

The Sydney Morning Herald

ESSENTIAL GUIDE TO

DEBT RELIEF



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ESSENTIAL GUIDE TO *DEBT RELIEF*

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1 – DEBT: THE GOOD AND THE BAD



For most people, debt is a part of life. It often helps us buy things, such as a car or a house, that we can't afford in one big payment.

Debt can be a positive in our life and is not a problem if you know how much you owe and can pay it off.

But when you can no longer service your loans or meet the payments on your credit cards then your debt may be out of control.

This could be because of your poor spending habits or something that affected your income, such as an illness, loss of your job or a relationship breakdown.

First Step

Don't ignore the problem. Instead, sit down and take stock of your financial situation.

Get it down in writing

Add up your total debt – all loans and all amounts outstanding on your credit cards.

Don't forget to include store cards.

It can be hard to know where all your income goes, so for one week write down all your expenditure. You may be surprised or even shocked how much buying lunch and coffee adds up to in a week.

Next, work out how much you pay over a year on all your bills, such as electricity, mortgage payments or rent, rates and all insurance policies.

Add the totals together then match your costs with how often you are paid. So, if you are paid weekly divide the year's total by 52. If you are

paid monthly divide by 12 or, fortnightly, divide by 26.

This will put you back in touch with how much money you need each time you are paid to cover the expenses of your life.

Another way to establish your costs is to carefully go through all your credit-card and bank records and mark off all the spending and make your calculations from there.

Then you can compare your results with where you want your finances to be.

For most families, about 60 per cent of net income (after tax) should go towards living expenses such as housing, transport, food and utilities.

The next 10 per cent should go on things you enjoy, such as clothes, holidays, sport and entertainment.

To have a secure future you should then aim to put the next 10 per cent towards short-term saving, leaving the remaining 20 per cent for long-term saving or debt repayment.

After working out your finances, you may find that your living expenses and entertainment are taking all your income. This will leave you no spare cash to repay debt or to cover any loss of income. *This is a dangerous financial situation to be in.*

If you spend more than you earn, and continue to do so, you will fall even further into debt.

Following is a questionnaire to check if debt is a problem for you.

Do you spend more than you earn on a monthly or yearly basis?			
a) Never <input type="checkbox"/>	b) Sometimes <input type="checkbox"/>	c) Often <input type="checkbox"/>	d) Always <input type="checkbox"/>
How many credit cards do you have?			
a) 0 <input type="checkbox"/>	b) 1 <input type="checkbox"/>	c) 2 <input type="checkbox"/>	d) 3 or more <input type="checkbox"/>
Are your credit cards at the limit or over it?			
a) Never <input type="checkbox"/>	b) Sometimes <input type="checkbox"/>	c) Often <input type="checkbox"/>	d) Always <input type="checkbox"/>
How often do you pay only the minimum due each month or less?			
a) Hardly ever <input type="checkbox"/>	b) Sometimes <input type="checkbox"/>	c) Half or more <input type="checkbox"/>	d) Always <input type="checkbox"/>
Do you use one credit card to pay off another?			
a) Never <input type="checkbox"/>	b) Sometimes <input type="checkbox"/>	c) Often <input type="checkbox"/>	d) Always <input type="checkbox"/>

If you answered mainly a) then you have your finances under control.

If you answered mainly b) then your debt is manageable but you need to be careful not to increase it.

If you answered mainly c) then you are in a danger zone and should look for ways to manage or reduce your debt to a more manageable level.

If you answered mainly d) then you urgently need to deal with your debt. You may benefit from professional help to find a plan that will put you back in control.



2 – TAKING CONTROL

Once you have worked out where all your money is going and the total amount you owe on credit cards and other loans then you can begin to take action.

First steps

One of the first steps to regaining control of your debt is to talk to your creditors.

Talk to your bank and credit-card providers. If there has been an unforeseen change in your circumstances, explain what has happened.

The bottom line is that lenders want to see their money. They would prefer to work out a way for you to work off the debt than have to write it off.

You may be able to negotiate a longer timeframe for your loan or they may agree to suspend payments for a set period until you can get back on track and bring your finances under control.

