NCLR
NATIONAL COUNCIL OF LA RAZA

Eroding a Generation of Wealth
Abusive Lending Practices Targeting Latino Communities

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Good morning. My name is Janet Murguía. I am the President and CEO of the National Council of La Raza (NCLR) – the largest national Hispanic[1] civil rights and advocacy organization in the United States. For the last four decades, NCLR has been committed to improving opportunities for the nation's 40 million Latinos. To this end, NCLR conducts 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. I would like to thank Chairman Serrano for inviting me to participate in this timely and important panel, and for your diligent work on behalf of Latino families. Specifically, we would like to thank you for being a champion on funding for Community Development Finance Institutions and for opposing damaging anti-immigrant amendments that have been attached to financial services legislation.

NCLR is deeply concerned that a generation of Latino wealth is under attack. Historically, Latinos have been marginalized from mainstream financial services, such as basic banking and checking accounts. Despite the many barriers, Latinos are entering the financial services market in record numbers. Unfortunately, these same barriers leave Hispanic borrowers vulnerable to abuse. As a leading voice for Latino consumers, NCLR has been warning corporations and governments for years that the financial markets do not serve Latino consumers well. The crisis in the mortgage market has exposed the cracks in the system. NCLR and its Affiliates have been doing our part to ensure that potential Latino homeowners do not fall through these cracks. As a housing counseling intermediary, NCLR serves more than 30,000 homebuyers and homeowners every year. The NCLR Homeownership Network (NHN) is expanding its work in this area to launch a campaign to prevent foreclosure in low-income communities. We understand what it takes to build sustainable wealth in Latino and immigrant communities and have executed a successful strategy to do so.

All Americans rely on financial products to help them buy homes and otherwise build wealth and financial security. Access to safe and affordable credit is a critical means to this end for Latinos as they more fully integrate into the mainstream financial system and work to gain access to the American middle class. Yet, there are clear disparities between the quantity and quality of financial products made available to low-income and minority consumers. These disparities perpetuate the wealth gap between minority and White households. Household debt, foreclosures, and reports of fraud are on the rise. Congress must take this opportunity to improve the quality and quantity of credit available to marginalized communities while also protecting consumers.

We have yet to see the robust response from Congress and federal agencies necessary to overcome the financial crisis facing all communities. Today we will discuss the major structural barriers in the market that have left low-income and minority borrowers vulnerable to abuse, the areas where the consumer protections have fallen short, and recommendations for congressional action.

Structural Barriers

[1] 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.

Latino borrowers are unique. For example, 22% of Latinos have a "thin" credit file, or no credit history, which usually results in a "0" credit score, compared to only 4% of Whites.[2] Approximately 35% of Latino families do not have basic checking or savings accounts.[3] Many Latino consumers rely on fringe financial products, such as payday loans, car title loans, and check cashiers to pay their bills and otherwise make ends meet. Creditors do not look favorably on characteristics outside the traditional borrower profile when qualifying consumers for the best-priced products. As a result, many Latino families are channeled to more expensive credit cards, car loans, and home loans, regardless of their actual risk or creditworthiness. For example, credit card issuers analyze consumers' credit scores, 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, among other factors, when determining the terms of a contract. The automated underwriting systems employed by mortgage lenders often do not take into consideration nontraditional credit histories such as rent, utility, and other bill payments. These structural barriers are inherent in the financial systems and contribute to the abuse of Latino consumers. This is even more troubling considering the rate at which Latinos are entering financial markets. In the sections below, we briefly outline the structural barriers in credit card, auto loan, and mortgage markets.[4]

Credit Cards

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 all surveyed respondents said that they use credit cards, compared to only 56% of Hispanic households.[5] 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%.[6] Increased quantity, however, has not necessarily come with increased quality. A recent study by Demos shows 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]

Although wise credit card use is a good method for building a credit history, unethical credit card practices trap consumers in less-than-favorable terms. Not only do families spend hard-earned income on unnecessary fees and extra interest, predatory practices hamper their ability to save

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[2] Michael Stegman 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 (Chapel Hill: University of North Carolina, April 2001).

[3] *2002 National Survey of Latinos* (Washington, DC: Pew Hispanic Center/Kaiser Family Foundation, 2002).

