Are Your Clients Losing Sleep Over Money Problems?

Understanding High-Cost Financial Services Products *<u>and</u> Mainstream Banking Alternatives*

A Quick Reference Guide for Community Organizations and Practitioners – 2011 Edition

“Lower income families tend to pay higher than average prices for a wide array of basic household necessities…than higher income households…

For instance:
Check Cashing and Short-Term Loans
Car Prices and Car Loans
Furniture, Appliances and Electronics

“Public and private leaders need to promote consumer responsibility and empower lower income consumers with better market information.”

Source:

“From Poverty, Opportunity; ***Putting the Market to Work for Lower Income Families*****”**
The Brookings Institution, Metropolitan Policy Program, 2006
http://www.brookings.edu/~/media/Files/rc/reports/2006/07poverty_fellowes/ 20060718_PovOp.pdf

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The views expressed in this document are those of the authors and do not necessarily reflect the official positions of their organizations.

The content should not be construed as definitive guidance. Most of the information used in its preparation was obtained from publicly-available sources that are considered reliable. However, the use of this information does not constitute an endorsement of its accuracy by the authors or their respective organizations.

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Introduction

We have all experienced economic ups and downs. Our finances are a deeply personal matter. We do not often talk about what we earn, let alone the financial stress we may be under. And if we do decide to say something or seek help, too often that does not happen until the situation has reached or passed a crisis point. Because finances are so personal, the degree of one's financial stability (or instability) has far-reaching impact in every facet of life, from mental health to family relationships to workplace performance.

Financial stress can leave people vulnerable to exploitation. A lack of knowledge about financial products and services is a breeding ground for myths and misunderstandings about financial options.

Consider the following about Americans:

Only 16 percent feel satisfied with their current personal financial condition. [1]
More than half – 55 percent – are living paycheck to paycheck, spending all of their household income, or even more. [2]
1 in 4 workers - 30 million - experience financial distress as a result of living pay check to pay check. [3]
80 percent of financially distressed employees reported using work time to worry about and address financial issues. [4]
Research has found a connection between high levels of financial stress and high levels of absenteeism in the workplace.[5]
Nearly 25 percent use one or more non-bank credit products. [6]
12 million are caught in a cycle of 400 percent interest payday loan debt every year. [7]

Applied knowledge is power, and this Guide provides simple and useful information about:

- Dangerous (or dangerously used) financial products and services that can cause or exacerbate stressful financial situations at home or work and in the community, and
- Resources to contact for help

Readers are welcome to share this Guide with colleagues, partners, and others, as helpful and appropriate.

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[1] FINRA 2010 Survey
[2] ID.
3 *Financial Education in the Workplace: Motivations, Methods and Barriers;* New America Foundation (November 2008).
[4] *Id.*
[5] Jinhee Kim, Benoit Sorhaindo, and E. Thomas Garman, "Relationship between Financial Stress and Workplace Absenteeism of Credit Counseling Clients." *Journal of Family Economic Issues* (2006).
[6] Charlene Crowell, Center for Responsible Lending www.washingtoninformer.com
[7] Center for Responsible Lending

Statement of Purpose

The Boston Alliance for Economic Inclusion (BAEI) prepared this Guide for intermediaries such as social service agencies and others who regularly serve clients in their communities. The purpose is to enable practitioners to respond to clients who are experiencing financial distress, *in addition* to the issues being addressed by the organization's primary services, by helping to:

- Recognize some of the non-bank financial services providers whose high-cost or *predatory* products and services (see below) do not focus on building long-term financial stability for individuals and families, and
- Connect clients to appropriate resources for further information and assistance

This Guide is not intended to comprehensively describe these practices, products or services, or anticipate and answer all questions. It is a starting point to support broader financial stability efforts, providing background information on several of the most common financial products and services known to contribute to financial distress. Each topic is presented as a standalone piece, including a "For More Information" section to encourage people to seek better services or help.

As a basic principle, the BAEI believes that a consumer's best interest is most often served by establishing a relationship with a regulated and insured financial institution – a mainstream bank or credit union – and then maintaining that relationship appropriately.

The decision to do business with a particular financial service provider should not be taken lightly. Each person's self-interest matters and should be carefully considered to empower sound decision-making, including determinations about whether a particular provider is concerned about the individual's long-term interests. For example, high-cost or predatory providers who do not routinely report <u>favorable</u> payment activity to credit reporting agencies do little to expand consumer access to the financial mainstream and contribute to long-term financial stability.

When possible, this Guide provides realistic options and alternatives. Practitioners will certainly have clients for whom alternatives may not be available, at least in the short-term. In such cases, they can strongly encourage their clients to begin today to build a more secure financial future, by seeking financial education or legitimate debt counseling, learning practical budgeting techniques, the value of starting a savings plan, and using some of the many available resources, such as www.mymoney.gov.

The path to building greater self-sufficiency is not easy. Neither is continuing to rely on high-cost or predatory providers and their services indefinitely.

A Few Words About *Predatory Practices*

There is no single, universally-accepted definition of *predatory* financial products and services. It is commonly accepted that a particular loan product or transaction service may be considered predatory when it features <u>one or more</u> of the following elements:

- The loan approval is based on the debtor's assets, rather than ability to repay.
- The borrower is encouraged to refinance rather than pay off a loan so that the lender can charge additional fees.
- The lender engages in fraudulent or deceptive practices to conceal the true cost of the loan product from an unsuspecting or unsophisticated borrower.
- Excessive fees and/or interest rates are charged beyond those that would cover a lender's risk and profitable return.

- Fraudulent, high-pressure, and misleading marketing and sales efforts.
- Excessive fees or other costs relative to the product or service.
- Abusive collection practices, including aggressive repossession
- Aggressive solicitation of residents of low-income or minority neighborhoods, or other vulnerable populations

Sources:

FDIC Financial Institution Letter, FIL-6-2007, January 22, 2007

Testimony of FDIC Chairman Donna Tanoue, before the Committee on Banking and Financial Services, U.S. House of Representatives, May 24, 2000

A Note About this Guide's Resources:

Some content in this Guide reflects existing law and regulation. Such rules are subject to change and whenever necessary, readers are encouraged to contact the appropriate authorities for updated information.

The websites listed are intended to be representative of resources available to people wanting to learn more about particular issues. The Internet links listed are the English-language sites; some also provide content in Spanish and other languages, depending on the constituencies they serve.

Internet sites can be frequently updated and content as well as location of specific documents, appearance, etc., are subject to change.

Table of Contents

Matrix of Key Potential Problems and Solution Strategies

This table summarizes the content of the *Products and Services* discussed in Section One. Please note that any particular suggested *Alternative* may not be available to every consumer or be inherently low-cost in the short-term. But, as mentioned in the Statement of Purpose, above:

The path to building greater self-sufficiency is not easy. Neither is continuing to rely on high-cost or predatory providers.

