

Latino Credit Card Use: Debt Trap or Ticket to Prosperity?

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INTRODUCTION

In recent years, select lawmakers, experts, and consumer and civil rights advocates have been urging Congress to examine policies and practices in the credit card industry more carefully. Credit cards are now ubiquitous and used by most Americans to improve their credit ratings for wealth-building purposes or to sustain themselves financially. However, the growth of the credit card market has been accompanied by mounting public outrage over policies and practices in the industry and an emerging public policy concern over the implications of rising household debt. The 110th Congress has begun with a thematic focus on the economic challenges facing middle-class American families, and the current policy environment has given momentum to a renewed focus on the credit card industry.

With respect to credit cards, Hispanic** families are at an important intersection. They need to access credit but are in danger of becoming victimized and, because of their economic

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** 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.

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standing, rising household debt is a serious concern. At the same time, a staggering racial and ethnic wealth gap exists; in 2002 the median net worth of Hispanic households was \$7,932 compared to \$88,651 for White non-Hispanic households.¹ Increasing wealth levels for Latinos will undoubtedly be accompanied by some form of increased household debt. Good public policies are needed that promote wealth accumulation and access to good credit, without endangering the financial standing of families.

As previous National Council of La Raza (NCLR) analyses show, disparities in wealth can be traced to factors that result in limited access to financial wealth-building products such as mortgages and savings accounts. Many have sought to explain the disparity in participation between Latinos and non-Latinos in financial markets as related to language or cultural issues. Accordingly, the remedies have often been relegated to activities such as translating promotional materials for financial products, while few experts have even bothered to document or study the Hispanic experience in any depth.

That said, moving Latino families into the ranks of the American middle class will undoubtedly entail more Hispanic workers having access to and using credit cards. It is imperative that policy-makers and experts have a better understanding of the Latino experience and perspective if effective policies are to be developed and implemented. Accordingly, this issue brief examines how the structure of the market and credit card industry policies and practices impact Hispanic access to affordable credit and the lack of regulatory oversight in the market. Finally, the brief will provide policy recommendations for empowering and protecting Hispanic consumers.

BACKGROUND

The U.S. credit card market is dynamic and complex and includes a number of important players: banks or credit card issuers, payment facilitators, credit bureaus, merchants, and consumers.

Many banks and merchants, including utility companies and other creditors, accept credit and debit card payment for consumer purchases. For this reason, card payment associations that facilitate and process credit card transactions between these parties are central players in the market. Associations, such as Visa and MasterCard, compete with Discover and American Express, two proprietary cards with their own payment networks. These associations have been instrumental in innovating and expanding the credit card market, in large part by integrating technology that helps to connect credit card issuers with merchants in more advanced ways (e.g., telephone and online purchasing). Although credit card issuers set pricing, associations set credit card processing rules. In midyear 2006, Visa and MasterCard remained the largest credit card brands with purchase volume reaching nearly \$600 billion and a 71.2% share of the market.² Visa and MasterCard alone reported 584 million credit cards in circulation and 6.8 trillion transactions.³

The ten credit card issuers with the largest credit card balances outstanding own 90% of the total market.⁴ Top issuers include Citigroup Inc., Chase Card Services, Bank of America, which now owns MBNA, and Capital One Financial Corp. Furthermore, credit cards are a major part of overall U.S. banking business; Citigroup's credit card services reportedly accounted for approximately 17% of the bank's

\$24.59 billion of net income in 2005.⁵ Credit card business is attractive to big banks, in large part because the profits that a bank collects from credit card lending can be three or more times the ordinary rate of return on the bank's equity for traditional deposits and lending services.⁶ In 2004, the credit card industry as a whole collected \$43 billion in profit from interest and finance charges, annual fees, and punitive fees charged to customers, such as late payment, over-the-limit, and balance transfer fees.⁷

In the marketplace, consumers are broadly differentiated by factors such as their credit history and income. They may also be distinguished by their credit card behavior. For example, credit card users may be placed into several general categories, including individuals who 1) use credit cards but do not carry a balance; 2) sometimes carry a balance; and 3) usually or always carry a balance. There are also American households who do not have credit cards at all. The figures on Hispanic household credit card use reveal the following:

