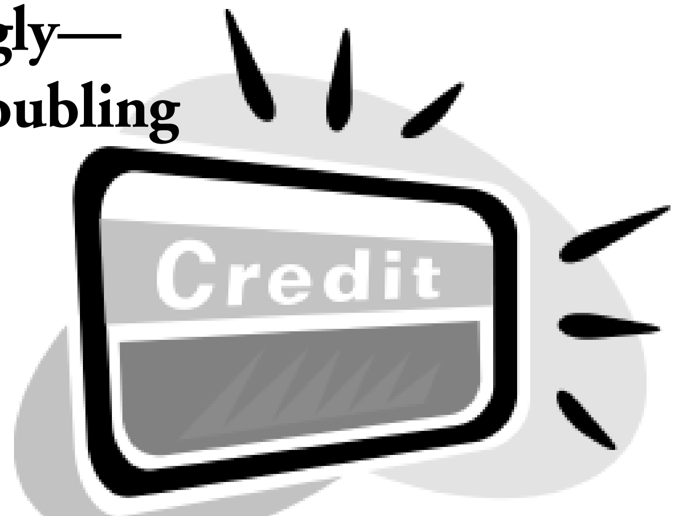
Family Financial Education Foundation | Edition 1, Volume 3

The Good, the Bad, and the Ugly—Credit Card Companies Are Doubling Minimum Monthly Payments



In case you haven't heard, credit card companies are demanding higher minimum monthly payments on card balances. So far, MBNA, Citibank, and Bank of America have all announced they are doubling minimum monthly payments from 2% to 4%. Other companies are expected to follow suit quickly.

What does this mean for consumers? Well, the good news is that the 40% of Americans who carry a credit card balance month to month will be able to pay off the balance faster and save a ton on interest charges and other fees. The bad news is that it will be tougher coming up with the extra money each month to cover the increased minimum payment. And if you carry high balances on several cards, it could get downright ugly.

A Revolving Debt Cycle Consumers May Never Escape

Low minimum payback rates of between 2% and 2.5% over the past few years have encouraged Americans to

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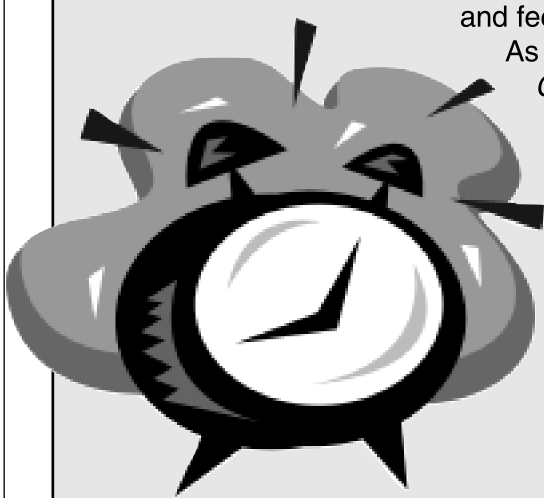
Wake Up to the Dangerous Revolving Debt Cycle

Thanks to pushback from several government agencies, (see "The Good, the Bad, and the Ugly" article), major credit companies are boosting minimum balance payment requirements to ensure credit card holders are paying down a portion of their outstanding principal balance each month, not just covering interest and fees.



As reported by Lauren Ray Brimmer for San Diego-area newspaper *North County Times*, the new minimum payment levels reflect roughly a 10-year repayment schedule. Previously, the credit card industry had been trending toward ever-lower minimum payments, with many bankcard customers experiencing "negative amortization," where their monthly interest and fee payment contributed nothing to principal, meaning that their balance would never be repaid. Most major banks previously required only 2% minimum payments (often reduced because of fees) that amortized debt over nearly 30 years.

Let's look at two scenarios that illustrate how paying only the monthly minimum can turn a big charge into a life-long commitment that accumulates a debilitating amount of interest:

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The Good, the Bad, and the Ugly

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overspend, racking up credit card debt of nearly $10,000 per household on average. (See related article “Wake Up to the Dangerous Revolving Debt Cycle.”)

Realizing that the current system of low minimum payments has created a risky revolving debt cycle that many consumers will never escape, federal regulators have been leaning on banks to nudge consumers toward financial freedom by forcing them to pay off the interest, fees, and a portion of the balance each month. This comes as a result of recommendations first issued to banks in March 2003 by government agencies that include the Office of the Comptroller of Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corp. (FDIC), and Office of Thrift Supervision.