Product/Service	Potential Problems	Options and Alternatives
Check Cashing	• High fees are common. • Less money to save or spend on necessities. • Receiving income in cash makes it difficult to save toward future goals.	• Direct deposit for immediately available funds at no fee. • Shop around for no-frills accounts with the lowest check cashing fees.
Payday Loans	• High fees with short repayment period. • Borrowers often cannot pay back in 2 weeks, so fees accumulate. • APR often exceeds 500%. • Positive payment performance rarely is reflected in credit history.	• Build savings to cover next short-term cash need. • Local bank or credit union may have a short-term credit product. • Borrow from friends or family • Community or charitable organization programs. • Credit card advance or overdraft line of credit.
Auto Title Loans	• High fees with short repayment period. • Fees often equal 25% of loan principal each month. • APRs over 300%. • Risk losing vehicle.	• Loan from friends or family. • Loans from local bank or credit union. • Charitable organizations. • Build savings for future needs.
Pawn Shops	• Pawn shop's value of the item can be far less than its actual worth. • If the loan is not repaid, the collateral becomes the property of the pawn shop.	• Secure a part time job for extra cash. • Pay advance from employer. • Loan from family or friends.
Rent-to-Own	• High prices and limited selection. • Many fees. • Missed payment means losing item and money already paid.	• Save first, then purchase. • Layaway plans. • Garage sales, second-hand stores, and classified ads.
Subprime Car Financing	• High fees and APRs. • Inflated vehicle sales price.	• Credit counseling to improve credit and access prime rate loans. • Carefully check a car's condition and market value before making a deal.
Subprime Credit Cards	• High APRs. • Excessive fees (up to 25% of credit line). • Lower credit limits. • No grace period.	• Secured credit card. • Improve credit score through financial education and counseling.
Tax Prep & Refund Anticipation Loans	• High fees. • High APRs.	• Volunteer Income Tax Assistance Sites provide professional tax filing services at no charge.

Matrix Continues on the Next page

Product/Service	Potential Problems	Options and Alternatives
Credit Repair/Relief/Counseling:		
Credit Counseling	• Some may over-promise or over-charge for services that do not truly assist the consumer.	• Self-help, using rights provided under federal or state law and the resources listed throughout Sections One and Two. • Seek help from a reputable credit counseling agency.
Debt Management Plans	• Need sufficient income to meet the payment required. • May include high fees.	• Self-help, using rights provided under federal or state law and the resources listed throughout Sections One and Two. • Negotiate directly with creditors. • Seek help from a reputable credit counseling agency.
Debt Consolidation	• Requires collateral (often home equity). • Converting unsecured debt to secured debt may put assets at risk. • High fees.	• Contact creditors directly. • Develop and stick to a spending plan. • Seek help from a reputable credit counseling agency.
Debt Settlement/ Negotiation	• Substantial fees for this service with no guaranteed results. • Deceptive claims (speed or scope of the so-called repairs).	• Negotiate directly with creditors. • Seek help from a reputable credit counseling agency.

CHECK CASHING

Check cashers can be individual store-front providers or interstate chains. They cash personal and payroll checks by charging a significant flat rate or a percentage of the face value for each check presented. Additional services such as bill paying, money orders, and wire transfers may be offered, ordinarily for additional fees.

Why Use a Check Casher?

Most consumers have the basic choice of paying bills through a checking account at a bank or credit union or doing business with a check cashing service. Check cashers offer convenience through the scope of basic services provided as well as hours of operation (sometimes 24 hours a day, and seven days a week). No deposit account relationship between the consumer and the provider is required and therefore, a consumer has no account management responsibilities. Check cashers may require less documentation and also seem friendlier and less intimidating than the stereotypical bank or credit union. The combination of these features may be perceived by some consumers as advantages that outweigh the high costs.

What is the Problem?

These providers frequently charge fees that are disproportionate to (1) the amount of work they perform, (2) the costs of the actual services provided, or (3) the extent of legitimate risk that should be compensated. FDIC research suggests that most checks are cashed with low risk, and losses to the check cashing operations are also low. (See *For More Information* on the next page for a link to this research.)

What is the Result?

According to a 2006 study by the Consumer Federation of America, the average cost of cashing a paycheck at a check cashing service was 2.34% (of its face value), but ranging to as much as 6%. To cash a *pay check* of $320, the average cost would be $7.49 each week, and a whopping $389.48 for the year. And the average cost of cashing *personal* checks is even higher -- 9.36% of face value.

By contrast, banks and credit unions frequently offer basic, no-frills checking accounts with little or no cost when managed correctly. The *Basic Banking for Massachusetts Program*, sponsored by the Massachusetts Community & Banking Council and offered at more than 100 financial institutions throughout the Bay State, has low-cost checking and/or savings accounts designed for consumers whose transaction needs are limited.

Check cashers charging high fees also impose an *opportunity cost* on consumers. The more money that is spent on basic financial services that could be obtained at lower cost elsewhere, the less money consumers have to spend or save. Checking accounts are also one of the best ways for consumers to establish and build long-term mainstream banking relationships that can lead to an increasingly broad array of more affordable deposit, credit, and investment products and services to meet the growing needs that often arise from growing financial stability and self-sufficiency.

What Are Some Alternatives?

In addition to the resources listed below, contacts for counseling and education are included in later sections of this Guide.

For More Information:

The **Massachusetts Division of Banks** licenses check cashers: www.mass.gov, search for "Check Cashers"

The **Massachusetts Community & Banking Council's** *Basic Banking for Massachusetts Program*: http://mcbc.info/basic_banking

Consumer Federation of America: www.consumerfed.org/pdfs/ckcasherspr.pdf; www.consumerfed.org/pdfs/CFA_2006_Check_Cashing_Study111506.pdf

The **Massachusetts Credit Union League**: http://www.maleague.org/

The **Massachusetts Bankers Association**: http://www.massbankers.org/

FDIC Quarterly Journal; "Alternative Financial Services: a Primer"; 2009, Vol. 3 #1: http://www.fdic.gov/bank/analytical/quarterly/2009_vol3_1/AltFinServicesprimer.html

PAYDAY LOANS

A payday loan (also called a paycheck- or payday- advance) is a small, short-term, high-cost loan that is payable on the borrower's next payday. These are typically made to consumers in financial distress who have checking accounts and verifiable employment. The consumer writes a post-dated check or debit authorization to cover the principal and interest due. Fees are ordinarily taken up-front from the loan proceeds.

Payday loans traditionally have been governed by individual state laws, which vary widely throughout the United States. State usury laws ban payday lenders from physically operating in Massachusetts, but this prohibition does not completely protect Bay State residents from payday lenders operating on the Internet.

<u>Why Use a Payday Lender?</u>

A payday loan is often a last resort for a borrower in financial distress and without another way to get cash quickly. At first, the cost may seem relatively small and easy to repay. That is only true if it is actually repaid within the short initial time frame. If the borrower's money problems continue, repayment is likely to be extended by rolling-over the loan for additional periods.

<u>What is the Problem?</u>

The nature of this form of credit is illustrated by a simple example adapted from the National Consumer Law Center: a consumer takes out a 14-day payday loan by giving the lender a post-dated check for $200 and is charged a 15% fee on the face amount. The consumer actually receives $170 in cash and the lender pockets the $30 up-front fee. This produces an Annual Percentage Rate of 458%, IF the loan is repaid in two weeks. However, if the borrower cannot repay, it is rolled over into a new payday loan, an additional fee of $30 is tacked on, the loan amount increases to $230, and the APR jumps to 917%.