[4] NCLR has published several reports, public statements, and testimony on each of these issues. These are available at www.nclr.org. Key reports include: Beatriz Ibarra and Eric Rodriguez, *Latino Credit Card Use: Debt Trap or Ticket to Prosperity?* (Washington, DC: National Council of La Raza, 2007); *Saving Homes, Saving Communities: Hispanic Brokers Speak Out on Hispanic Homeownership* (Washington, DC: National Council of La Raza and National Association of Hispanic Real Estate Professionals, 2007); and Janis Bowdler, *Jeopardizing Hispanic Homeownership: Predatory Practices in the Mortgage Market* (Washington, DC: National Council of La Raza, 2005).

[5] NCLR calculation based on unpublished tables from the *2004 Survey of Consumer Finances*.

[6] Javier Silva and Rebecca Epstein, *Costly Credit: African American and Latinos in Debt* (New York: Demos, May 2005).

[7] Jennifer Wheary and Tamara Draut, *Who Pays? The Winners and Losers of Credit Card Deregulation* (New York: Demos, August, 2007).

for big-ticket items, such as a reliable vehicle, a home, or an education. The average credit card debt among Hispanics increased by nearly 20% between 1992 and 2001, from $3,082 to $3,691.[8] Recent data show that Latinos are having difficulty managing their credit card debt. Approximately 19.3% of Hispanics in one survey described their situation 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]." This is in comparison to only 12.7% and only 7.3%, respectively, of all non-Hispanic respondents in the same survey who characterized their debt situation in the same way.

Auto Lending

Auto financing is another area where Latino consumers are particularly vulnerable. In 2002, slightly more than one-quarter (25.4%) of Latino households did not own any assets other than a vehicle or unsecured liabilities, compared to 6.3% of White households. Reports show that Latinos and African Americans are often the victims of discrimination in auto financing. Economist Mark Cohen of Vanderbilt University conducted a series of studies chronicling the impact of a pricing component known as a "markup" on Latino and African American consumers. Dr. Cohen found that minority car buyers were more likely than their peers, regardless of creditworthiness, to have a marked up auto loan. For example, in a statistical analysis of more than 1.5 million race-coded sale files, Dr. Cohen found a staggering disparity between the amount of the markup paid by minorities and that paid by White customers. This racial disparity exists in every state analyzed and in all credit tiers. As a result, Hispanic and African American consumers with the same creditworthiness as White customers nevertheless pay more for credit. In a second report, Dr. Cohen examined 219,278 financing records of a major auto company from 2001 to 2004. He found that 57% of Hispanic customers who financed their car through the company were charged an unwarranted markup, compared to 40.2% of White customers. The average markup for Hispanic customers was $715, compared to $464 for White customers.[9]

While some companies have imposed a cap on the markup charge, recent data show that the lower markup cap only reduces the disparity between African American and White consumers but does not eliminate it. One study showed that even after the markup cap was put in place in one company, the average markup for African Americans was $498, compared to $343 for Whites. These reports clearly indicate that lawmakers need to take a closer look at the auto financing industry and expose practices that undermine the ability of Latinos and minorities to get fair and equal access to credit.

Mortgages

As the largest and most significant asset most families own, homes create wealth that allows families to send their children to college and save for retirement. Latino homeownership reached an all-time high of 49.5% in 2005, up from 42% in 1995. However, much like the auto and credit card markets, this increased access came at a price. Latinos and other minorities often find themselves channeled toward the products most profitable to the lender, but which may be

[8] Ibid.

[9] Mark A. Cohen, "Imperfect Competition in Auto Lending: Subjective Markup, Racial Disparity, and Class Action Litigation" Vanderbilt Law and Economics Research Paper (Nashville: Vanderbilt University, December 14, 2006), No. 07-01.

expensive and risky for borrowers, regardless of their creditworthiness. Research shows that Latinos are 30% more likely than Whites to receive a high-cost loan when purchasing their home. Other research shows that nontraditional mortgage products such as Option Adjustable-Rate Mortgages (Option ARMs)[10] and interest-only mortgages are disproportionately concentrated among minority borrowers; Latinos are more than twice as likely as Whites to receive an Option ARM. Some lenders sold Latino families stated-income loans rather than take the time to verify their cash income and savings. Nontraditional products were easier to originate and more profitable than taking the time to manually qualify borrowers for products designed to accommodate attributes common among first-time Latino homebuyers. Though it has not been well studied, NCLR is concerned that disparate advertising also plays a role. A brief review of Spanish-language press shows that they are dominated by advertisements for subprime loans. Compare this to English-language press, which often feature neat tables that display rate information for the area's top lenders.