- ▶ **The vast majority of American households use credit cards, but a substantial share of Latino households do not.** According to the 2004 Survey of Consumer Finances, more than 80% of all respondents said that they use credit cards compared to only 56% of all Hispanic households.⁸
- ▶ **Credit card use is on the rise in the Hispanic community.** Between 1992 and 2001, the share of Hispanic families who held credit cards grew from 43% to 53%.⁹ The average credit card debt among Hispanics is also on the rise, increasing by nearly 20% between 1992 and 2001, from \$3,082 to \$3,691.¹⁰

- ▶ **The majority of American households who use credit cards do not carry a balance, but most Latino households do.** According to the 2004 Survey of Consumer Finances, more than 45% of all respondents who use credit cards reported carrying a balance compared to about three out of four (77%) Latino respondents.¹¹

- ▶ **A substantial share of all credit card users and a proportionately larger share of Latino credit card users have difficulty managing their credit card debt.** According to a recent survey, approximately 19.3% of Hispanics 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].”¹² However, 12.7% of *all* respondents 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].”¹³

Credit cards are an important method for establishing a consistent and verifiable track record of borrowing and paying back credit, which is critical for long-term family wealth-building. Using credit cards and paying the balance each month may also improve an individual's credit score. A recent study showed that 17.1% of Hispanics say they keep some debt to build their credit score, compared to 16.7% of African Americans and 12.9% of Whites.¹⁴ Nevertheless, to build a good credit history, Hispanic consumers need greater access to mainstream financial institutions where the most affordable credit products are developed and sold.

The disparity in credit card use between Hispanics and their non-Hispanic peers is problematic. Without access to mainstream, affordable, unsecured credit cards, Hispanic consumers are forced to rely on subprime or predatory lenders that charge fees which can effectively add up to 300% interest for short-term loans. These lenders often prey on vulnerable, low-income populations to make a profit. Some loan products are even inherently designed to put borrowers in a perpetual debt cycle, such as payday loans.

At the same time, accumulating and revolving substantial amounts of credit card debt can also

negatively affect a consumer's financial status. The amount of revolving credit debt outstanding among Americans reached \$825.2 billion in 2005,¹⁵ and there are concerns about the impact that accumulating debt has on net worth, particularly for Hispanics. In 2001, the average Hispanic household with credit card debt spent 19% of its income on paying down debt, compared to 24% for White households and 20% for African Americans.¹⁶ These data reveal that Latino credit card users are disproportionately within the category of American households most likely to struggle with managing credit card debt.

Important Court Cases: In Brief

The first charge card appeared on the market in 1914 to cover the cost of goods and services bought from a particular merchant. Banks entered the credit card market in the late 1950s, which over time enabled the expansion of the open-end, general purpose credit card for use nationwide. Not all consumers had access to credit following the development of credit cards. Lenders began to market credit cards more aggressively following the 1978 U.S. Supreme Court decision, *Marquette vs. First Omaha Service Corp.** The Court held in *Marquette* that lenders could charge the highest interest rate allowed in the state where it is incorporated. Because companies could easily relocate to states with higher usury rate ceilings, the case resulted in the liberalization of state usury ceilings, forcing states to deregulate their credit card laws. Virtually free from state usury restrictions, lenders could offer credit to consumers whom they perceived to be high-risk borrowers and charge high interest rates to cover the risk. Many credit card issuers incorporated in states where they would have the most flexibility in the rates and fees that they charged, such as Delaware and South Dakota.

In *Smiley vs. Citibank* (1996), the Court held that fees, like interest rates, could be determined by the laws of the state where the lender is incorporated.** The decision led to a sharp increase in the amount that issuers charged for late fees.

The *Marquette* and *Smiley* decisions contributed significantly to the credit card industry's growth and profitability. Today, the weakest state laws govern the industry nationwide, essentially creating barriers for other states to enact usury rate ceilings.

* *Marquette Nat'l Bank of Minn. V. First of Omaha Serv. Corp.*, 439 U.S. 299, 301 (1978).

