Beware the Great Credit Card "Balance Transfer" Scam

The offers are legit—it's the high interest on new purchases where they fleece you.
by Suzanne Gerber

Two great things happened in the United States in 1959: We got Hawaii, and we got our first revolving-credit credit card.

Individual retail stores had been issuing credit, in the form of coins and metal plates, since the late 19th century, but the first actual cardwas issued by Diner's Club in 1950. Quaintly, it was made of cardboard, used mainly for travel and entertainment, and the balance had to be paid in full each month.

Smelling profit, American Express and Bank of America, with its BankAmericard (which morphed into Visa), quickly hopped aboard the bandwagon. But it took another decade for the concept of revolving credit to catch on. Even visionary American Express, which in the 19th century invented travelers checks and issued money orders and was the first company to introduce a plastic credit card (in 1959), didn't get into the "revolving" game until 1987.

In the 1960s and '70s, cards fell into two broad camps: "open loop" cards like Visa and Mastercard, which require interbank cooperation and funds transfers; and "closed loop"—American Express, Diner's Club and (since 1986) Discover— which don't. Countless international banks got involved, fees started to climb, and rules grew increasingly Byzantine. Credit cards may offer a tremendous convenience and a needed service, but if you think those card issuers are purely benevolent, there's a bridge here in Brooklyn I can sell you.

The "Low-Interest Transfer" Scam

This post isn't meant to be a history of credit cards. But the point is: For nearly as long as there have been credit cards, there have been questionable practices, including unregulated high interest rates, double-billing cycles (when you're charged interest for purchases made during your grace period) and universal default (i.e., your "locked-in" rate goes up to an astronomical default level because you missed a payment on another bill).

Over the past several years, the government has passed regulatory measures to protect consumers from predatory practices, but credit card companies always manage to find ways around them. The Federal Reserve claims that "credit card earnings have been consistently higher than returns on all commercial bank activities," and Visa's net income for fiscal 2013 was $5 billion. That's one card, in one year, and most of those earnings are derived from interest on cardholders' balances.

The latest target of the Washington, DC–based Consumer Financial Protection Bureau (CFPB) is deceptive interest-rate marketing promotions. You've probably seen these promotions in action in your own mailbox. A letter arrives with an enticingly low (or zero percent) interest rate for balance transfers from your presumably higher-interest card to theirs.

At first blush, the deal sounds great, and often what's stated is, in fact, true. But it's the other aspects of the deal that *aren't* revealed that's got the CFPB's knickers in a twist. See, that sweet low-interest rate applies only to the amount transferred. New purchases are typically charged at the full rate (often in the high-20s), with no grace period in which to pay. That's what spurred the CFPB to issue a warning to lenders last September against such deceptive practices. And while some card companies are big on transparency, others are not.

"Credit card offers that lure in consumers and then hit them with surprise charges are against the law," says CFPB Director Richard Cordray. "Before they sign up, consumers need to understand the true cost of these promotions… so that they can make informed choices about their credit card use." Without foreknowledge, these unexpected charges can make paying off the transferred balance more expensive than had it been kept on the original card.

From here a vicious, and costly, cycle begins. Only those cardholders who pay their total monthly balance receive an interest-free grace period. Should you carry your promotional credit card balance past the due date, you forfeit the grace period and are charged the default interest rate on *all* new purchases. The only way out of this mess is to pay off the entire statement balance—what was transferred over *and*the new purchases. And of course, if you could have afforded to pay off the balance, you wouldn't have transferred it in the first place.

Tips to Avoid the Burn

These might seem obvious, but even the savviest of us can get complacent—or fall victim to wishful thinking.

1. Read the small print. Find out the exact terms of your deal. If anything isn't clear, call the lender and ask direct questions concerning the points raised in this post. (I often come right out and ask, "What's the catch?") Then request that those facts be sent to you in writing.

2. Comparison shop. Don't grab the first tempting offer. Compare rates and terms to determine which will be better in the long run.

3. Avoid accruing too high a balance. We know: Easier said than done. But paying down debt is the best thing you can do for you credit rating and your savings/retirement fund. To avoid high-interest charges on new purchases, consider writing a check, paying with cash, charging to another credit card or—tough love—going without.

4. Don't "try"—*do* make payments on time to avoid surprise charges. And if you have a deferred-interest balance, make every effort to pay it off in full before the end of the promotional period.