<u>What is the Result?</u>

A consumer unable to repay within the initial loan term faces at least two potential problems: (1) getting trapped in an extended payment scenario where fees and interest pile up with each roll-over. The accumulating interest and fees can be substantial and, in too many cases, exceed the original amount borrowed. Or, (2) if the lender attempts to cash the check securing the loan when there are insufficient funds available, the consumer's check can bounce, incurring fees and adversely affecting how he or she may be listed by the various firms that report on how consumers manage their accounts. Poor performance can cause a financial institution to close a person's account and make it much more difficult to open one at another institution.

<u>What Are Some Alternatives?</u>

Be aware of the benefits of limiting the dollar amount borrowed and repaying it with the next paycheck, breaking the cycle of extensions. A realistic budget can control some spending and allow a paycheck to go further. Also:

1. Some banks and credit unions may offer short-term loans for small amounts at more competitive rates. Consider a licensed small loan company. A local community development organization or non-profit service provider may offer small dollar financing for emergencies. A cash advance on a credit card also may be possible, and while the interest rate will probably be fairly high, it will likely be lower than the cost of a payday loan.

2. If the economic distress is related to problems meeting existing credit

obligations, current creditors should be contacted as quickly as possible. Many may be willing to work with consumers who they believe are acting in good faith. They may offer a payment extension or other steps that will cost less than a payday loan.

3. A reputable credit counseling agency (see page 21) can help work out a debt repayment plan with creditors, as well as provide financial education including how to develop and stick to a budget. Employers, mainstream financial institutions, housing authorities, and other parties can help locate a reputable credit counseling service. Various community-based organizations offer financial education at no- or low-cost.

4. A committed effort to reduce spending may relieve some of the financial pressure. Consumers should identify and avoid unnecessary purchases (the cost of small, every-day items like a cup of coffee accumulate into surprisingly large sums). They should also try to build some savings; like expenses, small deposits can also add up and even a modest savings plan can help avoid high-cost emergency borrowing.

5. Talk with a bank or credit union about less costly alternatives, such as a savings account-linked line of credit or an affordable small-dollar loan.

Additional Guidance

The FDIC has issued guidance on Payday Lending Programs in Financial Institutions Letter 14-2005, which states, in part:

"…providing high-cost short term credit on a recurring basis to customers with long-term credit needs is not responsible lending." It further states that "Institutions should ensure that payday loans are not provided to customers who have had payday loans outstanding from any lender for a total of three months in the previous 12 month period."

For More information:

The **Massachusetts Division of Banks** licenses small loan companies: www.mass.gov, search for "Small Loan Companies"

Massachusetts Association of Community Development Associations: http://www.macdc.org/docs/membership_list.html

National Consumer Law Center: http://www.consumerlaw.org/issues/payday_loans/index.shtml

Consumer Federation of America: http://www.consumerfed.org/

FDIC, Financial Institutions Letter 14-2005: http://www.fdic.gov/news/news/financial/2005/fil1405a.html

PAWN SHOPS & RENT – TO - OWN

I. PAWN SHOPS

Pawn brokering dates back to ancient times, more than 3000 years ago. The pawnshop business of today uses a working model similar to what has been used throughout history: an individual takes an item of value (such as jewelry, electronics, or a musical instrument) into a pawnshop to serve as collateral for a short-term, high-cost loan. The pawn broker must hold the item for a specified period of time to give the borrower the opportunity to repay the loan and redeem the item.

Why Use a Pawn Shop?

Consumers who use pawn shops are often unaware of other options available to them, such as bank or credit union loans. In other cases, the consumer may have little access to credit or be delinquent on repayment, making it difficult to borrow from traditional lenders. There is also the perceived ease of the transaction, including less stringent identification and documentation requirements, which some consumers prefer and may accept in return for paying higher costs.

What is The Problem?

If the loan is not repaid, the collateral becomes the property of the pawn shop and any value in excess of the loan amount is lost. Appraised values used for pawn transactions result in consumers generally receiving only a fraction of the current retail price of their item.

What is the Result?

The pawn broker places a monetary value on the item (usually much less than the item's actual worth), determines an interest rate and term for repayment, and gives cash to the borrower while holding onto the collateral. If the borrower pays the loan according to the agreement, the item is redeemed. If the borrower defaults on the loan, the pawn broker reserves the right to keep the collateral and sell it to recover the unpaid balance. Interest rates at pawn shops are usually disclosed at moderate limits. However, since repayment periods are often short, Annual Percentage Rates tend to be very high, compared to credit at mainstream banks and credit unions.

II. RENT- TO - OWN

Rent-to-Own (RTO) establishments permit individuals to purchase items such as furniture and electronics by extending credit and collecting weekly or monthly payments. The consumer may choose only from the merchandise offered by the RTO, at the price the operator sets.

Why Use Rent-to-Own?

RTO stores may be attractive to borrowers who have limited or negative credit histories. RTO customers may perceive their transaction to be easy, and may not even be aware that other options exist with lower costs and/or more selection.

What is the Problem?

Buying merchandise from a RTO store is expensive, and too often consumers do not understand all of the fees they may be charged. Purchases through RTO programs may cost several times more than had the product been purchased new from a department or appliance store. If the difference between the total payments RTO contracts charge and the fair market value of the product purchased were expressed as an annual percentage rate, it would commonly range from 100% to 300% more. In addition to the recurring payments, there are additional costs associated with RTO transactions: fees for processing, delivery, set-up/installation, in-home collection, damage waivers, and reinstatement (charged if a payment is late or missed and the consumer wants to continue the transaction).

What is the Result?

An item is "rented" during the loan's term and if repaid according to the contract, the borrower owns the merchandise. The RTO concept is generally more expensive than a direct purchase. The price of a given RTO item may be higher than its cost at other retailers. The rent-to-own operation may inflate prices to increase the financing charges. If the borrower defaults on the payment, the RTO company can repossess the item, and money paid up to the time of repossession is not refunded.

What Are Some Alternatives?

Conventional installment loans or credit card purchases can represent less expensive financing for consumers who qualify and properly manage repayment.

Obtaining more affordable financing on their own also empowers consumers to shop around for the best deal on the product they want, at a competitive price, from any retailer they choose. Lay-away accounts may be viable options.

Purchasing the item *used* may allow the consumer to get a fully functional product while building savings to purchase the new product.

For some people, there may be no short-term alternatives. But these consumers do not have to be trapped into doing business with high-cost providers forever. They can start today to develop long-term strategies (budgeting, regular savings, etc.) to escape the trap of dependence on high cost financial services.

Please note that pawn brokers and rent-to-own stores ordinarily do not report positive repayment behavior to credit reporting agencies, so consumers do not help themselves to build good credit track records and long-term financial stability.

For More information:

Licenses for pawn brokers are mandated by state law but **issued at the municipal level** (mayor, city council, board of selectmen, city or town clerk, licensing board, chief of police, etc.).

Concerns or complaints about service providers not otherwise regulated by specific authorities should be directed to the **MA Attorney General's Consumer Protection Division**: http://www.mass.gov/. First select Attorney General from the *Government Links* section, and then click on the link for *Consumer Protection*.

SUBPRIME *USED* CAR FINANCING

Used cars are the overwhelming choice for low-income consumers because they usually represent the best value for their limited dollars. However, getting a reasonable car for a fair purchase price, with financing at a fair interest rate, requires patience and knowledge. Used cars are a big profit opportunity for sellers and financers. Profits can come at the expense of trusting consumers who may unknowingly be charged excessive fees based on high interest rates and inflated car prices.

