Section 2 | Financial Institutions

Are you unbanked?

About 10 million American households have no relationship with a mainstream bank. These families are "unbanked." Minority families—African Americans and Hispanics—are often among the unbanked.

Unbanked families obtain financial services from somewhere, of course. They often depend on financial services from these alternative sources:

- Check-cashing outlets
- Providers of payday and title loans
- Rent-to-own stores

Why not be unbanked? The advantages

Many families have discovered advantages in using alternative financial services. Here are three reasons why. First, these outlets offer financial services that people find useful. Many banks don't offer short-term loans for small amounts of cash. And people often find it convenient to use check-cashing services, money orders, and wire transfers. Second, the outlets that offer these services tend to be conveniently located. In some neighborhoods there are more check-cashing outlets than grocery stores. Obviously, these outlets are responding to demand in local communities for the services they provide. Third, these outlets provide quick services with a minimum of hassle. Cash may be provided quickly, with few questions asked and few papers to sign.

A closer look at alternative financial services

Check-cashing outlets

At check-cashing outlets, customers pay a fee to cash their checks. That raises one problem. Keeping cash can be very risky. Cash can be easily lost, stolen, or spent. And most people don't keep records of cash transactions. Cashing checks at check-cashing outlets does not allow individuals to establish a financial history. As a result, when it comes time to seek a financial service from a mainstream bank—getting a car loan, for example—there is no financial history for the bank officials to use in making decisions about an individual's creditworthiness.

Payday and title loans

Payday loans are small loans made by a short-term lender to individuals—usually for $150 to $300. Most customers write a postdated check and leave the check with the loan provider for an agreed-upon amount of time—usually two weeks or until the next payday. When the time period is up, the loan provider cashes the check unless the customer reclaims the check and repays the loan. Title loans are small loans provided by short-term lenders, often for 30-day periods. In the case of title loans, the equity value of a car is used as collateral. The applicant must own the car free and clear. Failure to repay the loan, or to make the agreed-upon interest payments to extend the loan, means that the lender can take possession of the car.

Some customers find it advantageous to use payday loans and title loans. The key advantage is that such loans may be helpful to people facing a sort-term financial emergency—an unexpected moving expense, a medical expense, a car repair bill, and so forth. While banks often do not offer loans for less than $1,000, short-term lenders do. Also, payday loans are easy to obtain. They do not involve a credit check, and loan transactions are often completed within 10 minutes. Finally, the loans are confidential. People who use payday or title loans do not need to approach an employer or a family member to ask for help.

There are several disadvantages to payday loans and title loans. These loans are usually very expensive. There are two ways to look at the expense involved. Suppose the fee for a two-week, $100 loan is $33. If you convert that fee to an annual percentage rate, it comes to 858 percent. That is a terribly high rate. But it may be misleading to use an annual percentage rate in thinking about how expensive a two-week loan is, so let's look at the cost in another way. The main disadvantage of payday loans is that many people do not pay them back on time. If a person is a little short of cash before the end of one pay period, it is easy to imagine that he or she will be short of cash during the next pay period. When the borrower cannot pay off the loan, the loan is renewed or "rolled over." This means taking out another loan to pay off the first loan. Or the loan agreement may specify that an interest payment will be required to extend the first loan if it is not paid off on time. Either way, it's expensive. Imagine that a person takes out a payday loan for $200 for two weeks at a fee of $40.00. If this loan is refinanced four times, the cost increases dramatically. In fact, in the course of four renewals, the borrower will wind up paying about $200 to borrow $200 for 10 weeks.

Rent-to-own

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.

The key advantage of rent-to-own arrangements is they provide immediate use of a product for people who may lack cash and find it difficult to obtain credit from other sources. The rent-to-own transaction is usually convenient and fast. There are no credit checks, and the agreement can be easily canceled.

