Issue Briefs

2009-4 Family Financial Education

UW Extension Cooperative Extension

Nothing like a recession to bring out the scam artists

The recession of 2008-2009 was more severe and longer than many previous economic downturns of the last half century, but it had one feature common to times when jobs are more scarce: a burst of shady financial products and services preying on people in hard times. This brief highlights a few of the issues consumers face, even as the economy recovers and expands.

Defining "scam"

It is most important to note that many 'scams' are actually not illegal. There is a wide continuum of practices that are at best shady and at worst criminal. Sketchy practices that lurk in the shadows are met with skepticism in the popular press.

At one end of the spectrum are financial products or services with high upfront fees and with little or no recourse to allow the consumer to back out later. Examples might include high-pressure sales of life insurance or of home equity loans where the underlying product might be fair and reasonable, but the commissions and fees make the transaction so expensive that the benefits are swamped by the costs. Other variations might include commitments to make monthly installment payments for a long period of time, or using a monthly payment plan in order to obscure fees. (For example, the consumer's monthly payment is set at $100, but unbeknownst to them only $60 goes to debt payment and the balance, $40, to commission/fees.) Too often the fees involved are too high for the value provided.

Related are products or services which are legitimate, but sold through processes that make it hard for a consumer to make carefully informed decisions. For example, a firm might promote an investment or loan product via a web page or unsolicited email. While the site may make the vendor appear reliable it is all too easy for information to be fabricated or websites to disappear after purchase. Door-to-door sales are another shady practice whereby people may be cajoled into committing to a decision they did not actively seek out...financial products or services that are "sold not sought."

Then there are companies that make marvelous claims, yet have no established history. With no guarantees of continued viability a consumer might commit to a product only to find there is no firm to go back to later if there is a problem. Too often these types of firms target people in stress or who are vulnerable--offering cash or a way out of financial problems.

Aside from poor product design or marketing practices, there are other scams that involve flat out deception--where consumers are tricked or offered a good product ("bait") until at the last minute a poor substitute with high fees is actually on offer ("switch"). These practices are more clearly in the realm of illegal practices. However, scam artists may try to persist for quite a while before being caught and prosecuted.

Other more severe forms of fraud include identify theft (see ID Theft Brief posted 10-8-2010), falsifying signatures, and forging documents.

Legally, consumers can and do bring civil lawsuits on all of these issues. Other options include complaints with the Wisconsin Department of Financial Institutions (http://www.wdfi.org/), Wisconsin Department of Agriculture, Trade and Consumer Protection (http://datcp.state.wi.us/), the Attorney General's office (http://www.doj.state.wi.us/ag/) and local Better Business Bureaus (http://wisconsin.bbb.org/). At the federal level, bank regulators such as the FDIC and consumer protection such as the Federal Trade Commission are available to file complaints.

These agencies may not be able to react at a pace that helps every potential victim. The process is often slow and requires aggregation of multiple complaints. Because scams are always changing it can be challenging just to notice a pattern of deception especially with complicated products.
Below are a series of recent scams to emerge on the scene as of mid 2009.

Stimulus

Stimulus Tax Check

In 2009 the Federal Government offered stimulus payments outside of the regular tax cycle. Past stimulus programs required recipients to have a tax form on record, even if they did not earn enough income to requiring filing a return. Scam artists have promoted high cost tax preparation services just to receive a stimulus check. Others have solicited tax information--such as social security numbers and adjusted gross income--under the rouse of helping people receive stimulus payments. The IRS requires no such information and will never ask for it: http://www.irs.gov/newsroom/article/0,,id=98269,00.html. Suspected tax fraud can be reported to the IRS using IRS Form 3949-A, Information Referral.

Federal Stimulus Grant Scams

The use of federal funds for infrastructure and financial stabilization grabbed headlines in 2008. Scammers immediately sent out emails and posted websites offering to connect people to "free government money." But buried deep inside the small print of agreements on the site is an enrollment in multiple paid programs that can result in unexpected monthly credit card charges. Other scams involved collecting personal financial information with the intention of identity theft.

Foreclosure Scams

The rise in foreclosure since 2008 has been historic by most measures. So too has the rise in foreclosure related scams. One form of scam is collecting a fee for useless counseling or advice to negotiate a loan workout or modification. Given that HUD housing counseling offers free counseling services such offers hardly seem like a good first step. Other scams offer to "make payments for you." Here people might pay the 'counselor' only to find the payments were kept rather than used to repay the loan. Other scams include rescue frauds where a homeowner is tricked into signing over title to the home, or a rent-to-buy scheme where the scammer takes title and then rents the home back to the borrower, but then raises rent or evicts tenant with no recourse and either re-rents the home or sells it without fulfilling any promises to share any home sale profits.

