High Cost Financial Services

While there are many excellent financial products available that can help you achieve your goals, there are a few loans, lines of credit, and services to avoid because of their expensive fees and problematic terms. To help you make wise borrowing and financial service choices, this program will cover:

- Prime credit, subprime credit, and predatory lending
- Types of subprime credit products: payday loans, finance company loans, expensive credit cards, car-title loans, and pawn shop loans
- Types of fringe financial services: check-cashing services and rent-to own retailers
- Recovery methods
- Financial alternatives

Chapter 1: Prime Credit, Subprime Credit, and Predatory Lending

There is a wide spectrum of financial products, ranging from loans and lines of credit that have excellent terms to those that are much more costly. The type that you may qualify for depends on many factors, including your current finances and how you have treated credit products in the past.

If you are in the market for a low-rate loan or credit card, be aware that you need to have a long and proven history of borrowing and repaying money responsibly and, in many cases, a certain amount of income and assets in order to qualify. However, if you don't meet the standards for the very best products now, it doesn't mean you can't in the future.

Top tier credit is called prime, and anything under that is subprime. While a few subprime credit products can create rather than solve financial problems, not all are negative. For example, using a credit card that has a higher than average interest rate can help you build a great credit history so you can qualify for better products down the line.

Prime Credit
Prime credit products have the lowest interest rates, few and reasonably priced fees, and favorable repayment terms.

Every financial institution sets its own lending standards, though in general you can qualify for prime credit products by having an excellent credit rating, a stable income, and some assets. If you do, the financial institution takes little risk in lending you money because you have demonstrated that you've repaid what you've borrowed before, have enough income to pay what you borrow, and have property that they may be able to take if you fail to pay in the future.

Subprime Credit
Subprime financial products, on the other hand, have interest rates that are higher than the prime

products. They also tend to have more expensive and excessive fees, and less than favorable repayment terms.

If your income is low, or if you have few assets, already owe a lot of money, have an inconsistent payment history, or haven't yet established a positive credit rating, you probably will not qualify for prime credit. A lender will likely perceive you to be a high-risk borrower and offer you loans and lines of credit with a subprime rate.

It is possible to use subprime credit products to your advantage – all you have to do is pay the loan or credit line on time and in full. However, if you regularly spend more than you earn and then rely on expensive credit products to make ends meet, your financial problems will increase rather than decrease. Borrowing money when you are already in over your head can offer temporary relief, but in the long run it just leads to more debt that you'll soon have to deal with – especially if you are using costly subprime credit products.

Predatory Lending and Financial Services

Some financial services that cater to the subprime market are considered predatory. Predatory lenders deceptively convince borrowers to agree to unfair and abusive loan or credit terms. The interest rates and fees for the products they offer are unusually high – far greater than prime – and the terms make it difficult for the borrower to repay the debt. For secured predatory loans, if you are late on a payment, the lender may be able to claim the property that secures the loans quickly and aggressively.

While predatory lenders may target lower-income and minority borrowers and cash-strapped senior citizens, people from every ethnic group, age range, neighborhood, and income and education level are victims.

A federal law called The Truth in Lending Act ensures that all lenders disclose their loan or credit card terms in the application or contract. If you are seeking a loan or credit card, be sure to read the contract and understand the terms before signing the agreement.

If you believe that a lender unlawfully changed the terms, misled you, added products you didn't agree to, or coerced you into accepting a credit product that had worse terms than you are qualified for, contact the Federal Trade Commission and file a complaint: www.ftccomplaintassistant.gov or call 1-877-FTC-HELP (382-4357).

It is important to keep in mind that not all subprime loans and lines of credit are predatory in nature. If the interest rate is high and the terms are poor, it is probably because the lender is taking a risk in lending you money. Remember, prime credit is typically reserved for those whose financial circumstances are stable and who have established a long and positive credit history.