** *Smiley v. Citibank* (S.D.), N.A. 517 U.S. 735, 740-47 (1996).

CREDIT CARD MARKET: STRUCTURAL FACTORS AND BARRIERS

There is general agreement that the credit card market currently maintains a level of competitiveness that should benefit all consumers. Though several companies dominate the market and the number of credit card issuers is shrinking, the proliferation of offers with “teaser” rates (i.e., low or zero introductory interest rates) is evidence of robust competition and suggests that many consumers may be well served.* Indeed, individuals who use credit cards but do not carry a balance can be said to be exerting considerable pressure on card companies to improve offers in the market.¹⁷

That said, Latinos are less likely than their non-Latino peers to have access to mainstream credit cards. Moreover, for those who use cards, Hispanics are more likely than Whites to have credit cards with high interest rates. For example, a recent study revealed that 12.89% of Hispanic households have an interest rate greater than 20% on their credit card with the highest balance, compared to 7.5% of White households.¹⁸ These disparities in the market

can be traced, in large part, to the following factors:

- ▶ **The methods used to evaluate creditworthiness.** Before extending credit to a consumer, a credit card issuer will undertake a process to gather and analyze information on existing or prospective borrowers regarding their ability to repay. Under the Fair Credit Reporting Act (FCRA), credit card issuers have access to consumer information collected by the three major credit bureaus: Experian, Equifax, and TransUnion.** In addition to relying on consumer credit scores, issuers take into account the number of credit cards the consumer currently holds, combined credit card balances, credit limits on every credit card, and any record of past delinquencies.¹⁹ How well a consumer is rated on these factors will determine whether the lender extends credit, the amount of credit extended, and the annual percentage rate.

The industry’s reliance on these factors suggests that Latinos are less likely than their peers to receive offers of credit. According to a study by the Center for Community Capitalism, 22% of Hispanic borrowers had no credit score compared to

* Notably, the Government Accountability Office (GAO) reports that consumers with access to credit cards with low or zero introductory interest rates hold on to that rate for an average of eight months.

** These credit bureaus compile and sell lists of consumer names and credit reports to credit card issuers, which contain sensitive, personal financial information of these consumers. Under FCRA, issuers may also access confidential consumer information requested in connection with “firm offers of credit.” The information sold to issuers may only be used to inform preapproved credit card solicitations and may not be used to target and market to potential customers. In March 2001, the Federal Trade Commission issued a ruling against TransUnion for violating FCRA by selling information to target marketers who lack one of the “permissible purposes” enumerated under the Act. The ruling may be found at: <http://www.ftc.gov/opa/2000/03/transunion.htm>.

Credit Limit and Balance of Total Households and Hispanic Households

Average among those who use cards	Total Households	Hispanic Households
Number of Cards	3	3
Carry a balance*	45%	77%
Median balance	\$2,380	\$1,900
Median credit limit for households who reported carrying a balance	\$12,000	\$6,000

Hispanics carry higher balances as a percentage of their credit limits. The median balance for Hispanics represents 32% of their credit limit, compared to 19.8% for other households.

Source: Unpublished data from the 2004 Survey of Consumer Finances tabulated by the Federal Reserve on behalf of NCLR.

* NCLR calculation based on data from the 2004 Survey of Consumer Finances.

4% of Whites and 3% of African Americans.²⁰ Latinos' aversion to debt arguably makes them more creditworthy than their peers, but they are penalized for their lack of a repayment history. Furthermore, the standard observable characteristics that credit card issuers rely on to determine creditworthiness ensure that Hispanics with credit scores will receive offers with less favorable terms than their peers. For instance, Hispanics who use cards are more likely than their peers to report making late payments that

exceed 60 days.²¹ In a recent study, among the individuals who reported making late payments, 43.95% were Hispanic.²²

Search costs. Consumers expend time and energy on identifying which cards to apply for, completing credit card applications, and waiting for a response from the credit card issuer. The effort needed to complete this process may differ depending on the type of borrower and the borrower's resources, including education and Internet access. In many cases, rather than consumers seeking credit card issuers, companies use consumer information to identify and pursue potential new customers. Credit card issuers rely on consumer credit information to determine whether to tender preapproved credit card offers. Those with good credit payment histories may be more likely to receive multiple credit card offers, effectively reducing these customers' search costs. The number of credit card solicitations mailed to individuals has significantly increased, from 1.1 billion in 1990 to 5.23 billion in 2004.²³ In some ways, through prescreening and preapproval offers, credit card issuers are choosing their potential customers.* Another source estimates that the average consumer in the U.S. receives approximately 40 credit card solicitations a year.²⁴ Because of overall credit status and limited experience in the U.S. credit market, Hispanic consumers are less likely than their peers to receive multiple credit

* Another important means of identifying and targeting consumers is through the use of affinity credit cards. Affinity credit cards, which consist of a contract between an issuer and a group or club formed around a common interest, have proven to be a successful marketing tool for reaching new customers. For example, credit card issuers have developed affinity cards to target religious groups, university alumni, and minority groups.

card offers and, thus, need to spend relatively more time and energy searching for cards with favorable terms.

