

Section 2 | FINANCIAL INSTITUTIONS

OBJECTIVES

- Participants identify the advantages and disadvantages of using financial services from alternative financial institutions and services from mainstream banks.
- Participants identify the services provided by mainstream financial institutions including banks, credit unions, brokerage firms, and so forth.
- Participants identify insurance (including homeowner's, renter's, health, and auto insurance) as a way to manage risk.
- Participants analyze scams and identify safeguards against them.

MATERIALS

- Section 2 of the *Your Credit Counts Challenge* participant's guide.
- Transparencies or PowerPoint slides of Visuals 2.1 through 2.26.
- Duplicated copies of Handout 2.1: The Costs of Using Non-Mainstream Financial Services.

PROCEDURE

Overview

Display Visual 2.1: Connecting With Mainstream Financial Institutions Overview. Explain that the purpose of this session is to explore the advantages and disadvantages of being unbanked, to identify important services provided by mainstream financial institutions, and to become aware of scams and schemes (such as identity theft) and ways to prevent them.

Presentation

1. **Display Visual 2.2:** Unbanked Households to highlight the extent to which many families are unbanked. Explain that being unbanked means having no relationship with mainstream financial institutions.
2. **Display Visual 2.3:** Non-Mainstream Financial Services. Explain these alternative financial services.
 - Check-cashing outlets are fast and do not require much identification. They offer other services including money transfers.
 - Short-term lenders offer small loans for \$150 to \$300. Payday loans are the most common sort of loan. Usually customers write a postdated check and leave

the check with the loan provider for an agreed-upon amount of time — often two weeks or until the next payday. Then the loan provider cashes the check unless the customer reclaims the check and repays the loan.

- Rent-to-own stores rent and sell many products including appliances, furniture, television sets and CD systems. Ordinarily a customer agrees to rent a product for a period of time, perhaps one week or one month. If the customer rents the product for a specified period of time — commonly 18 months — he or she will become the owner of the product.

3. **Display Visual 2.4:** Why Not Be Unbanked? Explain that people often find alternative financial services to be useful. Many banks don't offer short-term loans for small amounts of cash. These outlets are often conveniently located and they offer a variety of services, quickly and with a minimum of hassle.

4. **Distribute Handout 2.1:** The Costs of Using Non-Mainstream Financial Services. **Display Visual 2.5** Paul's Payroll Check. Ask the participants to calculate how much it costs Paul per year (52 weeks) to cash his check at the check-cashing store. (\$1,040)

5. **Display Visual 2.6:** Check Cashing Outlet. Discuss the advantages and disadvantages. Ask: When it comes to cashing his payroll check, what might be a better alternative for Paul? (Accept a variety of answers. He might cash his check at a bank. No fee or a small fee would be charged. Or he could arrange for a direct deposit of the check into a checking account at a bank with no fee.)

6. **Display Visual 2.7:** What Might Be a Better Choice? Reinforce the less expensive choices Paul could make.

7. Direct the attention of the participants to Case 2 on Handout 2.1, and **display Visual 2.8:** Super Bowl Sunday to provide an overview of the Super Bowl problem. **Display Visual 2.9:** Fred's Terms at the Rent-To-Own Store. Provide an overview of the terms offered by the rent-to-own store. Ask the participants to calculate how much it costs Fred to rent the TV set. Ask:

- What would it cost Fred to buy the TV set for cash? (\$300)
- What is the total cost to Fred for leasing the TV set? (\$645)

8. **Display Visual 2.10:** Rent-To-Own and discuss the advantages and disadvantages. Ask: What might be a better alternative for Fred? **Display Visual 2.11:** What Might Be a Better Choice?

(Buy a used TV at a garage sale or a second-hand store. Borrow a TV for Super Bowl Sunday. Save \$50.00 a month for six months and buy the TV outright.)

9. Direct the attention of the participants to Case 3 on Handout 2.1, and **display Visual 2.12:** An Unexpected Trip to the Dentist. Provide an overview of the unexpected trip to the dentist. **Display Visual 2.13:** Payday Loan. Provide an overview of the advantages and disadvantages of obtaining a payday loan. Ask:

- What is likely to be Diana's main problem in obtaining the loan?

