Predatory Lending
"Don't Become a Victim"

Life Smarts:

1. Determine the federal laws that assist consumers from becoming victims of predatory lending.

What is predatory lending?

Predatory lending is the unfair, deceptive, and possibly fraudulent practice of some lenders during the loan process. A predatory lender entices a borrower into taking a loan with high fees and interest rates and strips you of your equity. Predatory lenders take advantage of consumers who have no credit, poor credit, and who might have temporary financial difficulties. They need cash and are desperate to make a purchase, causing financial hardship. Loans offered by predatory lenders are usually referred to as **Payday Loans**. According to a survey by The Pew Charitable Trust, 5.5% of adults nationwide have used this type of service. Most payday loan borrowers are white females 25 to 44 years old. The survey also found that 8% of renters earning between $40,000 and $100,000 have used payday loans. People from all demographics use these types of services as a way to cover an unexpected emergency, such as a car repair or medical expense, until the next check comes in. In simple terms, payday loans exist to help people who don't have enough money to get by until their next paycheck.

Predatory practices exist in almost every area of finance: mortgage lending, credit cards, student loans, and auto loans. Many working families struggle to manage debt while coping with mostly stagnant incomes. Many have had a substantial decrease in wealth. In recent years, foreclosures have wiped out nearly $2 trillion in family wealth. Automobile interest rates have cost consumers nearly $26 billion each year. Private student loans vs. safer federal loans have cost lower credit tier individuals up to 68% more.

Your best defense against this type of practice is to educate yourself about financial matters so as to stay out of debt, thus never having to succumb to lenders that will take advantage of you, your money, and your future.

1. Name three ways to prevent yourself from having to borrow money from a payday lender.

   Answers will vary: Develop an emergency saving fund; budget; if you can’t afford it – don’t buy it; don’t impulse -buy, determine if the purchase is a need or a want.

How does predatory lending work?

A person needs money, so he walks into a payday loan business and postdates a personal check for up to 14 days ahead of his next paycheck. The check amount is for the amount of money borrowed plus the fees charged by the lender making the loan. He receives the amount of the loan in cash or check. The payday loan business agrees not to deposit his check until an agreed-upon date.

> **Example:** You decide to take out a two-week payday loan for $200. You write a postdated check for $220 to cover the loan amount and associated fees charged by the business. The payday loan business gives you $200 in cash knowing that in two weeks, they can cash your check for $220. If we break down the $20 fee per day, it comes to $1.43 per day: **$20/14 days = $1.43**

Although this doesn't seem like much, what happens if you can't afford to pay the loan off in two weeks, because you used the money to pay other bills?

After two more weeks in fees, (a total of four weeks), you owe a total of $240:

$1.43 x 28 days = $40.04 + $200 in principal = $240

As each pay period comes and goes, you have trouble paying off the loan. You are living paycheck to paycheck and bills keep popping up that need to be paid. Eventually, an entire year goes by, and you still haven't paid off the loan balance. How much will you owe after one year?

$1.43 x 365 days = $521.95

Wow!!!! Let's break this down to an Annual Percentage Rate (APR) on the loan:

($521.95/$200) x 100 equals approximately 261%

Ouch! As you can see, the payday loan business profited more than twice what you owed them originally.

Most states regulate how much a payday lender can hold you accountable for over a long period of time. It can be extremely expensive for borrowers if they continue to roll over the loans for several pay periods.

1. Let's say you want to borrow $500 for two weeks from a payday lender that charges a $100 fee for the loan. It takes you a year before you are able to pay them back.
   Compute the APR below:

   Answer: $100/14 days = $7.14 per day; $7.14 x 365 days = $2,606.10; ($2,606.10/$500) x 100) = 521.22%

Background on pay day loans

The payday lending industry operates about 22,000 locations and makes loans at an estimated amount of $27 billion each year. There are more payday lender outlets than McDonald's. Their interest rates range from 300 to 500%. These loans result in about $3.5 billion in fees each year. The average payday lender customer will make five or more loans in a year.