- ▶ **Shopping.** The effort a consumer spends on “shopping” for credit is influenced by various factors. The 2004 Survey of Consumer Finances showed that 52% of individuals who use credit cards characterize their shopping for credit as “moderate” to “substantial.” This may suggest that individuals are more likely to comparison shop for rates and fees. Only 7% of Hispanic consumers *who carry a balance* report “substantial” shopping for credit, compared to 12% for similar White consumers. Low shopping among individuals with credit card balances serves to lock in vulnerable consumers. The research also shows that households with large credit card balances are more likely to be rejected or to be granted a lower-than-desirable credit limit, suggesting that these households may be discouraged from shopping.²⁵ The 2004 Survey of Consumer Finances reports that 25% of Hispanic consumers who use cards and were denied a loan did not reapply for fear of rejection. In other words, negative experiences with shopping for credit can cause some Latino consumers, especially those with balances, to stop shopping altogether.
- ▶ **Economic status.** Individuals who are unable to pay off their credit card balance every month often depend on credit cards to make ends meet. A recent household debt survey showed that, of the individuals carrying credit card debt, only 12% did not report any type of safety-net usage.²⁶ When asked what contributed to their credit card debt, a leading answer from *all*

respondents was basic living expenses (33%) and medical expenses (29%).²⁷ For Latinos, 39% reported basic living expenses and 30% reported medical expenses as contributing to household debt.²⁸ Notably, for many Hispanic consumers, lending money to family members is a significant contributor to their overall household debt.

- ▶ **Industry policies and fees.** Credit card issuers also develop and implement certain policies in addition to standard fees for existing customer accounts. Standard fees that apply evenly to all consumers are relatively well-known (e.g., balance transfer fee, late fee). Other credit card policies, on the other hand, are relatively more obscure and include monthly minimum payment requirements, grace periods on purchases, deadlines for payment receipt, and standards regarding whether to offer more than one card to a customer. As with fees, the application of these policies can vary widely among credit card issuers and with different types of credit cards issued by the same company. Such policies can significantly influence the likelihood that a consumer is charged a punitive fee. The impact of a card issuer’s policies and fees also vary depending on the financial status of the borrower. For those who are revolving credit card balances and accumulating debt, issuer policies and fees can exacerbate their financial troubles and firmly ensconce them in long-term and unmanageable household debt. (See box on page 11 for other fees and abusive practices.)
- ▶ **Switch costs.** Consumers are often charged a fee to switch or transfer a balance to another credit card. Frequently switching or transferring a balance may also

harm a consumer's credit score. Still, for consumers facing interest rates as high as 28% or 30%, transferring a balance to a credit card with more favorable terms may be in their best interest. However, consumers with high balances are more likely to have their transfer credit card application denied by the issuer. These consumers are also more likely to be offered credit cards with unfavorable terms. This is significant because high-balance consumers who accept credit card offers with inferior terms are more likely to default.²⁹ Furthermore, those consumers who have a hard time switching cards are more likely than others to be held captive by their credit card issuer.

The 2004 Survey of Consumer Finances shows that 34% of Hispanic households who carry a balance reported being rejected for a loan. Hispanic households are also slightly more likely than total households to cite "credit" as a reason for the rejection (23% compared to 20%, respectively).³⁰ The opportunity to switch or transfer a balance to a credit card with more favorable terms is not available to all credit card customers. For Hispanics, the inability to switch credit cards may extend the time it takes to pay down balances, explaining why some Latinos disproportionately report that credit debt is burdensome.

CHALLENGES IN POLICY AND PRACTICE

As described in the previous section, there are a variety of structural factors and market forces that help to explain inadequate participation by

Secured and Unsecured Credit Cards

Two major types of credit cards dominate the market: secured and unsecured. Secured credit cards may be used to pay for the same goods and services as unsecured cards, but require consumers to open an account or purchase a certificate of deposit as security for the line of credit they receive. If a borrower misses a payment, the lender may withdraw money from the borrower's account. The issuer tenders credit in accordance with the terms of a contract, and the borrower promises to pay. These cards are typically reserved for those without easily verifiable payment histories or those with poor credit ratings. Although many secured credit card issuers charge an application and processing fee that may be burdensome for low-income consumers, there are conditions under which this type of card is good for consumers. For those who lack access to unsecured credit cards, secured credit cards may be the only method for building (or rebuilding) a credit history. Furthermore, some secured credit card issuers report the card to credit bureaus as unsecured, which may improve the borrower's credit score depending on their behavior. By contrast, unsecured credit cards provide a line of credit that is not secured by personal property.

