

Predatory Lending courtesy of AICCCA Member American Financial Solutions



Predatory loans are those that expose the borrower to risks like high fees, unreasonably short pay back times and very high interest rates. Examples of these types of loans include payday loans, predatory mortgage loans, tax refund loans, overdraft loans, and some credit card arrangements. Let's take a look at each of these.

Payday Loans

According to the Center for Responsible Lending, a payday loan works like this: the borrower gives a postdated check to the payday loan provider and receives a small loan—perhaps \$300. The payday loan company charges fees on this \$300 and gives the borrower the difference. So, on a \$300 loan, the borrower might only receive \$255 after the fees are deducted.

When the borrower's payday arrives, he must pay the \$300 in its entirety, or they have the option of rolling over the loan which results in more fees. In fact, it is not uncommon that one loan might be rolled over four or five times before it is paid off. In worst case situations, a borrower might borrow from one payday loan company to pay off another one. The result is a cycle of deepening debt, at exorbitant cost.

The Center for Responsible Lending estimates that the interest rates can be as high as 400% on such loans, and that 75% of such loans must be rolled over because the principal cannot be repaid on time. And, unlike a standard bank loan, there is no provision for partial repayment or negotiation.

Predatory Mortgage Loan

A predatory mortgage loan is aimed at those who are unsophisticated or unfamiliar with how mortgages work or those who have poor credit scores and are desperate for a home loan and cannot secure a traditional mortgage.

Some characteristics of predatory mortgage loans include:

- Excessive and unwarranted fees for unnecessary insurance or other products.
- Penalties for borrower's early payments potentially extending the payoff time of the loan.

Mandatory arbitration, making it difficult or impossible for the borrower to seek legal remedies.

Such loans are typically offered by finance companies rather than banks, whose market consists of home-buyers with less than perfect credit.

Tax Refund Loan

For a loan fee, ranging from about \$30 to \$90 plus electronic filing fees of \$40, you receive a loan for the amount of your refund (usually up to \$5,000) within a few days. When your refund is received it is forwarded to a special bank account set up by the lender and the loan is repaid. The fees for the average refund of about \$2,000 equate to an annual percentage rate of 222.5%. According to the Consumer Federation of America and the National Consumer Law Center, some taxpayers pay the equivalent of a rate of over 2000%. Yet 12 million American taxpayers paid over \$900 million dollars in fees last year just to get their refunds a little faster.

This type of loan is aimed at those who are desperate for cash, and can't wait a few weeks to get their check from the IRS. You can avoid this predicament by skillfully managing your money, so that such a high interest loan is unnecessary.

It is also helpful to understand how to prepare your own taxes if possible. New technology and software available on the market today has made filing taxes quick and easy.

Overdraft Protection Plans are offered by most banks, as a “service” to checking account customers. At the moment the customer’s account balance becomes overdrawn, the loan is extended.

Such loans may involve high fees or interest charges on top of overdraft charges. Since they are not technically called “loans”, the banks are not obliged to follow normal Federal Reserve loan rules.

Unreasonable Credit Arrangements

Credit cards can and often do involve fees and interest rates that could be considered predatory. Those individuals who do not pay off their credit card balances may expose themselves to interest rates well above 20%. Additionally, if a late payment is made or charges exceed the credit card limit, a penalty of at least \$29 is added on the credit card account.

Although credit card debt is a reality and a convenience, it is not subject to the same laws regarding interest rates and fees that banks are. Therefore, a credit card holder must strive to pay off such debts on time each month or face the financial consequences.

Those who become victims of these practices often have a low credit standing, few sources of ready cash, or knowledge of better loan alternatives. If you practice good financial management, you should qualify for your bank’s best loan rates—and should you run into bad luck, you’ll probably be able to negotiate a reasonable solution. Negotiation is normally impossible with predatory lenders.