Eight Unsavory Practices that Strip Cash from Working Families

Check Cashing – Check cashing operations serve customers who do not have or can not qualify for a bank account. They typically charge a fee of between 3% and 7% for cashing a check. *For tax refund checks alone, it is estimated that check cashers cost low-income families $205 million in 2004* (Consumer Federation of America - CFA). Check cashing operations often offer other predatory financial transactions such as payday lending. They can act as a "gateway" to more abusive products by building trust and a customer relationship.

Credit Cards – Unsavory practices in the credit card industry sink millions of Americans into an ever-growing mountain of debt. Frequently targeting low-income families and youth with no credit history, credit card companies make most of their profits through high interest rates, late fees and penalties paid by families who can not afford to pay off the balances on their cards,. In 2005, late fees and penalties equaled 75% of industry's profit for the year. Many lenders manipulate terms of their cards to increase these fees and penalties. "Universal default" is one particularly nasty practice that traps millions into high rates. Universal default kicks in when a borrower falls behind on some other debt, or the borrower's credit score declines. When this happens, the card issuer raises the borrower's rate on existing and future balances by an average of 22 percent (CFA, 2005), making it impossible for many families to repay their debt. In assessing penalties on past balances, the credit card industry is the only industry in America allowed to impose retroactive penalties on completed financial transactions.

No Credit/Poor Credit Automobile Dealers – No credit/poor credit auto dealers take advantage of the desperate need for an automobile for rural families to maintain employment and meet other daily needs. These dealers buy the cheapest cars available at auto auctions and sell them for inflated prices with high interest/long-term financing. Interest rates charged typically begin at 25% apr and may run much higher. Loan payments are based on what the customer can pay rather than the value of the automobile, often with an amortization period that extends far beyond the remaining useful life of the car. If the car dies before the loan is paid, some dealers will roll the balance into a loan for another car, increasing both the interest rate and the payment. Loans are typically structured with payments due on every payday. Dealers often include an undated voluntary repossession agreement in the paperwork the borrower signs. They keep a spare set of keys, and will repossess the car the night after a payment is missed. Customers pay for the car several times over compared to the payments on a conventional automobile loan.

Overdraft Loans – Nearly all large mainstream banks now include "courtesy overdraft loans" in their standard account terms. These loans, offered at the discretion of the bank, charged an average cost of $28.57 per check honored in 2005 (CFA). Because they are treated as loans, they are not subject to the consumer protections in place limiting traditional overdraft fees. Many banks have also adopted a practice of processing checks presented for payment from largest to smallest, to maximize the number of fees charged in an overdraft situation. If these loans are not repaid within a few days, most banks charge an additional sustained overdraft surcharge. No apr can be computed on these transactions because the loan fee is a standard amount regardless of the amount involved, but typically equate to several hundred to several thousand percent apr. In 2005, banks collected between $10 and $22.7 billion in fees just for overdraft loans (CFA).

Payday Loans – Payday lending is a quickly growing form of predatory lending in rural America. Payday lenders make a loan secured by a post-dated check drawn on the borrower's checking account. Interest rates and fees typically run between 650% or 780% apr (CFA, 2004). A typical $500 two-week loan will cost the borrower $650 to repay. Payday lenders make it easy to roll over a loan and discourage borrowers from paying off the principle, maximizing the interest and fees collected. At these rates, if a $500 two-week payday loan were rolled over for just three months, it will cost the borrower over $900 in fees and interest – for an entire year it would cost $3,900. A proliferation of Internet and telephone based services located offshore or claiming protection of interstate banking laws means that even rural communities without payday loan stores, or in states with protective laws, are vulnerable to this practice.

Refund Anticipation Loans – Refund anticipation Loans (RALs) are short term loans made by tax preparation chains which provide their customers with the chance to receive the expected refund within 24 to 48 hours. The customers typically pay interest and loan fees averaging 235% apr in order to access their funds seven to fourteen days earlier than with direct deposit. (CFA, 2004). This is in addition to often exorbitant tax preparation fees averaging $146 for a simple return. In 2004, RALs cost working poor families in America at least $900 million in loan fees and interest alone. Most families do not recognize that these "Instant Refunds" are actually loans which they must repay if for some reason the IRS does not issue the refund. Poor rural communities are frequent targets of these tax preparation chains, especially minority communities, Indian reservations, and towns near military bases.

Rent to Own – Rent to own stores capitalize on the credit problems of poor families by renting furniture, electronics, appliances, and other goods to families at a cost that would typically be considered usurious if expressed as principle and interest in a financing agreement rather than as a fee in a rental contract. Customers typically make small weekly payments for an extended period of time. The total of these payments greatly exceeds the value of the item and any reasonable interest charges. For instance, a rent to own contract for a $200 television could run about $8.50 per week for 78 weeks (six and a half years) with a one time $37 "buy out fee". Payments for this typical contract would total $700. Interest rates and fees on rent-to-own contracts usually range from 100% to 300% apr. (Wisconsin Dept. of Financial Institutions) In addition, in most states the laws governing merchants regaining possession of rental goods are much more lax than for repossession of financed goods, increasing the potential for abusive practices.

Sub-prime Predatory Mortgage Lending – Sub-prime predatory mortgage lending has probably stripped more wealth out of low income rural families than all other practices combined. While sub-prime mortgage loans (loans offered at higher interest rates due to additional credit risk) have a useful role in making credit available to low-income families, these loans become predatory when they use legal but unethical practices like these:

- Steering a borrower who could qualify for a conventional loan with a lower interest rate into a more costly sub-prime loan
- Loading the loan up with excessive points and fees, or single premium credit or life insurance premiums, which are then typically rolled into the principal and financed at high cost
- Assessing high prepayment penalties, trapping the borrower into a high cost loan – rural borrowers are 20% more likely than urban borrowers to have a prepayment penalty term of 5 years or more (Center for Responsible Lending – CLI – 2004).
- Flipping – the practice of encouraging frequent refinancing designed to extract equity through additional fees
- Including a kickback called a "yield spread premium" to a mortgage broker for steering the borrower to a higher cost loan
- Setting a high minimum mortgage size for a lender's conventional loans, and steering low-income and rural borrowers who typically seek smaller loans to sub-prime lending subsidiaries regardless of their credit history

Estimates of the amounts extracted from low-income rural families by practices like these run into the billions of dollars per year.