Predatory
LENDING

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FOOTHILL Credit Union
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MONEY
THING®

YOUR GUIDE TO

Identifying Abusive or Unfair Lending Practices

Predatory Lending

COMES IN MANY FORMS


CHECKS CASHED
24·7·365
PETE'S
PAWN
SHOP
PREPAID DEBIT
0000 0000 0000 0000
FIN'S
FINANCING

PAWNBROKERS

- Individuals or businesses that offer secured loans to people, with items of personal property used as collateral
- The word *pawn* is likely derived from the 15th century French word *pan*, meaning pledge or security, and the items pawned to the broker are themselves called pledges or pawns, or simply the collateral

PAYDAY LENDERS

- Offer payday loans (also called payday advances, salary loans, payroll loans, small dollar loans, short-term loans or cash advance loans)
- These are small short-term unsecured loans, regardless of whether repayment is linked to a borrower's payday

PREPAID DEBIT CARDS

- Typically not considered predatory
- However, some of these cards have been criticized for their higher-than-average fees (such as a flat fee added onto every purchase made with the card)

LOAN SHARKS

- Individuals or groups who offer loans at extremely high interest rates
- The term usually refers to illegal activity, but may also refer to predatory lending activities like payday or title loans
- Loan sharks sometimes enforce repayment by blackmail or threats of violence

Look for these

TELLTALE WARNING SIGNS

Failure to present the loan price as negotiable

- Most reputable lenders will negotiate the price structure of the loan with you, the borrower
- In some situations, you can even negotiate an outright reduction in the interest rate or other charges on the loan
- Don't be afraid to ask

Unjustified risk-based pricing

- This is the practice of charging a lot more—in the form of higher interest rates and fees—for extending credit to consumers who are identified by the lender as posing a greater credit risk than others

- While a modest increase to cover potential loss is justifiable, watch out for exorbitant rates and fees being charged to cover unjustified risk

Failure to clearly and fully disclose terms and conditions

- This happens most when an unsophisticated borrower is involved, especially with home loans
- Mortgage loans are complex transactions involving multiple parties and dozens of pages of legal documents
- In the most egregious of predatory cases, lenders or brokers have not only misled borrowers, but have also altered documents after they have been signed

Short-term loans with disproportionally high fees

- These short-term loans can come in the form of payday loans, credit card late fees, checking account overdraft fees and tax refund anticipation loans
- The fee paid for advancing the money for a short period of time works out to an annual interest rate significantly in excess of the market rate for high-risk loans

Understanding

ANNUAL PERCENTAGE RATE

APR

Knowing how the annual percentage rate (APR) is calculated is the key to understanding your true cost of borrowing

- As a form of consumer protection, lenders (banks, credit unions and financing companies) are required to disclose the cost of borrowing in a standardized way to make it easier to compare lenders and loan options
- In the United States, the calculation and disclosure of APR is governed by the *Truth in Lending Act* (which is implemented by the Consumer Financial Protection Bureau in Regulation Z of the Act)

WATCH OUT FOR THE FEES

"CASH MONEY" FOR A $50[1] FEE

You may see a payday lender's late-night TV commercial promoting a short-term, interest-free loan for a modest fee

LOAN	TERM	INTEREST	FEE
$300	14 days	–	$50

*See the second-last slide for notes on these examples

WATCH OUT FOR THE FEES

Look very closely before you leap—all lenders are required to disclose the effective APR of their loans in the fine print

435%[3] EFFECTIVE APR

If you took two weeks to pay this $300 loan back, it would cost $350 total. This may seem OK.

However, if you took one year to pay back this $300 loan, it could cost you more than $1,300—yikes!

*See the second-last slide for notes on these examples

IT ADDS UP FAST

How does the cost of that short-term $300 payday loan compare with other credit products?

Comparing the costs of a $300 loan taken for 14 days[1]	Payday loan	Credit card cash advance	Overdraft protection on a bank account	Borrowing from a line of credit
Interest	–	$2.13	$2.42	$1.15
Applicable fees	$50.00	$2.00	–[2]	–
Total cost of loan	**$50.00**	**$4.13**	**$2.42**	**$1.15**
Cost of loan expressed as a percentage of the amount borrowed[3]	435% per year	36% per year	21% per year	10% per year

*See the second-last slide for notes on these examples

AVOID THE DEBT TRAP

- If you get behind on a traditional loan from a credit union or bank, you (the borrower) pay late fees or penalty fees only one time
- The payday loan “debt trap” forces you to pay fees every month
- In the end, revolving payday loan fees increase your debt load and financial hardship
- This vicious cycle can lead you into bankruptcy, rather than helping you get back on your feet

[1] The costs and fees shown in these examples are for illustration purposes only.

[2] The monthly service fee that you pay for your banking service package often covers any processing fees for overdraft protection. To be sure, check your account agreement or check with your financial institution.

[3] This is an estimate of the annual cost of the loan. This is calculated by adding together all of the fees, charges and interest charged after 14 days, and projecting the costs over a one-year period.

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Sources: Center for Responsible Lending, US Federal Reserve, USLegal.com

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