Credit Traps for the Unwary

It's hard to imagine functioning in today's society without access to credit. However, you need to be careful not to fall victim to some of the pitfalls associated with it.

Revolving credit can make it hard for you to pay off debt.

Credit cards allow you to spend money you don't currently have, and to repay what you've spent over time instead of all at once.

When you use a card, the balance you owe increases, and your remaining available credit decreases. As you make your payments to reduce your outstanding balance, your available credit once again increases. Thus, your credit revolves around for you to use again.

Since you can spend more than you currently have, you can easily spend more than you can afford. As your balance increases, your minimum monthly payments also increase, and soon you'll find yourself in over your head -- especially if interest rates and a variety of fees are high.

Interest and fees can add to the cost.

Credit card debt generally carries a high interest rate. Your minimum monthly payment -- a percentage (often as low as 2 to 4 percent) of the total balance due -- may cover little more than the monthly interest charge. Consequently, your minimum payment may only minimally decrease what you already owe. If possible, increase your monthly payment above the minimum required. The higher you can make the payment, the faster you will pay off the debt. When opening a new account, always check to see how the finance charge is calculated. Here are some of the methods used:

- Adjusted balance method: Balance due at the beginning of the billing cycle less any payments made during the cycle; excludes new purchases made during the cycle
- Previous balance method: Balance due at the beginning of the billing cycle
- Average daily balance method: Total of the balances due each day in the billing cycle divided by the number of days in the cycle; payments made are subtracted as posted to determine daily balances; new purchases may or may not be added in

The amount of your finance charge can vary widely from method to method. In an effort to attract your business, many lenders offer very low introductory rates - 3.9 percent annually or less. However, these rates generally last no more than three to six months and increase to the current market rate thereafter. Moreover, the introductory rates may apply only to balances you transfer from other cards. They may not apply to new purchases and rarely if ever to cash advances. Finally, if your monthly payment is late, the interest rate may be raised to the current market rate--and sometimes beyond.

A credit card issuer may increase the interest rate you're charged under specific circumstances. These circumstances are (1) the index on which the rate is based changes, (2) it is a promotional rate that has expired, (3) you have failed to comply with a hardship workout plan, or (4) your account falls 60 days past due. If your rate is increased because the account falls 60 days past due, you must be informed that the rate increase will be terminated (and the rate restored to what it was before the increase) once you have made timely minimum payments for six months. However, in this case, it's doubtful the rate would be restored to the original low introductory rate.

If you have two different interest rates on one account (e.g., a lower rate for purchases, a higher one for cash advances), the creditor will post the minimum payment toward the lower interest rate balance, not the higher. However, a credit card company must apply any payment over the minimum payment due toward the portion of an existing balance with the highest interest rate.

You may also incur a wide variety of fees. Creditors may charge you an annual fee to maintain the account. These fees can range from $25 to $50 or more each year. They may also charge fees to transfer balances from other cards. Generally, these processing fees equal 2 to 4 percent of the amount you transfer. Many banks levy a similar surcharge on transactions involving conversions from foreign currencies. If you're late with your monthly payment, you may be charged a late payment fee that can be as much as $39 each month you're overdue. If you authorize the creditor to complete a transaction that sends your balance over your approved credit limit, you will be assessed an over limit fee.

When these fees add up, you may find that making your minimum monthly payment won't bring your balances down. In fact, your balance will increase if your monthly payment isn't greater than the accumulated interest and fees due, since these unpaid charges become a part of the principal you owe. Moreover, your account may then be considered past due and reported as such to the credit bureaus.

If you surf your debt, beware of the wake.

You may periodically transfer your balance from one introductory offer to the next. This is known as surfing. Done successfully, surfing lets you avoid the higher interest charges that your debt would incur when the original card offer expires. By the time the interest rate on the original card increases, you've surfed over to a new offer at another low rate.

Although surfing helps keep your interest charges to a minimum, it's not without pitfalls. You may be offered a low rate only on balance transfers; if new purchases and cash advances are billed at a higher interest rate, these charges could offset the savings you would otherwise enjoy. Moreover, as creditors move to counteract the surfing trend, many stipulate that if you transfer balances to another card within a certain time after opening your account, you'll be retroactively charged a higher rate of interest on the amount you transfer. Thus, surfing before this time period is up eliminates the savings.

Finally, if you transfer balances to a new card, close the original account as soon as you've paid it off. Write the creditor a letter (keep a copy for your records) asking it to inform the credit bureaus that the account was closed at your request. This prevents new potential creditors from denying you credit when they see too many open lines of credit, and it also deters anyone else from fraudulently using an inactive account.

Protect yourself against credit fraud and identity theft.

Credit fraud (the illegal use of your accounts) and identity theft (opening new credit using information about you) are two of the fastest-growing crimes today. In many cases, you may not know you've been victimized until it's too late. Here are some indicators of these crimes:

- A creditor informs you that it received an application in your name
- You've been approved for or denied credit you didn't apply for
- You no longer get your credit card statements in the mail
- Your credit card statements include purchases or cash advances you never made

To minimize the chances of being victimized, take precautions to safeguard your credit account information. Don't carry credit cards you don't use often. Be sure to sign your cards, and never sign a blank charge slip. When you use the card, try to keep it within your sight. Save your receipts, and obtain and destroy any carbons. Don't allow a sales clerk to write your credit card number on a check "for identification." Finally, never give out your account number over the telephone unless you initiated the call and know the organization to be reputable.