FDIC Consumer News

EDITOR: *Josie Downey* — *The Bank Customer's Publication* — July 1981

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Repaying A Loan Early May Be More Costly Than You Think

Many people borrow from a bank or other lenders and arrange to repay the loan with interest in a number of monthly installments. After several payments, they may decide to repay the entire loan and are disappointed to learn that the balance due is higher than they anticipated.

Some consumers assume that the interest on the amount of money they borrow is divided evenly over the number of payments they agree to make. For example, some consumers believe that if they pay off the loan after 10 months instead of 30 months as originally agreed, they would owe only one third interest. Creditors, however, do not compute interest on loans by dividing the interest evenly over the number of payments.

When a consumer decides to pay off a loan early, there are two common methods creditors use to determine the rebate — the portion of the interest that will reduce the balance due in case of early repayment. The two formulas are the rule of 78's and the actuarial method.

The rule of 78's is recognized as the most simple method for allocating earnings and computing rebates for installment loans. Most states permit use of the rule to calculate rebates.

For example, if a $1,000 loan is to be repaid in 12 equal monthly payments at an 18 percent annual percentage rate, the finance charge (interest) amounts to $100.04. The total to be paid is $1,100.04, and the monthly payments are $91.67 ($1,100.04 divided by 12). If the consumer prepays the loan at the end of the sixth month, $550.02 or half of the loan might appear to be due. The remaining half, however, includes the unearned finance charge (interest) — unearned because the lender has received his money back at the end of the sixth month rather than at the end of the twelfth month.

Under the rule of 78's the customer would owe $523.09. The money the consumer would save would be $26.93 ($550.02 minus $523.09) — the finance charge (interest) unearned by the creditor for the remaining six months. This would be the "refund" or "rebate."

If the creditor is using the rule of 78's, the customer would not receive as large a rebate as she or he would receive under the actuarial method.

The actuarial method is the second common method to determine rebates. Under this method, using the previous example, the customer would need to pay $522.38 or 71 cents less than under the rule of 78's. While the difference is small in this example, the difference between the rule of 78's and the actuarial method can be substantial in loans of longer maturity.

Under the actuarial method, each monthly installment is allocated to the payment of interest and principal on the basis of how much money remains as borrowed. In other words, interest is computed on the outstanding balance.

As the principal reduces, the part of each installment required for interest decreases. For example, a $1,200 loan, including $1,100 principal and $100 interest is repayable in 12 monthly installments of $100 each. Obviously, the outstanding total debt is 12 times greater in the first month ($1,200) than in the final month ($100). Since the debtor is using more of the creditor's money in the first few months than the final months, the creditor charges more interest in the first few months and less interest in the final months.

Keep in mind that paying off a loan in 6 months instead of 12 will not produce a savings of one half of the interest. You may, however, be entitled to a rebate of certain other charges when you prepay a loan, such as a portion of the premium for credit insurance.

The current Truth in Lending law requires that creditors disclose the method used to calculate any prepayment rebate. Look for the prepayment disclosure statement before you sign a loan agreement. Ask for an explanation if you don't understand. Under the revised Truth in Lending law, you will have to read the contract to find out the method of rebate of interest or finance charges if the loan is prepaid ahead of schedule.

—Thomas C. O'Nell
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Cosigning A Loan May Be Expensive For The Cosignor

Consumers should be aware of the risks involved in cosigning a loan. Many people believe that when they cosign a loan for a relative or close friend, they will not have to pay. They sign the loan agreement believing that only the borrower is liable for the debt; however, in some instances the cosignor ends up paying. According to a survey submitted by the National Consumer Finance Association to the Federal Trade Commission, almost half of the people who cosigned loans are asked to pay them.

In many states, if the borrower can't repay the loan, the lender can hold the cosignor personally responsible for the debt. The debt may include late charges and fees if the borrower is late in making payments. If the lender cannot contact the borrower, the lender can sue the cosignor instead of the borrower. If the lender wins, not only is the cosignor liable for the court costs and attorneys' fees, but may lose his wages or property to the lender as well.

When you are asked to cosign a loan, remember you are taking a risk a professional lender won't take. The lender protects himself by requiring the borrower to have a cosignor. However, there may be times when you may want to cosign. If you should decide to cosign, keep the following tips in mind.

- Be sure you can afford to pay the loan before you cosign. If you are asked to pay and can't, you may be sued or your credit rating may be ruined.
- Ask the lender if you can be liable for a certain amount of the loan. Keep in mind that he isn't obligated to do this. Agree to pay the principal balance on the loan, but try not to be responsible for late charges, court costs, and attorneys' fees. Ask the lender to write a statement in the contract saying that you will only be responsible for the principal balance on the loan in the event of default.
- Ask the lender to agree in writing, to notify you if the borrower misses a payment. Notification should come before a late charge is added and always before the loan is "accelerated" (the total amount of the loan is demanded). You may have time to make the late payments without having to pay the total amount of the loan.
- It is important that you get copies of all the papers signed by the borrower: the loan contract, the Truth in Lending Disclosure Statement, and any warranties for products purchased if it's a credit sale. These may be needed in case there is a dispute later between the borrower and the seller.
- Don't be pressured into cosigning a loan for a relative or close friend. Many people sign under pressure and are faced with paying off the loan. Consider carefully the consequences of cosigning a loan. After you sign, it's too late to withdraw your signature.