The main disadvantage of buying goods from a rent-to-own store is the cost. Ordinarily, it costs two to five times more to purchase a product from a rent-to-own store than it would cost to buy the same product from an ordinary store. If the difference between the total payments and the price of the product at a conventional department store were expressed as an interest rate, the rate would commonly be over 100 percent, and at times it reaches more than 300 percent. And besides the payments and tax, rent-to-own agreements may involve other fees, including the following:

- Service fees
- Delivery fees
- Installation fees
- Sales tax
- Home pick-up fees
- Reinstatement fees (charged if a payment is late or missed and the customer wants to continue renting)

Even for people operating on a tight budget, there are alternatives to rent-to-own arrangements. One is to save up the money needed to pay the full purchase price, or a down payment on a layaway or installment plan, at a conventional store. People who manage to do this will pay much less than the costs involved in rent-to-own arrangements. Garage sales, auctions, second-hand stores, and the classified ads in the newspapers also may provide money-saving alternatives.

Advantages of using banks and other mainstream financial institutions

Mainstream financial institutions include commercial banks, savings and loan associations, credit unions, consumer credit companies, and so forth. For many families, it is advantageous to use such institutions. For example, banks offer many advantages over the check-cashing outlets and providers of payday loans. Most importantly, banks offer a safe place to keep money. The federal government insures deposits in banks. In contrast, holding cash savings at home is very risky. Cash can be easily lost or stolen. Banks and similar institutions offer several other advantages as well. They enable bank customers to accumulate savings, develop a credit history, keep records, and use various financial services at comparatively low rates.

An overview of financial institutions

In the past, each type of financial institution offered specific services. Banks took in deposits for savings accounts, checking accounts, and certificates of deposit. Banks then made loans to individuals and businesses. Savings and loan associations offered savings accounts and home mortgages. Credit unions were member-owned cooperatives that made low-interest loans to members. Brokerage firms were businesses that bought and sold stocks and bonds.

Today the lines between all these institutions are blurred. For example, commercial banks can now sell stocks and bonds. Savings and loan associations can offer many types of loans in addition to home mortgages. And everybody, it seems, offers credit cards. There is a lot of competition among various sorts of financial institutions today.

Here is an overview of the financial services offered by mainstream financial institutions such as banks and credit unions.

Figure 2.1: Deposit and Savings Services

Types	Characteristics
Checking accounts	Paying by personal check is a convenient, safe, and less expensive way to pay bills. The federal government insures deposits for up to $100,000 per depositor.
Savings accounts and certificates of deposit (CDs)	Savings accounts are safe and convenient ways of saving. Certificates of deposit are safe, offer somewhat higher rates of interest, and require leaving funds on deposit for specified periods of time.
Automated teller machines (ATMs)	ATMs offer easy access to funds in savings and checking accounts.
Debit cards	Debit cards allow buyers to pay for purchases from a checking account without having to write a check.
Direct deposits and automatic withdrawals	Employees can have their paychecks deposited directly into an account for no fee. Some bills (for car payments, mortgage payments, and insurance premiums) can be paid automatically from an account.
Safe deposit box	For a fee, valuables can be kept in a bank vault.

Figure 2.2: Credit Services

Types	Characteristics
Credit cards	Credit cards offer convenient credit up to the amount of the approved credit limit.
Installment loans	These are loans for major expenditures (for a new or used car, college tuition, home improvements, and so forth), enabling borrowers to pay back the money they owe in several agreed-upon payments, or installments.
Mortgage loans	Mortgage loans enable buyers to pay for a major purchase (usually of a home) by regular payments to the lender. During the period of the loan, the lender owns the property. Ownership shifts to the borrower when all the payments have been made.
Home equity loans	These are loans for which the paid-up value of a home serves as collateral.
Student loans	These are loans issued at below-market interest rates to enable students to pay for a college education.
Small business loans	These are loans issued to help borrowers start up or expand a small business.

Figure 2.4: Opening and Using a Checking Account, Continued

Reconciling your checkbook	• Financial institutions send a monthly statement that summarizes the activity of your checking account including deposits, checks written, service charges, and any interest earned. • Compare your checkbook register to the monthly statement. Check off deposits and withdrawals. Record in the register any service charges or interest earned. • Use the printed form sent by the financial institution with your statement to reconcile your checking account. • Write the ending balance as shown from the statement. • Add deposits to the ending balance that are listed in the register but not in the statement. • Subtract withdrawals listed in the register but not in the statement. • Note the adjusted balance; it should equal the checkbook register. • If the account does not balance, check possible explanations such as having missed checks that did not clear the account, fees charged, interest paid, calculation errors, or transposed numbers.
ATMs and debit cards	• Automated teller machines (ATMs) allow you to conveniently deposit, withdraw, or transfer funds, and verify your account balance. • ATMs use a PIN (personal identification number) to allow you to do a transaction. • A debit card is issued by many financial institutions. • A debit card allows you to have the amount of a purchase withdrawn directly and immediately from your checking account. • Be sure to keep receipts when you use your debit card, and record the transactions in your check register.

