HOW YOU CAN PROFIT FROM CREDIT CARDS

Using Credit to Improve Your Financial Life and Bottom Line

CURTIS E. ARNOLD

Founder of CardRatings.com, the leading site for independent consumer credit card information

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CHAPTER 1

It's Not Just Plastic—It's Money

What would we do without **credit cards**?[1] Most of us have at least one in our wallet. From purchasing airline tickets and shopping online to filling up the grocery cart and topping off the gas tank, we use credit cards as a convenient, quick way to pay.

But they can be far more than just fast and easy. Although it sounds counterintuitive and even an oxymoron, *you can actually profit from credit cards* if you apply the insider tips I share in the following chapters:

- Your cards will pay you between 1% and 5% in cash just for charging things you would have bought anyway.
- You can use cards as creative financing tools to buy virtually anything, at **rates** as low as 0%.

These ideas have helped countless consumers, including me, get hundreds and even thousands of dollars from their credit cards. It's my sincere hope and expectation that this book will do the same for you.

The Power of Credit Cards

With more than a billion cards out there—around five cards for every American—it's a safe bet that you've got at least one handy. Take a good look at it. What does it

[1] This term and others that you see in bold are defined in the Glossary.

represent to you—a financial management tool or a burden? Do you receive many benefits from your cards, or is the lender the one receiving all the benefits, in the form of interest payments and fees from you?

Credit makes it easy to buy what we need and want, but in this society obsessed with obtaining all kinds of things, credit can become a crutch instead of a convenience. Still, credit cards have become virtual necessities in our capitalistic, technology-driven society. Try to rent a car without a card, and you'll see what I mean!

With credit cards, shopping online is a breeze. What about reserving airline tickets? Ordering from a catalog? And mailing a check is almost a thing of the past. Using a credit card is faster, easier, and generally a more secure way of doing business.

What's more, if you follow my advice and strategically use the right cards, you'll get many other benefits from them, including generous gift certificates, airline tickets, and cash rebates. If you're wondering how that can be possible, it's largely because of competition. At any given time, typically thousands of competing credit card offers are targeting you. Card **issuers** want your business so badly that they're willing to dangle all sorts of juicy carrots in front of you, chock full of tempting rewards and rebates.

Industry research indicates U.S. card issuers will spend $18.4 billion on rewards in 2010. In 2006, they "only" spent $10.3 billion. If they're giving away that much to get and keep our business, imagine how much money they're making! Still, isn't it great that competition is so tough for them, they have to offer generous perks just to woo and keep us?[2] If you "play your cards right," you'll become what lenders call a *deadbeat,* meaning you reap the rewards of your cards without paying any interest or fees. Or maybe you're a cardholder with *revolving debt,* which

[2] Bézard, Gwenn. (2007, January 18). Loyalty & Rewards: A Market Overview. Aite Group. Statistic retrieved from aitegroup.com/reports/200701181.php

means you don't pay off your balance in full each month—and you do pay interest. If you fall into this category, you're the credit card issuers' ideal customer.

Whichever type of card user you happen to be, you can learn a lot about using credit wisely, getting out of debt, avoiding a high-debt lifestyle, *and* taking advantage of the benefits and rewards of card usage. That's just the kind of valuable information we focus on in this book.

In fact, a very unique value proposition of this book is that credit cards can significantly enhance your financial well-being. Stick around, and I'll empower you to become a savvy credit card user who wisely manages your plastic for personal profit!

Choosing a Credit Card That Will Benefit Your Bottom Line

Comparison shopping is the best way to find a card with the right perks for you. Before we get to fun subjects like deciphering the fine print in credit card offers, let's quickly go over the basic characteristics of a credit card.

One of the easiest ways to understand how a credit card works is to compare it to a **debit card**. Even though a debit and credit card look the same, their functions are very different.

Credit Card Basics

Every time you use a credit card, you're actually borrowing money from a bank or other financial institution. When you charge something, the card-issuing bank pays what you owe to the merchant that accepted your card for payment. In turn, you pay the money back to the bank.

By signing up for a credit card, you agree to pay back the money that you borrow, plus any **interest** or **finance charges** that accrue on the amount you owe until you've paid it all back. Put simply, credit cards are a type of loan.

Debit Card Basics

Most banks now give you the option of using a debit or check card to get instant access to the money in your checking account. When you use one, your bank takes the funds directly from your bank account on the same day or soon thereafter.