Latinos in the mainstream credit card market. In addition to these factors, many policies and practices adopted by credit card issuers adversely affect consumers.

As the data and analyses reveal, Latinos who use credit cards are more likely to find themselves with unmanageable debt and are highly susceptible to adverse policies and practices. As a result, many low-income Hispanic families are trapped in a cycle of debt. The following issues, challenges, and policies are of particular concern for Latinos.

- ▶ **Monthly minimum balance requirements are deceptive.** By making only the monthly minimum payments, consumers carry their credit card balances longer, which means they ultimately pay more in interest and are at higher risk for incurring fees. As a result, these consumers are heavily burdened by their credit balances. Many consumers do not recognize the disadvantage of paying only the monthly minimum payment requirement. According to a PBS investigatory report, 35 million Americans pay only the required minimum,³¹ and credit card issuers benefit from this practice through more finance charges. As previously mentioned, Latino consumers report carrying higher balances than their peers and having trouble managing debt. Some consumers are unaware of how much it costs to make only the minimum payment, and for other consumers the minimum is all they can afford. Without the knowledge or necessary funds to pay the principal, many consumers will be paying off their debt for many years to come.
- ▶ **Universal default and change-in-terms provisions are unethical.** Universal default is a policy that enables a credit card issuer to increase a consumer's interest rate based on the consumer's credit

behavior with other creditors. Events that may trigger application of the universal default policy include exceeding credit limits; making a late payment on a mortgage, auto, or credit card loan; or negative changes in a consumer's credit score. Depending on the credit card issuer, the penalty interest rate could exceed 30%. The Government Accountability Office (GAO) recently reported that while many card issuers have ceased applying universal default, some still do.

The GAO also reported that four of the largest credit card issuers list unfair change-in-terms provisions in their credit card agreements.³² Change-in-terms provisions enable the issuer to change the terms of the credit card agreement at any time as long as the issuer provides written notice to the consumer 15 days before the issuer changes the consumer's rates. Although written notice is better than never disclosing the change in rates, studies show that a majority of consumers do not read change-in-terms notices, defeating their purpose.³³ Even those who do read such notices are likely to be confused by the complex and technical language used. The ability of an issuer to unilaterally change a contract whenever it chooses is exceptional and dangerous for consumers.

This so-called "penalty pricing" is common in many industries for defaulting on a promise to pay. However, the penalty interest rates that credit card issuers apply to customer accounts far exceed their cost. This is especially true because many issuers also collect a fee from consumers for the triggering event (e.g., over-the-credit-limit fee or late payment fee) leading to a change

in rate. Additionally, the penalty interest rate, in many cases, does not adequately represent the customer's risk. For example, a customer with a favorable 5% annual percentage rate (APR) who has never missed a credit card payment could be subjected to an interest rate of as much as 30% APR or more for being one day late on a payment. Further, the penalty interest rate may be applied retroactively, effectively charging consumers more for products or services that they already purchased.³⁴ Finally, Hispanics are more likely than their peers to report making late payments that exceed 60 days.³⁵ One study showed that among the individuals who reported making late payments, 43.95% were Hispanic.³⁶ Consequently, universal default policies and change-in-terms provisions disproportionately and adversely harm Latino customers.

- ▶ **True comparison shopping is next to impossible.** In its review of multiple credit card agreements, the GAO made the following statement regarding disclosures: “[R]equired disclosures often were poorly organized, burying important information in text or scattering information about a single topic in numerous places. The design of the disclosures often made them hard to read with large amounts of text in small, condensed typefaces and poor, ineffective headings to distinguish important topics from surrounding text.”³⁷ It is close to impossible for a consumer to differentiate

between credit cards that are available on the market. Important pricing information, such as the change-in-terms provision, is hidden in the fine print of the credit card agreement, and it is hard to anticipate the effect of such a clause until it is invoked. Consequently, consumers may not be aware that issuers can change their rate terms until their rates are changed on existing debt and they are notified through the mail.

