

Further breakdowns are possible—for example, (b) could be divided into interest that accrued before a payment was made (that is, interest based on the total balance) and interest that accrued after a payment (that is, on the remaining balance). Dividing total interest charges into too many components, of course, leads to confusion and defeats the purpose of the breakdown.

Retailers would be little affected by such a disclosure requirement: most retailers calculate interest on a monthly basis from the statement date, so their interest charges would fall only into category (b) above. Financial institutions would face large programming costs with such a requirement.

Interest charges in categories (a) and (c) above often surprise consumers and lead them to think that the pricing of credit cards is unfair (one can, for example, pay off a card balance in full and still have interest charges accrue in category (c)). If consumers saw the components of total interest—and understood the rationale for each component—there might be fewer complaints about credit cards. But such disclosure would not help a consumer choose the card that would offer the lowest effective rate of interest.

As an example, consider the case where you make a purchase for \$1000 on July 10th. The statement on July 25th shows an outstanding balance of \$1000 (no interest charges are shown for a new purchase). On August 5th you make a partial payment of \$400. The statement on August 25th shows a new balance of \$621.15, the sum of the remaining balance of \$600 and interest charges of \$21.15.

These interest charges may be broken down into the components (a) and (b) above. Component (a) is \$8.77 and represents the interest charges on \$1000 for the 16 days between July 10th (the purchase date) and July 25th (the statement date after the purchase). Component (b) is \$12.38 and represents the sum of charges on two implicit loans, one for \$1000 for the 10 days running from July 26th (the first day of the new statement, or billing, period) to August 4th (the day before the partial payment was made) and the second implicit loan for \$600 from August 5th (the payment date) to August 25th (the next statement date).

Assume you pay the entire balance of \$621.15 on September 7th and have no new transactions during the September billing period. The statement on September 25th will show a new balance of \$3.95. This is the residual interest, or component (c) above, on the implicit loan of \$600 from August