—By
Josie Downey

El Cofirmar Un Préstamo Puede Ser Costoso Para El Cofirmante

Los consumidores deben estar informados del riesgo envuelto al cofirmar un préstamo. Muchas personas creen que al ellos cofirmar un préstamo para un familiar o un amigo no tendrán que pagarlo. Ellos firman el contrato de préstamo confiando que sólo el prestatario es responsable por la deuda. Sin embargo, en algunos casos el cofirmante termina pagando dicha deuda. De acuerdo con un estudio presentado a la Comisión Federal de Comercio ("Federal Trade Commission") por la Asociación Nacional de Finanzas del Consumidor ("National Consumer Finance Association"), casi la mitad de las personas que cofirman préstamos se le exige pagarlos.

En muchos de los estados, si el prestatario no puede repagar el préstamo el prestamista está en posición de hacer al cofirmante personalmente responsable por la deuda. La deuda puede incluir cargos por demora si el prestatario se demora en sus pagos. Si el prestamista no puede comunicarse con el prestatario, el prestamista puede presentar pleito en contra del cofirmante en vez del prestatario. Si el prestamista gana el pleito, el cofirmante no sólo es responsable de asumir los cargos de corte y los honorarios de abogado, pero también puede perder su sueldo o propiedad a favor del prestamista.

Cuando a usted le pidan cofirmar un préstamo recuerde que está asumiendo un riesgo que el prestamista profesional no asume. El prestamista se protege a sí mismo, al exigir que el prestatario tenga un cofirmante. Sin embargo, puede que haya ocaciones que usted desee cofirmar. Mantenga los siguientes consejos presentes si usted decide cofirmar.

- Asegúrese de tener recursos para pagar el préstamo antes de cofirmarlo. Si a usted le exigen pagar y no puede, pueden presentar pleito en su contra o su evaluación de crédito puede ser arruinada.
- Solicite que el prestamista lo haga responsable por cierta cantidad del préstamo. Recuerde que él no está bajo la obligación de hacer ésto. Llegue a un acuerdo para pagar el balance principal

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El Cofirmante

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del préstamo, pero trate de no hacerse responsable por los cargos por demora, cargos de la corte y honorarios de abogado. Solicite que el prestamista escriba una claúsula en el contrato señalando que en caso de incumplimiento usted sólo será responsable por el balance principal del préstamo.

- Llegue a un acuerdo en escrito con el prestamista para ser notificado si el prestatario no cumple con sus pagos. La notificación debe llegarle antes de añadir un cargo por demora y siempre antes que el pago total del préstamo sea adelantado ("accelerated" — le exigen la cantidad total del préstamo).
- Es importante que usted consiga copias de todos los documentos firmados por el prestatario: el contrato del préstamo, la declaración conforme a la Ley de Veracidad en Actividades Prestatarias, y cualquier garantía de los productos que ha comprado si es una venta a crédito. Estos documentos pueden ser necesarios si más tarde hay una disputa entre el prestatario y el vendedor.
- No deje que un familiar o un amigo cercano ejerzan presión para que usted cofirme un préstamo. Muchas personas que cofirman bajo presión se cofrontan con que tienen que pagar el préstamo. Considere cuidadosamente las consecuencias de cofirmar un préstamo. Recuerde que después que usted firme es muy tarde para retractar su firma.

Traducido
Por
Madeleine Rivers

Older Consumers Have Equal Access To Credit

Problems involving credit can be particularly serious for the elderly. The use of credit cards and installment loans for buying goods is relatively new and many older buyers are being confronted for the first time with the concept that buying on credit is both acceptable and necessary. For many older Americans, the idea of buying goods and services on credit is a foreign concept, since many of them have paid most of their obligations in cash. Many older people have neither credit ratings nor experience with buying on credit.

In spite of their inexperience with credit, more and more elderly persons have begun using credit. Several laws have been enacted to protect consumers' rights. A number of these laws directly affect the elderly. The Equal Credit Opportunity Act (ECOA) prohibits creditors from discriminating against the elderly in any aspect of a credit transaction. Despite the Act's prohibition of age discrimination, many of the elderly may continue to be treated unfairly in the credit market. The following are some of the problems older buyers encounter.