With a debit card, you don't have to carry cash or checks, and you don't have to pay interest or finance charges. Now that they're accepted at a variety of places, including gas stations, grocery stores, restaurants, and retail stores worldwide, it's no surprise that debit cards are becoming more popular. In fact, for the first time, debit card usage actually surpassed credit card usage in 2006.

Debit or Credit—Which Is Better?

The answer is, it depends. How careful are you? How do you actually use your card? Can you trust yourself not to rack up a pile of debts?

The features that make debit cards convenient—instant access to your money, plus the ease of not having to write a check and often not having to drag out your photo ID—also make fraud much easier. Unless reported quickly, theft of your debit card can quickly deplete your bank account.

A thief can spend all the money in your checking account in a matter of minutes, leading to bounced checks, overdraft fees, and a major headache! This is where there's a big difference between credit and debit cards.

Stricter Liability Laws

Credit cards are subject to strict **liability** laws that limit a consumer's cost for credit card fraud to $50. Even better, almost all credit cards now come with zero liability policies, meaning you generally don't have to pay a cent for any unauthorized charges. Of course, restrictions apply, but most consumer feedback regarding this benefit has been quite positive.

> **TIP**
>
> No matter what your liability, report fraud as soon as possible. It will often save you time, grief, and money.

With debit card fraud, your liability is $50 *if* you notify the bank within two days. After two days, your liability increases to $500 for purchases and charges you didn't make—and up to your entire account balance after 60 days.

Although many banks have implemented voluntary plans that limit debit card liability to $50, there's no federal requirement. And although Visa and MasterCard do extend limited zero liability protection to debit cards branded with a Visa or MasterCard logo, there are restrictions.

Even if you're fortunate enough to recover all your money and get all the associated fees reversed, once your checking account is exposed to fraudsters, you might face **identity theft** issues. Many fraud victims spend countless hours straightening it all out. And, as the wise old saying goes, time is money!

Consumer Protection

Credit cards also offer more consumer protection. On purchases, for example, if items are stolen within a limited time frame (typically, 90 days), you usually get your money back. Unfortunately, I can personally attest to this: When my family's brand new lawn mower was stolen, I got a check in the mail for the full purchase price of the mower a few weeks later. The theft was very upsetting, but that check definitely helped ease our pain!

Similarly, chargeback privileges, which are standard benefits protected by law, come in handy when we have disputes with merchants over goods or services bought with a credit card. Some cards also come with extra insurance, which can be a real benefit—for example, in case there's damage to something that's shipped to you. Chapter 10, "Maximize the Benefits of Your Cards by Taking Advantage of Additional Free Perks" contains a detailed listing of such benefits.

Establish or Build Your Credit

One final but very significant advantage of credit cards is that they're a great tool if you need to establish or build a good credit history. Credit cards typically report account activity to at least one of the three major national **credit reporting companies** (Equifax, Experian, and TransUnion) on a monthly basis. Their report of your responsible credit card use helps improve your credit rating, also known as your **credit score**.

The better your credit, the more likely it is that you'll get the most favorable terms (low **interest rates**, low fees, and so on) on all types of credit, including credit cards, car loans, and mortgages. That could easily translate into thousands of dollars in savings. Good credit can also lead to big savings on your insurance premiums year after year, and it can even help you land your dream job. (For more on **credit reports** and credit scoring, see Chapter 9, "Your Credit Report and Score: The Better You Look, the More You Profit.")

Which Card Should Be in Your Wallet?

Follow these three simple tips to decide which card or cards are best for you:

1. Put yourself in the driver's seat.
2. Understand the *terms and conditions*.
3. Learn about credit card features and how they can benefit you.

Put Yourself in the Driver's Seat

Be proactive instead of reactive. The goal is to find a card that will work *for you*—by offering low interest rates, incentives, services, and so on. There's no benefit in allowing a bank to profit excessively from you, raking in **annual fees**, **late fees**, high interest charges, and more, right?!?

Many consumers that I talk with assume the offers they get in the mail are the best offers that they can get. Did you know that those "**preapproved**" offers you're probably inundated with aren't guarantees of credit at all? Your name was simply retrieved from a mailing list, and the offers are the result of expensive marketing campaigns.