- ▶ **Inflation and application of fees are out of control.** The amount and range of fees is on the rise.* In the 1980s, a typical late fee ranged from \$5 to \$10.³⁸ Today, the average late fee applied to a consumer account is \$33.³⁹ Notably, the price set for fees does not appear to be associated with the cost or additional risk to the lender. Credit card fees have dramatically increased while the cost for banks to purchase funds has not. Credit card issuers claim that they charge fees to deter consumers from paying late. However, many credit card issuers apply penalty fees even if the consumer pays on the day that payment is due, and some issuers charge a fee for paying over the phone.
- ▶ **Double-billing is unfair.** The foreign conversion fee is applied to a customer's account to cover the cost of converting foreign currency into dollars when a purchase is made outside of the U.S. Firms that process credit card transactions, such as Visa or MasterCard, traditionally charge

* The wide range of fees include the annual fee, balance transfer fee, late payment fee, over-the-credit-limit fee, credit limit increase fee, set-up fee, return item fee, expedited payment fee, expedited delivery fee, replacement card fee, additional card fee, and the foreign conversion fee, just to name a few. For example, credit card issuers may charge consumers an annual fee, a participation fee, a program fee, or a monthly maintenance fee. Further, some fees are one-time fees, some are monthly, and some are charged annually.

Additional Abusive Credit Card Industry Practices

Double-cycle billing: Double-cycle billing enables credit card issuers to charge interest to a consumer on a debt that the consumer has already paid. For example, if a consumer with a zero-interest rate credit card pays \$450 on a \$500 balance, the issuer will charge the consumer interest on the \$500 amount plus the \$50 amount that the consumer has left to pay.

Issuing multiple low-limit credit cards to borrowers: According to a recent article in *BusinessWeek* magazine, Capital One Financial Corp. (COFC) has adopted the practice of issuing multiple credit cards with \$300 to \$500 credit limits to subprime borrowers.* Owning multiple credit cards with low credit limits increases the likelihood that a consumer will exceed those limits and make late payments because of the difficulty associated with juggling multiple cards. For banks and issuers, giving multiple credit cards to subprime borrowers increases their opportunity to collect penalty fees.

Late payment cut-off times: Many credit card issuers penalize consumers who pay on the day that payment is due but not before a certain "cut-off" time. For example, a payment received on the day payment is due, but after 2:00 p.m., may be late under some credit card issuer policies, leading to a late payment charge averaging \$34. Some banks also impose penalty interest rates for even a single late payment.

Mandatory arbitration clauses: Mandatory arbitration clauses are prevalent in credit card agreements, essentially stripping consumers of their day in court. Moreover, arbitration appears to disproportionately benefit card issuers over consumers. Studies show that out of 19,705 cases decided in arbitration, only 87 consumers prevailed.**

Fees for telephone payments: Some credit card issuers charge a fee to consumers for paying their bill over the telephone, even if the payment is on time. Further, disclosing the telephone payment penalty fee in a credit card solicitation is not required under the Truth in Lending Act. Many of the practices listed above are either unfair or unreasonable. These practices harm consumers even when they are exhibiting good consumer behavior such as paying their credit card on the day payment is due. Some in the industry have clearly adopted these practices for the sole purpose of maximizing profits.

* Berner, Robert, "Cap One's Credit Trap," *BusinessWeek*, November 6, 2006.

** Carter, Carolyn, Elizabeth Renauart, Margot Saunders, and Chi Chi Wu, "The Credit Card Market and Regulation: In Need of Repair," *North Carolina Banking Institute*, Vol. 10, March 2006.

the fee to the consumer. According to Consumer Action's 2004 credit card survey, these firms charge 1% of the cost of each transaction,⁴⁰ and American Express charges 2% of the cost of each transaction.⁴¹ More recently, credit card issuers have begun charging an additional fee for purchases made abroad. A recent study showed that 26 out of 45 issuers

charge a foreign conversion fee in addition to the fee charged by transaction processing firms.⁴² The total average conversion fee may be as high as 3% of the amount of each transaction in U.S. dollars.⁴³ Foreign conversion fees charged by both the transaction processing firm and the bank results in double-billing for the consumer for every purchase they make abroad.

Consumer Rights in the Fair Credit Reporting Act (FCRA): In Brief

In sum, FCRA promotes accuracy and fairness in the credit reporting process and privacy of information in files of consumer reporting agencies. Under the Fair and Accurate Credit Transaction Act of 2003 within FCRA, consumers have the right to:

- Receive notice if their application for credit has been denied and receive information about the agency that provided the information to the creditor
- Receive a free credit report annually from each credit bureau
- Dispute inaccurate or incomplete information in their credit report directly with the furnisher of the information
- Place a fraud alert in their credit file to prevent identity theft or fraud

For more information, visit the National Consumer Law Center website at http://www.nclc.org/action_agenda/facta/nclc_analysis.shtml.

