

Factsheet on Payday Lending

If you are short on money to pay bills, are payday loans a good idea?

You may have heard the terms 'fast cash,' 'short-term loan,' 'payday loan' advertised on TV to convince you that there is a perfect solution to getting money quickly. These terms relate to a high-cost short term loan that provides you with money to buy things like a fridge or pay for unexpected emergencies or bills.

The payday lender makes it very easy for you to access the money, however it can become an expensive option if you cannot pay the loan back.

How much money can you loan from payday lenders?

By law, you can borrow \$2,000 or less under a Short-Term Credit Contract and Small Amount Credit Contracts. If you need a larger loan, you can borrow between \$2,001 to \$5,000 under a Medium Amount Credit Contract.

Depending on what amount you are going to borrow, the term of the loan will be different. The term for a:

- Short-term credit contract is at least 15 days or less.
- Small amount credit contract is at least 16 days, but not longer than 1 year.
- Medium amount credit contract is at least 16 days but not longer than 2 years. If you are entering into a medium amount credit-contract security may be taken for the loan.

Are credit checks conducted?

If a payday lender advertises that they do not do credit checks this is a 'red flag'. If payday lenders do not do credit checks, they have other risk management strategies such as:

- Charging high interest so that if you do not repay your loan, the lender is covering their loss; and
- Aggressive enforcement strategies such as debt collection.

The law requires payday lenders to assess your financial position and make sure can afford to repay the loan without substantial hardship. Payday lenders can assess you by checking your evidence of income and bank statements.

What are the fees and interest rates?

Before you sign the payday loan, find out what the fees are and whether there will be any extra fees if you miss repayments or default. It is also important to check all the terms and conditions prior to signing.

Payday lenders can legally charge you the following fees and interests.

You will be charged an establishment fee of 20% of the loan. For example, if you have a loan for \$2,000, the establishment fee can be up to \$400. The total you will have to repay is \$2,400.

You will be charged a monthly fee of up to 4% interest per month. Although 4% interest may sound low, this is the equivalent of 48% of annual interest. This interest is higher than getting a personal loan from the bank or a credit card.

You may be charged high default fees if you miss a payment and fail to pay back the loan. The maximum fee the payday lender can charge you is twice the amount of the total of the loan.

The payday lender may require you to also pay enforcement costs if you fail to pay back the loan. Because of the high fees, people may end up paying the equivalent of 800-1200% of the base cost of their loan. Government fees or charges may also apply depending on your loan.

What are the potential risks with payday loans?

Payday loans are generally repaid via direct debit timed to debit a person's account when their income arrives. The repayments are often a significant portion of a person's income, leaving them with little left over to pay for essential expenses like food, bills and rent.

This means the person with the payday loan may be 'caught short' when a loan payment is due, and they have little choice but to take out an additional payday loan to make ends meet. The result: they are soon trapped in a debt spiral and are struggling to make loan repayments.

Key points:

- You may end up in a debt spiral if you are not able to make the loan repayments and pay the interest.
- You may apply for another payday loan to repay the previous payday loan.
- Your credit rating may be affected.
- Your payday repayment may be Direct Debited from your account before you have paid your other expenses such as rent, bills and groceries.

Are there alternative options to payday loans?

- You may be better off using a low-limit credit card. Credit card rates are between 12-20% per year and may have interest free periods if you repay the card payments every month.
- If you have bills that you cannot pay straight away, contact your provider and they can assist you with a payment plan, changing your billing to monthly to fortnightly or downgrading you to a more affordable plan.
- You can apply for a No Interest Loan Scheme to pay for essential household goods or personal services of up to \$1,500.
- Contact Centrelink to apply for a Centrelink Advance Payment to pay for large expenses or bills.

What to do if you are experiencing a debt problem?

If you have any issues, you can contact:

- National Debt Helpline** – they are a not-for-profit service that offers a professional financial counsellor for free and independent advice.
ph: 1800 007 007
- Australian Financial Complaints Authority**
ph: 1800 931 678
- ASIC Money Smart Guide**
website: www.moneysmart.gov.au