Illustration 1

CHECKING ACCOUNT DEPOSIT SLIP

15-77
250

Jay L. Mulligan
1525 Elm Road
Milwaukee, WI 53211-1211

Date____________________ 20_______

NATIONAL BANK
MILWAUKEE, WI

		DOLLARS	CENTS
CASH			
CHECKS			
TOTAL FROM OTHER SIDE			
TOTAL			
LESS CASH RECEIVED			
NET DEPOSIT			

USE OTHER SIDE FOR ADDITIONAL LISTINGS

BE SURE EACH ITEM IS PROPERLY ENDORSED

: - 0 2 4 5 9 5 8 7 2 - : 0 3 1 4 0 4 7 2 :

Figure 2.4: Opening and Using a Checking Account

Opening a checking account	• Take identification to the bank officer who handles new checking accounts. • Choose the type of checking account that best fits your needs. • Complete a signature card. • Make an opening deposit.
Choosing a checking account	There are three main types of checking accounts: • Special account: Service fees are charged at a low, flat rate with an additional fee for each check written in a given period. • Standard account: Customers pay a set monthly fee with no check charge. Often customers may avoid the fee by maintaining a minimum balance. • Interest bearing account: Interest is paid to the customer if a minimum daily balance is maintained during the month.
Making a deposit	Know the parts of a deposit slip. See the model in Illustration 1. • Write the date. • Write the amount of currency and coins to be deposited in the box marked "cash." • If checks are being deposited, write in the amount of each check. • Total the cash and check amounts. • Subtract any cash you wish to receive back. • Keep a copy of the deposit slip for your records. • Record the date and the amount of the deposit in your check register. Add the amount of the deposit to the balance.
Endorsing a check	• An endorsement is a signature on the back of a check instructing the bank on how the check may be cashed. • A blank endorsement is simply your signature on the back of the check. This makes the check as good as cash to anybody who holds it. • A restrictive endorsement tags a check for a specific purpose, such as for deposit only in a checking or savings account. • A special endorsement allows you to transfer the check to another person. No one except the person named in the endorsement may cash or deposit the check.
Writing a check	• Know the parts of a check. See the completed check in Illustration 2. • Complete all the parts of the check including date, "pay to the order of," numeric account, written amount, and signature line. If you wish, complete the memo line to indicate the purpose of the check. • Use a pen. • Write clearly. • Sign your name as it appears on the signature card. • When you make a mistake, write void on the check and keep the check for your records. • Be sure that you have enough money in your account to cover each check you write. • Record the number, date, payee, and amount of the check in your check register. Subtract the amount of the check from the balance.

Figure 2.4: Opening and Using a Checking Account, Continued

Reconciling your checkbook	• Financial institutions send a monthly statement that summarizes the activity of your checking account including deposits, checks written, service charges, and any interest earned. • Compare your checkbook register to the monthly statement. Check off deposits and withdrawals. Record in the register any service charges or interest earned. • Use the printed form sent by the financial institution with your statement to reconcile your checking account. • Write the ending balance as shown from the statement. • Add deposits to the ending balance that are listed in the register but not in the statement. • Subtract withdrawals listed in the register but not in the statement. • Note the adjusted balance; it should equal the checkbook register. • If the account does not balance, check possible explanations such as having missed checks that did not clear the account, fees charged, interest paid, calculation errors, or transposed numbers.
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CHECKING ACCOUNT DEPOSIT SLIP

