Latino Credit Card Use: Overcoming Disparities, Structural Challenges, and Harmful Industry Practices

Submitted to:
U.S. House Financial Services Committee
The Honorable Barney Frank, Chairman

Submitted by:
Raul Gonzalez, Legislative Director
National Council of La Raza

National Council of La Raza
Raul Yzaguirre Building
1126 16th Street, NW
Washington, DC 20036

July 25, 2007

INTRODUCTION

The National Council of La Raza (NCLR) – the largest national Hispanic[*] civil rights and advocacy organization in the United States – works to improve opportunities for Hispanic Americans. Part of this mission includes conducting research, policy analysis, and advocacy on a variety of financial services issues that impact the ability of Latinos to build and maintain assets and wealth. The most recent household wealth survey revealed that the median net worth or wealth of Hispanic households is $7,932, compared to $88,651 for White non-Hispanic households.[1]

All Americans rely on financial products to help them buy homes and otherwise build wealth and financial security. Credit cards are one important way for Americans to gain experience in financial markets or personal finance and build a credit history. Access to safe and affordable credit has become increasingly critical for Latinos – the fastest-growing and largest minority group in the country – as they more fully integrate into the mainstream financial system and work to gain access to the American middle class. Yet, clear disparities in credit card use and in the application of fees exist between racial groups, which only perpetuate the wealth gap. Currently, household debt is on the rise. Many consumers report that they are "maxed out," and low-income families often rely on credit cards as a safety net to make up for limited income. This is a critically important time for Congress to shed light on the credit card industry.

As experts and policy-makers deliberate on how to regulate the credit card market, developing a deeper understanding of the experience of low-income Latino and immigrants with credit cards can help to shape policies that positively impact all consumers. This statement will briefly outline recent data on Latino credit card use, structural barriers in credit markets, and harmful credit card industry policies and practices, and will provide recommendations to improve access to affordable credit and shift the balance of power back into the hands of consumers.

LATINO CREDIT CARD USE

The increase in credit card use among low-income households has been significant, in large part due to heavy marketing by the industry to these consumers.[2] However, while the vast majority of American households use credit cards, a large share of Latino consumers do not. Data from the 2004 Survey of Consumer Finances show that 80% of surveyed respondents said that they use credit cards, compared to only 56% of Hispanic households.[3] Still, more Latinos are using credit cards today than ever before. Between 1992 and 2001, the share of Hispanic families who held credit cards grew from 43% to 53%.[4] Increased credit card use among Latinos is a sign that they are becoming more integrated into the financial fabric of the country. An increase in credit card use, however, has also led to an increase in debt. The average credit card debt among Hispanics increased by nearly 20% between 1992 and 2001, from $3,082 to $3,691.[5]

Although wise credit card use is a good method for building a credit history, an increased reliance on credit cards hampers a family's ability to save for big-ticket items, such as a reliable vehicle, a home, or an education. Recent data show that Latinos are having difficulty managing their credit card debt. Approximately 19.3% of Hispanics in one survey described their situation

---

[*] The terms "Hispanic" and "Latino" are used interchangeably by the U.S. Census Bureau and throughout this document to identify persons of Mexican, Puerto Rican, Cuban, Central and South American, Dominican, and Spanish descent; they may be of any race.

as “burdensome and not enough money to pay down [the balance],” and 11.4% of Hispanics reported they were “maxed out and can’t use [their cards].” However, 12.7% of all respondents in the same survey characterized their debt situation as “burdensome and not enough money to pay down [the balance], while 7.3% were “maxed out and can’t use [their cards].”

STRUCTURAL BARRIERS TO ACCESSING GOOD CREDIT

NCLR recently released a report entitled, *Latino Credit Card Use: Debt Trap or Ticket to Prosperity?*[6] In this report, we found that many structural factors and barriers hamper Latino access to mainstream credit cards with the most desirable contract terms. A forthcoming study by Demos will show that Latino and African American consumers are more likely than White consumers to pay interest rates higher than 20%. More specifically, 13% of Latino, 15% of African American, and 7% of White cardholders pay interest rates greater than 20%.[7] The following factors may explain why such barriers exist:

- **Creditworthiness.** Credit card issuers rely on several factors to determine whether or not to extend credit to consumers, including credit score, the number of credit cards they currently hold, their combined credit card balances and credit limits on their cards, and any record of past delinquencies. Approximately 22% of Hispanic borrowers have no credit score, compared to 4% of Whites and 3% of African Americans.[8] Individuals who lack a repayment history or other observable characteristics will either not be approved for a credit card or receive a card with undesirable terms.