What is the Problem?

Consumers in financial distress can be attracted by advertisements that seem to throw them a lifeline, such as the ones that shout "No Credit? Bad Credit? Bankruptcy? NO PROBLEM!" Dealers that offer the *convenience* of quick sales and *easy* financing seem to provide a simple way to get back on the road. The reality is not usually so innocuous.

Consumers should be wary of subprime auto finance companies that charge interest rates set at the state maximum (21% in MA). Depending on how interest is calculated and the fees are structured, the Annual Percentage Rate (APR) can be much higher than the statutory cap. An example is a loan with monthly "service fees" calculated by adding interest on the unpaid balance to the balance itself before posting any payments.

Care should be taken with used car dealers partnering with finance companies who markup interest rates, charge high markups on after-sale products such as insurance and warranty protection, or adjust vehicle prices to take advantage of large down payments.

Care should also be taken with so-called *Buy Here-Pay Here* (BHPH) businesses where the customer purchases, finances, and makes payments on a car all under the same roof. While they may be the only place for a person with poor credit and a limited income to get a car, care must be taken to get the best possible deal on both the car and the financing. BHPH sellers do not routinely report favorable repayment to credit reporting agencies, so consumers who repay faithfully may get no closer to reestablishing their credit standing.

Before buying, the value of the car should be checked against the value listed in any reputable car rating book. The condition of the car should be reflected in the price.

What is the Result?

Consumers can pay hundreds, and even thousands, of dollars more than they should because of hidden costs and inflated car prices. Some of these costs can be avoided with a basic understanding of consumer rights and options. The Federal Trade Commission requires dealers to post a *Buyers Guide* in every used car they offer. This disclosure document gives buyers crucial purchasing and warranty information, but only provides protection if consumers take the time to read it.

Even generally savvy borrowers can pay far more in interest than their credit score would suggest, if they lack an understanding of the used car sales field. Hidden markups may particularly affect African-Americans, Hispanics, and females more frequently than other buyers. For example, according to the Consumer Federation of America, African-Americans pay 2% higher interest rates than do other Americans to finance used cars, and the difference is 1.5% higher for Hispanic-Americans.

What Are Some Alternatives?

As with many predatory practices, the consumer's greatest weapons are information and options. A consumer should:

- Know how much he or she can afford each month for car payment, gas and maintenance and insurance. This will help the buyer understand the cost of owning and running the car, rather than just the cost of purchase and financing.
- Check out cars at no fewer than two dealerships.
- Get *pre-qualified* at a bank or credit union for an amount representing those expenses.
- Understand a car's actual value and overall condition before making a deal.
- Make sure a loan is obtained from a licensed lender.

For More information:

The MA Division of Banks licenses *Motor Vehicle Sales Finance Companies*: www.mass.gov/, search for "Motor Vehicle Finance"

Helpful tips on evaluating and buying a used car: www.waystowork.org .

A Federal Trade Commission *Consumer Alert* on how to buy a used car: http://www.ftc.gov/bcp/edu/pubs/consumer/alerts/alt035.shtm

An introduction to **"Buy Here Pay Here" Financing**: http://www.autotrader.com/research/article/car-finance-advice/26068/buy-here-pay-here-car-financing-basics.jsp

More Than Wheels is a non-profit focused on increasing mobility for lower-income wage earners by helping build personal money management skills and providing technical assistance for car buying and financing: www.morethanwheels.org

Budgeting techniques and other consumer finance information: www.mymoney.gov

Used Car values, pricing, and buying information are provided by a number of online services. Use any search engine to search for "automobile value estimator" or a similar phrase.

SUBPRIME CREDIT CARDS

Subprime credit cards are issued to customers with bad credit, or no credit history at all. Subprime credit is generally offered at comparatively high cost because subprime borrowers, by definition, present a higher level of repayment risk. Subprime cards are commonly issued with low credit limits, typically as little as $250 to $500.

These products were once referred to as *fee harvester cards* in the credit card industry because of the practice of collecting hefty up-front fees. Limits on these fees were among the protections for consumers, and restrictions for card issuers, implemented under the Credit Card Reform Act of 2009 (CARD Act). However, the law did not cap interest rates, which can be a significant cost factor for consumers who carry-over balances from month-to-month.

Why Use a Credit Card?

A credit card gives consumers considerable convenience and flexibility to make purchases, cover unanticipated or emergency expenses, conduct business via the Internet, etc. Renting a car, for example, almost always requires a credit card. A credit card, responsibly used and carefully managed, can also help a consumer build *good credit* when the card issuer shares that positive performance with credit reporting agencies.

What is the Problem?

The CARD Act has a number of beneficial provisions, including one that requires a card issuer to consider a consumer's ability to make the required minimum periodic payments before opening a new credit card account or increasing the credit limit on an existing account.

However, the CARD Act does not cap interest rates. High-rate cards can still be high-cost products for consumers carrying over a balance each month. This is illustrated by a December 2009 Associated Press (AP) story entitled “Subprime credit card firm’s 79.9% interest rate targets riskiest customers”. The AP focused on the redesigned subprime card to be offered by one of the nation’s 10 largest credit card issuer. This product was, in fact, launched under the rules that went into effect on February 22, 2010.

Under the previous credit card rules, this issuer had charged “a minimum of $256 in fees in the first year for a credit line of $250”, AP reported. The new law limited the card issuer to upfront fees of no more than 25% of the credit line. However, the permissible interest rate (Annual Percentage Rate) is not capped. The article illustrated the retooled subprime card, with a **79.9%** rate, to be marketed to pre-approved prospects:

Credit Limit: **$300**

First Year Fee: **$75** (25% of the credit limit)

Annual Percentage Rate: **79.9%**

Monthly Interest Payment (on a $300 balance at $79.9%): **$20**

What is the Result?

Consider the scenario AP reported (and the card issuer later defended). The consumer pays a $75 up-front fee (25% of the stated credit limit, and permitted under the CARD Act). That reduces available credit from the full $300 to $225. Even with that modest credit line, interest payments could run over $200 a year for a consumer carrying-over significant balances each month. For cash-strapped consumers already in financial distress, a subprime credit card with a less jaw-dropping APR than 79.9% could still represent a serious repayment challenge.

What Are Some Alternatives?

Debit Cards can offer similar convenience but will require some account management effort to keep track of available funds.

Secured Credit Cards are available at some banks and credit unions. These products require the deposit of a stated amount of money to serve as collateral to off-set the legitimate risk associated with a *subprime* consumer's credit history. Usually issued at terms reasonably similar to unsecured cards, they may give a person some purchasing power and the chance to build a positive credit history, at a cost that reflects actual repayment risk. An obstacle may be a consumer's ability to save the amount needed for the required initial deposit.

Financial Education and Counseling are sound strategies for consumers wanting to improve their credit standing, increase their mainstream options. Actively learning ways to improve personal money management skills will help control spending, increase saving, rehabilitate a poor credit history, and build a good track record for long-term financial stability.