More Than Meets Your Eye

Ira Stoller, a senior member of the CardRatings.com forum, says,

> *Preapproved offers can hit your mailbox from any and every card issuer. They are not what you might think they are. If you read the fine print you will see that all a 'preapproved' offer means is that you fit into a series of gross [marketing] parameters that the card issuer gives to the* **credit bureaus** *or agencies. The credit bureaus send a list of potential clients to the card issuer who then sends out a solicitation piece trying to interest folks like you and me in actually applying for the card. There is no guarantee that we will be approved.*

The industry loves to bait us with tempting offers that frequently include very generous **credit lines** and rock-bottom rates. The odds that you'll actually qualify for that much credit are small unless you have a high credit score and above-average income. Otherwise, you'll probably get a card with a lower **credit limit** and a higher annual interest rate (also known as the *APR*).

Look for the phrases "as low as" and "up to" in the sales pitches. They're usually associated with many card offers and should alert you to carefully review the terms of the offer.

Definitely review mail solicitations where you can find some great direct-mail offers. However, if you consider only the offers that show up in your mailbox, you're probably missing out on some great opportunities. It pays to explore every available avenue when you're on the hunt for a great card, including websites, personal finance magazines, and newspapers. Picking up the phone to call your bank or other card issuers directly is another good idea. (Visit CardRatings.com/Book for the phone numbers of the major card issuers as well as for more information on many of the resources mentioned in this book.) Each avenue might yield unique card offers that you won't find anywhere else.

In comparing several different cards, I strongly advise that you rely on unbiased, up-to-date resources. A great place to start is our website, CardRatings.com, which is now the most comprehensive free source for comparing cards. We strive to give an accurate picture of the best (and worst) of the *current* crop of cards out there. Issuers frequently change their offers, so it's advantageous to check out the latest opportunities.

Perhaps the most unique feature of the site is the "Consumer Reviews" section, where some 20,000 cardholders rank cards based on various criteria, like fees, rewards, and customer service. What could be a more valuable measure of how good or bad a particular card is than the word of many real, live users?

Understand the Terms and Conditions

When you apply for a credit card, the company assumes that you agree to the terms and conditions—whether or not you really understand them. Most people do quickly glance at the fine print. But let's be honest: When the words start sounding too legal and the print is too small, isn't that when we lose interest and tell ourselves that we know enough to use the card wisely? All those pesky details don't really apply to us, right?!?

Wrong. The terms and conditions apply directly to us! Knowing our intolerance for legalese, the card industry is notorious for slipping some very important clauses into the terms and conditions, making them extra hard to decipher, even for many attorneys. Historically, many issuers have taken advantage of fine print technicalities, and critics claim that a significant share of the industry's revenues comes from "deceptive tactics" hidden in the fine print.

Some clauses do seem sneaky or unfair, but as long as the card issuer discloses certain information in the terms and conditions, they're perfectly legal. No one said we had to like it, though!

Regulating the Card Industry

So many cardholders and consumer advocates have been complaining about controversial industry practices. Both houses of Congress—as well as key federal agencies—are considering legislation and regulations that, if implemented, would represent the most far-reaching crackdown on the card industry in decades. Hopefully, by the time you read this, the system will be fairer. The powerful banking industry is claiming that more regulation

> would lead to higher prices and less consumer credit. While I do have fears that too much regulation might backfire, we're a long way from too much regulation. As an added benefit, lenders may find that more reasonable terms and conditions might actually help lower credit card delinquency and bankruptcy rates.
>
> While I'm optimistic that some improvements are in the offing, there will likely always be details buried in card agreements that can cost you big bucks. My goal is to explain the system as it exists today and give you the heads-up on what might be changing in the near future.

What's in that fine print determines how you can profit from a card. You've been forewarned! Now it's time to forearm you with tools that make it easy to take advantage of the financial benefits that come with clever credit card use.

The Schumer Box

Card offers have to include a handy table known as a *Schumer Box* that clearly shows key card info. Named after Senator Chuck Schumer of New York and first introduced in 1988, a Schumer Box includes these important terms:

- Annual fee (if applicable).
- Annual percentage rate for purchases (APR)—Although a rate will be shown, the actual rate you'll

get will be based on the lender's evaluation of your creditworthiness.