- **Search Costs.** Roughly 5.2 billion credit card solicitations were sent to U.S. households in 2004.[9] Through the collection of consumer financial information, issuers essentially prescreen and select their customers. Individuals with robust credit histories will receive multiple offers from which to choose. Subprime and low-income borrowers who are not operating in the mainstream financial system are less likely to receive multiple offers. These borrowers will have to spend a significant amount of time and resources searching for a credit card that meets their needs.

- **Shopping.** Latino consumers are less likely to shop for a credit card. According to one survey, only 7% of Hispanic consumers who carry a balance report “substantial” shopping for credit, compared to 12% for similar White consumers.[10] Research also shows that Latinos are not shopping and applying for credit cards for fear of rejection. Approximately 25% of Hispanic consumers who use credit cards and were denied a loan did not reapply for fear of rejection.[11]

- **Switch Costs.** For many consumers, relief from a credit card with a high interest rate comes from switching or transferring their balance to a credit card with a lower interest rate. Transferring balances from one card to another is not an option for consumers who carry high interest rates and who are often rejected for credit. Approximately 34% of Hispanic households who carry a balance reported being rejected for a loan, and 23% cited “credit” as a reason for the rejection.”[12] These consumers are essentially held captive by their issuer.

CHALLENGES IN POLICY AND PRACTICE

Consumers who use credit cards can be placed into three general categories: 1) consumers who use their card but pay the balance in full each month; 2) consumers who sometimes carry a balance; and 3) consumers who usually or always carry a balance. Consumers in the third category are struggling to make ends meet and using their credit card as a safety net. Consequently, these consumers are also more likely to make a late payment and trigger harmful industry policies and practices that lead to penalty interest rates that exceed 30% and a laundry list of fees. A recent survey showed that borrowers who pay late are more likely to be low income, single, or non-White.[13]

Given the issues listed above, the following industry policies and practices provide notable challenges for Latino consumers:

- **Universal default.** Universal default enables an issuer to increase a consumer's interest rate based on the consumer's credit behavior with *other* creditors. Depending on the credit card issuer, the penalty interest rate that is applied could exceed 30%, even if the consumer has never missed a payment.

- **Change-in-terms provisions.** Change-in-terms provisions enable a credit card issuer to change the terms of a consumer's credit card agreement at any time and for any reason as long as they provide written notice to the consumer 15 days before the change. While recent attention by Congress on credit cards has led one major issuer to cease the application of these provisions, a recent credit card survey revealed that half of the top 20 banks still apply these policies.[14]

- **Double-billing on purchases made outside the U.S.** Firms that process credit card transactions, such as Visa and MasterCard, traditionally charge 1-2% of the cost of *each* purchase made abroad for converting currency, often called the foreign conversion fee. In addition to this fee, however, many credit card issuing banks charge an additional fee for these purchases, even though there is no additional cost to the bank. A recent credit card survey showed that 26 out of 45 issuers charge a foreign conversion fee, in addition to the fee charged by the transaction processing firms, with a total average fee of 3% for *each* transaction. This constitutes double-billing and particularly impacts immigrants who frequently return to their home country.

- **Deceptive monthly minimum balance requirements.** Some consumers are unaware of the consequences of paying only the monthly minimum payment requirement while, for others, the minimum is all they can afford. Consumers who pay only the minimum will ultimately pay more in interest and extend the time that they will be subject to fees.

- **Inflation and application of fees.** Today credit cards come with a laundry list of fees that issuers charge to consumers, such as the annual fee, late payment fee, over-the-credit-limit fee, credit limit increase fee, foreign conversion fee, expedited payment fee, and the replacement card fee, just to name a few. The cost of fees has dramatically increased over the past ten years, even though the cost to banks to purchase funds has not. A typical late fee in 1980 ranged from $5 to $10, compared to $33 today.

- **Credit card-related scams.** Research conducted by the Federal Trade Commission (FTC) shows that 14.3% of Hispanics are victims of fraud, compared to 6.4% of non-Hispanic Whites.[15] One type of scam is the existence and distribution of affinity and fake credit cards.[16] Affinity credit card scams involve individuals who sell credit cards to Hispanic consumers, claiming that they are custom-tailored to meet their needs. Similar to fake credit card scams, these affinity credit cards are worthless and cannot be used to purchase goods or services.

- **Obscure consumer complaint system.** Currently, the burden is on the consumer to determine which federal agency regulates their credit card issuer and determine how to file a credit card-related complaint. It is highly unlikely that consumers are familiar with the role and responsibilities of the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, or the Office of Thrift Supervision, all of which regulate credit card-issuing banks. The Customer Assistance Group (CAG) of the OCC was created to receive, track, and resolve consumer complaints against national banks. However, CAG's consumer complaint hotline does not appear on credit card statements, and the agency has done little to reach out to Hispanic consumers who have a tendency not to file complaints.