For More information:

FDIC Consumer News, article on the Credit Card Act of 2009, *Summer 2009*:
http://www.fdic.gov/consumers/consumer/news/cnsum09/newlaw.html

Federal Reserve Bank of Boston, article on subprime credit cards in Communities & Banking, *Vol. 19, Number 4*:
http://www.bos.frb.org/commdev/c&b/2008/fall/Anderson_subprime_credit_cards.pdf

Federal Reserve Board, interactive online *Consumer Guide to Credit Cards*:
http://www.federalreserve.gov/creditcard/

Summary of the federal Credit Card Act of 2009:
http://www.federalreserve.gov/consumerinfo/bcreg20081218a1.pdf

Information on a wide-range of credit card products, by category of card types, personal credit quality, or by a specific card issuer:
www.creditcards.com and www.bankrate.com

INCOME TAX PREPARATION AND REFUND ANTICIPATION LOANS

A majority of U.S. taxpayers get help from someone else to prepare and file their federal income tax returns. Because tax laws are so complex and change frequently, many taxpayers do not feel comfortable preparing their own tax return and seek more experienced help. The Earned Income Tax Credit (EITC), currently the nation's largest anti-poverty program, is designed for low and moderate working families. Families may be eligible for more than $4,000 in EITC, making this credit alone fertile ground for over-priced or fraudulent tax return preparation and predatory lending practices.

A refund anticipation loan (RAL) is credit based on the anticipated tax refund. RALs are often promoted by for-fee tax prep services as a way to get money immediately. Particularly vulnerable are distressed consumers who cannot wait even a few extra days for their e-filed refund. The cost of the tax prep and the RAL fees and interest are often deducted from the refund amount, so the consumer may incorrectly perceive that there are no out of pocket costs, and walk away with less money in hand than they expected.

What is the Problem/Result?

Many paid preparers charge sizable fees and if they make mistakes, the taxpayer often ends up paying penalties and interest for those errors.

Almost any business can be in the tax preparation field. Some pawnbrokers, used car dealers, check cashers, rent-to-own companies and others attract taxpayers by making exaggerated promises and promoting the *convenience* of getting their refunds *instantly* (through a RAL).

Some make promises that can mislead, such as guaranteeing large refunds and/or base their fee on the amount of the refund; both practices are prohibited by the IRS.

RALs are extremely expensive loans. Annual Percentage Rates commonly range from 60% to over 700%. The Consumer Federation of America pointed out that: "RALs are one to two week loans made by banks and offered by tax preparers, secured by the taxpayer's refund. RALs can be expensive; this year, [a lender] is charging $61.22 for a RAL of $1,500, which translates into an APR of 149%. RALs target low-income taxpayers, especially recipients of the Earned Income Tax Credit, a special tax break for working poor families."

When taxpayers get a RAL, they are paying a high price to borrow their own money, just to get their refund a few days earlier, rather than waiting as little as a few days to get it for free from the IRS. Not only are RALs expensive, but because they are based on the estimated refund amount, they also can be risky. If the IRS denies or delays the refund, or if the refund is smaller than originally claimed on the tax return, the taxpayer must still pay back the entire loan – even if the money has already been spent. This in turn can lead to credit and collection problems.

What Are Some Alternatives?

- Use a **free** Volunteer Income Tax Site (VITA) or other community-based service staffed by IRS-trained and certified volunteers.
- E-file with direct deposit. Electronic tax filing speeds up the refund. The taxpayer tells the IRS to deposit the refund directly into their bank or credit union account and gets their refund in about ten days without paying one cent extra for a loan. With direct deposit, taxpayers can split their refund and put part of it in a savings account or savings bond to build a nest egg, and still have a portion to spend.

Products & Services; *PARTS OF THE PROBLEM*

- Delay gratification. Is it essential to receive a tax refund today? Taxpayers will save $200 or more just by waiting as little as a few days to no more than a couple of weeks.
- If there is an urgent bill, ask the creditor for more time until the IRS sends the refund. There may be no need to get a new and expensive loan to pay an old bill.
- Avoid check cashers who charge hefty fees to cash RAL and tax refund checks. Instead, use your bank or credit union savings or checking account.
- If you don't have an account, take the refund check to a local institution and apply to open one.

For More information:

The **Boston Earned Income Tax Coalition** provides connections with free tax prep sites in the City of Boston, as well as broader resources, including Credit and Homebuying, Affordable Healthcare, Food Stamps, and Financial Education: www.bostontaxhelp.org

IRS

Free Tax Prep Site Locators:

- Taxpayer Assistance Center sites – enter your zip code and find the nearest location: www.irs.gov/app/officeLocator/index.jsp, and
- State-to-County locator: www.irs.gov/individuals/article/0,,id=219171,00.html

Circular 230: www.irs.gov/pub/irs-utl/circular_230.pdf

AARP Tax Assistance site locator – enter your zip code and find the nearest location: http://www.aarp.org/applications/VMISLocator/searchTaxAideLocations.action

"EASY" CREDIT FIXES – CREDIT REPAIR/RELIEF/COUNSELING

Many people seek *debt relief* from a variety of providers. For the purpose of this Guide, we have included the most common types of services consumers may encounter. Seeking help in times of financial trouble is a responsible thing to do. Understanding the nature of some of these providers can help avoid costly mistakes and connect people with parties who can provide genuine assistance.

This is also a very confusing part of the service market. D*ebt Management, Settlement* and *Negotiation* are different approaches that often fall under the umbrella term *Credit Counseling*. Sound consumer decision making requires a clearer knowledge of the players.

I. Credit Counseling

These firms advise consumers on managing money and debts, help develop a budget, and offer free educational materials and workshops. Reputable counselors are trained and certified in consumer credit, debt management and budgeting. They confidentially analyze their client's entire financial situation and help develop a personalized plan to address the problems. They may help *manage* debt by taking one monthly payment from the client and distributing the money among several creditors with whom they've often worked out lower payments and lower interest.

Why Use Credit Counseling Agencies?
Reputable agencies provide financial education materials and classes and little at no cost.

Consumers use credit counselors for many reasons. They:

- Need to break the cycle of living paycheck to paycheck.
- Have trouble paying bills on time, and receiving overdue notices from creditors and debt collectors.
- Can't seem to create or stick with a workable budget.
- Can't seem to save any money.
- Constantly face financial crisis.

What is The Problem?
- Consumers may lack the knowledge or skill to identify a reputable credit counseling agency.

What is the Result?
- High fees and/or poor service.
- Limited range of services may leave serious needs unmet.
- Ineffective or inaccurate budget. counseling or financial education.

What Are Some Alternatives?
- Seek a reputable credit counseling agency. Services should be offered for free or at low cost and should include advice and education on managing money, debts and budgeting. Counselors should be certified and trained – ask for their credentials.
- Self help. Try to negotiate directly with creditors and use online resources.
- Additional alternatives are listed in the "For More Information" section, below.

II. Credit Repair

Credit Repair agencies offer to fix a consumer's credit standing, for a fee, by disputing inaccurate or incomplete information on the client's credit report. (Note: the Federal Fair Credit Reporting Act allows consumers to do this directly for free; no agent or intermediary is required to dispute something with a credit reporting agency.) However, a credit reporting agency has no obligation to change or remove information that is negative-but-accurate, and credit repair claims to the contrary are deceptive. Consumers can improve their credit report legitimately, but it takes time, a conscious effort, and sticking to a personal debt repayment plan.