In limited circumstances, it may also be possible to agree to pay a lower interest rate, which could make the monthly payments more manageable.

Pride

It can be embarrassing or humiliating admitting that things have got out of control. The causes of your debt may be personal and you may not want to talk about them. But ignoring the problem is not an option. Financial institutions have professionals who deal with debt problems every day. They are not there to judge you but rather to get the best return for their business.

Income

Once you have spoken with your creditors then ask yourself if you can increase your income.

- If full-time work is not an option, can you find part-time or casual work?
- Check with the Office of Family Assistance (phone 136 150 or see www.facs.gov.au) to ensure you are receiving all the payments to which you are entitled.
- Do you have adult children who could contribute more to the running of the household?

Spending

It is time to trim all the fat from your spending. There are many websites – such as at the Australian Securities and Investments Commission (www.fido.gov.au) – which have calculators and financial saving tips.

Here are some basic ideas to get you started:

- Do you need magazine subscriptions, gym memberships or pay TV?
- Are you getting the best deal for your mobile, internet and landline? Speak to your providers and ask if there are any deals or if there are discounts for bundling your services or signing up for a set period.
- Check with your health insurer and cancel any cover you don't need.
- When shopping, choose generic brands or shop at one of the discount supermarkets, and pay by cash to avoid a credit surcharge.
- Use lay-by rather than a credit card for that item “you just must have”. By doing this you avoid interest payments.
- Make fortnightly or even weekly payments on your credit cards or personal loans. This way



you make more payments over a year at more manageable amounts.

Banking

- Do you know how much your bank fees are? Institutions are becoming more open with this information and should be able to help you.
- If you don't already have one, consider opening an easy-access cash account that has a debit card attached, and stop using credit cards. Use cash whenever possible to help keep track of your spending.
- Try to only ever use your own bank's ATM to avoid charges and don't go over your free withdrawals limit.

- Use internet and phone banking where possible to keep fees to a minimum.

Tip

Don't make your budget too strict because, like a diet, if it is miserable then you will give up quickly. Make sure there is some money to spend on yourself.

Credit Cards

When you know the total amount you owe on your credit and store cards set up a plan to pay them off. The basic rule of thumb is to try and pay off the one charging the highest interest rate while still paying the minimum on any others. This is the most expensive money you have borrowed and so the faster you pay it off the better it will be.

3 – LOOKING FOR OUTSIDE HELP



Sometimes, the situation is so serious that simply cutting the grocery bill and making a saving won't have a real impact on your debt. There are many reasons why people find themselves with unmanageable debt.

It can happen to a business owner who sees their business collapse due to a change in the economy.

Or individuals can experience problems with large debts after investing in, say, the sharemarket or in property when prices are dropping.

Some people find themselves landed with debt run up by partners, and it can be a shock to discover they are liable. Still others who have ignored a growing problem over a number of years suddenly find themselves in a situation way beyond their control.

Or you may have a number of different debts

with several different financial institutions, and trying to deal with them all individually can be overwhelming.

You may find that some lenders are willing to negotiate more than others but it is often hard to know which ones. So rather than tackling it all on your own, one option is to seek professional help. It can be a big step but knowing when to ask for help is one of the ways of getting on top of your debt.

Here are some of the signs that you may need professional help:

- Repaying your debts, credit cards and loans, apart from your mortgage, is taking more than 20 per cent of your disposable income.
- You have used cash advances from cards to pay off other cards and have applied for new cards specifically for this purpose.

- You have been contacted by a debt-collecting agency by phone or letter about outstanding debt.
- You are unable to sleep and are worrying about your financial future.
- You are selling or pawning your belongings.
- You cannot meet your rent, mortgage payment or a utility bill.

If you are experiencing any of the above then you may need professional help. If you choose not to act then you may find that big decisions are made for you and you run the risk of being forced into bankruptcy (see chapter 7). This will have a major impact on your financial future.

A debt-relief professional can assist you in confidence, provide counsel and even negotiate with your creditors to try to find a solution that works for everyone.

