Credit cards & store cards

Factsheet July 2012

Credit cards are a convenient form of short-term finance. **Store cards** are credit cards issued by particular retail stores.

Both types of card are easy to get and easy to use. With a credit card, you can carry less cash and buy things easily over the phone or online.

But if you have trouble controlling your spending on credit, you may end up owing more than you can pay off.

That's when credit cards can lead you into a dangerous debt spiral.

Ricky always pays off the balance

I sometimes use my credit card when I'm shopping or caught without cash. But I'm 100% committed to paying off the balance within the interest-free period. I'm already paying off my HECS debt from uni, so I don't want to get into more debt.

How do credit cards work?

- Credit cards allow you to borrow up to a **maximum spending limit**. You can keep borrowing as long as you make regular **minimum repayments** and stay below the limit.
- You usually pay an annual fee and are charged interest on all transactions if you don't pay your full balance each month. If you use a card without an **interest-free period**, you are charged interest from the date of your transaction.
- Unless you use a card that is interest-free and fee-free, buying on credit will always **cost you more** than if you pay for something upfront with cash.

TIP How to save money on your credit cards

- Try to pay off the balance within the **interest-free period** to avoid paying interest. If you regularly pay off your credit card balance in full, shop around for a card with no annual fee or a low annual fee, rather than a lower interest rate.
- Even if you can't pay all you owe in full, try to pay off **more than the minimum repayment** to reduce the amount of interest you pay. Shop around for a low-interest credit card if you know you usually have difficulty paying the credit card balance in full each month.
- Avoid **cash advances** – they have no interest-free period, charge ATM fees and often incur higher interest charges.
- Limit the number of credit cards you have, especially if you can't pay them off within the interest-free period. Be aware that **store cards** usually charge higher interest than standard credit cards.
- Make sure your credit card limit reflects the amount of debt you can manage. If you need to **lower your limit**, contact your credit provider and ask them to do this.
- **Read your statements** carefully to check that you are charged correctly. You may be able to reverse a transaction if you did not get the goods you paid for. Contact your credit provider immediately if you discover any transactions on your statement that you did not authorise.

Choosing a credit card

	How it works	What to watch out for
Debit cards	The most common type of debit card is an **ATM** or EFTPOS card. You can use this type of card to withdraw money at ATMs and make purchases. Some debit cards, such as Visa Debit or Debit MasterCard, can be used exactly like a credit card – so you can make purchases on the internet and while overseas. The difference is that a debit card uses money already in your bank account instead of credit, so you won't pay any interest (unless you have an overdraft).	Make sure you have enough money in your account to cover your purchase. Some debit cards also have a **credit facility**, but can charge high interest if you use it. Make sure you don't end up getting into debt without planning to. Be very careful when using debit cards on the internet or overseas where there is a higher risk of fraud. Unlike with credit card fraud, any amount stolen comes directly from your own funds and it may take some time to get the money back into your account. Consider **limiting** the amount of money available in your debit card account and make sure you always have access to other funds.
Interest-free days	You pay no interest for a certain number of days after making a purchase. That's good if you always pay off your credit card in full within the **interest-free period**. But if you don't, you could end up paying a higher interest rate and fees than you would with a card with no interest-free period.	There are no interest-free days for **cash advances**. You will be charged interest either from the day you make a purchase or from the statement date, unless you repay in full within the interest-free period.
No interest-free days	You pay interest either from the day you make a purchase or from the day your monthly statement is issued. For cash advances, interest is usually charged from the date of withdrawal. This kind of card usually has lower annual fees and a **lower interest rate** than a card with an interest-free period. This kind of card is a good choice if you know you won't be paying your card off in full straight away.	Read the **conditions of use** *before* you apply for a card to check when interest will be applied. As with all credit cards, watch for fees such as annual account fees and late payment fees.
Awards cards	You receive **reward points** for each dollar you spend on your card. Afterwards, you can redeem your points for goods or airline flights. Awards cards work best if you use your card a lot and pay the balance off in full within the interest-free period, avoiding interest. Before getting one of these cards, check that you will use it enough to qualify for the rewards. There's no point buying things you don't need to earn rewards; you'll only spend more.	Awards cards tend to have higher interest rates and fees. You may be charged a fee to use the awards. The program may discourage you from shopping around for the best priced goods and services. If you carry over a significant balance on your card each month, you'll probably lose more in fees and charges than you gain in rewards. You may also have to **redeem** rewards points within a certain time.