Chapter 2: Types Of Subprime Credit Products

Payday Loans

As long as you are employed and have a checking account, you aren't required to have a good credit history to take out a payday loan. All you need to do is write a personal check to the lender for the amount you wish to borrow and include their fee, which is typically 10-25% of the loan. The lender then gives you the cash and holds onto your check until your next payday. In most cases you have up to two weeks to repay the loan.

When the loan comes due, you have a choice. You can:

- Pay it off in full by allowing the lender to cash the check.
- Pay the fees and roll it over (refinance) for another term (may not be an option provided by all lenders).

The first choice is the best, since the one-time fee for the loan isn't too high relative to the cost of rolling it over. However, if you don't have the money to pay the loan in full, you may be forced to choose the second option. If you refinance, the lender will add another round of fees to the debt. The balance grows every two weeks, making repayment difficult. Because the fees are expensive and the repayment term is short, the translated interest rates for these loans tend to be very high. For instance, if you wrote a check for $115 to borrow $100 for two weeks, the APR (the interest rate expressed as a yearly rate) would be 390 percent.

Be aware that if you don't pay or refinance the loan, the lender has the right to cash your check. If you don't have enough funds in the account to cover the check, your financial institution will likely assess fees and penalties for insufficient funds. Collection action for these debts may be swift and severe.

> *Example: Due to an unexpected financial emergency, Janice needs $300 to pay her rent. To cover the shortfall, she decides to borrow that sum from a payday lender. Janice writes a post-dated check of $345: $300 for her landlord and $45 for the payday lender's fee. When her paycheck comes in, however, she discovers that it's not enough to repay the loan and meet her expenses. Therefore Janice extends the loan for another two weeks, and the payday lender adds another $45 to the balance. She now owes $390. Every 14 days the loan grows and each month becomes more of a hardship.*

High Interest Loans: Finance Companies
If you want to purchase a big-ticket item, such as a new mattress or washing machine, you may be able to take out a loan from a finance company to pay for it. There are a few factors to consider when using a finance company loan, however:

- Beware "zero percent interest" deals. If you do not pay the entire sum you borrowed within the specific time frame, all of the accumulated interest will be added to the balance. The interest rate percentage often starts in the mid-20s and can go much higher.

- The item you buy usually secures the loan – if you default (do not pay as agreed), the finance company can repossess the property.

You also may be able to get an unsecured personal loan (called a signature loan) from a finance company. A common reason to take out a signature loan is to consolidate existing consumer debt. The interest rate for some of these consolidation loans, however, can be higher than the rates for your original debt. In that case, repayment will be more expensive than it was before. Additionally, many finance companies allow you to borrow more than you currently owe. This gives you cash in your pocket, but only increases your debt.

Example: James has $15,000 in credit card debt. He decides to take out a $20,000 signature loan (using the extra $5,000 to go on vacation) from a finance company. With an APR of 28% and a monthly payment of $600, it will take James 5.5 years to pay off the loan and cost him more than $19,000 in interest payments.

Expensive Credit Cards
Almost anyone can get a credit card, but the best are reserved for those who have an established pattern of responsible borrowing. Sub-prime credit cards are marketed to people who:

- Are just starting out in the world of credit.
- Have poor credit due to past financial problems.
- Are not aware that they don't have to accept such poor terms.

Most credit card companies will penalize cardholders who pay late or exceed their credit limit with a fee, but there are other charges and terms to look out for. These include a/an:

- Application/set-up fee just to open the account.
- High annual fee.
- Fee if you request and obtain a higher credit limit.
- Monthly maintenance fee if you do not use the card that month.
- Short grace period. Some issuers give just 15 to 20 days to pay in full before they assess interest.
- Very high APR – if you have no or a poor credit history, a credit issuer may offer you a card with an interest rate of 30 percent or higher.

Car Title Loans
A car title loan is a secured product: your vehicle is collateral for the amount you borrow. The term is usually short – no longer than 30 days – and if you cannot repay it in this time frame, the lender has the right to repossess the car and sell it to recoup the money they lent.

