What Is a Balance-Transfer Credit Card?

Description

A balance-transfer credit card helps you move debt from one credit card to a card with a much lower interest rate. It can be an effective way to pay down debt, so long as you play the balance-transfer game right.

How do balance-transfer credit cards work, and how can you use one to your advantage? Let's break them down and see.

What is a balance-transfer credit card?

First off, a balance transfer is when you transfer debt from a high-interest card to a card with a much lower interest rate. A balance-transfer *credit card* is simply the card that receives the balance transfer. These cards typically have low APRs for a limited period of time (usually anywhere from a few months to a year), and they may charge a fee for the balance transfer itself.

How do balance-transfer cards work?

Once you get approved for a balance-transfer card, you'll typically have a limited number of days to initiate the balance transfer (often 60 days). You can transfer the balance directly online, or, if you prefer physical payment, you can get a convenience cheque delivered to your new card issuer.

Keep in mind that you can't transfer more than the credit limits on your new card. For instance, if you want to transfer $2,000, but your new card has a credit limit of $1,500, you'd have to leave $500 on your old card. Occasionally, a balance-transfer card will limit your transfer to a percentage of your new credit limits, like 50%, but, with the best balance-transfer cards, you can typically transfer up to your full credit limits. Note that while it's tough to say exactly what the average credit limit in Canada is, the Bank of Canada has estimated that 41% of Canadian cardholders have a limit of $10,000 or more.

To start the balance transfer, you'll often pay a balance-transfer fee, usually 1% to 3% of the amount you're trying to transfer. These fees can seem like a nuisance, but often they pale in comparison to the high APR charges on your old credit card. Though be sure to do the math to make sure that the amount you will save during the promotional APR period justifies the fee.

After your balance transfer has gone through, you can finally get to work paying down your debt. Of course, the promotional APR period doesn't last forever. So, the sooner you can pay down your debt, the less likely you'll have to pay interest charges later. If you're unable to pay all your credit card debt before the low APR period ends, your interest rate will skyrocket to a new rate, which could put you in the same position as before.

Can you make purchases with a balance-transfer card?

Yes, you can make purchases with a balance transfer card. It is, after all, a credit card. But making purchases with a balance-transfer card comes with one big caveat: the APR on new purchases will generally be pretty high.

The promotional APR applies only to the transferred balance. Any new purchases or cash advances will be subject to the card's standard APR, which — surprise — will be quite a bit higher than the promotional one.

In addition to this, it could take you a long time to pay off your new purchases. That's because any payments you make will apply to your old, transferred balance first, not the new ones. Until you pay back the transferred balance, new balances will stay on your account, potentially accumulating interest.

So, yes, you can buy things with your balance-transfer card. But should you? Unless you absolutely have to, you probably shouldn't.

If you need a credit card for new purchases, consider a rewards credit card or cash-back card. Leave the balance-transfer card for the transferred balance and leave new purchases for a card that can help you earn hefty bonuses and rewards.

Can you do multiple balance transfers?

Yes, you can. No rule says you have to keep a transferred balance on one card. If the promotional period ends and you haven't paid down your balance, you could transfer it to another balance-transfer card with a low promotional APR. As long as you intend to pay off the transferred balance before *that* card's promotional APR ends, you should be in good shape.

But be careful here. You'll still pay balance-transfer fees to move balances around. And if you're not working to pay down debt, multiple balance transfers can become a nasty habit.

For that reason, you should only take out a balance-transfer card if you have a strategy to pay down all (or most) of your credit card debt before the promotional APR period ends. An emergency expense may derail your repayment plan, which could make a second balance-transfer card a good safety net. But don't just take out multiple balance-transfer cards just "because." Do it with intention, and you'll get yourself out of debt.

Can you consolidate credit card debt?

Absolutely. In fact, a balance transfer can be a super-effective way to pay off multiple credit cards. Instead of paying high APRs across numerous cards, you can consolidate your debt into one card with a much lower interest rate.