- **Ineffective financial education structure.** A variety of financial education programs has been created to increase financial literacy in the Hispanic community. These programs include workbooks, DVDs, Internet seminars, and brochures. Although financial education is important for raising awareness among consumers, many financial education materials contain generic information or are not custom-tailored to address the unique credit needs of Latinos. Additionally, distribution of materials has been limited, and consumers may have already fallen into debt trouble before gaining access to these resources.

RECOMMENDATIONS

- **Ban universal default and change-in-terms policies.** Policy-makers should enact the "Universal Default Prohibition Act of 2007" (H.R. 2146), which prohibits issuers from increasing interest rates on a consumer's credit card for failing to make payments to another creditor. Additionally, issuers should be prohibited from changing the terms of a consumer's credit card agreement. These policies are fundamentally unfair.

- **Inflation and application of fees.** Policy-makers should require that credit card fees relate back to the cost incurred by the issuer. In regard to the foreign conversion fee, consumers should not be double-billed for purchases made abroad. To this end, banks should cease applying an additional conversion fee to transactions made abroad. Additionally, regulators should require credit card issuers to highlight the foreign conversion fee in non-English-language credit card offers.

- **Enact a mandatory, individualized minimum payment warning.** Policy-makers should enact the "Credit Card Repayment Act of 2007" (H.R. 1510), which requires conspicuous, front-page disclosure of the outstanding balance, a minimum payment warning, and the amount of time that it would take consumers to pay off their balance if they pay only the minimum.

- **Stop credit card-related scams.** Federal agencies, credit card issuers, and local consumer protection agencies should partner with community-based organizations (CBOs) to raise awareness of credit card-related scams that strip wealth from the Latino community. CBOs serve as the "eyes and ears" of the Latino community and understand its needs.

- **Create a community-based financial counseling network.** One-on-one financial counseling has proven to be an effective method for building wealth in the Latino community. Congress should create a community-based financial counseling infrastructure similar to the Housing Counseling Program that the Department of Housing and Urban Development currently oversees. The primary purpose of the program would be to help consumers manage their personal finances, learn how to avoid unmanageable debt, and spot credit card-related and other scams in the community. Resources would be used to hire and train community-based financial counselors and to develop software to track client progress.

- **Improve the consumer complaint system.** Federal regulators should market their consumer complaint centers and highlight any toll-free consumer complaint phone number on all materials sent by credit card issuers to consumers. Furthermore, this information should be provided in languages and formats that consumers understand. Finally, federal regulators should collect consumer complaint information by race and ethnicity to more effectively detect trends within segments of the population, help to shape efforts to eradicate scams, and develop strong cases against predators.

CONCLUSION

It is critical that Congress take the necessary steps to eliminate disparities in credit markets and enact legislation to protect consumers from harmful industry policies and practices. Furthermore, it is vital that the voice of Latino and immigrant communities be part of the debate. The ability of all consumers to save for a home, their retirement, or an education is not a narrow special interest.

---

[1] Kochhar, Rakesh, *The Wealth of Hispanic Households: 1996 to 2002*. Washington, DC: Pew Hispanic Center, 2004.
[2] *Improving Credit Card Consumer Protection: Recent Industry and Regulatory Initiatives*, Testimony by Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation, before the U.S. House Financial Services Committee, June 7, 2007.
[3] NCLR calculation based on unpublished tables from the 2004 Survey of Consumer Finances.
[4] Silva, Javier, and Rebecca Epstein, *Costly Credit: African American and Latinos in Debt*. Demos, May 2005.
[5] *Ibid*.

[6] Ibarra, Beatriz and Eric Rodriguez, *Latino Credit Card Use: Debt Trap or Ticket to Prosperity?* National Council of La Raza, 2007. The report is available at www.nclr.org/creditcards.
[7] Wheary, Jennifer and Tamara Draut, *Who Bears the Cost of Credit Card Deregulation*, Demos, work in progress.
[8] Stegman, Michael, et al., "Automated Underwriting: Getting to 'Yes' for More Low-Income Applicants," Presented before the 2001 Conference on Housing Opportunity, Research Institute for Housing America, Center for Community Capitalism, University of North Carolina at Chapel Hill, April 2001.
[9] *Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers*, Government Accountability Office, September 2006.
[10] Unpublished data from the 2004 Survey of Consumer Finances tabulated by the Federal Reserve on behalf of NCLR.
[11] *Ibid*.
[12] *Ibid*.
[13] *Who Bears the Cost of Credit Card Deregulation, op. cit.*
[14] Consumer Action Credit Card Survey, 2007.
[15] "Consumer Fraud in the United States: An FTC Survey," Federal Trade Commission Staff Report, August 2004.
[16] *A Conversation on Latino Credit Card Use*, Transcript from a Roundtable Discussion held at the 2006 NCLR Annual Conference in Los Angeles, California.