

Personal loans



Factsheet

August 2011

Thinking about taking out a personal loan to pay for something special, such as a holiday or car?

Costs will vary depending on whether you take out a secured or unsecured loan, so work out which option is best for you before you go ahead.



TIP Check that you can make extra repayments

Check that a loan allows you to make extra payments as you go along without a penalty, because the more payments you can make, the quicker you can pay off the loan. Some loans are set up for a fixed term and require fixed repayments. If the interest rate is fixed, you may have to pay a fee or penalty if you make extra payments.

How do personal loans work?

- ▶ **Personal loans** are typically used for specific purchases, such as a holiday or car. You borrow an amount of money that you agree to repay within a certain period of time (called the **term**). This can vary, but is usually between 12 months and 5 years. You will have to sign a credit contract which will specify the amount borrowed and how you will repay it.
- ▶ You pay interest on the amount you borrow, which may be at a **fixed rate** (where the interest rate is locked in for the term) or **variable rate** (where interest may go up or down over the term), plus any fees and charges. While a fixed rate loan offers the benefit of set repayments, if you want to make extra payments from time to time, you will usually have to pay an additional fee – so think about what options are most important to you.
- ▶ A personal loan may be **secured** or **unsecured**, depending on whether you offer an asset such as your car as security for the loan. Secured loans can offer a lower interest rate, but run the risk that the credit provider may have the right to sell the security if you can't pay. You will need to consider carefully which type of loan best suits your needs.



TIP How to borrow wisely

- ▶ Organise your loan before you go shopping.
- ▶ As with any credit product, compare interest rates, fees and charges to get the best deal.
- ▶ If you want to borrow a **small amount** (less than \$5,000), you may have difficulty getting a personal loan from a bank or other mainstream credit provider:
 - ▶ Some credit providers offer small personal loans in return for comparatively high interest rates and fees. Search for 'payday loans' at moneysmart.gov.au for what to watch out for with these kinds of loans.
 - ▶ Consider using a **credit card**, which may be a better option than other loans available to you. See our factsheet *Credit cards and store cards* at moneysmart.gov.au.
- ▶ If you are on a low income, you may be eligible for a **no or low-interest loan**. See our factsheet *No or low-interest loans* at moneysmart.gov.au to find out more. You can also call our Infoline on 1300 300 360 and we'll send any of our factsheets to you for free.
- ▶ Try to pay your loan off quickly to reduce the interest you have to pay, subject to the conditions of your loan.
- ▶ Find out whether you will be charged any **default fees** and/or interest if you can't meet the loan repayments.
- ▶ Contact the credit provider early if you have trouble meeting loan repayments to discuss your options (see step 5 on page 5).
- ▶ Get help from a free financial counsellor or free legal service if you can't pay your debts. See our factsheet *Can't pay your debts?* at moneysmart.gov.au.

Choosing a personal loan

Secured loan

How it works

- ▶ You offer an asset, such as your car, as **security** or **collateral** for the loan.



What to watch out for

- ▶ If you don't make repayments, the credit provider can repossess and sell your asset to get its money back (without going to court).

Unsecured loan

How it works

- ▶ You do not need to offer an asset as security. Unsecured loans are usually harder to get, as you need to convince credit providers that your credit worthiness and financial position are good enough for them to give you a loan without you having an asset to sell if you can't pay your debt.



What to watch out for

- ▶ If you fail to repay the loan, the credit provider can still take you to court to sell your property and recover the money.
- ▶ Interest rates are usually higher than for secured loans, since the credit provider is taking a bigger risk.



TIP

Interest rates, fees and charges can stack up, so do your homework before you sign up for a loan.

Shopping around for the best deal

What is the term of the loan?

- ▶ A loan may seem more attractive than other forms of credit because it offers a lower interest rate, spread over a longer term. But it could end up costing you more by the end of the loan term. Remember, the longer the term, the more interest you will pay.
- ▶ When comparing loan options, make sure that the **term** of the loan is the same for each loan you are comparing (for example, compare a five-year loan with other five-year loans). That way you'll get a true picture of the difference in interest rates.

What is the annual percentage rate (APR)?

- ▶ The **annual percentage rate (APR)** is the percentage interest your bank or other credit provider charges you to borrow money – this is usually referred to as the **listed** or **published** rate. Once you know the published rate, you can compare personal loans offered by different credit providers.
- ▶ If you multiply the published rate by the term, you will get an idea of how much interest you will have to pay over the life of the loan (bearing in mind that fees and charges are in addition to this).
- ▶ Credit providers may also advertise **comparison rates**, which include the APR plus the main fees and charges, to make it easier to compare the total cost of different loans. So while one loan may have a lower published rate (APR), it may have a higher comparison rate because it carries higher fees – and so would cost you more overall.
- ▶ Banks, building societies and credit unions usually offer cheaper interest rates than finance companies.

What are the fees and charges?

- ▶ Check if you will be charged a **loan application fee** (may be as high as \$250), and whether there are any monthly **service fees** charged (may range up to \$10 per month).
- ▶ Most credit providers prefer you to make monthly payments by direct debit from your bank account so you don't miss any payments. Check whether your bank charges a late fee so you know what to expect if you do miss a payment. If you are paid on a regular date, set up the direct debit for the day after payday to minimise the chance of not having enough money in your account.
- ▶ Ask if there are **penalties** for paying off the loan in full before the end of the agreed term. You need to offset this against how much you'd save in interest by paying it out early.

What are the credit contract terms and conditions?

- ▶ Always check the **terms and conditions** of any loan contract before you go ahead.



Six steps to smarter borrowing

Step 1.

Work out if you can afford to borrow

- ▶ Before you borrow money or consider refinancing, use the **budget planner** at moneysmart.gov.au to see exactly where you spend your money and how much you can afford in repayments.
- ▶ Save up as much as you can, so you can borrow less and save on interest.
- ▶ Remember to 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

- ▶ If you decide to borrow, take 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**.
- ▶ Research published by the independent consumer group CHOICE can also help you find the right product for your needs and budget – see 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 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

- ▶ Keep your repayments up-to-date to avoid **penalty fees**.
- ▶ Make extra payments when you can, to save on interest (subject to the conditions of your loan).

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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