These fees affect all consumers who travel and especially immigrants who travel from the U.S. to their home country and use their credit card to make purchases.

- ▶ **Credit reporting and scoring are flawed.** The current system of credit reporting has three main flaws. First, there is no requirement for banks to report consumer behavior to the three major credit bureaus. Second, the information contained in a consumer's credit report may vary from one credit bureau to the

next. This particularly impacts Hispanic consumers with limited credit histories because lenders may not have all the information necessary to assess their creditworthiness. Studies show that 29% of consumer credit scores differ by 50 points between credit bureaus.⁴⁴ This may not matter for a high-scoring consumer, but could place millions of other consumers unfairly into subprime ratings. Furthermore, studies show that 50% to 70% of credit reports contain inaccurate information regarding a consumer's general credit history.⁴⁵ Third, there is no requirement for lenders to weigh all three credit scores to determine the creditworthiness of potential customers. Also, most credit scoring models collect only limited information on other data that could demonstrate creditworthiness, such as utility bills. These trends may explain why many Hispanics remain disconnected from and underserved by credit markets, including auto, mortgage, and credit card lending.

- ▶ **Predators target Latinos for credit card-related scams with impunity.** Hispanics are more than twice as likely as non-Hispanic Whites to be victims of fraud. According to a Federal Trade Commission (FTC) survey, 14.3% of Hispanics are victims of fraud, compared to 6.4% of non-Hispanic Whites.⁴⁶ Common credit-related scams committed in the Hispanic community include fraudulent credit repair services and affinity credit card scams.*

* Credit repair service scams involve individuals claiming to repair a consumer's credit record for a fee. The consumer pays the fee but receives nothing in return, often spending up to \$200 for the service.

Although affinity credit cards have been a successful tool for reaching new customers, they may also be used to lure consumers into harmful scams. Affinity credit card scams involve individuals who purport to be offering a credit card that is custom-tailored to meet the needs of Hispanic consumers. In reality, the consumer is paying for a fake card that cannot be used to purchase any goods or services. Consumers who are victims of credit repair or affinity credit card scams may file a complaint with the FTC. When the FTC observes a trend in consumer complaints, it may choose to take action. Because the FTC often does not collect data by race/ethnicity, it is difficult to determine if predators are targeting particular communities or to document these trends. Despite the FTC's efforts to collect consumer complaint information from the Hispanic community, credit card-related scams persist, stripping income from the families who can least afford it.

- ▶ **Regulator is weak.** The Office of the Comptroller of the Currency (OCC) is the principal regulator and supervisor of national banks in the U.S.* Part of its congressionally-mandated mission is to “ensure fair and equal access to financial services for all Americans.” This includes protecting consumers against wrongful treatment as it relates to credit cards. To

The Mortgage Lending Example

Policy-makers have made great strides in the mortgage lending arena by enacting several consumer protection laws. Although these laws can and should be strengthened, they serve as an example of the kinds of protections that are needed in the credit card lending industry. Indeed, consumers who use credit cards and act responsibly and in good faith should be protected from abusive policies and practices.

- **Home Mortgage Disclosure Act (HMDA):** Requires HUD to collect data by race and ethnicity and make data available to the public. HMDA made it easier to identify possible discriminatory lending patterns.
- **Fair Housing Act (FHA):** Prohibits lenders from discriminating in mortgage loans on the basis of race, color, religion, national origin, sex, familial status, or handicap.
- **Consumer Reinvestment Act (CRA):** Imposes affirmative obligations on banks to serve low-income minority markets better.

meet its mission, the OCC created the Customer Assistance Group, a call center designed to assist consumers with complaints against national banks, including those that issue credit cards. Although the OCC collects thousands of complaints each year, it faces several conflict of interest problems that limit its ability to effectively address the needs of consumers. For example, the OCC is funded by the same

* Before filing a complaint, a consumer must determine which agency regulates the bank that issued the credit card. In addition to the OCC, the Board of Governors of the Federal Reserve System exists to supervise banks that are chartered by individual states and that elect to become members of the Federal Reserve System, bank holding companies, and branches of foreign banks. The Federal Deposit Insurance Corporation regulates state-chartered banks that are not members of the Federal Reserve System. The Office of Thrift Supervision supervises federal savings and loan associations and federal savings banks. Finally, the National Credit Union Association regulates federally-chartered credit unions.

national banks that it regulates. Operational funds are collected through bank assessments, examinations, and processing fees. The OCC does not receive any appropriations from Congress. Banks may also, in effect, choose their regulatory agency, enabling them to choose the least restrictive.

