High-Cost Financial Services Podcast

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Nikki:

You're listening to high-cost financial services. Hi. I'm Nicky, your host for today's podcast. While there are many excellent financial products available that can help you achieve your goals, there are a few products to avoid because of their expensive fees and problematic terms.

To help you become smart about your financial service choices, we're going to discuss five important topics in this podcast, the different tiers of credit, subprime credit products, fringe financial services, recovery methods and financial alternatives.

There's a wide variety of borrowing options available today, ranging from the best type of credit, called prime, to not so desirable credit, called subprime. What's the difference? Prime credit products have the lowest interest rates, few and reasonably priced fees and favorable terms. Most prime credit products require an excellent credit rating, a stable income and some assets.

Subprime financial products, on the other hand, have higher interest rates, tend to have more expensive and excessive fees and offer less-than-favorable terms. If your income is low or you owe a lot of money, have a negative credit history or haven't established a positive credit rating, you'll probably find it difficult to qualify for prime credit. A lender will likely see you as a high-risk borrower and offer you subprime products.

While a few subprime products can create more financial problems than they solve, not all are bad. For example, using a credit-building credit card with a higher-than-average interest rate can actually help you establish or reestablish your credit history.

It is possible to use subprime credit products to your advantage. All you have to do is make your payments on time and in full. However, if you regularly spend more than you earn and then rely on subprime products to make ends meet, your problems will likely increase.

Some financial services that focus on subprime borrowers are considered predatory. Predatory lenders trick desperate borrowers to agree to unfair and abusive loan or credit terms. The interest rates and fees are unusually high, far greater than prime, and the terms make it difficult for the borrower to repay the debt.

For secured predatory loans, if you're late on a payment, the lender will be able to claim the property that secures the loans quickly and aggressively. However, there is protection for consumers. A federal law called the Truth in Lending Act ensures that all lenders disclose their loan or credit card terms in the application or contract. If you're applying for a loan or credit card, be sure to read the contract and understand the terms before signing.

Next, let's look at the different types of subprime credit products. Probably the most well-known are payday loans. With a payday loan, all you need to do is write a personal check to the lender for the amount you wish to borrow and include their fee, which is typically 10 to 25 percent of the loan. The lender then gives you the cash and holds on to your check until your next payday.

In most cases you have up to two weeks to repay the loan. When the loan comes due you have a choice. You can pay it off by allowing the lender to cash the check or refinance it for another 14-day term. This may sound easy, but make no mistake. This can get very expensive very quickly.

You see, if you don't have the money to pay the loan in full, you may be forced to refinance the loan. Then the lender will add another round of fees to the debt. Every time you do this the balance grows, making repayment more and more difficult. Because the fees are expensive and the repayment term is short, the interest rates for the loans can get very high, among the highest of all loan products. It's not uncommon for rates to reach 300 percent and even higher.

Another type of high-interest loan can come from a finance company. Although a finance company can help you buy a big-ticket item like a flat screen or a washing machine, there are a few things to consider before signing on the dotted line.

First, be aware of zero-percent interest deals. They sound great, but if you don't pay the entire amount you borrowed within a specific timeframe, all the accumulated interest will be added to the balance. The interest rate often starts in the mid-20-percent range and can go up from there.

Second, the item you buy usually secures the loan, so if you do not pay the loan as agreed, the finance company can repossess the property. Even if you already paid a few thousand dollars, default on your loan and you can lose it all.

Finance companies also offer unsecured personal loans, which may be called signature loans. The most common use for a signature loan is to consolidate existing debt. However, the interest rate for one of these loans can be higher than the rates for your original debt, making repayment even more expensive than it was before.

You may have heard subprime lenders advertising loans where you have $5,000, $10,000 or more deposited into your checking account overnight. To apply for these loans, all you have to do is complete a simple form. If you pass the credit requirements, which are typically pretty loose, you'll get your loan.

Sound too good to be true? That's because the terms of these products are extremely undesirable. How bad depends on the interest rate and the number of months or years you have to repay it. Imagine paying more than $16,000 dollars in interest for a $5,000 loan, or worse, paying more than $34,000 for a $10,000 loan. These are true and frightening examples of predatory loans. These products are short-term solutions at best and financial disasters at worst.