(The loan is at a high interest rate. It may be difficult to pay it back during the next pay period. Then she might need to renew the loan, adding to the cost of the loan.)

10. Ask: What might be a better alternative for Diana? **Display Visual 2.14:** What Might Be a Better Choice? *(Obtain a cash advance on a credit card. Talk to the dentist about spreading the payment out over, say, two months.)*

11. **Display Visual 2.15:** Why Is Being Unbanked a Problem? Review the problems that come with being unbanked. Stress the idea that being unbanked is expensive and risky.

12. Introduce mainstream financial institutions. **Display Visual 2.16:** Mainstream Financial Institutions. Provide an overview of financial institutions. **Display Visual 2.17:** Financial Services at Mainstream Institutions. Explain the types of services available from mainstream financial institutions. **Display Visual 2.18:** Regulations of Financial Institutions. Explain briefly how financial institutions are regulated.

13. **Display Visual 2.19:** Benefits of Mainstream Institutions. Explain the benefits of using mainstream financial institutions. Stress the point that these institutions are not only safer and less expensive, they also reward saving and provide a way to establish a credit history.

14. Introduce the concept of insurance as a way to reduce risk. **Display Visual 2.20:** All Choices Involve Risk. Explain that we face risks every time we make a decision. Ask: How might you cope with the risk of having an accident

when driving?

(First, you could choose to stop driving, deciding instead to ride the bus, take a taxi, walk, or stay home. Second, you might resolve to become a safer driver. This might mean taking a course in defensive driving, studying the state's road-safety manual, avoiding driving during rush hours, and so on. Third, you might purchase auto insurance. You can purchase insurance to protect you from financial loss for car repairs, medical costs, or law suits that result from an accident.)

15. Explain that the purpose of insurance is to spread out risks over several people. **Display Visual 2.21:** How Insurance Works. Explain how the resident's association could charge \$10.00 plus a fee for theft insurance as a way of spreading the risk among the 100 residents.

16. **Display Visual 2.22:** Insurance. Provide an overview of the types of insurance that people often purchase. Stress the basic types of coverage provided in each category.

- Home: Physical damage insurance reimburses for fire or water damage to a house or other structures on the property. Loss or theft reimburses for personal property damaged or stolen. Liability protects against loss from a lawsuit for injuries to invited or uninvited guests.
- Renter's: Reimburses policy owners for loss of possessions in a rental unit due to fire, theft, water damage, and so forth
- Health: Basic health covers office visits, laboratory, hospital costs, and routine care. Major medical protects against large bills for catastrophic illness or injury.
- Life: Term life offers protection for a specified period of time. Whole life offers protection that remains in effect during the lifetime of the insured and acquires a cash value.
- Auto: Collision provides for the repair or replacement of the policy owner's car damaged in an accident. Liability covers the cost of property damage or injuries to others caused by the policy owner. Comprehensive covers the cost of damage to an auto as a result of fire, theft, or storms.
- Disability: The policy owner selects a replacement income for lost wages if an illness or accident prevents the person from working. Disability income is paid for a specified time after a waiting period.

17. **Display Visual 2.23:** Scams and Swindles. Explain that millions of financial transactions are completed each day. In the vast majority of cases, all sides benefit. But the world is not a perfect place. The financial industry, like any other industry, has a few people who operate on the edge. Some of these people are flat-out thieves — people who commit identify theft and run loan scams and fraudulent credit-repair schemes.

18. **Display Visual 2.24:** Scams to Watch For. Briefly explain that identify theft and credit-repair scams are common schemes.

- Identity theft occurs when a scam artist gets your name, Social Security number, credit card number, or another important piece of personal information. He or she uses this information to open a new credit card account, using your name, date of birth, and Social Security number.
- A credit-repair scheme occurs when a company advertises that it can erase your bad credit history or remove a bankruptcy from your credit records. The company requests that a fee be paid up-front for which the company promises to “repair” the consumer’s credit report. However, there is little, if anything, such a business can do to “repair” a customer’s poor credit record.

19. **Display Visual 2.25:** Avoiding Scams. Explain the commonsense advice on how to avoid scams.

REVIEW

Display Visual 2.26: Review.