	How it works	What to watch out for
Store cards	Some large stores or retail groups promote their own cards that operate like regular credit cards but usually charge much higher interest. **Watch out:** using store cards can be an expensive way to shop.	The interest rates for store cards may be much higher than for other credit cards. Before signing up for a store card, compare the interest rate with other forms of borrowing. The benefits may not be worth paying a higher interest rate. Be careful when you get a store card as part of an **interest-free deal** where you buy now and pay later (see our factsheet *Interest-free deals* at **moneysmart.gov.au**). New purchases on the card are unlikely to be interest-free. In fact, you may pay more in interest than you would using a regular credit card.

TIP Read the key facts sheet

When you apply for a credit card, you must be given a **key facts sheet**. If you don't receive one, ask your credit card issuer. The facts sheet contains important information you need to know before you sign up for a card:

- the minimum repayment (or how it will be calculated)
- the rate of interest that applies to purchases and cash advances
- the rate of interest that applies to balance transfers and how many months it will apply for
- the promotional interest rate (if any)
- the length of the interest-free period (if any)
- annual and late payment fees (if any).

Turn $3,000 on your credit card into a 19-year loan and double your debt!

Imagine you've run up $3,000 worth of debt on your credit card. It's a typical card: you must make minimum monthly repayments of 2.5% of the outstanding amount, or $10 (whichever is more). You've decided to stop using the card so you can pay off what you owe.

You are charged interest at 16% per annum from the date of purchase, unless you pay everything off each month. There are no fees on the account.

Your monthly interest is $40. So, if you pay the minimum repayment of 2.5% ($75) each month, only $35 is going to come off your debt. At this rate, it will take you over 19 years to pay off the debt.

During that time, you'll pay over $3,100 interest on top of the $3,000 you borrowed – that's over $6,100 in total.

On the other hand, if you pay $200 a month, you'll pay off the balance in around 18 months, and pay only $370 in interest – a saving of over $2,700!

> **TIP**
>
> **Remember: if an offer seems too good to be true, it probably is.**

Beware of credit offers

Credit limit increase invitations

- If you can't afford to pay off your balance in full each month, you're better off saying no to receiving invitations to increase your credit limit. A higher credit limit makes it possible for you to get into more debt – and you'd end up paying a lot more in interest too.
- As of 1 July 2012, a credit card issuer is not allowed to send you invitations to increase your credit without first getting your agreement. At any time, you can decide to say no to receiving credit limit increase invitations by contacting your credit provider. If you choose not to receive invitations, you will still be able to ask the credit card issuer for an increase at any time.
- If you do need an increase to make a purchase, try and pay the debt off quickly so you can reduce the limit back to a more manageable amount.

Honeymoon rates and other incentives

- Sometimes cards offer an introductory or **honeymoon interest rate**, typically for six months. Check how much the interest rate will rise at the end of the honeymoon period, and what fees and charges come with the offer.
- A card with higher fees might negate your honeymoon savings before long. The same principle can apply to offers of **no fees for 12 months**.
- **Cashback** credit card offers come with similar pitfalls. Cashback benefits are quickly outweighed by extra interest charges if the card offering the cashback has a higher than usual interest rate.

Balance transfers

- This is when you transfer outstanding balances from one credit card to another - often at a lower interest rate - for a certain time (for example, 4.9% for 6 months).
- You can get the full benefit of this by paying off the balance transfer amount within the balance transfer period. Just make sure you check the interest rate that will apply once the balance transfer period is over.
- Be aware that, if you use your new card to buy something, your purchase will attract the full interest rate of the new card (not the special balance transfer rate).
- It is a good idea to check how different credit card features may apply when you transfer your balance to a new card. For example, you may be unable to take advantage of any interest-free period on new purchases until the balance transfer amount is paid in full.
- When you make a payment on your new card, there are two ways it can be applied:
  - the credit card issuer will apply it to the balance with the highest interest rate (for example, purchases you have made at the standard interest rate or cash advances at the cash rate, whichever has the higher interest rate)
  - subject to the credit card issuer's aggreement, you may request that payments be applied in a different way (for example, that any payments made during the balance transfer period will be applied to the balance transfer amount, even if the interest rate for this is lower).
- When the balance transfer period is over, if you have not paid off the full balance transfer amount, the amount remaining will be charged interest at the standard interest rate or cash advance rate (which may be higher). Check the conditions to see what rate applies.