Why Use Credit Repair Agencies?
Credit reports are widely used to make decisions about important things we apply to receive, like loans, insurance, housing and employment. People with damaged credit can feel desperate and may be taken advantage of as they look for help and hear promises about how fast and easy credit repair can be. They may believe that they must hire someone or lack the confidence and knowledge to help themselves.

What is the problem?
- Claims about speed and effectiveness can be grossly exaggerated. In fact, there is no quick fix to repairing negative credit – it takes time.
- The consumer can be charged high fees for a service they can do themselves. Accurate information will stay on a credit report for the allotted time frame and no provider can prevent that, regardless of their claims.
- Money paid to a dubious credit repair service might be better spent to reduce outstanding debt.
- Time lost to do-little credit repairer further delays taking constructive action to address and improve one's credit.

What are Some Alternatives?
- Use a reputable credit counseling agency for a credit report review and to learn about options.
- Obtain the basic knowledge to more confidently communicate with credit reporting agencies.

III. Debt Management Plans

A *debt repayment program*, commonly referred to as a Debt Management Plan (DMP), is designed to help consumers consolidate and pay-off unsecured debt. A DMP is one of the services offered by credit counseling agencies, and can be used to:

- Stabilize heavy debt load with growing outstanding balances. A DMP provider can negotiate reduced interest rates, re-aging of accounts, and fee waivers from creditors.
- Use monthly payments to simplify a complicated financial situation.

Successful completion of a sound DMP can take 2-5 years, so the consumer and the agency must be committed to staying the course.

What is the Problem?
- Consumers need to have enough money in their spending plan to meet the payment required.
- A DMP is not the best solution for everyone, but some practitioners may push it as a universal cure-all.
- Some agencies pressure consumers to sign up for a DMP they can't afford.
- A DMP typically requires a "set-up" fee as well as a monthly fee.
- Fees can range from modest to high.

What is the Result?
- Creditors are paid the full amount owed, but will often agree to some concessions – lower interest rates; waiving fees and/or re-aging accounts that are behind.
- Ineffective or deceptive DMPs take already limited funds from the debtor without any benefit; more time passes and the debt situation can worsen.

What Are Some Alternatives?
- Consumers can try to work with creditors directly to lower interest

rates, have fees waived, and/or have delinquent accounts re-aged

IV. Debt Consolidation

The provider rolls up one or more existing debts into a new loan product. The monthly loan payment is lowered by extending the length of the loan. Collateral, such as the debtor's home, is typically required to *secure* a debt consolidation loan. Consumers use debt consolidation to:

- Simplify payment of several loans by rolling them into a single one.
- Make payment more manageable by extending repayment over a longer period of time, which lowers the monthly cost.

What is the Problem?

- Debt consolidation loans typically require some sort of collateral, often replacing unsecured debt with secured debt.
- Failure to make the payments puts the collateral at risk which *could* lead to home foreclosure, vehicle repossession, etc.
- Costs of consolidation loans can add up.

What is the Result?

Effective debt consolidation can lower payments and help address current cash flows issues. However, consumers finding themselves with more money to spend could get deeper in debt if a realistic spending plan is not developed. The goal should be to lower the reliance on debt for the future since debt is expensive, and only gets more expensive the longer it is outstanding.

What Are Some Alternatives?

- Self help; contact creditors directly.
- Develop a spending plan to help reduce debt.
- Locate a reputable credit counseling agency to learn about options.

V. Debt Settlement/Negotiation

These firms promise that unsecured debt (usually credit card debt) can be paid off for just 10 to 50 percent of the balance owed. Debt negotiators commonly charge consumers substantial fees for their services, including an up-front fee to establish the account, a monthly service fee, and a final fee representing a percentage of the money supposedly saved.

Regardless of promotional claims, success cannot be guaranteed. Also, under current tax laws, the amount of debt that may actually be written off can be added to the debtor's taxable income.

For-profit debt relief companies who make telemarketing calls or are called by a consumer in response to debt relief advertising are prohibited from collecting fees for their services until:

- The company successfully negotiates, settles, reduces or otherwise changes the terms of at least one of the consumer's debts; and
- The consumer makes at least one payment to their creditor after the successful negotiation or settlement.

What is the Problem?

- Exaggerated or deceptive claims of effectiveness (too much cost for too little actual service).
- Substantial fees.
- Payments sent to creditors late, or not at all
- Late fees and interest may continue, causing debt levels to escalate.
- Consumers may continue to be contacted by creditors or debt collectors.

- The amount of "forgiven" debt can be added to the debtor's taxable income.

What is the Result?
Money problems take a financial and emotional toll on debtors and their families. People in distress are ripe targets for predators happy to make money from the misery of others. Poor service can further destroy the consumer's credit standing. It can be difficult to recover money paid for services not performed.

What Are Some Alternatives?
- Try to negotiate directly with creditors before enlisting outside help. This can be done for free.
- Contact a reputable credit counseling agency, which can provide guidance at little or no cost.
- Bankruptcy can be a legitimate option based on informed decision-making.

The resources listed in the *For More Information* box on the next page will connect you to reputable agencies and organizations responsible for addressing many of the problems this section of the Guide highlights.

<u>IV. Some Final Words of Advice for this Section</u>

- Require that any prospective provider give the real dollar savings, the extent of interest reduction, and the true financial benefit, before enrolling in any program.
- Consider the impact of all fees, including up-front or enrollment fees, monthly fees, and any other expenses the company may charge.
- Money that goes to fees will not be applied to the debts, and excessive fees can outweigh any *savings* that might otherwise be gained.
- Be sure that free financial education and learning resources are provided to help improve knowledge, money management skills, and make positive and lasting behavioral changes. Education should be provided even to consumers who decide not to enter into a formal debt management program.
- Avoid any provider whose claims are *too good to be true*. The Federal Trade Commission urges consumers to steer clear of companies that:
    - Guarantee they can remove unsecured debt;
    - Promise that unsecured debts can be paid off with pennies on the dollar;
    - Require substantial up-front and/or monthly service fees;
    - Demand payment of a percentage of money saved;
    - Tell consumers to stop making payments to or communicating with creditors;
    - Claim that creditors never sue consumers for non-payment of unsecured debt;
    - Promise that using their system will have no negative impact on one's credit report; and
    - Claim that they can remove negative-but-accurate information on one's credit report

For More information:

Massachusetts Attorney General's Office – search online for registration reports to determine if a particular provider is a registered non-profit: http://www.charities.ago.state.ma.us/

If a report does not appear in the database, one further check with the Attorney General's *Non-Profit Organizations/Public Charities Division*: charities@state.ma.us, or (617) 727-2200x2101, is recommended.

See also: Complaints & Mediation Services; and Local Consumer Programs

Federal Trade Commission –

*Credit Repair: How to Help Yourself***:**
http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre13.shtm , and

Fiscal Fitness: Choosing a Credit Counselor:
http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre26.shtm

Better Business Bureau - office locator: http://boston.bbb.org/find-a-bbb/

Federal Reserve - *Handbook to Credit Protection Laws:*
http://www.federalreserve.gov/pubs/consumerhdbk/

U.S. Department of Justice, Trustee Program; approved credit counselors: http://www.justice.gov/ust/eo/bapcpa/ccde/CC_Files/CC_Approved_Agencies_HTML/cc_massachusetts/cc_massachusetts.htm. (The U.S. Trustee Program is the component of the Department of Justice responsible for overseeing the administration of bankruptcy cases.)

