The New Rules of Credit Cards

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Banks are raising rates and cutting credit. You can beat them at their game.

Paul McNamee has four credit cards, which he generally pays off in full each month, and always on time. So the Ellicott City, Md., computer scientist was taken aback when he recently received letters regarding three of the cards in the span of a couple of weeks.

Interest rates on two of them were going up -- one by nearly six points -- and fees on a host of transactions, including balance transfers and cash advances, were rising on the third card. "I'm perturbed," says McNamee.

Steve Comkowycz, a software consultant in Greenwich, Conn., used his annual bonus earlier this year to shave the balance on his credit card below 30% of the credit limit, on the advice of a finance officer at the car dealership where Comkowycz had failed to qualify for the lowest loan rate. Shortly afterward, the card issuer cut Comkowycz's credit limit by more than half -- and he was again above the 30% threshold that lenders strongly prefer. "I try to follow the rules," says Comkowycz, who was told the cut was the result of a "loss-mitigation review."

New York City real estate broker Fran Kaback typically schedules 12 months' worth of credit-card payments through her bank's online bill-payment program. Distracted by her elderly mother's hospitalization last fall, Kaback didn't realize 12 months were up on one card until the issuer called to tell her a payment was one day late. Though she paid on the spot over the phone, Kaback's 2.99% promotional balance-transfer rate jumped to 26.3%. "I feel so ripped off," says Kaback, who paid off the $14,000 balance and closed the account rather than fork over hundreds of dollars more each month in interest.

Cardholders across America are fuming over changes in the terms of the agreements they had -- or thought they had -- with their credit-card companies. Many are mystified because they have been good customers, paying their bills on time and sending in more than the minimum payment each month. Suddenly, pulling out the plastic at the grocery store or the gas pump feels like navigating a minefield.

Fueled by populist anger, lawmakers on Capitol Hill have pushed through legislation to give cardholders more rights, while card issuers counter that a rising tide of delinquencies and defaults leaves them little choice but to toughen up.

"Frankly, we're in extraordinary times," says Adam Levin, former director of the New Jersey Division of Consumer Affairs and founder of Credit.com, a credit-card information and consumer-advocacy Web site. Even if you have a pristine payment record, take stock now of every card in your wallet -- and that goes for the cards stashed in your desk drawer, too.

Fortunately, you still have options if you discover your credit-card issuer has done you wrong. And chances are, it has.

A survey by Credit.com last March found that more than one-third of cardholders surveyed had been penalized by their credit-card companies in some way. Fifteen percent of cardholders reported higher interest rates, 11% said issuers had raised minimum payments, 8% said their credit limits had been lowered, another 8% reported that their rewards program had been cut back, and 7% said their account was simply closed.

Awash in losses

Times are hard, say credit-card companies. Issuers will reserve $65 billion -- just over 9% of total loans -- to cover losses this year, says Robert Hammer, chief executive of RK Hammer, a Los Angeles bank consultant. In a stable economy, losses typically run just 5% or so of total loans. So issuers are repricing their products accordingly, charging more to risky borrowers. Trouble is, everyone is a risky borrower now.

"The unfortunate fact is that pretty much all of us are less creditworthy today than we were a year ago," says Peter Garuccio, a spokesman for the American Bankers Association. "You may not have done anything wrong. But in a recession, the risks associated with lending go up, and credit cards are the riskiest form of consumer lending out there."

In fact, many change-of-terms notices are landing in mailboxes without any credit-risk trigger. A study by Fair Isaac, which devised the FICO credit score, found that more than 20 million people lost access to some of their credit last year through no fault of their own.

For example, Capital One notified some customers in February that their rates were going up -- not because of a change in their credit profile, but simply based on their current rate, how long they'd had it and how long their account had been open.

Bankers warn that industry reforms that cut too far into risk-based pricing models will raise rates for everyone and decrease access to credit for all but five-star borrowers, possibly short-circuiting the economic recovery. But generating sympathy for credit-card issuers these days is about as easy as soliciting support for bigger bonuses at AIG.

Despite the powerful bankers lobby, President Obama signed on May 22 the Credit Card Accountability, Responsibility and Disclosure Act of 2009, which goes into effect in February 2010. "I believe that if consumers aren't late on their payments and have otherwise been good customers, they should not be subject to the full range of tricks and traps that card issuers use to increase their fee income," says Rep. Carolyn Maloney (D.-N.Y.). The new law incorporates new Federal Reserve regulations that were scheduled to take effect in July 2010 and provides additional consumer protection.

Changes you'll see include an end to arbitrary rate hikes on existing balances, payments over the minimum applied to the highest-rate balance first, and a provision that lets you forbid your card issuer from approving any transactions that will exceed your credit limit. If you do this, you will never receive an over-limit fee. Other provisions include no more double-cycle billing, clearer disclosures of account terms (statements will indicate fees paid in the current month and year to date and the reasons for the fees). There will also be an explanation of how much interest you will pay and how long it will take to pay off your balance if you pay the minimum and the amount you must pay to pay off your balance in 36 months.