- Other APRs:
  - Balance transfers—In this situation, you pay off a credit card balance with another credit card. A typical balance transfer offer is 0% for 6 to 12 months, with the rate applying only to balances transferred from another card. (More about this and all the other Schumer Box details later.)
  - Cash advances—This is the rate you must pay when you use your card to get cash, for example, from an ATM.
  - Default and penalty rate—This is the rate you must pay if you make a late payment, go over your credit line, and so on.
- Grace period for purchases—This is the amount of time you have, after the billing period ends to pay off your credit card balance before you're charged interest. It's typically 20 to 25 days and applies when you are not carrying a balance.
- Interest or finance charge calculation method—This is how the issuer determines how much interest you owe if you don't pay the balance in full.
- Other transaction fees—These could be for cash advances, balance transfers, late payments, and so on.

Because this information is included in all offers in the same basic format, Schumer Boxes let us do "apples to apples" comparisons to find a card to use to our best advantage. Table 1.1 illustrates a sample Schumer Box as seen on the following page.

Table 1.1 Sample Schumer Box

Annual percentage rate (APR) for purchases	9.99%–23.99%
Other APRs	**Balance transfers:** 0% until the last day of the billing period ending during April 2009; then the standard APR for purchases.
	Default or penalty rate: Up to 32.24%
	Cash advances: 22.99%
Variable rate information	The standard **purchase APR** may vary monthly and equals the prime rate plus an amount between 2.74% and 9.74%. (The prime rate used is the highest prime rate listed in *The Wall Street Journal* on the last business day of the month. The **prime** rate as of the printing of this book is 5.25%. Visit CardRatings.com/Book for the current prime rate.)
Grace period for repayment	At least 20 days when you pay your balance of the balance of purchases in full each month.
Method of computing the balance for purchases	Two-cycle average daily balance, including new purchases.
Annual fee	$0
Minimum finance charge	50¢
Cash advance transaction fee	3% for each cash advance, with a minimum of $5 and no maximum.
Late fee	$15 on balances up to $500, and $39 on balances over $500.
Over-the-limit fee	$15 on balances up to $500, and $39 on balances over $500.

Billing Cycles

Interest is calculated in two common ways: **two-cycle billing** and **average daily balance** methods. Be wary of cards that use two-cycle billing, aka double-cycle billing. They calculate interest on your average daily balance over the current *and* the previous billing periods instead of on the average daily balance for just the current billing period.

With two-cycle billing, you usually end up paying much more in interest, especially if you occasionally carry a balance. The good news is that, because of political and media pressure, Chase abandoned this practice in early 2007 and now most major issuers don't use this billing method. New legislation or regulations may outlaw it entirely. (Visit CardRatings.com/Book for a list of the major card issuers that do and don't use two-cycle billing.)

Fees

Fees, fees, and more fees! Card issuers have become increasingly dependent on fee income in the last few years. Some surveys claim that fees are now almost as important to their bottom lines as interest income. In 2007, card issuers raked in some $160 billion industry-wide, according to industry expert R. K. Hammer, who estimates that 39% of that amount (some $63 billion) comes from fees. For comparison, in 2000, fees amounted to only 28%. In 2006, penalty fees alone generated $17.1 billion, according to Hammer.

Although fees are usually defined in the Schumer Box, they can be hard to comprehend. Fortunately, in May 2007, the Federal Reserve began an initiative to require lenders to provide additional disclosures regarding fees in an easy-to-read format. And even better, they're considering a ban on exorbitant fees in Washington, and lenders may be prohibited from charging interest on certain fees.

The most common fees are levied for paying late and charging over the credit limit. Late fees have risen much faster than inflation, from an average of $12.83 in 1995 to $33.64 in 2005. They're currently as high as $39 and will probably continue to spiral upward.

Balance transfer fees are also increasingly prevalent, and they're on the rise. Most balance transfer offers, designed to entice us to take advantage of super-low **introductory (aka teaser) rates**, now have fees attached. Alas, the days of virtually unlimited no-fee balance transfer offers are becoming a thing of the past.

Some transfer fees increased as much as 300% to 400% just in the first few months of 2008. Despite such dramatic increases, you can still find good transfer offers and save a lot of money in the process. Chapter 3, “Unlock the Key to Huge Savings: Master Credit Card Rates and Transfer Offers,” shows you how.

On a positive note, annual fees, which were prevalent 15 years ago, are now few and far between. When they do exist, it’s usually for cards that offer generous airline reward points. (More on cards that will be a boon to all you travelers in Chapter 2, “Show Me the Money! Credit Card Rebates.”)