U.S. Department of Housing and Urban Development; approved housing counselors:
http://portal.hud.gov/portal/page/portal/HUD/i_want_to/talk_to_a_housing_counselor

Association of Independent Consumer Credit Counseling Agencies:
www.aiccca.org or

National Foundation for Credit Counseling: www.nfcc.org

PERSONAL IDENTIFICATION

Reliance on alternative service providers may be based on the belief that mainstream banks and credit unions have overly stringent and inflexible personal identification requirements that many consumers cannot satisfy. Financial institutions have sometimes operated under similar beliefs.

The Boston Alliance for Economic Inclusion has addressed many of these misperceptions through the following Five Things you should know about… Customer Identification Programs. These *Five Things* are based significantly on the viewpoint of the federal regulators who enforce the applicable law and regulations.

1. What is a Customer Identification Program (CIP)?

The USA Patriot Act has several provisions "intended to facilitate the prevention, detection, and prosecution of international money laundering and the financing of terrorism."[1] A CIP prescribes "the minimum standards for financial institutions and their customers regarding the identity of the customer that shall apply in connection with the opening of an account at a financial institution." [2]

An institution's CIP should be "appropriate for its size and type of business"[3] and enable a bank or credit union to determine whether the depositor is who he or she claims to be ("form **a reasonable belief**" [4]) [emphasis added].

2. What are the general requirements for financial institutions?

The CIP Final Rule has six general requirements:

- An internal written program
- Four pieces of identifying information -- customer name, date of birth, address, and identification number
- Identity verification procedures
- Recordkeeping
- Comparison with government lists
- Customer notice

Although some elements of a bank or credit union's CIP are not public information, members of the public should feel free to discuss account-opening issues as they would any consumer banking product or service.

3. What kind of Identification Number is required?

For a "U.S. Person"[5] that means a tax identification number

For a "Non-U.S. Person"[6] it means **any** of the following:

- Tax ID number
- Passport number and country of issuance
- Alien ID card number
- Number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard

The CIP regulation gives each institution reasonable discretion to determine which specific forms of identification it will accept.

4. What are a "U.S. Person" and a "non-U.S. Person"?

- A U.S. Person is "a U.S. Citizen, or an entity established or organized under the laws of a State or the United States."
- A non-U.S. Person is "a person who did not satisfy either of these criteria."

5. What options are available if documentary verification is not possible?

Financial institutions *may* use one or more of the available options, including:

- Contacting the customer
- Comparing information received from the customer to information obtained from a consumer reporting agency, public data base, or other source
- Checking references with other financial institutions
- Obtaining a financial statement

Consumers should ask a bank or credit union if any of these, or other, identification alternatives are used.

All cited references are from the CIP Final Rule, published in the Federal Register, Vol. 68, No. 90; May 9, 2003

[1] & [2] Section I – Background; page 25090

[3] Section 103.121(b) (1); page 25109

[4] Section 103.121(b) (2); page 25109

[5] & [6] Section II -- Section-by-Section Analysis of Final Rule; 103.121 (a) (7), and (8); page 25095

For More information:

Federal Register, May 9, 2003:
http://www.fdic.gov/regulations/laws/federal/03joint326.html

Inter-Agency FAQ's relating to Customer Information Programs:
http://www.fdic.gov/news/news/financial/2005/fil3405a.html

FDIC Consumer News, CIP article, *Winter 2003/2004*:
http://www.fdic.gov/consumers/consumer/news/cnwin0304/proof.html

FINANCIAL EDUCATION

Predators succeed when they are able to keep consumers uninformed, unaware, and powerless. Knowledge empowers individuals to understand that they can make better choices, and arms them with the information to do so. Financial education is one path to giving people the knowledge and the confidence they need to make more informed decisions and resist too-good-to-be-true come-ons.

Consumers don't always recognize the need to be better educated until it is too late. While the benefits may seem obvious, there are lots of reasons why consumers don't eagerly invest time and effort to improve their knowledge. This is basic human nature, and familiar to anyone who has found it difficult to lose weight, exercise more, stop smoking, etc. This challenge can be overcome, but does need to be understood throughout the processes of education program design, outreach, execution, etc.

Financial education can come in many forms, including group classes, tutorials for individual study, and one-on-one counseling. Fundamental objectives should be clearly conceived (basic skills such as budgeting and bill paying, opening mainstream banking accounts rather than using high-cost service providers, homeownership preparation, etc.). Defining and measuring success should be realistic. A commitment to patient program refinement and growth will give organizations a sound basis to establish and sustain the effort.

For More information:

U.S. Financial Literacy and Education Commission; *Direct Links to 20 Federal Agencies and their Financial Education Resources:* www.MyMoney.gov

FDIC Money Smart; *Curriculums for Adults and Teenagers*: www.fdic.gov/consumers/consumer/MONEYSMART/

U.S. Treasury Office of Financial Education; *Financial Education Resources:* www.treas.gov/offices/domestic-finance/financial-institution/fin-education/council/OFE-CFAP-Resources.pdf

Jump$tart Coalition for Personal Financial Literacy; *Online Clearinghouse of curriculums and other materials:* www.jumpstart.org/search.cfm

United Way of Massachusetts Bay & Merrimack Valley; *Financial Education Community Toolkit:* www.financialedtoolkit.org/

The MA Financial Education Collaborative and the Midas Collaborative; *Financial Education Resources:* http://www.MassSaves.org

PARTNERSHIPS

Individual non-profits, financial institutions, public agencies, and others seldom have all the resources they need to address serious problems on their own. Even under the best of circumstances, problem-solving requires problem-*solvers* to join forces. By leveraging their individual resources, they can create a far-stronger action plan greater than the sum of their individual parts.

Partnerships can be built from a combination of individual and mutual self-interest. Both types of benefits should be actively explored so that each party understands exactly why combining forces will serve their organizational purposes as well as the needs of their own clients and the community at-large.

Specific sectors may have incentives intended to promote the creation of such synergies. For example, banks, state-chartered credit unions, and certain mortgage lenders in Massachusetts are subject to the Community Reinvestment Act (CRA). Using the Federal Deposit Insurance Corporation's *Money Smart* financial education program as a case in point:

The FDIC encourages banks to work with others in their communities to deliver financial education and appropriate financial services to individuals who may be unfamiliar with the benefits of having a relationship with an insured depository institution.

The Money Smart program can help banks fulfill part of their Community Reinvestment Act obligations. The Community Reinvestment Act of 1977 (CRA) encourages federally insured banks and thrifts to help meet the credit needs of their entire community, including areas of low-and moderate-income. When a bank's CRA performance is reviewed, the institution's efforts to provide financial education and other retail services are a positive consideration.

(Source: www.fdic.gov/consumers/consumer/moneysmart/overview.html)

For More information:

Public-Private Partnerships for the Financial Services Sector; FDIC F*inancial Institutions Letter* 82-2008 (August 21, 2008) describes the benefits of establishing public-private partnerships: www.fdic.gov/news/news/financial/2008/fil08082.html.