It’s predicted that many Americans will find it extremely difficult to meet the new minimum payment requirements, especially if they use several credit cards. For example, if a minimum payment increases from $175 per month to $250 per month on 5 cards, that’s an extra $375 a month. Most people can’t simply snap their fingers and come up with that kind of money.

When all is said and done, most financial experts agree that increasing the minimum monthly credit card payments makes a lot of sense because it will help consumers get out of debt sooner by forcing them to pay off the interest, fees, and a portion of the balance each month. It is also hoped that the new, higher minimums will get consumers to rethink what they can genuinely afford, instead of viewing purchases as a monthly expense that drags on indefinitely.

Ways to Meet the New Payment Requirements:

Bankrate.com suggests the following ways people can find an extra 10 to 15% in their budget to meet the new payment requirements:

- **Pay less in taxes.** In 2004 for example, 80% of taxpayers got an average refund of $2,400. By adjusting your withholdings, you can keep that money in your own pocket and put an extra $200 a month toward your debt.
- **Curb your spending.** Even small changes, like taking your lunch to work, limiting how many DVDs you rent or how often you go out to eat or to movies can free up to 10 to 15% of your income. One suggestion is to track your spending for an entire week, even for a soda out of the vending machine. You’ll be amazed at how small expenses like a candy bar, mocha latte, or a soda adds up over time.
- **See a credit counselor.** The new bankruptcy law mandates at least two financial counseling sessions during the bankruptcy process, but if you see a counselor now you may be able to avoid reaching that point altogether. ■

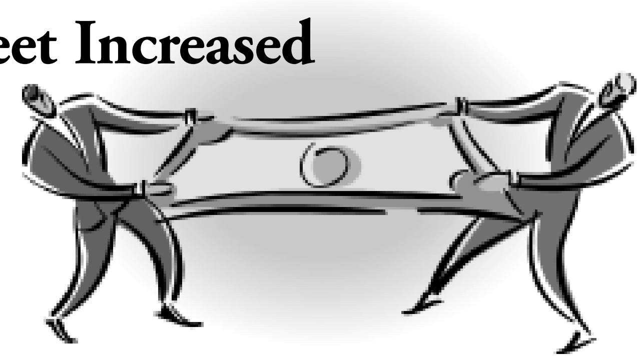
Wake Up to the Dangerous Revolving Debt Cycle *(continued)*

Scenario #1: Let’s say you charge a $2,000 ski trip, cruise, or beach vacation to your credit card with an 18% interest rate. If you consistently make just the minimum payments, not adding any extra to the balance, it would take you about 30 years to pay off the trip and you’d end up paying out nearly $5,000 in interest. However, by making 4% minimum payments on the same debt, you’d pay it off in 10 years, and your interest payments would amount to roughly $1,100. (calculated using bankrate.com)

Scenario #2: Suppose you carry a card balance of $10,000, which is about the national average per household (of the 40% of Americans who carry a balance from month to month). Let’s say your interest rate is 13%. If your minimum payment is 2% of the total balance, the minimum payment is $200 a month. At this rate, you would pay off the debt in 33 years, with interest totaling $11,450. However, if your minimum payment doubles to 4% of the total balance, the minimum monthly payment is $400. At this rate your debt would be paid off in 13 years (20 years sooner) and total interest paid would be $3,664, saving you more than $7,700 in interest. (calculated using bankrate.com)

Let’s face it. While doubled minimum payments may be a bitter pill to swallow in the short run, it’s actually good medicine. As these scenarios illustrate, you’ll climb out of debt sooner and fork out a lot less interest.

Money-Saving Ideas to Help Meet Increased Monthly Minimum Payments



More suggestions for finding money in your budget to pay increased minimum credit card payments include little things you do daily and weekly:

Gasoline

- Comparing prices at different stations may take a little extra time, but it can save you hundreds of dollars a year. Use self-serve pumps instead of full-serve pumps, and use the lowest-octane gas recommended in your owner's manual for even more savings.
- Keep your engine tuned and your tires inflated to the proper pressure. These two simple details will save up to $100 a year on gas.

Food Purchased at Markets

- Do your grocery shopping at the lower-priced or discount food stores. Convenience stores or gas marts usually charge much more so resist the temptation to shop every time you stop.
- Making a grocery or shopping list before leaving home goes a long way to spending less.
- Compare the price-per-ounce or other unit prices on shelf labels. Buy items with the lowest per-unit costs. Look carefully—sometimes the smaller-size container is actually a better buy than the larger container. You can save hundreds of dollars a year by doing this.