A professional can help you explore all your options.

They will explain these options and their benefits and consequences and can help you when negotiating with or just talking to your creditors.

They could make the process of resolving your debt situation easier.

However, before you take any advice from a debt-relief professional there are questions you should ask yourself:

- Do I fully understand all the options that have been presented to me?
- Do I fully understand the option I have chosen?
- Will the solution be of real benefit to me or will it be a short-term fix?
- Have I achieved control over my debts?

- Have my payments been decreased and not increased?
- Have I been told – and do I understand – the consequences of the option I have chosen?
- Do I understand all the costs – and are there any hidden costs?
- Will I be better off as a result of the option I have chosen?

When creditors call

If you fall behind with payments on a loan or a bill you may be contacted by either the creditor (the company or person to whom you owe the money) or their lawyer or a debt collector or their lawyer.

There are laws that protect people from being harassed by a creditor.

A creditor or someone acting on their behalf cannot:

- Threaten you physically or threaten you with prison.
- Visit or call you at work.
- Threaten to tell employers or other family members.
- Take any property or threaten to take property – unless they have a mortgage or some form of security – without a court order.
- Visit or call more than a reasonable number of times per week (up to three times) or at a reasonable hour, e.g. not before 7am.

4 – FINDING THE RIGHT SOLUTION

A debt-relief professional can explore all the options available to you to help resolve serious debt problems.

Everyone's circumstances are different and what will work in one situation may not be appropriate for another. Your debt adviser can look at your entire circumstances and work with you to find the best solution.

One option is an *informal agreement*, which is negotiated with your creditors.

This is not binding on your creditors and is usually only a short-term solution. It also works best if you have only a handful of creditors.

There are also formal arrangements to solve your debt problems. These include a debt agreement, a personal insolvency agreement, a debt consolidation loan and mortgage refinance.

A debt agreement

A **debt agreement** is a legally binding agreement between you and your creditors, which must be accepted by the majority of your creditors. It is an alternative to bankruptcy (see chapter 7).

Under an agreement, you can offer to pay your creditors in instalments or with a lump sum and over a specified period of time. You can even propose a freeze on your debts to allow you to get back on your feet.

It is up to your creditors, however, to vote on whether to accept or reject your offer. If they accept it then it becomes legally binding on you and your creditors.

The benefit

There can be benefits to being in a debt agreement: your debt problem should come under control; you should know how much you have to pay your creditors and for how long; your creditors cannot take any action against you while the agreement is in place.

Are you eligible?

To be eligible to submit a debt agreement you must:

- Be insolvent, which means that you cannot pay your debts as and when they fall due.
- Not have been bankrupt or entered into a debt agreement during the past 10 years.
- Have an after-tax income (net) of less than \$60,196.50.
- Have unsecured debts of less than \$80,262.
- Have property (which would not be exempt from bankruptcy) worth less than \$80,262.



Case study

Here is a fictional example of how a debt agreement helps a couple recover from a job loss, which pushed them into debt.

Ian and Carol had been struggling to pay their personal loan and credit card-debt for more than a year. The required minimum monthly credit and store card payment was 3 per cent of the balance on each card, while the loan was a set monthly amount.

Ian was made redundant 18 months earlier with no payout. It took Ian five months to find a new job and during that time Carol was the sole earner.

Her income covered their basic living expenses but payments on their loan and credit cards were not made. They were threatened with legal action, including taking steps to garnish Carol's wages. Some creditors lodged defaults on their credit record.

Loan Account	Interest Rate	Balance	Monthly payments
NowCash Credit Card	17.50 %	\$6500	\$195
Bank of Cash Credit card	17.85%	\$8500	\$255
Personal Loan	12.50%	\$1800	\$210
ShopsRus Store Card	27%	\$1000	\$30
Total		\$17,800	\$690

Under a professionally prepared debt agreement proposal, agreed to by their creditors, Ian and Carol could see their monthly payments drop from \$690 to \$370. This would save them \$320 a month, plus about \$6693 in interest payments over the longer term.

The exact details of individual debt agreements will vary depending on personal circumstances and the creditors.