Ask:

1. Why are check-cashing outlets, rent-to-own purchases, and payday loans often bad choices?
(These services are expensive, often deal in cash, do not allow for saving, and do not provide a way of establishing a credit history.)
2. What are the advantages of using mainstream financial institutions?
(They offer a wide range of services at relatively low costs; they reward saving and enable customers to establish a financial history.)
3. Why have insurance?
(Insurance is a way to reduce risk.)
4. What is the most common sort of scam today?
(Identify theft.)

**HANDOUT 2.1: THE COSTS OF USING NON-MAINSTREAM FINANCIAL SERVICES****Case 1: Paul's Payroll Check**

- Paul has a weekly paycheck of \$500.
- Each week he goes to a check-cashing store near his apartment
- He pays \$20.00 to have his check cashed.
- How much does it cost Paul per year (52 weeks) to cash his check at the check-cashing store? _____

Discussion

1. When it comes to cashing his payroll check, what might be a better alternative for Paul?

Case 2: Super Bowl Sunday

It's almost Super Bowl Sunday. The Wilsons always have a Super Bowl party for friends and family. On the Saturday before Super Bowl Sunday, the Wilson's television set dies. Fred doesn't have much cash. He decides to go to Rick's Sale and Lease Store. Fred wants the 27-inch flat screen but doesn't have the \$300. He decides to lease it. Here are Fred's terms to lease the TV:

- Automatic approval for the lease
- \$50.00 payment for 12 months
- Service fee = \$30.00
- Return the TV any time
- 5 percent sales tax on the TV = \$15.00

Discussion

1. What would it cost Fred to buy the TV for cash?
2. What is the total cost to Fred for leasing the TV?
3. What might be a better alternative for Fred?

Case 3: An Unexpected Trip to the Dentist

- Diana pays her bills on time.
- This week, however, her daughter Cassandra needed to have some unexpected dental work done.
- The bill for dental work is due by the end of the week.
- After Diana pays the bill, she won't be able to get through to her next paycheck.
- She decides to take out a payday loan.
- The fee for the two-week loan is only \$25.

Discussion

1. What is likely to be Diana's main problem in obtaining the loan?
2. What might be a better alternative for Diana?



Visual 2.1: Connecting with Mainstream Financial Institutions Overview

- Who are the unbanked?
- Advantages and disadvantages of alternative financial services
- Mainstream financial institutions
- Insurance
- Scams and schemes



Visual 2.2: Unbanked Households

- About 10 million households are unbanked.
- Over 57% of the households are minority households.
- About 50% of African American households are unbanked.
- About 29% of Hispanic households are unbanked.



Visual 2.3: Non-Mainstream Financial Services

Unbanked households depend on:

- Check cashing outlets
- Short-term lenders
- Payday loans
- Rent-to-own stores



Visual 2.4: Why Not Be Unbanked?

- Many financial services are provided.
 - Loans
 - Check cashing
 - Wire transfers
- Services are nearby.
- Services are quick.
- Services are provided with a minimum of paperwork and hassle.



Visual 2.5: Paul's Payroll Check

- Paul has a weekly pay check of \$500.
- He goes to the check-cashing store at the corner.
- He pays \$20 to have his check cashed.
- How much does it cost Paul per year (52 weeks) to cash his check at the check-cashing store?



Visual 2.6: Check-Cashing Outlet

ADVANTAGES

- Cash the check immediately
- It is easy.
 - *The check-cashing store is nearby.*
 - *All that is required is some identification.*
- Use the cash however you wish.

DISADVANTAGES

- Pay a fee.
- Risk losing the cash.
- No record of the money.
- Failure to establish a financial history with a bank.



Visual 2.7: What Might Be a Better Choice?

- Paul could cash his check at a bank.
- Paul could arrange to have his check deposited directly in a checking account.



Visual 2.8: Super Bowl Sunday

- It's almost Super Bowl Sunday and the Wilsons want to have a party.
- On Saturday, the television set dies.
- Fred Wilson wants to get a new television set, but he doesn't have the \$300 in cash.
- Fred decides rent-to-own is the way to go.



