

Does Your Credit Card Carry a Hidden Danger?

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"I've consolidated all our bills into one missed payment."

Submitted by Kerri Sullivan-Kreiss, CFP®

It seems that some credit card issuers get you coming and going. They charge you when you carry a balance, or when you do not carry a balance. They charge you an annual fee. They charge you for going over your limit or for paying late. When you do pay late, they penalize you in two ways- through a flat fee or with an increase in your annual percentage rate (APR).

Universal default clause

But, there's a third, less well-known way credit card issuers can penalize you – through the universal default clause. And the kicker is that this penalty may have nothing to do with the company that imposes it; it may be because of a late payment you have made on another credit card, a mortgage, or a gas bill. A universal default clause allows a creditor to reserve the right to increase your interest rate if you pay another creditor late. Creditors find out about these defaults

because they have the right to monitor your credit report whenever they want. Banks can do this monthly, quarterly, or annually (or not at all).

Why are creditors allowed to do this?

Creditors reason that your late payment to another creditor jeopardizes your payment to them; this makes you a bigger credit risk because you may have too much debt. If you pose more of a risk to them, they will increase your APR. The more late payments you have, the more likely a creditor will check on you.

What can you do?

It is estimated that one-third to almost one-half of credit cards carry a universal clause, depending on whose statistics you read. The good news is that there are steps you can take to lessen the chance that a universal default clause will be invoked against you:

- The most obvious step is not to carry a card with a universal default policy or not to open a new card account that has such a clause. To find out if the issuer has this policy, check the Other or Miscellaneous APRs section (or anything that discusses default pricing) of the updated agreement the credit card company sends you.
- A credit card agreement is a legally binding contract. If you can't understand the agreement's terms, it doesn't hurt to call the issuer directly and ask if it has this clause. Ask what circumstances would cause an increase in your APR.
- Know how much you owe to all of your creditors and know their late penalties.
- Pay more than the minimum balance each month. If you ever need to negotiate with your credit card lender to reverse a universal default rate increase, it might be in your favor to have a record of higher payments.
- Transfer balances from cards with universal default clauses to those that don't – or concentrate on paying these cards off first. (Please note: Canceling the card could have a negative effect on your credit score if it increases the percentage of debt to your available credit.)
- Pay bills on time or when they arrive, not just before they are due. If you use electronic payments, set them up so that they arrive a week before they're usually due, just to be safe.
- Get your credit report and credit or FICO score at least annually, and then from all of the principal credit bureaus. Each bureau has access to different information, and sometimes mistakes can be made on your report. Act quickly to dispute anything that looks erroneous. If a default clause gets triggered against you, it can be difficult and time-consuming to get it reversed.

• Financial set backs can happen any time. If you lose a job or are faced with catastrophic health bills that will affect your payments, be proactive and call your lenders to negotiate a lower payment as soon as possible. Credit card companies would rather receive something from you than nothing at all.

Help may be on the way

There is some good news. One or two of the national credit card issuers have ended their universal default practices – they have other ways of maximizing revenue from cardholders. In addition, Congress and some state legislatures are starting to look into the universal default clause and are considering legislation to prevent it. Still, until that happens, your best defenses are to avoid late payments and to stay aware of the penalties for them.

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