A typical payday loan of $325 is flipped about eight times, which results in about $468 in interest. Therefore, to fully repay the loan, it takes $793. The borrower is in debt for about 212 days each year.

Payday lenders offer convenience for their customers. Although you may be able to apply for a loan through a payday lender online, most people go to stores in their neighborhood. These lenders don't request much information; the application usually consists of just your employment, banking (if possible – some payday loan users do not have banks), and contact information. They might request contact information for family and friends, too, in case you don't pay. Payday lenders rarely check your credit, which is another reason why some people rely on them. Payday loans also stay open in the evenings and on weekends. This makes it easy for customers to visit their sites rather than more reputable credit unions and banks.

Car-title loans

Car-title loans cost consumers about $3.6 billion in interest each year. These loans are similar to those of payday lenders, except their term is usually 30 days and secured by the title of a vehicle owned by the borrower. They share a triple-digit interest rate and many times have a **balloon** (large) **payment** at the end of the loan period.

About 7,730 car title lenders operate in 21 states and make about 1.7 million loans annually. Borrowers often renew loans about eight times and pay $2,142 in interest on a principal loan of $951. This is because the borrower usually receives a loan for one quarter of the car's value but pays 300% APR.

Mortgage loans

Some consumers with low or irregular income, poor credit reports, or limited financial knowledge may turn to “sub-prime” sources for mortgage loans.

Subprime mortgage brokers charge high fees and interest rates so they receive a higher commission than brokers affiliated with reputable financial organizations. Points (prepaid interest) can range from 8-10, meaning an individual will pay $8,000- $10,000 in prepaid interest on a loan for each $100,000 of principal.

These brokers and lenders also offer **bill consolidation loans** as home equity loans. Their target consumers convert short-term debt into 15 or more years of obligation. These loans share many of payday loans’ predatory features: triple-digit interest rate; a balloon payment at the end of the loan’s term; and — critically — failure by the lenders to evaluate borrowers’ ability to repay.

Tips for staying away from payday loans

Stay away from payday lenders. If you are in desperate need of a loan, go to a credit union or a bank. In response to consumers’ financial difficulties, credit unions have created short-term loans with low interest fees to help people avoid using payday lenders. Set up an emergency fund where a percentage of your wages or salary is deposited into the account every pay day. You’ll be amazed at how quickly that emergency fund grows. You probably won’t miss the money if you never see it. You will be pleasantly surprised when you need to dip into this account for an emergency without having to borrow money. Start now when you are young, and keep this great habit throughout your life.

Resources available when dealing with payday lenders

Federal laws protecting consumers specify the rights and responsibilities for finding appropriate credit and signing credit agreements and contracts. The Consumer Credit Protection Act is divided into four other acts: **(1)** the Equal Credit Opportunity Act **(2)** the Fair Credit Reporting Act **(3)** Fair Credit Billing Act **(4)** Truth in Lending Act.

Research each of the following acts and explain how they might keep consumers from becoming victims of payday lenders:

Equal Credit Opportunity Act –

Equal Credit Opportunity Act –Answers will vary: prohibits discrimination in credit transactions on the basis of certain personal characteristics, such as race, color, religion, national origin, sex, marital status, age, because you receive public assistance, or because you've exercised your rights under the Consumer Credit Protection Act.

Fair Credit Reporting Act –

Fair Credit Reporting Act – Answers will vary: requires that a credit card company promptly credits your payments and corrects mistakes on your bill without damage to your credit score. It also lets you dispute billing errors on your credit card and withhold payment for damaged goods.

Fair Credit Billing Act –

Fair Credit Billing Act – Answers will vary: protect consumers from unfair billing practices.

Truth in Lending Act –

Truth-in-Lending Act – Answers will vary: inform consumers of their credit by requiring disclosures about terms and cost and how they are calculated.