Although you cannot have any liens on your car, you don't need good credit to receive a title loan. Just sign over your car title as collateral, hand in an extra set of keys, and you will receive your loan. Most lenders will let you borrow up to 50% of the car's value (minus any amount you owe on an existing car loan).

APRs for title loans can be deceiving because they are usually shown as monthly interest rates. It is not uncommon for a car title loan company to charge an interest rate of 25% per month, which on first glance may seem better than some credit cards. But keep in mind that this is a monthly rate. Multiply that figure by twelve to get an annual percentage rate and you will see that the 300% APR is far from moderate.

While written as a short-term loan, like payday loans, you generally have the option to roll it over if you can't afford to repay the debt in full when the loan comes due. In that case the lender will allow you to pay just the interest payment and let you extend the debt for another month. Even a few months of rolling it over can create an enormous balance.

Example: If the car title lender charges 25% monthly on a $1,000 loan, the interest would be $250. This means you owe $1,250. If you can't pay the entire loan, you may pay the $250 in interest for the first month, but will still owe $1,250 the next month because a new set of finance charges will be added to the balance.

Pawn Shop Loans
Many neighborhoods have pawn shops in them. You take a consumer good, such as an electronic device or jewelry, to the store, and are given a short-term loan (usually 30 days) in exchange for leaving the item there as collateral. If you pay back the loan, including interest, on time, you get the item back. Like with payday and car title loans, you may be able to renew the loan by paying the interest. However, if you fail to repay or renew the loan, your item can be sold. In addition to providing loans, some pawn shops will directly purchase your items.

The APRs for pawn shop loans are typically around 120-300 percent, much higher than the rate charged on credit cards. Many pawn shops also charge additional fees for insurance and storage. If you renew your loan a few times, it could cost you $3,000 to retrieve an $1,000 item. Nor are you likely to get a good deal if you sell your items to a pawn shop. Selling things you don't need to raise cash is not a bad idea, but you are better off placing an ad on-line or having a garage sale.

Chapter 3: Fringe Financial Services

Some financial businesses do not offer loans or lines of credit, but instead charge unusually high fees for services that you can get for free or at a much lower cost elsewhere.

Check-cashing Services
Millions of Americans do not use traditional financial institutions to cash their payroll, personal, and government checks. Instead, they use check-cashing services. The same companies that offer payday loans often provide check-cashing services. There are several reasons you may turn to check-cashing services, including:

- You haven't yet opened a checking account, or due to a history of bouncing checks, you have become ineligible for a checking account at a conventional financial institution.

- A check-cashing service seems convenient. Perhaps there isn't a financial institution in your immediate neighborhood or you need to cash the check during off-business hours.

- The people who work there speak your primary language, making you feel more comfortable and the atmosphere less intimidating.

To cash a check at one of these establishments, all you need to do is bring it in and pay the fee. The clerk will give you the cash, minus the fee.

Many check-cashing businesses charge two percent or more of the amount of the check to provide you with the money. Therefore, it could cost you $24 to cash a $1,200 check. The majority of these businesses post their fees in percentages, which can be hard to figure out on the spot. If you use a check-cashing service, be sure to ask for the fee in dollar amounts.

Although the fee may not sound overly expensive, it adds up if you are cashing several checks or use these businesses on a regular basis. If you can use a traditional financial institution where these services are free, paying extra for them doesn't make sense. Also, if you depend on check-cashing services, you may end up carrying a relatively large amount of cash with you, which can be a dangerous practice.

Rent-to-own Retailers
Need furniture, electronics, or appliances but you neither have cash nor good credit? Some retailers exist to help you get what you want with a rent-to-own arrangement. However, keep in mind that the long-term cost for these products can be very high, and may not be in your best interest.

Though the advertised payments are often low, the total cost to purchase an item may be two to three times more expensive than making the purchase through such traditional means as credit cards, store charge cards, layaway plans, and, of course, cash. Rent-to-own outlets routinely charge 200 to 300 percent interest on purchases.