For consumers who can't qualify for a regular credit card, some financial institutions are offering subprime credit cards. These are marketed to people who are just starting out in the world of credit, have poor credit due to past financial problems or who are just simply not aware that they don't have to accept such poor terms.

Here are some red flags to look for. Application or set up fee to open an account, high annual fee, fee if you ask for a higher credit limit, monthly maintenance fee if you don't use the card that month, short grace period or a very high rate if you have no or a poor credit history.

Another predatory loan is called a car title loan. This is a secured loan that uses your car as collateral. The term is usually short, no longer than 30 days, and the lender has the right to repossess your car if you fail to repay your loan. How does it work? Simply sign over your car title as collateral, hand in an extra set of keys and you'll receive your loan.

The majority of lenders will only make the loan if your car is paid off, and they're prohibited from lending more than the car is worth. The interest rates for a title loan can be deceiving because they're usually shown as monthly interest rates.

It is not uncommon for a car title loan company to charge an interest rate of 25 percent per month, which may seem better than some credit cards, but keep in mind that this is a monthly rate. Multiply that figure by 12 to get an annual percentage rate and you'll see that 300 percent isn't a very good deal at all.

Next on our list are what we call fringe financial services. These types of services are outside the mainstream of traditional financial institutions, and for a good reason. You see, many of these businesses don't even offer loans or lines of credit but instead charge unusually high fees for services that you can get for free or at a much lower cost somewhere else.

First up are check-cashing services. These companies cash payroll, personal and government checks for millions of Americans, but unlike the traditional financial institutions, these companies charge a fee for simply cashing a check. In many cases, the same companies that offer payday loans also provide check-cashing services.

Why would you pay to cash a check? There are several reasons. Maybe you've never had a checking account, or due to a history of bouncing checks you have become ineligible for a checking account at a conventional financial institution.

For some, a check cashing service seems convenient. Perhaps there isn't a financial institution in your immediate neighborhood or you need to cash the check during off-business hours or the people who work at a check cashing company speak your primary language, making you feel more comfortable and the atmosphere less intimidating. Cashing a check at one of these companies can cost you two percent or more of the amount of the check. For example, to cash a $1,200 check it would cost you $24.

Now, this may not sound overly expensive, but it adds up quickly if you do this on a regular basis. Besides, if you use a traditional financial institution where these services are free, paying extra for them just doesn't make sense. Also, if you depend on check-cashing services, you may end up carrying a relatively large amount of cash with you, which isn't very safe.

Another fringe service is called rent-to-own. A rent-to-own retailer will help you obtain merchandise such as furniture, electronics or appliances, whether or not you have cash or good credit. What's the catch? The long-term costs can be very high and may not be in your best interest. Rent-to-own outlets routinely charge 200 to 300 percent interest.

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

Keep in mind that using rent-to-own as a very-short-term rental arrangement really isn't such a bad deal. However, if you're using it to eventually own the products, the ultimate payout can be huge. For example, if you bought a $250 DVD player at a rent-to-own store, you could expect to pay upwards to $700 or more than if you used a credit card with an average-to-high interest rate.

Now that you've identified which companies do not work in your financial favor, the next step is to break free from high-cost products and services. The first step is to repay your most expensive credit balances. If you owe money to a lender that is charging high interest rates and fees, pay these balances as quickly as possible. Treat these types of debts as a financial priority.

Consider working overtime hours, picking up a second or part-time job or turn hobby into income and use the extra cash to add to your payment. If you have a high-interest-rate credit card, pay more than the minimum payment. Use the consistent payment method instead. To do this, determine a realistic and fixed amount that is greater than the minimum you can pay each month. Once you have made several larger-than-average payments, ask for a rate reduction.

You may also consider transferring high-interest balances to a card with a low rate. Lowering the interest rate is a great idea, but take into consideration any transfer fees that may be charged to your account. Weigh the cost of shifting the debt against the interest rate savings.