The expansion of the subprime market has helped some families with poor credit history access home loans. However, subprime loans are typically more expensive, riskier, and oftentimes easier to abuse. A study by the Center for Responsible Lending estimates that of the loans made to Latinos in 2005 and 2006, one in 12 will end in foreclosure. While forecasters are predicting 1.8 million foreclosures in 2008 alone, NCLR is concerned that the height of the crisis for Latinos will not come until 2009-2010, when Option ARMs and interest-only loans are scheduled to reset.

Consumer Protections

Overwhelming evidence shows that minority borrowers pay more to access credit than similarly situated White borrowers. As the current mortgage crisis is demonstrating, this pattern of overpayment, abuse, and discrimination disrupts the financial stability of low-income, minority, and immigrant communities, and prohibits their movement toward the middle class. It can also rise to the level of threatening the safety and soundness of entire financial markets. With record foreclosure rates and increasing defaults on credit cards, it is clear that the consumer protection system has not kept pace with a dynamic and evolving marketplace. The credit markets have grown considerably in scope and complexity in recent years. Too many creditors have adopted policies and practices that focus on making a profit, rather than on sound underwriting that would ensure borrowers are matched to credit products that meet their needs and are appropriate for their credit risk. Congress and regulators must address issues that have created gaps in protections, including the following:

- **Shopping for credit is nearly impossible.** Many credit offers are not transparent. Credit card, auto, and mortgage borrowers are often unaware of the hidden costs included in their loans. Few shopping tools exist that can help borrowers create true apples-to-apples cost comparisons. As a result, many borrowers forego shopping all together.

[10] Option ARMs are nontraditional home loan products where a borrower is able to choose the payment they wish to make month to month. Typically, borrowers are offered four payment options – a minimum payment, an interest-only payment, a payment that if made consistently would pay off the home in the traditional 30-year time (known as "fully amortizing"), and a payment that if made consistently would pay off the home in 15 years. Some originators abused this product by only qualifying families for the lowest payment. In this scenario, families are unknowingly adding a balance to their mortgage each month, since their payments do not even cover the interest expense. When the mortgage reaches 115% of value, the monthly payment is adjusted to reflect the higher debt.

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. 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] In the case of mortgage and auto loans, mortgage brokers and auto dealers serve as an intermediary between the borrower and the lender. While many borrowers believe these agents are shopping for the best deal on their behalf, they are under no legal or ethical responsibility to do so. While most consumers do not proactively shop for credit, credit issuers shop aggressively for borrowers. Roughly 5.2 billion credit card solicitations were sent to U.S. households in 2004.[12] Through the collection of consumer financial information, issuers essentially prescreen and select their customers. Individuals with robust credit histories 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.

- **Borrowers are steered toward expensive products regardless of creditworthiness.** As previously described, many low-income, immigrant, and minority borrowers have unique borrower profiles. Rather than take the time to match these consumers with existing products that accurately measure their true risk, lenders err on the side of higher risk and steer borrowers toward products that are easier to originate and highly profitable. The consumer bears the majority of risk in such a transaction. While lenders use credit enhancements – hidden fees in the case of credit cards, markups in auto lending, and pre-payment penalties in mortgages – to protect themselves from losses, borrowers have no such tools. Evidence of steering is all to clear. Low-income and minority borrowers are more likely than similarly situated White borrowers to receive high-cost mortgage loans, even after controlling for income, coapplicant, and credit. The scenario is the same for credit cards and auto loans – Hispanic and African American borrowers are more likely to get higher markups or pay higher interest rates than their White peers. In fact, in auto and mortgage lending, brokers and dealers are paid kickbacks (known as Yield Spread Premiums in mortgage loans) for putting consumers in loans with higher interest rates than their credit warrants.

- **Creditors trap borrowers in cycles of debt.** For some subprime borrowers, excessive fees, high interest rates, and mounting debt effectively trap them in the subprime market. For example, many credit card customers find relief from high interest rate cards by 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

[11] Unpublished data from the *2004 Survey of Consumer Finances* tabulated by the Federal Reserve on behalf of NCLR.

[12] *Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers*, (Washington, DC: Government Accountability Office, September 2006).

rejection."[13] In the case of home loans, the pervasive use of loose underwriting criteria led to the origination of loans that homeowners could never afford to repay. The mortgage industry bet that the value of home prices would continue to climb and clients would refinance if their mortgage product became too expensive. This practice led many families into a downward spiral of wealth-draining refinances that has contributed heavily to the current mortgage crisis.