Contracts for such plans are typically weekly or monthly, and can be renewed at the end of each rental period. After a specific number of payments, you own the goods outright. Some contracts require an additional (and often large) final payment.

Example: The cost to buy a $250 DVD player at a rent-to-own store would be much more than if you used a credit card with an average to high APR:

Rent-to-own Purchase	**Credit Card (Average-High APR)**
Amount Financed: $250	Amount Financed: $250
Weekly Payment: $57	Monthly Payment: $16
Number of Months: 18	Number of Months: 18
Finance Charge: $772	Total Interest Payments: $41
Annual Percentage Rate: 265%	Annual Percentage Rate: 19.8%
Total of Payments $1,022	**Total of Payments $292**

Besides the interest rate, rent-to-own companies may add on other fees, including:

- Processing fees
- Delivery fees
- Set-up/installation fees
- In-home collection fees
- Home pick-up fees
- Damage waiver fees
- Reinstatement fees (charged if you miss a payment but want to continue renting)

When used as a very short-term arrangement, obtaining merchandise from a rent-to-own company really isn't such a bad deal. However, if you are using it to eventually own the products, the ultimate payout can be huge.

Chapter 4: Recovery Methods

Now that you've identified which businesses do not work in your financial favor, the next step is to break free from high cost products and services.

Repay Expensive Balances
If you owe money to a lender that is charging high interest and fees, take immediate action to pay the balance. Unfortunately, many of these lenders do not reduce their interest rates to help you pay the debt faster and more efficiently. Therefore, treat these types of debts as a financial priority. Examine your budget carefully and adjust it so you can pay the balances down as quickly as possible. You may be able to add to your payment by:

- Increasing income. Consider working overtime hours, obtaining a second or part-time job, or turning a hobby into income.
- Eliminating or reducing all unnecessary expenses.
- Selling an asset.

If you have a high interest rate credit card, avoid wasting money and dragging the debt out by paying only the minimum. Use an accelerated payment method instead. The process is simple and efficient:

- Determine a realistic and fixed monthly payment that is greater than the minimum.
- Suspend credit use until you pay the balance in full.
- Pay more when you can – but never go under your pre-set amount.

Ask your creditor for a rate reduction when you have made several larger than average payments. You may also consider transferring high interest credit balances to a card with a low rate. Lowering the interest rate is often a great idea, but be aware that transfer fees can be about three percent of the transfer. Therefore, if you want to move $10,000 to a card with a lower interest rate, the transfer may cost $300. Before making a decision, check the transfer fees for your card, and then weigh the cost of shifting the debt against the interest rate savings.

After you've repaid your expensive loans and credit cards, commit to not relying on them in the future:

- Sign up for overdraft protection with your financial institution. Many people use expensive loans because they are worried about overdrawing their checking accounts.

- Make savings a priority. Save at least ten percent of your net income until you build three to six months' worth of essential expenses. Even a small nest egg can help you avoid borrowing money for an unexpected expense.

- Obtain the right insurance coverage. You can protect your savings and stem expensive borrowing by having enough medical, disability, liability, and other insurance coverage.

- Understand the root of the problem. Are you spending too much because your income is insufficient or because you splurge on items you can't afford? Develop a realistic budget so you always live within your means.

Create a Positive Credit History
With a long and positive history of borrowing and repaying money, you should be eligible for prime loans and lines of credit. Take action to build a desirable credit history:

- Review your credit report. Many reports contain errors that could make you ineligible for loans and lines of credit with a good interest rate.

- Commit to timely payments. Paying your obligations on time, every time is a sure way to build a good credit rating and is very important to lenders.

- Eliminate debt. Your balances should be less than half of your credit limit, and the lower, the better. Also, if you have accounts in collection agencies, you can make a fast improvement to your credit rating by paying them.

- Keep your older accounts active, have a mix of different types of accounts (loans, charge and credit cards), and don't excessively apply for credit.