Of course, this won't work for everyone. If you have multiple credit cards, each with a high credit-utilization ratio, you may find it difficult to secure a high enough credit limit, especially if your credit score is low.

But don't let that stop you. Even securing a credit limit that's just half your total credit card debt can help you tremendously. You can attack your debt on the balance-transfer card before your promotional APR period ends. Then, once you've paid it off, you can consolidate the remainder of your credit card debt onto one card, paying it off in turn.

How can you pick the right balance-transfer card?

Balance-transfer credit cards can feel like a godsend, especially when you're under mounds and mounds of credit card debt. But not all balance-transfer cards make great credit cards. Some have low promotional periods that make repayment difficult, if not impossible, while others have high fees. So, when you're shopping for the best balance-transfer card for you, here are some things to look out for.

1. Compare low-APR terms

Perhaps the most important thing to look for in a balance-transfer card is the promotional APR period. You want a card that keeps its APR low enough for you to pay off your balance. If you need six months to pay it off, look for a card that has *nine* months of promotional APR (just in case). If you need nine months, look for a card that has 10-12.

Likewise, look at the APR rate itself. The APR promo period may be long, but if the APR rate is higher than other cards, you could pay more in interest over the long haul.

2. Calculate the balance-transfer fees

Most balance-transfer cards charge you for the balance transfer. Since the fee is usually a percentage of the transfer, it can add up quickly. For instance, a 3% fee on a $10,000 transfer means you'll pay $300 to initiate a balance transfer. If you're transferring a large amount, consider a card with a lower balance-transfer fee.

Some cards don't charge balance-transfer fees, but be careful here. Often, what you don't pay in balance-transfer fees, you'll pay somewhere else, either in pesky "processing" fees or a higher APR. Do a full 360 review of a card's features before you conclude it's the best money saver for you.

3. Look at the credit limits

This one can be tricky. Often you won't know what your credit limits are until *after* your application is accepted.

But don't let that stop you from calling the credit card company and asking. Sometimes, you'll get through to someone who will disclose the credit limits ahead of time. Even if they don't, you can review card member agreements posted online to get an idea of how large the average credit limits are.

Is a balance-transfer card always worth it?

In the right situation, a balance transfer card can be just what the doctor ordered. A balance-transfer card helps you put more toward your debt than toward interest charges. The amount that you save on interest helps these cards carry their weight in gold.

But not every situation calls for a balance transfer.

For one, if you're nearly debt-free, you may not need a balance-transfer card. Often, you'd pay more in balance-transfer fees than you'll pay in interest charges. Of course, do the math to see which option is the least expensive for you. But, more likely than not, if you'll be debt-free in a few months or less, you're probably better off chipping away at your debt and skipping the balance transfer.

Secondly, a balance transfer isn't helpful if you don't pay a majority of your credit card debt before the promotional period ends. You may avoid paying interest for a short period of time, sure. But once the promo ends, you'll be back in the same place as before.

And of course, if debt issues have already affected your credit score, you may not qualify for a good balance transfer card. In these cases, you may need to work on improving your credit score to get the opportunity to use a balance transfer card.

Should you take out a balance-transfer card?

Do you have mounds of credit card debt? Are high APRs forcing you to dish out hundreds of dollars in interest? Are you sick of looking at your credit card statements and wondering when you'll be free from the mountain of debt? If so, a balance-transfer card may be right for you.

Before you take out a balance-transfer credit card, make sure you create a repayment plan. To take full advantage of the promotional APR period, you'll want to pay all (or most) of your credit card balance before it ends. That means you should calculate how much you can reasonably pay per month. Then match that with the promotional APR periods you see advertised to see if you can make it happen.

To get started, you can compare Canada's best balance-transfer cards to see which one is right for you. As long as you make a diligent effort to pay off your balance within the promotional APR period, you'll finally rid yourself of credit card debt.

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