There are also consequences

When you submit a debt agreement proposal – and your creditors vote to accept your debt agreement proposal – this information is recorded on the National Personal Insolvency Index. This information is used by credit-

reporting agencies to help companies assess the credit risk of individuals. It will stay on your credit file for seven years. It is highly likely that you will be unable to obtain credit during this seven-year period.

For more on credit ratings, see chapter 5.

5 – PERSONAL INSOLVENCY AGREEMENT

A personal insolvency agreement (PIA) is typically used when you have a large amount of debt and a good income.

Like a debt agreement, once the proposal has been voted upon and agreed to then it becomes binding on all parties. Again, like a debt agreement, a PIA allows you to propose a compromise to your creditors and it is another way you may be able to take control of your financial situation.

The first step you must take is to appoint a controlling trustee. This trustee, who charges a fee for their services, must be registered with the Insolvency and Trustee Service Australia.

It is the trustee's job to:

- Take control of your property or properties.

- Determine future likely income and establish your current circumstances.
- Call a meeting and present all your creditors with the proposal for a personal insolvency agreement. This is when the proposal can be rejected or accepted or when amendments can be made.
- Make a recommendation to the creditors whether or not the proposed agreement should be accepted.

There is set information that a PIA must contain and it includes details of all the property that is being made available in order to pay creditors and in what order the creditors will be paid. It also outlines any circumstances that would end the PIA.

Here is a fictional example of how a personal insolvency agreement might work.

Mark has his own IT consultancy business and earns \$200,000 a year. Five years ago he went into a marketed investment scheme, which accelerated his tax deductions. A letter then arrived from the Australia Taxation Office telling him that all his deductions on this investment scheme had been disallowed. He now had to repay the tax and was facing penalties that totalled \$250,000.

Even though Mark had two investment properties, the drop in the housing market had left him with no equity, so selling them would have made no difference and may have left him with even more debt. He also has personal loans and credit-card debt totalling \$95,000.

The proposed ATO repayment schedule has left him unable to pay off his other personal debt. Despite several meetings with the ATO the matter is still unresolved and he is not sleeping, is worried about legal action and possible bankruptcy.

Mark was not able to submit a debt agreement because his income and debts were higher than the threshold.

However, after working with a debt-relief professional, he submitted a personal insolvency agreement through a trustee and this was accepted by his creditors.

Through the PIA, the unsecured credit payments were reduced to \$3000 a month for 36 months. He paid his creditors about 30 cents in the dollar and through this action he was able to avoid bankruptcy.

Consequences

- Your name and details of the controlling trustee will be published in a local and national newspaper.
- Details will be registered with the National Personal Insolvency Index credit reference agencies for up to seven years.
- You cannot be a director of a company without court permission.

Your Credit file

Baycorp Advantage is one of Australia's leading credit reporting agencies. Rather than giving a credit score or rating, it collates a person's credit history into one file. Individual companies then use the information in the file to make their own assessment of your credit-worthiness.

Banks, retailers and credit providers will also use the information in your credit file to establish whether they should give you credit. An overdue payment or default can be registered on your file for up to five years.

Details of debt agreements and personal insolvency agreements are also held in your credit file. To check your file and to make sure all the information is accurate, visit www.mycreditfile.com.au

This service is free if you are prepared to wait about 10 days. If you want the details within 24 hours it will cost \$27.



6 – DEBT CONSOLIDATION LOAN

If you have debts with high interest rates, a debt consolidation can be most helpful. It takes all your various loans, outstanding balances on credit cards and store cards, as well as any other unsecured debt that you may have, and puts them all into one loan with a single, manageable payment.

Credit cards and store cards usually have interest rates that are higher than most personal loans and so you could benefit from consolidation and spreading payments over a longer period at a set rate.

The terms of the loan can be extended for up to seven years and, depending on the size of your debt, you may see your monthly payments drop by as much as 50 per cent.

A debt consolidation loan may not work for everyone. With the right advice you will be able to find out if such a loan is the answer for your situation.

