What to Know About Credit Card Interest Rates

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The Balance

One of the most important features of a credit card is the interest rate. It affects the cost of carrying a balance on your credit card, a cost you probably want to minimize or even eliminate. Here's what you need to know and understand about credit card interest rates so you can better manage your existing cards and choose the best credit cards in the future.

How Interest Is Charged

The credit card rate is expressed as an APR or annual percentage rate. You'll find a list of all the APRs for a credit card in the credit card disclosure. The interest rate currently being applied to your balances is on your billing statement along with each balance.

Most credit cards have a grace period during which you can pay your balance in full and avoid paying interest. Any balance left beyond the grace period will be charged interest in the form of a finance charge.

Finance charges are calculated in a variety of ways, depending on your credit card terms. Some credit card issuers calculate finance charges based on your average daily credit card balance, the balance at the beginning of the billing cycle, or the balance at the end of your billing cycle. Finance charges may or may not include new purchases made on your credit card.

Fixed vs. Variable Interest Rates

There are two basic types of credit card interest rates—fixed and variable. Fixed interest rates can only change in certain circumstances, and the credit card issuer must send advance notice before changing your rate.

Variable interest rates, on the other hand, are tied to another interest rate (the prime rate, for example) and can change whenever the index rate changes. Your credit card issuer doesn't have to give advance notice if your variable rate changes, so long as the change is the result of an increase in the index rate. The majority of credit card interest rates are variable.[1]

Several Different APRs

Your credit card may have different APRs for different types of balances. For example, your card may have a purchase APR, cash advance APR, and balance transfer APR. Each of these interest rates may be different. Your card may also have a penalty APR that goes into effect when you default on your credit card terms, for example by making a late payment.

When you make a payment to a credit card that has different balances with different APRs, any amount above the minimum payment must go to the balance with the highest APR.[1]

Periodic Interest Rates

Credit cards also have a periodic rate, which is really just another way of stating the regular APR for a period of time less than a year. The periodic rate for monthly interest, for example, is simply the APR divided by the number of months in the year. Periodic rates are more often based on a billing cycle shorter than one month. In that case, the periodic rate is calculated as (APR/days in a year) times days in a billing cycle. The daily rate is another periodic rate calculated by dividing the APR by the number of days in the year (365 or 366 in a leap year).

Calculating Periodic Rates

Here are a few examples of different periodic rates for a card with an APR of 20%:

- Monthly periodic rate: 20% / 12 = $1.67%
- Daily periodic rate: 20% / 365 = .055%
- Periodic rate for a shorter billing cycle, e.g., 22 days: .055% (daily rate) * 22 days = 1.21%

The periodic rate is helpful for understanding how your finance charges are calculated but, ultimately, the standard APR is the best way to compare different card rates.

When Interest Rates Can Increase

Your credit card issuer can raise your interest rate only at certain times:

- When you default on your credit card terms (your payment is more than 60 days past due)
- The index rate increases
- A promotional rate expires
- When changes are made to a debt management plan[2]

How to Opt Out of a Rate Increase

In most cases when you receive an interest rate increase notice, you have the right to opt out of the new interest and continue paying your existing credit card balance at the old rate. Your credit card issuer may decide to cancel your credit card if you opt out, but you won’t have to pay the higher interest rate. To opt out, simply send an opt-out letter to your credit card issuer within the 45-day notice period.[1]

How to Avoid Paying Interest

With most credit card balances, you can avoid interest by paying the full balance listed on your credit card statement each month on or before the due date. With certain balances, such as cash advances and balance transfers, it isn’t so easy to avoid paying interest because those balances don’t have a grace period. In that case, your best option is to minimize your interest charges by paying your balance off quickly.

The more you understand your credit card interest rate, the better you can use your card to your advantage and save money on interest in the long run.

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