Prescription Drugs

- Ask your physician to write your prescription for generic drugs whenever possible. Your pharmacist can also help with recommendations. Brand name drugs are usually much more expensive than their generic equivalents.
- Prices for medications vary widely from pharmacy to pharmacy so take some time to call around before you decide where to shop.
- Mail-order pharmacies can offer great savings if you take a long-term medication. You can often buy a supply that will last several months for considerably less than your local pharmacy would charge.

For more great ideas on how to save money, visit the Federal Trade Commission website at www.ftc.gov. ■

Help for Handling Your New Minimum Payments

With the help of FFEF, you can reduce your minimum monthly payments up to 50% or more, including past due amounts. Your interest rates can be lowered, overlimit and late fees can be waived, and creditor harassment can be stopped. Here's an example:

For more information about how FFEF credit counselors can help you with your debt management, call toll free (877) 789-4174, or visit www.ffef.org. ■

	Current Payment	Payment with FFEF
Credit Card #1	$309.00	$61.00
Credit Card #2	$143.00	$22.00
Credit Card #3	$152.00	$116.00
Credit Card #4	$16.00	$10.00
Credit Card #5	$210.00	$158.00
Credit Card #6	$52.00	$16.00
Totals	$882.00	$383.00

Total Savings: $499.00

Payroll Deductions That Work in Your Favor

Many Americans either neglect or completely ignore the need to save for retirement. Alarmed by this situation, the Department of Labor is trying to turn the tide by encouraging companies with 401(k) plans to enroll their employees automatically.

What Is a 401(k)?

The 401(k) is a long-term savings plan instituted by an employer and managed by an investment or brokerage company such as Smith Barney or New York Life, which determines, with your help, how your money is invested in stocks, bonds, certificates of deposits, money market accounts, or other similar investments.

Two very good things about a 401(k) are:

1. Employer's often contribute matching funds to your 401(k), e.g., if you deposit 1% of your salary, your employer deposits a matching amount of money.
2. Federal (and sometimes state) taxes are deferred until you withdraw the money (typically at retirement) so less is taken out of your paycheck.

What Is Automatic Enrollment?

Instead of you signing up for your employer's 401(k) plan once you become eligible, a percentage of your paycheck—usually 3%—is deposited in the 401(k) automatically. You must notify the plan manager if you don't want to participate. Employers are also incorporating automatic increases. If your employer includes this feature, your contribution will increase each year, usually by 1%.

Defined Benefit Plans and Contribution Plans

A defined benefit plan is a pension plan that is managed by your employer. It guarantees you a specific amount of money when you retire, usually paid in monthly checks for as long as you live. They are protected by the federal government which, ensures you will receive the benefits.

The 401(k) is a defined contribution plan. Other defined contribution plans include:

403(b) Tax-Deferred Annuities: Works like a 401(k), but participation is limited to nonprofit organizations.

Keogh Plans: These plans are designed for self-employed workers. Limits apply to annual contributions and to the total amount of contribution.

Small Business Plans: The Simplified Employee Pension (SEP) and the Savings Incentive Match for Employees of Small Employers (SIMPLE) are for small businesses that do not have other plans available. For information visit www.dol.gov.

Questions You Should Ask

When you start a new job, be sure you find out:

1. When you will become eligible for your employer's participating retirement plan;
2. What percentage is deducted from each paycheck;
3. How and when you can change the amount you contribute and the funds your money is invested in;
4. How and when you can stop making contributions at all if you so choose;
5. What the vesting schedule is for your employer's contribution;
6. What the penalties are for early withdrawal.

Individual Saving Options

There are excellent retirement-savings plans available for individuals. Talk with a financial advisor to see which are suitable for you and put your money to work.

Individual Retirement Account (IRA): Anyone, regardless of income, can contribute up to specific annual limits. Contributions are tax deferrable until withdrawal and may be deductible.

Roth IRA: You can start this plan anytime you are earning taxable income within specified limits. Deposits are not tax deferrable, but earnings and withdrawals are tax free within Roth IRA guidelines.

Annuities: A contract with an insurance company to which you contribute one lump sum or a series of payments. You receive payments for life or over a specific time period depending on the type of annuity. ■

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