How to fight back

Even with a reform law, many of the anticipated consumer safeguards won't take effect until next year. That means anyone who routinely says "Charge it" needs to be hypervigilant.

Start by regularly monitoring your account. Pay attention to credit limits and annual percentage rates and, above all, read notices that come in the mail. Don't automatically set your online bill-paying program to make the minimum payment (or just a little more) each month. A change in a formula or a rate hike could boost your minimum, and failing to make the minimum payment could be devastating, sticking you with a stratospheric interest rate. Another scenario with unfortunate consequences: You schedule payments at preset intervals and the issuer moves up the due date.

If you spot a change for the worse in your terms, especially if you can't remember a likely trigger, get on the phone and work your way up the customer-service chain. Your account may have been swept into a computer-run portfolio review. But humans, sometimes, have override capability.

You have the right to reject new terms, but think twice before you do. If you opt out, your account may be frozen while you pay off your balance under the old terms. Or you may be able to use your card until it expires. Either way, closing the account can have repercussions for your credit score, especially if you've had the account for a long time. That's why McNamee, the computer scientist, has decided to keep his cards despite the higher rates and fees. "The issuers have leverage because I've held the cards for so long. I'm between a rock and a hard place," he says.

If you do carry a balance and would like to find friendlier terms, be aware that balance transfers aren't what they used to be. Credit standards are stricter for 0% offers. A score of 720 used to suffice, but 750 now seems to be the cutoff, says Ben Woolsey, of CreditCards.com, a card-comparison site. Terms that used to last 12 months have been cut to six. Balance-transfer fees are now rarely capped, and some companies, including Bank of America, have raised fees from 3% to 4%.

Don't let cards lie dormant in your desk drawer. In the current economic climate, an unused credit line represents nothing but risk to the issuer, who may close your account, shaving points off your credit score in the process. "I've heard that the cut can be in the 50-point range," says Woolsey.

Nor should you depend on just one or two cards. It's true that a flurry of card applications will reflect negatively on your credit score. But if you rely on just a couple of cards, you risk losing access to credit completely if an account is suddenly closed or if the terms become too onerous. "In this day and age, don't have all your credit eggs in one basket," urges Gail Cunningham, spokeswoman for the National Foundation for Credit Counseling.

Smart cards

Credit users can still assemble a hardworking portfolio of credit cards -- especially by applying for cards from community banks and credit unions, which often have lower rates and better terms than money-center banks. One of Kiplinger's favorites is the Pentagon Federal Credit Union Visa Platinum Rewards card (800-247-5626). It has no annual fee, and you get a 5% rebate on gas, 2% on groceries and 1.25% on everything else. The card, with an interest rate of 13.99%, is usually best if you pay off your balance each month. But it also has a balance-transfer offer with a 2.99% rate good for the life of the balance and a maximum transfer fee of $100.

Another balance-transfer offer that's worth considering comes with the Visa Classic card from IberiaBank (800-217-7715). The 0% balance-transfer offer is good for six billing cycles, and there is no transfer fee. If you qualify, this card is also tough to beat for its low rate -- the variable purchase rate can be as low as 6.25%, compared with a national average of about 13%. Farm Bureau Bank's no-fee Platinum MasterCard currently carries a low, 5.24% variable rate (see Best Cards for the Way You Spend).

It's nice to get a little something back from your credit card, especially these days. The BP Visa gas card earns a 5% rebate on gas, 2% on travel and dining, and 1% on everything else. Plus, you get double rebates for the first 60 days.

We also like the Simmons First Visa Platinum Travel Rewards card because you earn a plane ticket after just $22,000 in charges. With the American Express Blue Cash card (800-223-2670), you'll earn a 1% rebate on grocery, drugstore and gasoline purchases, and 0.5% on all other purchases until you spend $6,500. After that, you'll earn 5% on groceries, gas and drugstore items, and 1.25% on the rest.

A raft of new cards is tapping into the newly frugal zeitgeist by helping you pay off your mortgage, rebuild your retirement fund or save for college. For every $2,500 you charge on your Wells Fargo Home Rebate card, the bank applies 1% of the amount to the principal of your Wells Fargo mortgage. Fidelity Retirement Rewards American Express card gives Fidelity account holders a 2% rebate that can be deposited in any Fidelity-managed individual retirement account. TheSchwab Bank Invest First Visa card sweeps a 2% rebate into your Schwab IRA or brokerage account.

The new Upromise World MasterCard from Bank of America deposits a 1% rebate on all purchases into your Upromise college-savings account, then adds another 10% rebate on spending at drugstores and grocers. Depending on the card, you can also add to your Upromise account with rebates on gas purchases and dining.

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