Visual 2.9: Fred's Terms at the Rent-to-Own Store

- Automatic approval for the lease.
- \$50.00 payment for 12 months.
- Service fee = \$30.00.
- Return the TV any time.
- 5 percent sales tax on TV = \$15.00.
- **Questions:**
 - ✓ What would it cost Fred to buy the TV for cash?
 - ✓ What is the total cost to Fred for leasing the TV?
 - ✓ What might be a better alternative for Fred?



Visual 2.10: Rent-to-Own

ADVANTAGES

- Obtain the TV immediately.
- Can return it any time.
- It is easy.
 - *The rental store is nearby.*
 - *All that is required is signing some forms.*

DISADVANTAGES

- Pay a much higher price for the TV than you would at an appliance store.



Visual 2.11: What Might Be a Better Choice?

- Buy a used TV at a second-hand store.
- Borrow a TV.
- Save \$50.00 per month for 6 months weeks = \$300 and buy the TV outright.



Visual 2.12: An Unexpected Trip to the Dentist

- Diana pays her bills on time.
- This week, however, her daughter Cassandra had unexpected dental work done.
- The bill is due by the end of the week.
- After Diana pays the bill, she will be short \$200 and won't be able to get through to her next paycheck.
- She decides to visit a payday lender.



Visual 2.13: Payday Loan

ADVANTAGES

- Obtain the \$200 immediately.
- It is easy.
 - *The payday loan provider is nearby.*
 - *All that is required is some identification and proof that she is employed.*

DISADVANTAGES

- Pay a higher interest rate.
- Risk being short again in two weeks.
- Risk falling further and further behind.



Visual 2.14: What Might Be a Better Choice?

- Cash advance on a credit card.
- Talk to the dentist to spread out the payment over two months.



Visual 2.15: Why Is Being Unbanked a Problem?

- No ability to save
- Higher cost
- Less secure: cash
- Less complete credit history
- No relationship with a bank or other mainstream provider



Visual 2.16: Mainstream Financial Institutions

- Banks
- Credit Unions
- Brokerage Firms



Visual 2.17: Financial Services at Mainstream Institutions

- Checking account
- Savings account
- Money market accounts
- Electronic transfers of funds
- Certificates of deposit
- Loans
- Mortgages
- Home equity loans
- Brokerage services
- Safe deposit box
- Credit cards
- Debit cards



Visual 2.18: Regulation of Financial Institutions

- Federal regulators
- State regulators
- Licensing of people who provide services



Visual 2.19: Benefits of Using Mainstream Institutions

- Lower cost
- Credit history
- Security
- Encourages saving
- Record keeping

**Visual 2.20: All Choices Involve Risk**

- How can you cope with the risk of having a car accident?
- Stop driving: take a cab, bus, or walk.
- Take a safe-driving course.
- Avoid rush hours and driving at night.
- Buy car insurance.



Visual 2.21: How Insurance Works

- Imagine a resident association that has 100 residents.
- The leaders want to offer insurance to the residents against theft.
- Suppose that each resident has an average of \$200 worth of possessions and that five residents each year have some loss.
- They lose \$1,000 (5 x \$200) each year.
- If every resident paid \$10 ($\$1,000/100$) plus some sort of fee to cover administration, the resident association could cover the loss.



Visual 2.22: Insurance

Obtaining insurance is a way to manage risks related to unexpected expenses. Types of insurance:

- Home
- Renter's
- Health
- Life
- Auto
- Disability



Visual 2.23: Scams and Swindles

- The credit industry is not perfect.
- It sometimes attracts unsavory operators who have no intention of making good on their promises.



Visual 2.24: Scams to Watch For

- Identity Theft
- Credit-Repair Scam



Visual 2.25: Avoiding Scams

- Don't allow people to appeal to your greed.
- Buyer beware:
 - Ask questions.
 - Walk away.
 - Tell the telemarketer to remove your name from the list.
- Live within or below your means so that you can use mainstream banks for loans at lower rates.
- Seek legal help if you need it.

**Visual 2.26: Review**

- Why are check-cashing stores, rent-to-own purchases, and payday loans often bad choices?
- What are the advantages of using mainstream financial institutions?
- Why have insurance?
- What is a credit-repair scam?

