

Overdrafts



Factsheet

August 2011

Want to be able to access extra cash when your pay cheque doesn't quite last until the end of the fortnight, or at other times when money is tight?

You may be tempted to get an overdraft on your bank account.

But be careful – an overdraft is just another form of credit, attracting interest, fees and charges.



How do arranged overdrafts work?

- ▶ An **arranged overdraft** is a credit facility connected to a bank, building society or credit account, which you apply for or that may be given to you as part of the account. It is designed to cover short-term needs only, such as having money in your account to cover bank fees.
- ▶ You can arrange an overdraft on your personal bank account, your home loan account or business account.
- ▶ An overdraft allows you to overdraw up to an agreed amount of money – an **overdraft limit** – that is more than you actually have in your account.
- ▶ You will be charged interest on the amount of money you use from your overdraft, and you may have to pay fees and charges as well.
- ▶ Overdrafts are usually **repayable on demand**. That is, if the credit provider demands repayment, you must repay the entire amount requested immediately.



TIP What to check before you arrange an overdraft

- ▶ Decide whether you really need to arrange an overdraft facility, or whether there is a cheaper alternative.
- ▶ Find out if there is an **agreed time limit** on your overdraft. You may have to pay it back or renew it by a certain date.
- ▶ Check the **terms and conditions** of the overdraft, especially if it is repayable on demand.
- ▶ Think twice before you agree to an overdraft on your account to help someone else, such as a family member or friend – you could find yourself owing more money than you realise. You could even risk losing your home or other valuable assets. (See our factsheet *Love and loans* at moneysmart.gov.au.)



What are unarranged overdrafts?

- ▶ An accidental or **unarranged overdraft** occurs if you make a payment but there are insufficient funds in your bank account to cover it. Your bank or building society honours the payment anyway, which creates a debt.
- ▶ While the policy varies between financial institutions, most cheque or savings accounts allow unarranged overdrafts to take place. You will usually find that you have agreed to this when you accepted the terms and conditions upon opening the account.
- ▶ Some banks will honour your overdrawn payment without charging you an unarranged overdraft fee, particularly if you are a valued customer or if it is your first time. Others will charge you a hefty penalty fee or a penalty interest rate on the overdraft amount.



TIP Things to know about unarranged overdrafts

- ▶ Ask your bank about their policy on unarranged overdrafts, so that you are aware of the possible penalty fees and interest rates, should you exceed your available balance.
- ▶ **Penalty fees** for exceeding your available balance can be anywhere from \$10 to \$30.
- ▶ Some banks don't charge a penalty fee, but impose a **penalty interest rate** on the overdrawn amount.
- ▶ Keep in mind that the amount overdrawn plus the penalty fee is **repayable immediately**.



Six steps to smarter borrowing

Step 1.

Work out if you can afford to borrow

- ▶ Before you decide to get an overdraft, use our **budget planner** at 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).
- ▶ If the overdraft needs to be **repaid on demand**, how will you repay it?

Step 2.

Shop around for the best deal

- ▶ If you do decide to arrange an overdraft facility, take the time to compare interest rates, product features and fees and charges. 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.

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 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

- ▶ You need to make sufficient repayments to keep the overdraft debt below the **agreed limit**. Even though your overdraft may not have a set repayment schedule, you could be charged penalty fees if you don't pay the interest on time. And the sooner you pay off your balance, the less interest you'll have to pay.
- ▶ Don't forget to **cancel** the overdraft once you don't need it anymore and it has been repaid.

Step 5.

Get help if you can't pay your debts

- ▶ Act quickly if you are having trouble making repayments. It may be difficult to face the problem, but ignoring it will only make things worse.
- ▶ If you can't make the full repayment, pay what you can. Contact your credit provider without delay.
- ▶ If you are experiencing financial difficulties, you have the right to apply to the credit provider for a hardship variation. If the credit provider refuses, you can complain to its independent dispute resolution scheme for a variation on the grounds of hardship (see step 6 below).
- ▶ There are places you can go for help – visit moneysmart.gov.au for sample letters and information about support services such as financial counselling and legal assistance, call the National Debt Helpline on 1800 007 007 or call ASIC's Infoline on 1300 300 630.
- ▶ See our factsheet *Can't pay your debts?* at moneysmart.gov.au.



Six steps to smarter borrowing

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**, the Australian Financial Complaints Authority (AFCA). Go to afca.org.au or call 1800 931 678.
- ▶ If you think a credit provider has acted unlawfully or in a misleading way, you can complain to ASIC online at asic.gov.au or call ASIC's Infoline on 1300 300 630.



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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