However, think before you apply for a personal loan. Ask yourself:

- Is it right for me; will I actually be better off?
- Do I have secure employment? To be eligible for a personal loan you will have to have secure employment. You will need this income to service your loan.
- Can I afford the instalments? Will I be able to make the repayments?
- Is the rate of interest, including all the fees and charges, lower than the overall cost of all my debts put together? If you end up paying more then you may be in deeper trouble than before you took out the loan.
- Will I see this loan as a way of solving my problems and not just as a temporary fix?
- Am I certain that the new loan does not have hidden charges and fees for paying off the loan early?

If you answer “yes” to all of these questions then a consolidation loan may be the solution for you.



Mortgage Refinancing

Everyone’s situation is different, however, the basic idea of mortgage refinance is to use the money or “equity” in your property to repay other high-interest debts.

When you refinance your mortgage you take out a brand new loan on your property. From this loan you pay the outstanding balance on your original mortgage, and you can also pay off any other debts.

Because your repayments are spread over a much longer period, the monthly payments could be much less.

It is important to check to see if there are any penalties or charges for paying off your existing loans.

Also beware: debt you accumulate on credit cards and store cards or through some personal loans is described as “unsecured debt” while the mortgage on a house is a “secured debt”. When you move your unsecured debt onto a secure debt then you run the risk of losing your house if your finances go seriously wrong again.

Tip

If you own the property jointly with someone else then they, too, could be liable for the new loan. You will need to discuss the plan

with them and make sure they understand and agree to the risks involved.

How to avoid repeating the past

If you take the big step of refinancing your mortgage or taking out a consolidation loan then it is crucial that you also take steps to stop building up debt again:

- At the same time as taking out a loan or refinancing, also cancel your credit cards.
- If you want the convenience of plastic use a debit card, which takes money out of your account only if you have money in the account.
- Request a copy of your credit report and make sure everything is up to date and correct.
- Buy nothing on credit no matter how good the deal looks. Zero per cent deals look good until you can’t pay them off fully, and then often very high interest rates apply.
- Don’t borrow money from friends or family. Just because you know your lender personally doesn’t stop it being debt.



7 – BANKRUPTCY

When you have creditors hounding you for money it can feel as though bankruptcy is a good way out. However, bankruptcy should not be seen as an easy option. It should be the last resort.

You should explore all other options first, such as those explained in the previous chapters. If these do not work then bankruptcy may be your best solution.

There are two ways to become bankrupt: either voluntarily or when your creditors force you into bankruptcy. A creditor cannot make you bankrupt for a debt that is less than \$2000 but there is no lower limit on voluntary bankruptcy.

When you choose voluntary bankruptcy

To file for bankruptcy you are required to complete a debtor's petition.

You must also complete a statement

of affairs. Then you must sign an acknowledgement that you have read and understood the *Prescribed Information* booklet. This booklet provides information about other options available. These documents must be submitted to the Insolvency and Trustee Service Australia (ITSA).

A trustee will be appointed to administer your estate. It is their job to carry out an investigation into the cause of your bankruptcy. They will look at your personal and financial situation and then make a report to your creditors. The trustee will identify all your assets and sell them to pay off the debt to the creditors.

Some assets are protected and they include:

- Ordinary, not luxury, household goods, e.g. furniture.

- Tools of trade up to the value of \$3250.
- Primary vehicle up to the value of \$6500.
- Superannuation.
- Any money from a personal injury claim.
- Centrelink payments are also protected.

If you want more detailed and accurate information about bankruptcy then call ITSA on 1300 364 785.

How long does it last?

Bankruptcy lasts for three years unless the trustee lodges an objection to you being discharged, and then it can be extended for another five years. Some debts survive bankruptcy. These include fines, child support and HECS fees. After your bankruptcy you become liable for any new debts, so it is important to make big changes to how you handle your financial affairs to avoid another build up of debt. Once the documents are completed and lodged with the ITSA you are made bankrupt the same day.

Restrictions

Once you file for bankruptcy or are forced into bankruptcy you face some legal restrictions:

- You are not allowed to be a director of a company.
- You may need written permission from your trustee to travel overseas.
- You will have difficulty obtaining credit or securing a loan. An undischarged bankrupt cannot use credit or borrow money or write a cheque for more than \$4623 without disclosing their bankruptcy.
- You may be required to make contributions from your income.