Many elderly citizens pledge their homes as security, and are sometimes coerced into purchasing major unneeded home improvements, such as a complete roof when the existing roof could be repaired. Elderly consumers need to know that when they pledge their home, they are provided under the Truth in Lending Act with a three-day right of rescission on the contract. They also need to understand that if their contract is sold, and they have a claim against the contractor, they can often assert that same claim against the holder of the note.

Creditors use various criteria to determine whether an applicant is creditworthy. They want to ensure that the applicant is both willing and able to repay the debt. However, evaluating elderly applicants by the same criteria applied to younger applicants may sometimes inequitably limit access to credit by elderly consumers. The Equal Credit Opportunity Act states that refusing to grant credit on the basis of age is against the law.

While it is permissible for a creditor to consider life expectancy tables in determining the likelihood of an applicant's repaying a loan, some creditors appear to use life expectancy factors as a means to limit the amount of credit or refuse to grant it to the elderly. Creditors may deny loans to older applicants because of fears that death of the applicant will prevent repayment of the loan or because a short life expectancy means the creditor will get less repeat business from an elderly applicant. Creditors may also terminate or fail to renew a loan because of decreased life expectancy, or offer such onerous terms that an applicant cannot possibly repay the loan on the terms offered. The Equal Credit Opportunity Act prevents the age factor from being used against the elderly when they need credit.

The elderly now have consumer protection credit laws to protect them. The Fair Credit Reporting Act (FCRA), the Electronic Fund Transfer Act (EFTA), the Truth in Lending Act (TILA), the Fair Credit Billing Act (FCBA) and the Fair Debt Collection Practices Act (FDCPA). Pamphlets on these laws are available at FDIC. Call FDIC's consumer toll free hotline 800-424-5488 to order the above pamphlets or write to FDIC, Office of Consumer and Compliance Programs, 550 17th St., NW, Washington, D. C. 20429.

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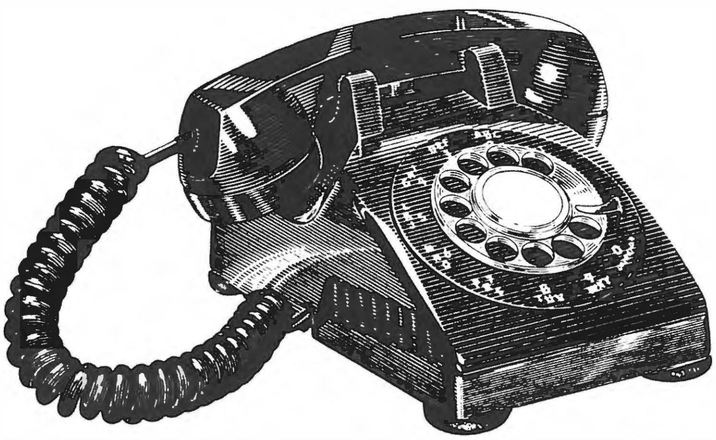
Questions From Bank Customers



FDIC CONSUMER HOTLINE

— 800-424-5488—

Q: In your April issue of the consumer newsletter, I read that the bank may enforce a penalty if it so chooses for early withdrawal of a time deposit upon the death of the owner or if the owner of a time deposit was declared incompetent by a court. I believe you are in error.

A: You are correct. According to Section 329.4 of the FDIC regulations, not only must a bank grant a request for early withdrawal of a time deposit upon death of the owner or if the owner has been declared incompetent by a court, but the bank must also honor the request without a penalty. The editor apologizes for the error.

Q: Can a bank require a minimum balance on a checking account to qualify for free checking and levy service charges if the account balance falls below the minimum?

A: Yes, as long as the service charges are uniformly applied to all customers that have the free checking service.

Q: If a person has an interest in more than one joint account, what is the extent of his or her insurance coverage by FDIC?

A: All joint accounts owned by the same combination of individuals are first added together and the total is insurable to $100,000. Then the person's insurable interests in each joint account owned by different combinations of individuals are added together and the total is insured up to the $100,000 maximum.

The Four C's Of Credit

When you apply for a loan, you may wonder just what factors the loan officer takes into consideration in approving or denying your application. Many banks use different methods in evaluating applications. The criteria most banks use fit generally into four categories: character, capacity, capital, and collateral. These are commonly referred to as the four C's of credit.

The following definitions will help you to understand what to expect from some creditors.

CHARACTER refers to your reputation, credit rating, business record, willingness and determination to pay your financial obligations.

CAPACITY relates to your ability to make payments on the loan. This would be influenced by your earnings record, training, education, and skills in addition to other obligations you may have.

CAPITAL is the analysis of your overall financial status, including the value of your assets and the amount of your obligations.

COLLATERAL relates to an evaluation of the property or asset being financed or promised to secure the loan. This "C" looks at the value, type, location, and other attributes of that property.

When filling out a loan application, it would be to your benefit to keep the four "C's" in mind although some creditors will place more emphasis on one than another.

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