Costs of breaking your financial commitments

When you sign a document to pay via cheque, get a loan or start a mutual fund SIP you agree to abide by terms and conditions failing which the other party is not obliged to stand by their commitment.

It is understandable; sometimes it can be unintentional. An unexpected job loss or illness can cripple one's ability to keep to their financial commitments and obligations. We've covered various penalties that you can encounter for missing on these and also what steps you can take to reduce chances of attracting them or actions to follow if you land in the unfortunate situation.

Minimum Average Balance in Savings Account

Certain minimum balance has to be maintained in savings account and current account. This varies across banks and with locality.

If you find yourself violating minimum average balance requirement of your savings account or current account often, it signals that you either have to get better control over your spending habits or choose a savings account with less stringent requirement.

Dishonoured cheques

Cheques are a liability and you are expected to maintain sufficient balance in your account for it to be encashed by the payee. If a cheque is returned to your bank for lack of enough funds you will be charged an outward return cheque penalty, which is about Rs 300 now.

One of the things you can do to avoid penalty due to returned cheque is to request payee to issue a post dated cheque or request payee to delay depositing the cheque by a specified time not exceeding 3 months. In the meantime you can arrange for funds.

Missed EMIs

Here again your bank would penalize you for dishonoured cheques or ECS mandate.

The lender would not seize your home or vehicle the next month but usually they send a notice if EMIs are missed consecutively for 3 months. If this is ignored and EMIs are not paid for 6 months then the bank would declare the loan as a Non Performing Asset (NPA). NPAs are a bank's nightmare. They can auction the attached asset in such a case.

Missing EMIs also mean that the loan tenure is extended so you might have to cough up additional interest. Talk to the lender and explain your situation at the moment you know you will be unable to stick to repayment. They would be willing to lax rules if they can see that your trouble is genuine and you have neat repayment track record. They might be willing to defer repayment or make changes in

the EMI structure to suit your situation.

Missed SIPs

your bank would penalize you for not maintaining sufficient funds for auto-debit mandate through ECS. Normally charges for insufficient balance in funds transfer are same as that in case of returned cheque.

To avoid this you can request you mutual fund to stop instalments for a time and start them again when you are in a comfortable financial position. You need to do this at least 15 days in advance of the next instalment date.

Lapsed insurance policy

An insurance policy lapses if regular premiums are not paid. Usually a grace period of 15 to 30 days after due date is provided where a notice is served to pay premium with some interest. If this notice is ignored, the policy lapses.

A lapsed life insurance policy means you lose life cover. In case of traditional policies and ULIPs that acquired paid-up value after 3 or 5 years, if policy lapses before that time the premiums you paid which goes for life cover and investment will be forfeited. The company pockets the money. Plus if tax rebates were claimed they will be forfeited unless 5 years have passed.

Don't ever let your vehicle insurance lapse because that could make driving your vehicle illegal! A lapsed policy can be revived by paying premiums along with interest. But if more than 6 months have lapsed then it might be considered a fresh contract and you might have to satisfy additional requirements.

To sum up

Apart from the direct costs of not keep with your financial commitments you could get hit indirectly as well. For instance missed premiums can ruin your credit score and screw your future loan or credit card approval chances.

So be on your guard. If you are unable to stick to commitments for genuine reasons talk to the concerned people and try to earn a compromise. Better still have a contingency fund in place which will take care of all your expenses- EMIs, SIPs included- for at least 3 to 6 months.

Source: Moneycontrol