

Can't pay your debts?



Factsheet

November 2011

Are your debts getting out of control? Maybe you're struggling to make ends meet because of unemployment, ill health, economic conditions or a relationship breakdown.

Perhaps this is the first time you've run into trouble with your family finances. You might not know what to do if you can't pay your bills or meet your repayments, or where to go for help.

Whatever your situation, it's important to act quickly. There is help available.



It's a juggling act for Steve and Nicky



Steve and Nicky have two children, aged two and five. Recently Steve's carpentry business has been slow and the family's income has dropped. For the first time in their lives, Steve and Nicky find themselves with no available cash and have to juggle credit cards to pay their bills. They've reached the limit on three out of their four credit cards and are using the fourth card to make minimum monthly repayments on the other cards, repayments on their home loan and to pay bills. Steve is confident that business will pick up. In the meantime, they're contacting their credit providers to ask if they can reduce repayments on their credit cards for a short time. They plan to try and keep up with home loan repayments because their mortgage is their most important loan.



TIP Avoid doing nothing

Talk with your credit provider

- ▶ If you can't keep up with repayments on a credit card or loan (including a home loan), talk with your credit provider as soon as possible and let them know you are experiencing **financial hardship** (see steps 3–6 on pages 4–5 overleaf).
- ▶ If you can't come to an agreement with your credit provider, ask them to review their decision if you think it's unfair. You can complain to an independent dispute resolution scheme if you're still not happy (see contact details for the Financial Ombudsman Service and the Credit Ombudsman Service Ltd on page 5).

Apply for a hardship variation

- ▶ If you want to repay your debts but can't, and you haven't been able to negotiate an arrangement with your credit provider, you have a legal right to seek a **hardship variation**. This is a formal process where you ask your credit provider to vary the terms of your loan contract.
- ▶ Without any change being made to your current interest rate, you can ask your provider to extend your loan period, so that you make smaller repayments over a longer period of time, OR postpone your repayments for an agreed period, OR extend your loan period AND postpone your repayments for an agreed period.
- ▶ After you apply for a hardship variation, the credit provider must respond to your request in writing within 21 days.
- ▶ If your credit provider refuses your hardship application, it must give reasons. If you think the reasons provided are unfair, **you can complain** to an independent dispute resolution scheme, such as the Financial Ombudsman Service or the Credit Ombudsman Service Ltd (see contact details on page 5).
- ▶ See sample hardship letters at www.moneysmart.gov.au.



Prioritise your debts

- ▶ Not all debts are created equal! Prioritise **secured debts** like your home and car loan over ongoing payments on unsecured debts like credit cards, so you don't risk making yourself and others more exposed.
- ▶ If all of your unsecured debt (for example, debts incurred on credit cards and store cards) is turned into a secured debt over the family home, then you've created some extra risk that your home could be on the line if things go wrong.
- ▶ If your home is owned with someone else, they will also be 100% liable for any new loan that's secured over the whole property. Similarly, if you have to ask someone to be a guarantor for your new loan, you'll be exposing them to financial risk.

Dealing with multiple credit card debts

While it makes sense to pay off the debt with the highest interest rate first, if you're having trouble managing several debts – for example, you're struggling to meet even minimum repayments on multiple credit cards – here are two payment options you could consider:

Option 1

- ▶ Continue making minimum payments on all cards, while aiming to clear the card with the **smallest debt** first.
- ▶ Then work your way up to the next smallest debt. This way you will reduce the risk of incurring multiple charges for late or missed payments, save on annual fees and be in a position to direct this money to clearing your other debts.
- ▶ You'll also be encouraged by having managed to clear a debt. This can be very motivating if you feel like your debts have become out of control.

Option 2

- ▶ Continue making minimum payments on all cards.
- ▶ Pay off the credit card with the **highest interest rate** first and then keep working your way through your cards. This may have the advantage of saving money you're paying in interest.

Whatever option you choose, **stop using all but one of your credit cards** (the one you want to end up with at the end). Try to use it only for emergencies.

As you clear each card, cut them up and close the account. This is important because, if you don't close the account, you may still have to pay fees on an account you don't use.

Lower the limit on the last remaining credit card to an amount that is manageable to repay within three months – say, \$2000.



TIP Don't borrow to pay bills

If you are having trouble paying a water, phone, gas or electricity bill, contact your water, phone or energy company. Most companies have hardship officers who can help you work out a plan to **pay the bill in instalments**. If the provider won't help you, you can complain to one of the ombudsman schemes.

- ▶ For phone bills, contact the Telecommunications Industry Ombudsman at www.tio.com.au or phone 1800 062 058.
- ▶ For energy and water bills, contact one of the ombudsman schemes in your state or territory:

ACT	www.acat.act.gov.au	02 6207 1740
NSW	www.ewon.com.au	1800 246 545
NT	www.ombudsman.nt.gov.au	1800 806 380
QLD	www.eoq.com.au	1800 662 837
SA	www.eiosa.com.au	1800 665 565
TAS	www.energyombudsman.tas.gov.au	1800 001 170
VIC	www.ewov.com.au	1800 500 509
WA	www.ombudsman.wa.gov.au/energy	1800 754 004



What about refinancing?