Other shady offerings include paying high legal fees to file bankruptcy with the idea that this might stop foreclosure. In truth, bankruptcy filing at best only temporarily stops a home foreclosure. The bankruptcy process is complicated, expensive, and stays on a credit report for up to 10 years. Moreover, unless bankruptcy frees up other debt that can be applied to the mortgage, the borrower may still may lose the home--bankruptcy courts cannot restructure mortgage debt under current laws.

Mortgage Payoff "Schemes"

Biweekly Payoff Programs

Most mortgages are paid monthly. Because some people receive paychecks every two weeks, one option is to make mortgage payments more often. By paying half a mortgage payment every two weeks, a borrower will make 26 half payments per year, or essentially making one extra monthly payment per year. This is a viable strategy to pay off a year mortgage faster than the standard amortization schedule. Paying down principal means that more of each successive payment goes toward loan repayment, reducing total interest costs. The scam that can take place with this otherwise useful strategy is paying a third party to manage payments or paying fees to set up a payment plan with the borrower. There are several ways to create bi-weekly payment plans yourself, including having a savings account to accumulate payments and then making the 13th payment at the end of the year. Paying fees for this strategy reduces the benefit significantly. Moreover it is important to check with your lender as some lenders may charge a fee or wait to post all payments until the end of the month.

Mortgage Acceleration using Home Equity Lines of Credit

Websites and community seminars have promoted various forms of mortgage acceleration schemes. These firms promote the use of specialized proprietary mathematical models that allow borrowers to pay off a loan faster than otherwise possible by using a home equity line to advance payments on the main mortgage. The design of these programs remains opaque making a full understanding or evaluation hard to accomplish. It is possible that there is some sort of arbitrage (that is – taking advantage of differences in lender offers of loan rates) to be had by moving funds from a mortgage to a lower-cost home equity line, but generally this will be modest at best. Many of the models advertised suggest creating far more savings than simply borrowing at a slightly lower rate to pay off a loan at a slightly higher rate. The problem is that any potential benefit is likely to be small and the costs of these models and the line of credit could be thousands of dollars. Any program with large upfront fees should be seen as a red flag of a potential problem--it will be hard to recoup that fee if the program is not successful.

Elderly Reverse Mortgage Fraud

Elderly homeowners can covert some of their home equity into cash without selling their home by using a home equity loan that is do upon sale or estate transfer. These reverse mortgages can be structured like an annuity where the owner receives a monthly payment (see brief on Reverse Mortgages posted Nov. 23, 2010). Like many other financial products targeted at seniors, there is the potential for high pressure sales and high fees. Other vulnerable populations include non-English-speaking consumers who don't understand how much they are losing as home equity is converted to sales commissions.

Energy Scams

Bogus Fuel Saving Devices

Concerns about high energy costs have resulted in a new wave of inventions promoting more efficient energy usages. Examples are "special pellets" or "magnetic device" to increase gas mileage for automobiles. These products are all frauds and in fact being actively pursued by the Federal Trade Commission (see : http://www.pueblo.gsa.gov/scams/sc16323.htm)

Energy rebates

The home energy tax credit offered in 2008, 2009 and 2010 resulted in home improvement contractors--many of whom are idled by the weak housing market--promoting projects qualifying for the credit. The danger comes from contractors who may inflate estimates knowing consumers will over estimate the value of the credit. Others may do shoddy or even fraudulent home improvement that fails to meet the specifications promised. Others might ask for tax information as part of an initial bid or estimate and never come back--trying to glean personal information for identity theft.

Bottom Line

Always be careful. Even when times are tough it is important to be a careful consumer. If it looks too good to be true, it probably is. Anything promoted as free or only provides benefits with no cost should be suspect.

Resources

Also visit www.mymoney.gov/scams.shtml, the scams and frauds section of the U.S. government's web site dedicated to financial education.

Find a counseling agency certified by the U.S. Department of Housing and Urban Development (HUD), by visiting www.hud.gov/offices/hsg/sfh/hcc/hcs.cfm or calling 1-800-569-4287.

To see a Federal Trade Commission warning about foreclosure rescue scams, go to: www.ftc.gov/bcp/edu/pubs/consumer/credit/cre42.shtm.

Reporting an issue: visit ftc.gov or call 877-FTC-HELP to reach FTC Consumer Sentinel http://www.ftc.gov/sentinel/ (a collaborative of federal agencies and local law enforcement).

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The University of Wisconsin-Extension (UWEX) Cooperative Extension's mission extends the knowledge and resources of the University of Wisconsin to people where they live and work. Issue Briefs are an ongoing series of the Family Financial Education Team. This brief was drafted by J. Michael Collins, Assistant Professor in Consumer Finance and Extension State Specialist.