15-77
250

Jay L. Mulligan
1525 Elm Road
Milwaukee, WI 53211-1211

Date___________________ **20**_______

NATIONAL BANK
MILWAUKEE, WI

		DOLLARS	CENTS
CASH			
CHECKS			
TOTAL FROM OTHER SIDE			
TOTAL			
LESS CASH RECEIVED			
NET DEPOSIT			

USE OTHER SIDE FOR ADDITIONAL LISTINGS

BE SURE EACH ITEM IS PROPERLY ENDORSED

: - 0 2 4 5 9 5 8 7 2 - : 0 3 1 4 0 4 7 2 :

Illustration 2

Jay L. Mulligan
1525 Elm Road
Milwaukee, WI 53211-1211

101

15-77
250

Date *April 15, 2003*

PAY TO THE ORDER OF *Cassandra Smith* $ *25.00*

For Instructional Use Only

Twenty five and 00/100 -- DOLLARS

NATIONAL BANK
MILWAUKEE, WI

For *Entertainment* *Jay L. Mulligan*

:-024595872-: 03140472:

Managing risks: Insurance

All choices involve risk. Let's consider driving a car. Everyone knows that there is always a risk of having an accident. You could cause an accident yourself or another driver could cause an accident that involves you. How can you cope with the risk of having an automobile accident? You have three choices.

First, you could choose to stop driving, deciding instead to ride the bus, take a taxi, walk, or stay home. But in case the no-driving alternative seems extreme to you, let's examine the remaining two choices.

Second, you could resolve to become a safer driver. That 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 could purchase auto insurance. You can purchase insurance to protect you from financial loss for car repairs, medical costs, or lawsuits that result from an accident. With insurance you may still have a wreck, but the consequences will not be as bad as they would have been if you did not have insurance.

Your choices about driving are similar to many other choices. Usually your best way of reducing risk is to take action yourself. For example, to reduce healthcare problems, eat right, get plenty of exercise, get enough sleep, avoid drugs, and so forth. Buying health insurance is another way to reduce the risk of facing high healthcare costs. To reduce the chances of theft, you might install good locks, stop mail and newspaper deliveries when you are away, and keep the area around your house well lit. Buying homeowner's or renter's insurance is another way to reduce the risk of financial loss from theft.

How insurance works

The purpose of insurance is to spread out risks over several people. Imagine an apartment complex with 100 residents. The resident association wants to offer insurance against the theft of possessions in the apartments. Suppose that residents have an average of $200 worth of possessions. Suppose further that on average five of every 100 residents have some loss each year. In a typical year, residents lose a total of $1,000 ($200 x 5 apartment break-ins). The $1,000 loss spread over 100 residents equals $10.00 per resident. If every resident bought $10.00 worth of personal property insurance, all the residents would be covered from financial loss due to theft of personal possessions.

In the real world, the fee would have to be large enough to cover not only the losses but also the cost of operating the business and providing a profit.

Figure 2.5: Types of Insurance

Insurance	Purpose	Examples of Coverage
Auto	Provides financial protection from losses due to an auto accident or other damage to a car.	• ***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.
Health	Provides payment for certain healthcare costs.	• ***Basic health:*** Covers office visits, laboratory, hospital costs, and routine care up to a certain amount. • ***Major medical:*** Protects against large bills for catastrophic illness or injury. • ***Dental and vision:*** Covers some costs of routine exams and specific services.
Renter's	Provides financial protection in case of loss of personal possessions in a rental unit.	• Reimburses policy owner for loss of possessions in a rental unit due to fire, theft, water damage, and so forth.
Homeowner's	Protects against financial loss from damage to a home or its contents as well as injury to others on the property.	• ***Physical damage:*** 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.
Life	Provides financial protection to dependents of the policy owner when the policy owner dies.	• ***Term life:*** Offers protection for a specified period of time. • ***Whole life:*** Offers protection that remains in effect during the lifetime of the insured; acquires a cash value.
Disability	Provides income over a specified period when a person is ill or unable to work.	• 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.

Scams and schemes

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 fraudulent credit-repair schemes. Others operate businesses that are completely legal but can place people already in financial trouble into a position from which it will be hard to recover. These include the payday loan and rent-to-own operators discussed earlier.