Office of Thrift Supervision version: http://files.ots.treas.gov/481131.pdf

Faith-Based Community Economic Development: Principles & Practices; *a 68 page paper from the Federal Reserve Bank of Boston detailing practices that can be adapted to any community-based setting:* www.bos.frb.org/commdev/faith/ced.pdf.

GLOSSARY of Common Personal Finance Terms

APR (annual percentage rate) – The percentage cost of credit on an annual basis and the total cost of credit to the consumer. APR combines the interest paid over the life of the loan and all fees that are paid up front.

ATM (automated teller machine) card – A form of debit card that you use in an ATM by punching in your personal identification number. Using an ATM card, bank customers can access a computer to get cash, make deposits or transfer money between accounts.

Bank statement – A statement given to you by your bank or credit union to keep you informed of all transactions you made during the statement period. These statements are sent on a regular basis or posted online.

Billing cycle – The number of days between the last statement date and the current statement date.

Budget – An itemized summary of probable income and expenses for a given period. A budget is a plan for managing income, spending and saving during a given period of time.

Capacity – A borrower's ability to repay debt.

Cash advance – Obtaining cash from a credit card instead of using the card to make a purchase. The grace period does not apply to cash advances. The advance is an instant loan and finance charges will be levied on this money from the time it is obtained until the loan is paid in full.

Character – A borrower's reputation for paying bills and debts in the past.

Check – A printed form directing a bank to withdraw money from an account and pay it to another account.

Checking account – An account held at a bank or credit union in which account owners deposit funds. Account owners have the privilege of writing checks on their accounts and are able to use ATM cards and debit cards to access funds.

Collateral – Property required by a lender and offered by a borrower as a guarantee of payment on a loan. A borrower's savings, investments or the value of the asset purchased that can be seized if the borrower fails to repay a debt.

Compound interest – Interest computed on the sum of the original principal and accrued interest.

Contract – A legally binding exchange or promise or agreement between parties that is enforced by law.

Credit cards – Cards that represent an agreement between a lender—the institution issuing the card—and the cardholder. Credit cards may be used repeatedly to buy products or services or to borrow money on credit. Credit cards are issued by banks, savings and loans, retail stores, and other businesses.

Credit history – A person's payment activity over a period of time.

Credit report – A loan and bill payment history, kept by a credit bureau and used by financial institutions and other potential creditors to determine the likelihood a future debt will be repaid.

Credit reporting bureau – An organization that compiles credit information on individuals and businesses and makes it available to businesses for a fee.

Credit rights – Refers to the protections put in place by law to help people obtain and maintain credits.

Creditor – A person, financial institution or other business that lends money.

Credit – The ability of a consumer to obtain goods or services before payment, based on an agreement to pay later.

Debit card – A plastic card similar to a credit card that allows money to be withdrawn or the cost of purchases paid directly from the holder's bank account.

Deposit – An addition of funds to an account balance.

Down payment – A portion of the total cost of an item that must be paid at the time of purchase; also an initial payment used to reduce the amount financed.

Elements of a contract – Competent parties, consideration and mutual agreement are the elements of a contract that must be present to make the contract legal and enforceable. Competent parties means that the individuals involved in a contract must be able to understand the conditions of the contract. Consideration refers to the fact that each party of a contract gives up something in exchange for what the other party is providing. Mutual agreement means that each party to the contract must be clear as to the essential details, rights and obligations of the contract.

Expenses – The costs people incur for goods and services. Expenses are often categorized as fixed, variable and periodic. Fixed expenses are those that occur each month in a regular amount such as rent, car payment or mortgage payment. Variable expenses are those that change from time period to time period, such as food, clothing, gasoline or entertainment. Periodic expenses are those that occur several times a year, such as car insurance or life insurance payments.

Fees – Money charged to review your application for credit or to service your credit account, such as maintenance fees or late fees. Banks also often charge fees for servicing bank accounts, these fees include charges for using a non-bank ATM.

Finance charge – The total dollar amount you pay to use credit, including interest, late charges and other fees.

Fixed interest rate – An interest rate that does not change during the term of the loan.

Foreclosure – In the case of non-payment of a credit obligation, the creditor has a legal right to take an asset pledged as collateral and sell it to pay the debt owed.

Grace period – A time period during which a borrower can pay the full balance of credit due and not incur any finance charges.

Income – The payment people receive for providing resources in the marketplace. When people work, they provide human resources (labor) and in exchange they receive income in the form of wages or salaries. People also earn income in the form of rent, profit and interest.

Interest – The price of using someone else's money. When people place their money in a bank, the bank uses the money to make loans to others. In return, the bank pays the account holder interest. Those who borrow from banks or other organizations pay interest for the use of the money borrowed.

Interest rate – The percentage of the amount loaned that is charged for a loan, usually a percentage of the amount loaned. Also, the percentage paid on a savings account.

Introductory rate – A low interest rate that is offered for a limited time as an incentive to use credit cards.

Late payment fee – In a credit arrangement, a fee is charged when payment is received after the due date.

Lien – The legal right to take or sell property as security for a debt.

Loan – A sum of money provided temporarily on the condition that the amount borrowed be repaid, usually with interest.

Minimum payment – The minimum amount a card holder must pay each month to remain a borrower in good standing.

Overdraft service – A fee-based service provided by financial institutions to generally approve and pay transactions when the account holder does not have enough funds to cover the transactions.

Principal – The original amount of money deposited or invested, excluding any interest or dividends. Also refers to the original amount of a loan without any interest.

Repossess – To take back goods or property from a buyer who has failed to keep up payments for them.

Savings account – An account with a bank or credit union in which people can deposit their money for future use and earn interest.

Secured loan – A loan that is backed with collateral.

Tax refund – Money owed to taxpayers when their total tax payments are greater than the total tax. Refunds are received from the government.

Unsecured loan – Loan that is not backed with collateral.

Variable interest rate – An interest rate that can increase or decrease during any period of the loan term as written in the contract.

Withdrawal – The removal of cash from an account, either at a bank or ATM.

Source: Federal Reserve Bank of St. Louis education lessons: *It's Your Paycheck* and *Cards, Cars and Currency*.

About the:
Boston Alliance for Economic Inclusion (BAEI)

The **Boston Alliance for Economic Inclusion (BAEI)** is a public-private collaborative. The BAEI's Mission is to enhance the economic well-being of the unbanked/underserved in metropolitan Boston by improving their access to the U.S. banking system, developing and marketing more responsive and affordable financial products and services, promoting financial education, and addressing technical or regulatory issues surrounding these developments.

The BAEI's effort includes offering banks, credit unions, and other financial institutions opportunities to work with the non-profit and public sectors to:

- better understand, and develop the means to tap into, the significant business potential of the unbanked/underserved market, and
- remain in compliance with all current banking laws

Contact:
Paul Horwitz, Community Affairs Specialist
Federal Deposit Insurance Corporation
Boston Area Office
15 Braintree Hill Office Parks
Braintree, MA 02184
(781) 794-5635
phorwitz@fdic.gov

The Worcester (MA) Alliance for Economic Inclusion, a companion initiative, is focusing on the same issues in that city. Contact:

Kip Child, Community Affairs Specialist
(781) 794-5636
kchild@fdic.gov