After you've repaid your expensive loans and credit cards, commit to not relying on them in the future. The second step is to end unfavorable contracts. For instance, if you've just taken out a car title loan, you have the right to cancel the deal within one business day without paying any interest charges. After that, the contract is set and you have 30 days to pay the loan plus interest.

If you have a rent-to-own arrangement, you have the option to return the merchandise at any time without further obligation. Ending the arrangement early will save you a lot of money down the line.

The third step is to create a positive credit history. Just because you had bad credit in the past doesn't mean you can't have good credit in the future. With a long and positive history of borrowing and repaying money, you can be eligible for prime loans and lines of credit. Paying your bills on time is a sure way to build a good credit rating. Also, as you eliminate your debt, keep your older accounts active. Have a mix of different types of accounts and only apply for necessary credit.

The fourth step is to establish or reestablish accounts at a traditional financial institution. Join a credit union by opening a share savings account. You can begin saving money for the future. Once you're a member, open a checking account and learn about the various other money management and investment products.

If you have damaged credit due to a history of bounced checks, get back on track. Contact the financial institution where you owe the money and work out a payment arrangement. You may be required to take a class or pay a fee, but in the long run it's the best thing for your financial future.

Finally, we're going to talk about alternatives to using high-cost financial services. In many cases you don't have to use subprime credit products or fringe financial services. There are plenty of options that are less expensive. Let's start with alternatives to using subprime credit.

Oftentimes subprime loans are used when emergencies and other financial troubles hit. If you find yourself in a financial hardship and need cash, contact your financial institution immediately. They may provide you with an unsecured loan with relatively low finance fees.

Other options include contacting your existing creditors and requesting a hardship plan where your payments may be reduced or eliminated for a few months. You can also use a credit card to cover a shortfall. A cash advance is often more expensive than a credit card purchase, but it's still probably cheaper than a subprime loan. Another idea is borrowing from a friend or family member. You can also take inventory of your belongings and sell what you don't need to raise cash.

You may even consider borrowing from your retirement plan. Again, check with your HR department for regulations and tax implications. If your credit is damaged or you don't have a credit history yet, consider a secured credit card. With this type of card, your credit line equals the amount you have in your savings account.

For instance, if you deposit $500 into a savings account, you will be issued a credit card with a $500 limit. It's important to understand that you won't be able to use the money in your savings, but you will earn dividends. Most importantly, you'll be building a credit history. When it comes time to borrow money from a traditional financial institution, consider your credit union. They often offer the most favorable rates and terms.

Next, let's talk about alternatives to fringe financial services such as check cashing. There is often no reason to pay extra for these types of services, so it pays to know your options. If you've been using check-cashing services because you thought it was more convenient or you feel the atmosphere is more comfortable, discuss this with your financial institution. You may find that they will go a long way to save you money and make your experience as convenient as possible.

If you're unable to open a traditional checking and savings account due to bounced checks and damaged credit, you may have another option. If you receive a federal benefit, wage, salary or retirement payment, you can open an electronic transfer account at your financial institution. With this you can cash checks for free and withdraw money from the account as early as the same day your check is deposited. While you can't write checks, you can get a money order so you can pay your bills.

Are you thinking about using a rent-to-own option to make a big purchase? Before you sign a contract, explore these less expensive options. For instance, use a credit card. The finance charges can be relatively reasonable if you pay the balance off within six months. Next, consider buying the merchandise on an installment or layaway plan at another store. Also, don't forget you can always apply for a loan at your financial institution.

Another idea is to shop used. Look for better deals at garage sales, online auctions, secondhand stores or use the classified section of your newspaper. Probably the best idea is to stop and ask yourself why you have to purchase the item in the first place. Is the item something you really need, or is it something that you want, something you can live without?

If you realize that you can wait before buying the item, start saving for it. Request that a set amount be transferred from your payroll or your checking account into a savings account. Buy what you want when you have enough money saved. By doing so, you won't owe a store or a lender and you will never have to pay a penny in interest or finance fees. That's all for today's podcast. I want to thank you for listening. This is Nicky saying goodbye.

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