If you have a problem managing your repayments, it can sound like a good idea to roll all of your loans into one – for example, using a personal loan or home loan. **Consolidating** or **refinancing** your loans can work for some people if it means they will be paying less in fees and interest. For others, it may be only a short-term fix, especially if you can't meet the repayments on your new loan.

There will often be extra fees and charges to pay as well, and some people end up paying more interest on their new loan. Even if the interest rate is lower on the new loan, paying a short-term debt (like a credit card or personal loan) over a very long term (such as with a 25-year home loan) means you will still pay more in interest and fees in the long run.

Another thing to consider is that consolidation may allow you to borrow even more money. For example, if your existing credit card balances are transferred onto your home loan, as part of the debt consolidation, you might be tempted to put new debt onto your credit cards. Or, if you get a line of credit, your borrowing limit may be more than your current debts. If you use the consolidation loan simply to increase your overall level of debt, you'll probably make your financial problems even worse.



TIP

Get independent legal advice or see a financial counsellor before you make any refinancing decisions to make sure you'll be better off. (See step 5 on page 5.)

Beware predatory brokers and credit providers



Avoid brokers who make **unrealistic promises** about getting you out of debt or who use advertisements claiming they can help no matter how desperate your financial situation is. Anyone who asks you to sign blank documents, refuses to discuss repayments, rushes the transaction, or won't put all loan costs and the interest rate in writing before you sign up, is not to be trusted.

Equity is the proportion of your property that you own outright. If there is no mortgage outstanding on a property in your name, you own 100% of the equity. If you sold the property, all the sale proceeds would belong to you.

For example, if you owe \$100,000 on your mortgage and your home is worth \$200,000, you own 50% of the equity. If you sold the property, half the sale proceeds (\$100,000) would belong to you and half would go to repay your mortgage.

Equity stripping is when someone takes advantage of borrowers in difficulty and exploits their desire to save their home by:

- ▶ charging high fees, sometimes more than 20% of the equity in the home.
- ▶ arranging for a refinancing arrangement where it is extremely unlikely the borrower will be able to afford the new repayments.

Be realistic about whether you can afford repayments under a new refinancing arrangement if you are already under financial stress. You may need to consider making the tough decision to sell your home or downsize rather than tapping into your equity in an attempt to keep your home.

If you do refinance but can't afford the new repayments, you may end up being forced to sell anyway – and there will be less equity left to repay your debts and make a new start.





Six steps to smarter borrowing

Step 1.

Work out if you can afford to borrow

- ▶ Before you borrow money or consider refinancing, use our **budget planner** at www.moneysmart.gov.au to 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).

Step 2.

Shop around for the best deal

- ▶ Before you take out a new loan, take time to compare interest rates, product features and fees and charges and how these stack up against your existing loan. Even a small difference in the interest rate can make a big difference to what you have to pay.
- ▶ Shop around online to **compare products** or use our multi-loan calculator at www.moneysmart.gov.au.
- ▶ Research published by the independent consumer group CHOICE can also help you find the right product for your particular needs and budget – see www.choice.com.au.

Step 3.

Know who and what you're dealing with

- ▶ 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 www.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

- ▶ If you can't keep up with repayments on a credit card or loan (including a home loan), talk with your credit provider as soon as possible.
- ▶ Don't forget to tell your credit provider that you are in **financial hardship** and why.
- ▶ Many credit providers will try to help you if you can't make repayments because of illness, unemployment or other financial difficulties. It's important to contact them as soon as you can. They will assess your situation and work out with you what kind of help is available, depending upon how long you are likely to have difficulty making repayments.
- ▶ Remember to only make **repayment arrangements you can afford**. There is no point in agreeing to pay an amount if you don't have the money to do so.
- ▶ If you have come to a new agreement with your credit provider, make sure you stick to the new repayment arrangements. If you can't, keep paying as much as you can afford, even if it is not as much as the credit provider is asking for. Don't stop paying because that will only make it harder for you in the long term.



Step 5.

Get help if you can't pay your debts

- ▶ Get help from a **financial counsellor** or **community legal service** to discuss your options.
- ▶ Financial counselling is a free service offered by community organisations, community legal centres and some government agencies. A financial counsellor can help you get a clear picture of your situation, provide information about your options and work out a budget. Visit www.financialcounsellingaustralia.org.au to find a financial counsellor, or call the National Financial Counselling Hotline on 1800 007 007 during business hours.
- ▶ Free legal advice is also available from community legal centres and Legal Aid offices. They can help you with credit disputes and debt recovery through the courts. Find a community legal centre at www.nalcl.org.au, your state's Legal Aid office at www.nla.aust.net.au or look in the front section of your telephone directory.
- ▶ For confidential telephone counselling and emotional support, call Lifeline on 13 11 14 (available 24 hours a day).

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**. This will be either the Financial Ombudsman Service (FOS) at www.fos.org.au or the Credit Ombudsman Service Ltd (COSL) at www.cosl.com.au. Both schemes can be reached by calling 1300 780 808.
- ▶ If you think a credit provider has acted unlawfully or in a misleading way, you can complain to ASIC online at www.asic.gov.au or call ASIC's Infoline on 1300 300 630.



www.moneysmart.gov.au

ASIC Infoline: **1300 300 630**

Disclaimer

Please note that this is a summary giving you basic information about a particular topic. It does not cover the whole of the relevant law regarding that topic, and it is not a substitute for professional advice.

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