Figure 1.1 shows the amount of money card issuers received in 2007 from these various fees.

The Notorious Fine Print

Everything in the Schumer Box is must-know information, and it pays (literally!) to understand other details as well. If you become familiar with common fine-print phrases, such as the following four examples, you won’t end up being sucker-punched by the bank, and you’ll be in a position to take maximum advantage of your cards:

- *…if the cardholder is reported as delinquent on an account with any other creditor, we may increase the APRs on your account up to the maximum default APR.*

  This controversial clause, commonly known as *universal default,* means that if you’re late paying another bill, the interest rate on your credit card

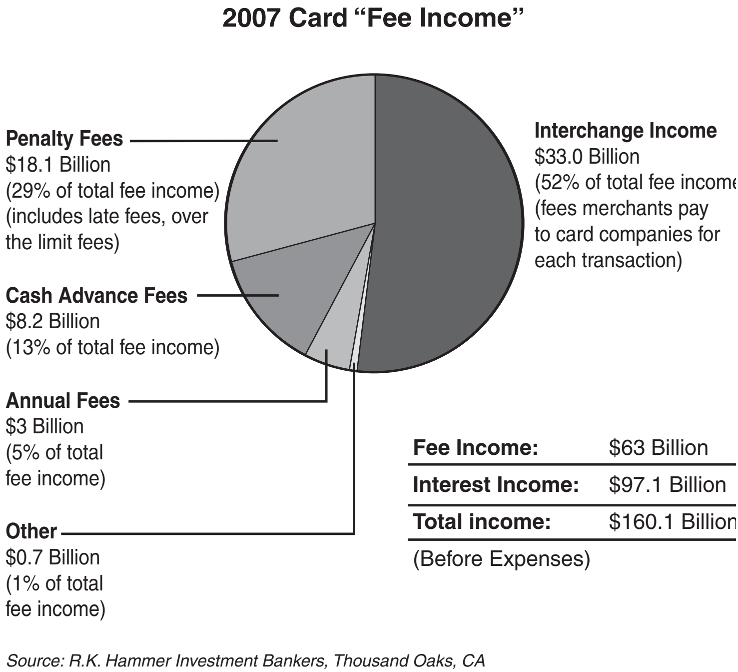

Figure 1.1 *Various sources of fee income in 2007*

could be raised. In fact, if your credit score is lowered for any reason (late payments, high debts on loans, and so on), the universal default clause can be activated. Yes, that's true even if you have a perfect bill-paying record with the card issuer.

Unfortunately, many card issuers now practice universal default, raising the rate on new and existing balances, even when they don't call it that. On a positive note, some issuers are starting to distance themselves from universal default, and soon, new laws may require any interest rate increases apply only to future card debts. It's a fairly complicated topic, so we delve into it in more detail in Chapter 11, "Master Advanced Card Techniques to Save and Make Money."

Universal Default in Action

Courtney, a frequent poster on the CardRatings.com forum, was surprised to find that the APR on her card had been raised from 8.99% to 18.49%. When she called the lender, she was informed her credit record revealed a "high **debt-to-income** ratio" that made the issuer decide her risk as a borrower had risen.

"I consider myself to be very capable with my finances," says Courtney. "But I've had a few years when I ran up more debt than usual, including a home equity loan. I made all of my payments on time, but evidently, my new debt affected what used to be a stellar credit record. It's frustrating."

Soon after, another credit card bill arrived from another company with a new interest rate of 27.4%—up from 8.9%. This was yet another unpleasant surprise for Courtney who said, "In all the years that I held this card, I never made a late payment."

- *Disputes relating to the account are subject to binding arbitration.*

This clause protects the card issuer from lawsuits and class action suits. If you have any problem or dispute regarding your account, you're limited to a *binding arbitration* hearing. The arbitrator is generally hand-picked and hired by the bank, and your legal options are normally severely limited.

According to Paul Bland, an attorney with Public Justice, a public-interest law firm, once an arbitrator has made a decision, it's next to impossible to get a court to overturn the decision.

"Few consumers read and understand all of the terms and conditions of the credit cards that they use," Bland explains. "Therefore, not enough consumers know about binding arbitration to produce a public outcry."