Identify theft

Can you be kidnapped electronically? You bet. Here is how it often works. Scam artists get your name, Social Security number, credit card number, or another important piece of personal information. They use this information to open a new credit card account, using your name, date of birth, and Social Security number. When they use the credit card and don't pay the bills, the failure to pay is reported on your credit report. The scammers may call your credit card issuer and, pretending to be you, change the mailing address on your credit card account. They make charges to your account. Because your bills are being sent to a new address, you may not realize there is a problem. These scam artists can hurt you in many ways. They might open cellular phone service in your name and make dozens of international calls. They might open a checking account in your name and write bad checks. Identity theft is illegal.

Credit-repair schemes

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. There are no quick or easy ways to repair a poor credit history. Credit-repair schemes are illegal.

Loan scams

An advertiser runs an ad offering a personal debt-consolidation loan, taking all your credit payments and rolling them into one. Rarely is a company name or street address given in these ads. Instead, the "lender" has an 800 or 900 telephone number for you to call. When you call, the company representative asks for only minimal information about the loan you want and about your financial history. He or she then explains that you will be called back to indicate whether or not the loan was approved. All the "loans" are approved. You are then instructed to pay a fee in return for the promised loan. The loan, of course, never arrives. Loan scams are illegal.

Pyramid scams

The key to a pyramid scam is that the first participants receive payment for recruiting additional members. The problem with pyramid scams is that there are not enough potential members to keep pyramids growing steadily for even a few months. These plans promise that if you sign up as a distributor of, say, telephone calling cards, you will receive commissions—not only on your sales but also on the sales of the people you recruit as distributors. Pyramid scams, however, can take several forms. They can be disguised as games, buying clubs, chain letters, mail order operations, or multilevel business opportunities. Pyramid scams are illegal.

Name that scheme

Read "The Pitch" in Column A and write the name of the scam in Column B. Select answers from the list below.

- Identity theft
- Loan scam
- Credit-repair scam
- Pyramid scam
- Payday loan
- Rent-to-own

Figure 2.6: Name That Scheme

Column A : The Pitch	Column B: The Scheme
1. Make big money using your home computer. Join our soy-burger distribution network. Cash in on this new health food craze. E-mail your friends. They can be distributors too.	
2. Need cash today? Can't wait until you get paid? You can get $50 to $500 in 15 minutes. No credit checks!	
3. Finally tired of that broken-down old cassette player with the lousy speakers? Want to step up to a new, state-of-the-art system but are short of cash? No problem! We can make it happen today!	
4. A collection agency calls, saying you have failed to pay a bill for nearly $10,000. You explain that the name on the account is correct but the billing address for the account is wrong. Soon you hear from a banker in another state who says that you are overdrawn by $2,500 in a checking account you didn't know you had.	
5. Credit problems? Tired of waiting for good credit? You need not suffer forever. Call us now. Don't wait! We can remove bankruptcies, liens, and bad loans from your credit report now. Join hundreds of satisfied customers.	
6. Over your head in debt? Made mistakes? Bill collectors harassing you? Can't sleep? We can help. We can find credit for you. It's guaranteed! Call us now at 1-800-1234.	

1. Pyramid scam 2. Payday loan 3. Rent-to-own 4. Identity theft 5. Credit-repair scam 6. Loan scam

Avoiding scams

Don’t ignore your common sense when someone tells you about some amazing financial scheme. The old adage, “If is sounds too good to be true, it probably is,” is sound advice. Don’t let people appeal to your greed. If a deal sounds interesting, ask a lot of questions. More than likely, the best advice is to walk away or hang up the phone.

The best way to avoid financial temptation is to live below your means. Then you can begin to accumulate some savings. That allows you to open a checking account or a savings account with a mainstream bank.

Seek legal help if you need it.

Here are some steps to reduce the chance of identity theft:

- Sign your credit or debit cards as soon as they arrive.
- Carry your cards in a safe place, separate from your wallet.
- Keep a record of your account numbers, their expiration dates, and the phone number and address of each company in a secure place.
- Keep an eye on your card during a transaction.
- Save receipts to compare with billing statements.
- Open bills promptly and reconcile accounts monthly.
- Report any questionable charges promptly to the card issuer.
- Do not lend your card(s) to anyone.
- Do not sign a blank receipt.
- Do not give your account number or any other number over the phone unless you are making the call to a company you know is reputable.
- If you lose your credit or debit cards, or if you realize they have been stolen, immediately contact the issuer of the card.