$20	2	\$ 182	\$ 278
		2% of unpaid balance or \$20	108	\$ 278	\$ 4,982

All calculations presume consumer stops using card for new purchases.

Table 2. Individual Savings from Lowered APR Rate on \$2,000 Balance

Starting Balance	Interest Rate Reduction	Consumer's Monthly Payment (whichever is greater)	Individual Savings From Lower APR		
			# of Monthly Payments Eliminated	First Year Interest Reduced	Lifetime Interest Reduced
\$ 2,000	From 16% to 10.47%	25% of unpaid balance or \$20	0	\$ 38	\$ 39
		10% of unpaid balance or \$20	1	\$ 73	\$ 108
		2% of unpaid balance or \$20	56	\$ 111	\$ 1,500

All calculations presume consumer stops using card for new purchases.

RECOMMENDATIONS FOR CONSUMERS

Despite eleven cuts to the prime rate over the last year credit card companies continue to charge consumers unjustly high interest rates.

Especially in times of economic hardship, consumers deserve fair interest rates. Consumers should demand fair APRs from their credit card companies. It takes only a five-minute phone call to achieve hundreds or thousands of dollars in household savings. This is money that could be reinvested in local economies, spurring economic growth and creating jobs.

Cardholders should take the following simple steps to deflate their rate:

- Call your credit card company today and ask for a lower APR. (Remember, your chances are best if you have had the card for some time, are not maxed out or close to your credit limit, and do not make late payments.)

Sample script: Hi, my name is [Your Name]. I am a good customer, but I have received several offers in the mail from other credit card companies with lower APRs. I want a lower rate on my card, or I will cancel my card and switch companies.

- Never pay just the minimum payment due; instead, always pay as much as you can afford. If you have more than one card, make your biggest payments on the cards with the highest APRs. If you pay only the minimum payment, you are running on a debt treadmill—the bank wins, and you lose.

METHODOLOGY

The State PIRGs asked 50 people around the country to call their credit card companies and request lower APR rates. Each caller was asked to complete a questionnaire regarding his/her own credit card use and the results of the call.

All phone calls were made over a 3-week period in January 2002.

All names collected were for verification processes only. To protect the privacy of our callers, all names have been left out of the report.

For a more complete listing of individual surveys and data charts, visit our website at www.truthaboutcredit.org/lowerAPR.htm. We also include the detailed amortization tables showing how long it takes to pay off credit cards at different payment levels.

ENDNOTES

¹ www.house.gov/financialservices/110101ds.pdf, U.S. House of Representatives, Committee on Financial Services, Subcommittee on Financial Institutions and Consumer Credit. Testimony of Dolores Smith, Director, Division of Consumer and Community Affairs, Board of Governors of Federal Reserve System. Smith estimated the total revolving debt at year-end 2000 to be \$675 billion. According to Stephen Brobeck, PhD, author of several reports on credit card debt (cited below), about 15% of reported Federal Reserve Board revolving debt is paid off before incurring interest, reducing the revolving debt on which interest is accrued to \$574 billion.

² Since credit card deregulation and elimination of state usury ceilings by Congress in 1980 and 1982, the use of revolving, open-end credit has skyrocketed. The formula used to arrive at this number is $(\$574 \text{ billion in revolving debt}) / [(105.5 \text{ million households})(55\% \text{ carrying balances})] = \$9,888 \text{ per household}$. The debt number in the formula comes from footnote 1; the number of households comes from the U.S. Census at <http://quickfacts.census.gov/qfd/states/00000.html>; the percentage of households carrying a balance is based on an interview with Stephen Brobeck, Executive Director of Consumer Federation of America, on March 14, 2002. Brobeck is author of numerous reports on credit card debt. Brobeck estimates revolving debt at \$10-12,000 household, so our results (\$9,888 or approximately \$10,000) compare favorably with his. Total revolving debt (including the current month) has increased each year since 1980 (\$55 billion) and throughout the 1990s—1990 (\$238 billion), 1995 (\$443 billion), 2000 (\$663 billion) to the Fed's 2001 year end figure of \$675 billion. (See Table 1190, Statistical Abstract of the United States for 2001, <http://www.census.gov/statab/www>).

For a detailed discussion of the relationship between average household revolving debt reported by the Federal Reserve (derived directly from bank data) and analysis of under-reporting by consumers of

their estimated individual debt loads in surveys such as the Fed's Survey of Consumer Finances, see *The Consumer Impacts of Expanding Credit Card Debt*, Stephen Brobeck, Consumer Federation of America, February 1997. Brobeck reports that "overall, households may under-report credit card debt by 50% or more."

³ At the end of the Fourth Quarter 2000, the Federal Reserve reported the average interest rate on all credit cards carrying balances to be 15.23% APR. Nationally, with annual compounding (simple interest) that works out to \$87 billion [$\$574 \text{ billion} \times 15.23\% = \87 billion .] The amortized annual interest for a family making a "typical 2% of the balance due" monthly minimum payment on a \$10,000 credit card balance is \$1,461.23.

The most recently reported average credit card APR, for cards carrying balances, was 13.88% APR, 4Q 2001, in the Fed's G-19 release for 7 March 2002, available at <http://www.federalreserve.gov/releases/g19/Current/>.

⁴ <http://www.cambridgeconsumerindex.com/about.asp>. Cambridge Consumer Index is a monthly random telephone survey of 1,000+ consumers. Its March 7, 2002 report estimated that 60% of families carry credit card balances. Brobeck (supra, FN 2) estimates 55% of households carry balances. U.S. PIRG estimates that typical minimum payments are 2% or \$20.

⁵ See testimony of Edmund Mierzwinski, U.S. PIRG, before the House Committee on Financial Services, 1 November 2001, <http://www.pirg.org/consumer/credit/creditcards1nov.htm>.

⁶ <ftp://ftp.ny.frb.org/prime/Prime.txt>, Federal Reserve Bank of New York

⁷ For a detailed discussion of credit card interest rates, floors, and other credit card abuses, see testimony of Edmund Mierzwinski, U.S. PIRG, before the House Committee on Financial Services, 1 November 2001, <http://www.pirg.org/consumer/credit/creditcards1nov.htm>.

⁸ <http://www.federalreserve.gov/pubs/bulletin/2000/0900lead.pdf>. Federal Reserve Bulletin, September, 2000, "Credit Cards: Use and Consumer Attitudes, 1970-2000" p. 629, chart. The survey asked consumers to respond to the statement that the "interest rates charged on credit cards are reasonable." 26% disagreed somewhat and 55% disagreed strongly, for a total of 81%.

⁹ These numbers depend on how Americans pay off their credit card debt. The smaller their monthly payments and the longer it takes to completely pay off a balance, the greater the interest that accrues and the greater the total amount paid. Thus, if Americans paid only the minimum amount due each month, their overall savings would be greater, but they would still pay much more overall.

¹⁰ We calculated her minimum payment at 3 percent, instead of the 2 percent commonly used by the industry, because a 31 percent annual interest rate equates to a 2.6% monthly interest rate. If a monthly interest rate is greater than the monthly payment, then payments cannot even cover interest. The principal would climb to infinity, rather than decline, and she would never pay off her debt.

¹¹ Half of all households have balances greater than the median household; half of all households have balances lower than the median.

¹² Interview with Stephen Brobeck, see FN 2.