Establish or Reestablish Accounts at a Traditional Financial Service Institution
If you have not yet had a checking account at a traditional financial institution, it is a great idea to open one now, as they typically provide the most cost-effective services.
If you are having trouble opening a checking account because you have a history of bounced checks or damaged credit, you can get back on track. Contact the financial institution where you owe the money and work out a payment arrangement. You may be required to take a class and/or pay a fee, but in the long run, reestablishing yourself in the world of traditional financial services is your best course of action.

Chapter 5: Financial Alternatives

In many cases you do not have to use subprime credit products or fringe financial services – you have options that are less expensive, both in the short and long run.

Subprime Credit Alternatives
While it is a common reaction to borrow more when financial troubles hit, it rarely makes sense. Do not fall for misleading and enticing marketing. In the end, it will just be another, more expensive debt to deal with.

Emergencies happen – and if you need cash fast but don't have savings to cover the shortfall, contact your financial institution immediately. They may provide you with an unsecured loan with relatively low finance fees. Other options may include:

- Turning to your existing creditors for a break. You may request a hardship plan where you make no or lower payments for a few months.

- Using a credit card to cover a shortfall. A cash advance is often more expensive than a credit card purchase, but still an option.

- Borrowing from a friend or family member.

- Taking inventory of your belongings and selling what you don't need or use.

- Getting an advance on your paycheck from your employer. Check with your human resources department for specific regulations.

- Borrowing from your retirement plan. As with an advance from your employer, check with your human resources department for specific regulations.

- Borrowing from a cash-value insurance policy.

If your credit is damaged, or you haven't established a credit history yet, consider a secured credit card. With this type of credit card, you deposit funds into a savings account at your financial institution, and they issue you a card where your credit line equals the amount you put down. These are often excellent alternatives to expensive unsecured credit cards. While there may be an annual fee, the interest rate is often reasonable.

After you have developed a positive credit history by borrowing and repaying responsibly, you will be eligible for prime loans and lines of credit, and there will be no reason to turn to expensive financing. The best place to turn to for loans and credit cards is a traditional financial institution. Their products will have the most favorable rates and terms.

Fringe Financial Services Alternatives
There is often no reason to pay extra for fringe financial services. Know your options.

Check-cashing Service Options
If you are worried you will not feel comfortable in a traditional financial institution, why not at least give it a try? Most financial institutions strive to provide excellent customer service and make their services accessible to the whole community. Don't be afraid to discuss any concerns you have with an employee.

If you had problems with bounced checks and your credit is damaged to the point where you can't immediately open a traditional checking account, you may have other options. Prepaid debit cards typically do not require a credit check, and while they do not allow you to deposit paper checks, you can have your paycheck directly deposited onto the card. You may have to pay a monthly and/or transaction fee, but it is generally less than the fees charged by check-cashing services. If you receive federal benefits, you can open an Electronic Transfer Account (ETA) at many financial institutions. Your benefits are electronically deposited, and you can withdraw money from the account at an ATM or, with some accounts, a debit card.

Rent-to-own Options
Before you sign a rent-to-own contract, consider other, less expensive, options:

- Use your credit card. When used as a short-term loan (under six months), the finance charges are relatively reasonable.

- Purchase the merchandise on an installment or layaway plan at another store.

- Apply for a loan at your financial institution.

- Put the rent-to-own payments in a piggy bank, wait a few months, and pay cash.

- Request that a set amount be transferred from your payroll or your checking account into a savings account. Buy what you need when you save enough.

- Seek better deals at garage sales, online auctions, second-hand stores, and the classified section of your newspaper.

Sometimes financing a large purchase just doesn’t make sense. Consider doing without. Do you really need a flat-panel television set or luxurious leather living room furniture? Some of the items you may want are desires, not needs. Buy according to your ability. If you really want the item, save for it. By doing so you won’t owe a store or lender, and you will never have to pay a penny in interest or finance fees.