Six steps to smarter borrowing

Step 1. Work out if you can afford to borrow	▶ Before you get a credit card, use our **budget planner** at **moneysmart.gov.au** to help you see exactly where you spend your money and how much you can afford in repayments. ▶ Allow for interest rate rises and anything that might affect your future income (such as changing jobs). ▶ Our **credit card calculator** at **moneysmart.gov.au** will help you work out what you need to be paying in order to pay off your credit card debt within 12 months.
Step 2. Shop around for the best deal	▶ If you decide to get a credit card, take the time to compare interest rates, product features, and fees and charges. Even a small difference in the interest rate can make a big difference to what you have to pay. See *Choosing a credit card* on pages 2–3, to decide which features will suit you best. ▶ Shop around online to **compare products**. ▶ Research published by the independent consumer group CHOICE can also help you find the right product for your needs and budget – see **choice.com.au**.
Step 3. Know who and what you're dealing with	▶ Read the **key facts sheet** on your credit card, making sure you understand how interest rates and fees are charged, before you sign. ▶ Anyone who wants to engage in credit activities (including brokers) must be licensed with ASIC, or be an authorised representative of someone who is licensed. If they aren't, they are operating illegally. ▶ There is currently an exemption from licensing for credit assistance provided through some businesses (for example, retail stores and car yards). While the store may be exempt, the actual credit provider must still be licensed. If you are unsure who the credit provider is, ask the person you are dealing with to point out the name in your credit contract. ▶ To find out if a credit provider is licensed, visit **moneysmart.gov.au** or call ASIC's Infoline on 1300 300 630. ▶ Anyone engaging in credit activities (for example, by providing credit or assistance to you) must give you either a **credit guide** (with information such as their licence number, fees and details of your right to complain) or a written notice with details of your right to complain about their activities.
Step 4. Keep up with your repayments	▶ Make at least the **minimum repayment** on your credit card statement each month. ▶ Make **extra payments** where possible, to save on interest. ▶ If you have more than one card, pay extra to the card with the smallest balance so you can pay it off first and then use your money to pay other debts. If your debts are similar in size, then pay off the one with the highest interest rate first. ▶ Try to **pay off the entire amount** owing on your credit card each month (or as much as possible). ▶ Check for fees or charges if you're thinking of transferring your balance to another card.

Step 5.

Get help if you can't pay your debts

- **Act quickly** if you are having trouble making repayments. It may be difficult to face the problem, but ignoring it will only make things worse.
- If you can't make the full repayment, pay as much as you can. If you can't keep up with the minimum repayments, contact your credit provider without delay.
- If you are experiencing financial difficulties, you have the right to apply to the credit provider for a **hardship variation**. If the credit provider refuses, you can complain to its independent dispute resolution scheme for a variation on the grounds of hardship (see step 6 below).
- There are places you can go for help – visit **moneysmart.gov.au** for sample letters and information about support services such as financial counselling and legal assistance, call the National Debt Helpline on 1800 007 007 or call ASIC's Infoline on 1300 300 630.
- See our factsheet *Can't pay your debts?* at **moneysmart.gov.au**.

Step 6.

Complain if things go wrong

- Try to resolve your problem with your credit provider first.
- If you aren't satisfied, take your complaint to your provider's **independent dispute resolution scheme**, the Australian Financial Complaints Authority (AFCA). Go to **afca.org.au** or call 1800 931 678.
- If you think that a credit provider has acted unlawfully or in a misleading way, you can complain to ASIC online at **asic.gov.au** or call ASIC's Infoline on 1300 300 630.

ASIC's MONEYSMART Financial guidance you can trust

moneysmart.gov.au

ASIC Infoline: **1300 300 630**