7 BIG CREDIT CARD TRAPS TO AVOID

Fall for these and you'll pay for it.

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When it comes to getting your first credit card, it all seems so simple.

Make purchases on the go, cash in on the rewards points and repay the lender on time to avoid the interest, right?

But as many seasoned cardholders will attest, there are plenty of unexpected ways that things can go wrong and hidden caveats that can land you in hot water.

Last year, the Australian Securities and Investment Commission (ASIC) flagged a number of major issues with the way credit cards function.

The watchdog concluded they are confusing, the promotional features mislead customers and are designed to keep people trapped in debt over a long period of time, sometimes decades.

And with hundreds of cards on the market and so many conflicting features on offer, choosing the right card can be particularly complex.

"The main trap is that they're called a credit card – because credit suggests that it's a good thing, and we all like to get credit for things," consumer rights advocate Christopher Zinn told YourMoney.com.au.

"There's a large number of people who either don't know what they're doing fully enough or lose control, confidence or perspective. That can end up costing them much more than they think," he says.

There are more than 14 million credit card accounts in Australia holding $45 billion of debt, according to ASIC.

To top that off, we're being charged around $1.5 billion in fees each year.

OVERWHELMING DEBT

Credit repair lawyer Joseph Trimarchi looks at hundreds of cases a year by customers that get in over their heads in debt. He says by far the biggest issue is credit card debt.

"Over-commitment, illness, job loss – and then debt becomes an issue. Plus, the credit card debt is the one that they tend to ignore first… before they know it, they've fallen off the cliff," he says.

"At the end of the day, the credit cards are the ones that get people in trouble. And for every [job] I do… I would say one in three would have stemmed from credit card debt."

But there are ways to protect yourself by using a card in a way that benefits you (not the lender) and learning the avoid the pitfalls.

Here are some of the biggest credit card traps that you should be wary of:

1. MINIMUM REPAYMENTS

Clearing the minimum repayment set by the bank each month can make you feel like you're on the right path – and you are, just not for yourself.

The trick to using a credit card well is to completely clear your total balance each month, but according to research by ASIC, around half of Australians make low repeated repayments and stay in debt month after month.

The reality is that paying just the minimum off can take you decades to clear even small amounts of debt.

"So, on my card, I'm owing $1,700 and the minimum is $34 (per month)," says Zinn.

"If I made the minimum payment on that, it would take me 24 years and nine months to clear the closing balance and I would pay the total amount of $6,400."

2. BALANCE TRANSFERS

Some card providers offer a zero per cent interest rate for a limited time – often 12 months – as an incentive for customers to transfer their existing card balances over.

While it can be a useful tool if used correctly, they've also been flagged by ASIC as a 'debt trap' for potentially exposing unwitting customers to even greater debt after the card switches back to the higher interest.

Roland Bleyer, founder of Sydney-based comparison websites Creditcard.com.au and Credit World, says it's one of the features people frequently get wrong.

"What does that [zero-interest] rate revert to? Today they pretty much all revert to cash advance rates and that's typically over 20 per cent," says Bleyer.

But in Bleyer's view, one of the biggest pitfalls is that you don't get interest-free days on any new purchases under the balance transfer deal – something he says people are often unaware of.

It means new purchases are charged the high interest of 20 per cent or so.

"The trap is, you do not spend on a balance transfer credit card," he reasons. "Keep your old card and use that to make new purchases and make sure to pay it off each month."

3. REWARDS CARDS

Reward cards that promise free flights, gift vouchers and other prizes are an attractive prospect for customers – a fact card providers know well.

But according to Zinn, they're too often used to hide higher than normal interest rates and annual fees that typically offset any benefits the cardholder receives – sometimes to their detriment.

"Most of the time you're better off with a non-rewards card. People should be far more focused on the interest rate as opposed to the points, but card companies know it's the other way around, that people are much more interested in the points," says Zinn.

Trickier still, there are usually caveats that go along with achieving rewards, such as a minimum or maximum monthly spend.

"So, if you're only spending $1,000 on the card a month, it's going to take you around 50 years to get a decent flight or some other reward," Bleyer gives as an example.

"The trap with rewards cards is to make sure, is there a cap on how many points you can earn? And does it change as I spend more and therefore not make it valuable for me?"

And if you're not a savvy rewards collector, the extra that you pay on fees and interest is rarely worth it.

"The basic thing is if you're not clearing your balance every month, then all the points in the world don't compensate for the amount that you're paying," Zinn agrees.

4. INTEREST-FREE DAYS

Credit cards typically come with a certain number of interest-free days (often between 40 to 60) during a cycle. But Bleyer says people often misunderstand what this means.

Say a card has 55 interest-free days, people sometimes assume that means you get 55 days to pay off each purchase. In fact, it means that you get a 55-day cycle in which all purchases over that time must be paid off in full.

So if you've bought a product on the first day of the cycle, you get 55 days to pay for it interest-free – but if you've purchased the product halfway through that cycle, you get less than half the time to pay it.

"Many people think that they've got interest-free days because they've got a $500 balance on a $10,000 card," says Bleyer.

"The fact is that you only get interest-free days on credit cards if you pay the balance off in full each period."

5. BUSINESS VS CONSUMER CARDS

Many people aren't aware that there are big differences between consumer and business debt, and that includes credit cards.

Trimarchi says if you've got an ABN, work as a freelancer or run your own business, there's a good chance the option of having a business credit card will have come up.

"The typical punter is really a consumer punter in disguise. It's normally a tradesperson who has a very small business working from home – he needs to buy a car – the accountant says to finance it through the business," says Trimarchi.

"But the real purpose of it is for domestic use. But he's getting caught up in a system whereby he's not protected."

The problem is that business cards come with fewer strings attached than regular cards and fewer restrictions on what lenders are allowed to offer, according to Trimarchi.

"Legislation dictates that the lenders must adopt certain policies and a certain pattern in treating [consumers] in how they apply finance and how they collect the finance. When it comes to commercial loans – there's no such legislation… so it's like the wild west," Trimarchi.

If a regular consumer gets in over their head in debt, the card provider can be held accountable on some areas such as whether they've provided enough information or whether they offered unsuitable card features.

Card providers don't have to abide by the same rules for business, and by that same token, customers don't get the same protections if anything goes wrong.

6. NO FOREIGN EXCHANGE FEE

Some cards don't apply a foreign exchange fee, which can be a major drawcard for online shoppers and travellers.

But according to card expert and founder of iFlyflat.com, Steve Hui, the real costs can be hidden.

Hui says the problem with the 'no fees' sell is they often recoup those costs through a poor currency exchange rate.

"You don't actually know what the true FX rate is. So, just because you have no fees, it doesn't mean you're getting the best deal on rates," says Hui.

7. DYNAMIC CURRENCY CONVERSION

You might not have heard of dynamic currency conversion, but according to Hui, it's one of the more common card mistakes Australians make when travelling abroad.

If an overseas merchant has ever asked you what currency you'd like to pay in, you're instinctive reaction might be to say AUD.

Unfortunately, paying in anything other than the local currency results in a pricey conversion from the local currency to the AUD with an added 'dynamic currency conversion' fee – which means you can get charged around twice the regular fees.

If you find yourself in the same situation – always choose the local currency.

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