Compounding the impact of predatory lending and the gaps in consumer protections is the rise of fraud and scams targeting victims of burdensome debt and foreclosure. 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.[14] One type of scam is the existence and distribution of affinity and fake credit cards. 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. Scams targeting victims of predatory lending and those facing foreclosure are also on the rise. Predators commit to refinances or temporary transfer of deeds where the family believes they will rent for a short period of time and earn their way back to ownership; others completely misrepresent the documents the client signs. Others pose as disinterested parties offering to negotiate with the lender/servicer on behalf of the borrower. In most cases, the contract is written with terms so onerous it is unlikely the family will ever be able to recover their home or benefit from the sale of the property.

Recommendations

In a time when Latino and other marginalized consumers were clearly not equitably served by credit markets, our government regulatory agencies have failed to act in a manner sufficient to ward off the worst abuses. Yet, access to credit remains critical to putting families on the path to the middle class. Without fairly priced credit, families are forced to waste hard-earned money on unnecessarily fees and high interest rates, or to rely on predatory, fringe financial providers. Regulators and government agencies must view consumer protection as an important element of their safety and soundness duties.

We would like to applaud the work of Sheila Bair at the Federal Deposit Insurance Corporation (FDIC). She has been a leader in promoting policies that represent a balance between consumer protections and responsible lending practices. We urge other regulators to follow her lead. That said, we also recognize that the ability of regulatory bodies to act is limited by authority given them by Congress. NCLR has provided a number of recommendations to Congress on the various issues we have raised in this testimony.[15] In this statement, we have focused our recommendations on this subcommittee's oversight authority over government agencies. We urge the committee to ensure that the federal regulatory and government agencies are furthering policies and regulations that protect the interest of the market's most vulnerable consumers. This will require substantive rulemaking; increased or improved disclosure statements will not curb abuses. Specifically, we make the following four recommendations:

[13] Ibid.

[14] "Consumer Fraud in the United States: An FTC Survey," Federal Trade Commission Staff Report (Washington, DC: Federal Trade Commission, August 2004).

[15] See www.nclr.org.

- **Stop the scams.** Federal agencies, credit card issuers, and local consumer protection agencies should partner with community-based organizations (CBOs) to raise awareness of financial scams that strip wealth from the Latino community. CBOs serve as the "eyes and ears" of the Latino community and understand its needs. Regarding foreclosure rescue scams, the Federal Reserve can clarify that these products qualify as extensions of credit under the Truth in Lending Act (TILA) and the Home Ownership and Equity Protection Act (HOEPA). In addition, 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.

- **Strengthen enforcement and consumer remedies.** Last year the Federal Reserve and other regulatory agencies issued joint guidance on nontraditional mortgages. While this guidance promoted many of the responsible lending practices that are important to connecting borrowers with safe home loans, it falls short in that it is only guidance, which is not as strong or binding as law. The Federal Reserve has also recently issued a new rulemaking aimed at curbing abusive practices in the mortgage market using HOEPA. NCLR intends to submit official comments on this rule. However, the rule falls short of even codifying current best practices, much less advancing consumer protections. The Federal Reserve should set a high standard for compliance by holding unethical lenders accountable and ensuring that victims have access to meaningful remedies. HOEPA should be amended to address home purchase abuses such as targeted and push marketing, steering to high-cost products and lenders, and the use of teaser interest rates.

- **Investigate auto lending.** Mounting evidence of discrimination in auto financing demands congressional attention. Congress and the regulatory agencies should investigate "markups" under Unfair or Deceptive Acts and Practices (UDAP) laws and the Equal Credit Opportunity Act through public oversight hearings. Independent reports and investigations should be commissioned to study the impact of selected industry practices on Latinos and minority consumers. Business leaders exhibiting best practices and offering their Latino and minority customers fair deals should be rewarded and enlisted to help push out those preying on vulnerable consumers.

- **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.

Conclusion

Rising foreclosures, abusive lending practices, and mounting household debt are aggressively eroding the financial security of the American middle class. Unfortunately, the collective response from the regulatory agencies has not risen to the same level. Congress, the Administration, and the federal agencies must present a united, comprehensive plan to curb abuse and protect wealth.