Moving on from bankruptcy

With rising prices and a worldwide economic downturn, the number of bankruptcies in Australia has risen.

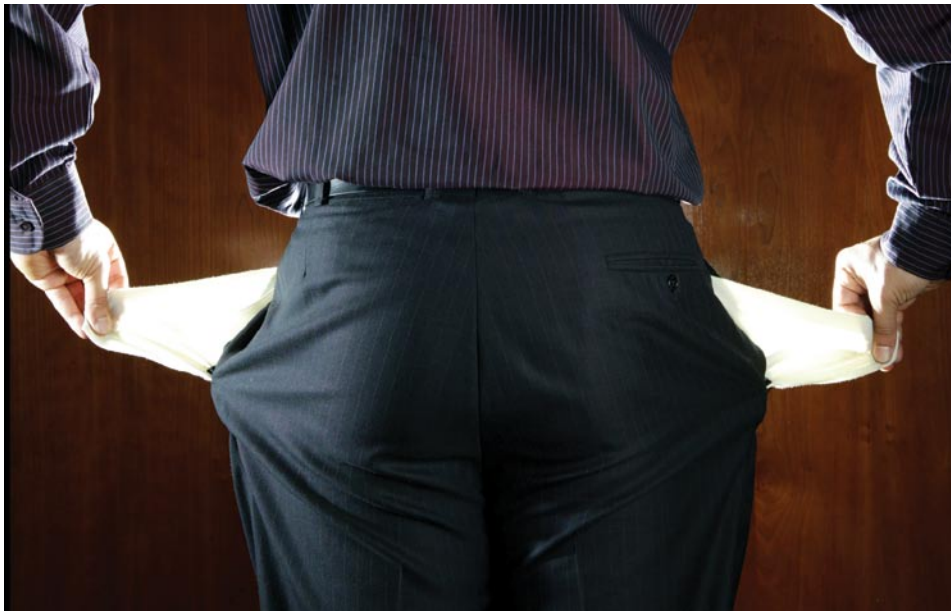
According to the ITSA, bankruptcies increased by more than 7 per cent in the 12 months to June 2008. It means that more people have run out of all other options.

While you may not have chosen to be a bankrupt, it could give you a fresh start. It is important, however, to learn from the experience and avoid falling into the same traps.

Cost of credit

One of the most serious issues people face after bankruptcy is that they are unable to obtain credit from mainstream financial institutions. If you are offered credit and you have disclosed you are an undischarged bankrupt then the rate of interest is likely to be prohibitive. It is important not only to look at the rate of interest but also at the fees involved.

Until you have established a good savings plan then it may be best to avoid credit altogether.



8 – CUT THE JARGON



Here is a short guide explaining some of the terms you may come across.

Annual percentage rate (APR)

The APR is the rate of interest that you undertake to repay on the money that you borrow. All credit providers are required to supply this figure to borrowers. However, it does not include any fees that may also be attached to a loan or credit card.

Budget

This is a record of the total of your income against the total of your expenses over a set period. A budget allows you to see if your spending is greater or less than your income.

Debt

A debt is money that you have borrowed. It can include loans and outstanding credit-card balances or it may be money that is owed to family or friends.

Disposable Income

This is the part of your total income that is available to spend once your tax has been paid.

Income

This is all the money that you receive. It includes the money you earn whether it is paid weekly, fortnightly or monthly. It also includes all interest that you receive from bank accounts, share dividends and any money that you are paid by tenants in an investment property or cash that any adult children pay for living in your home.

Personal loan

This describes a loan that is offered by a mainstream financial institution, such as a credit union, bank, building society or finance company. There is a set rate of interest and set period to make repayments.

Insolvency and Trustee Service Australia (ITSA)

This is the government agency responsible for the administration and regulation of the personal insolvency system in Australia. The ITSA also investigates possible offences under the Bankruptcy Act 1966 (Cth).

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