Unfortunately, cards without mandatory arbitration clauses are getting harder to come by. Some organizations, such as Union Privilege and AARP, have enough muscle to insist that the mandatory arbitration clause not be applied to cards issued with their name. (The same banks typically include the clause in other cards they distribute.) Additionally, credit unions and smaller banks are usually more consumer-friendly than the big card issuers and generally don't include such clauses.

Mandatory Arbitration Clauses Are Everywhere

According to GiveMeBackMyRights.com, mandatory arbitration clauses can also be found in health insurance contracts, telephone contracts, car contracts, rental clauses, bank loans, house repairs, and so on. Most consumers are in at least one binding arbitration contract...and don't even know it!

- *We apply payments and credits to balances with low introductory/special APRs (such as special balance transfer and purchase APRs) prior to balances with standard APRs. Therefore, your savings will be reduced by making additional transactions or having balances that are subject to standard APRs.*

  This is certainly quintessentially confusing credit card jargon! It means that any payment you send in will be applied to the balance with the lowest interest rate. In other words, if you have more than one interest rate being applied to the balance on your account, the company charges the highest interest rate for as long as it can. I sincerely hope this practice will be outlawed, and payments will have to be credited against the balance with the highest rate. But as of now, lenders are free to credit payments against our lowest rate debt.

  This can really burn you if you're taking advantage of a low-rate balance transfer offer and are also charging new purchases to the same card. This is a violation of cardinal rule #1 when it comes to the smart use of balance transfers. See Chapter 3 for details.

- *The Introductory APR does not apply to bank and ATM cash advances.*

  A very high APR of 20% to 30% is typical for cash advances. To maximize profit from your credit cards, never use those pricey cash advances. Keep away from the ATM at all costs. (More on cash advances in Chapter 5, "How to Slash Your Debt and Keep Your Hard-Earned Money for Yourself.")

Many other phrases included in the terms and conditions can be confusing. Consult the Glossary if you need help understanding any credit terms. Although spending time analyzing credit card terms is no fun, it's definitely time well spent because it can save you much stress and money down the road. And who among us wants more stress and less money, especially when the goal is to get more money and perks from our cards?

TIP

If you still have questions about an offer after you've looked it over, don't hesitate to call the issuer for further clarification—before you apply. Merely applying for credit can negatively affect your credit report, so if the customer service rep doesn't answer your questions to your satisfaction, then don't apply!

Learn About Card Features

Ask yourself these questions to decide which card is the best choice for you.

Which Type of Card Can I Get?

Several kinds of cards exist, including **secured**, platinum, business, student, and reward or **rebate** cards. The cards you'll qualify for depend largely on your credit history. If you're in the process of trying to rebuild your credit, for example, a secured card is best. See Chapter 8, "Use Targeted Cards to Your Financial Advantage Use."

Each type of card offers unique pros and cons. For example, although reward cards generally have great perks, they normally charge higher interest rates. That can end up being very, very costly if you don't pay your balance in full every month. See Chapter 2.

How Will I Use the Card?

Will you carry a balance or pay the entire bill each month? Your answer to this question should carry a great deal of weight in choosing a card. If you pay your bill in full every month, you'll never have to pay interest. You can take advantage of cards with attractive reward programs because you don't have to be as concerned about the interest rate.

If you'll be carrying a balance, pick the card with the lowest interest rate you can get. That will keep your cost of borrowing as low as possible. Usually perks won't be worth it until you no longer carry a balance. For the lowest rates, your credit score has to be very good. It's important to find out what your credit score is before you apply for a new credit card. See Chapter 3 to find out why.

What Rewards Will Benefit Me the Most?

Consider your lifestyle when you're reviewing card benefits and incentive programs. If you rarely travel, air miles won't prove very useful to you; you'd do better with a cash-back card.

So many reward cards are out there—take your pick! For example, you can get a card that rewards you with the following:

- Cash
- Air miles or frequent-flyer miles good for free tickets
- Generous rebates on future purchases of gasoline
- Gift certificates
- Contributions to your retirement or college savings plans
- Partial mortgage payments

By using these tips and the ones that follow, you'll find a credit card that comes with the right payoffs for you. As your situation changes—when you no longer carry a balance, for example—take a fresh look and adapt the tips to your current situation. Finding a card that fits you to a T and gives you bonuses for charging things you'd use anyway can be a very fun, profitable experience.

Credit cards, fun? Profitable? Who'd have "thunk" it? And we're just getting started! Now let's take a closer look at some of those great fringe benefits to smart charging.

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