There are other disincentives for regulators to aggressively and actively scrutinize abusive credit card practices or prohibit banks from offering other harmful products. The OCC's principal mandate is to promote "safety and soundness" of banks under its jurisdiction. Since credit cards are a highly profitable segment of their members' bank business, regulators may be reluctant to aggressively challenge abusive practices.

Currently, the burden is on the consumer to know that their issuer is an OCC-regulated bank and how to contact the OCC when problems arise. The OCC's consumer complaint hotline number does not appear on any credit card contract or monthly statement. The OCC has no obligation to follow up with consumers whose complaints have not been resolved, and complaints that cannot be resolved easily get filed for future reference; the result is a lack of confidence by consumers that their efforts will produce results.

- ▶ **Most current financial education strategies are ineffective.** There are a multitude of financial education programs targeted to the general public and the Hispanic community which include a credit component. Providers include financial institutions, including credit card issuers, federal and local government agencies, and national and community-based organizations

with a consumer protection focus. Financial education programs include brochures, workbooks, videos, Internet seminars, and classes. Although many credit education programs are now translated or "transcreated" into Spanish, few materials are custom-tailored to address the unique needs of Hispanic consumers in credit markets. Additionally, effective distribution of these materials into the hands of consumers who need it most and funding for active follow-up have been limited. The effectiveness of even well-resourced "financial literacy" programs is questionable.

NCLR's research shows that one-on-one financial counseling (not to be confused with creditor debt counseling) is a more effective method for increasing financial literacy and building assets for Hispanic consumers.⁴⁷ However, there are few resources to build the type of infrastructure that would be necessary to deliver such financial counseling services to low-income Hispanic families.

POLICY RECOMMENDATIONS

Abusive credit card policies and practices have hampered the ability of many Hispanic consumers to build a good credit history and save more of their hard-earned money. Consequently, the ability to build the assets and wealth necessary for long-term economic stability is also hampered. With the enactment of effective consumer protections, greater enforcement, and enhanced community awareness of industry policies and practices, Hispanic consumers may be better equipped to

improve their economic standing. The following recommendations are designed to reach this end:

- ▶ **Enact a mandatory, individualized minimum payment warning.** Policy-makers should enact the “Credit Card Minimum Payment Warning Act of 2005” (S. 393), which would require credit card issuers to insert standard language in a consumer’s credit card statement warning them of the consequences of paying only the monthly minimum payment requirement. The Act would also require credit card issuers to include personalized payment calculations that reveal how much consumers will pay, in months and years, if they pay only the minimum. This disclosure would both serve as a reminder for consumers who consciously pay the minimum every month and educate consumers who are unaware of the consequences.
- ▶ **Ban universal default and change-in-terms policies.** Policy-makers should abolish credit card industry policies that are fundamentally unfair. The universal default policy fits this definition because it enables credit card issuers to apply penalty rates to a consumer’s account even though the consumer has not missed payments or defaulted on their loan. Further, the charge may be applied retroactively, essentially charging consumers more for products or services that they already purchased.⁴⁸ According to the National Consumer Law Center, the credit card industry is the only industry that has the ability to apply a penalty interest rate to past purchases.
- ▶ Policy-makers should also prohibit unilateral change-in-terms provisions. At minimum, application of any change-in-terms provision should apply to new debt only. If a consumer does not consent to the change in credit card terms, this should not constitute a default and the issuer should not have the authority to demand that the consumer immediately repay their balance in full.
- ▶ **Eliminate binding and mandatory arbitration clauses.** Eliminating mandatory arbitration clauses would bring meaning back to many consumer protections that have been weakened by such clauses. Additionally, Hispanic consumers would be empowered to choose the best method to address their grievances.
- ▶ **Establish uniformity in contract language.** Policy-makers should follow the GAO’s recommendation to require credit card issuers to clearly disclose to the consumer – in languages and formats that the vast majority of consumers can understand – all policies and practices that affect costs. Furthermore, policy-makers should establish uniformity in credit card agreements, eliminating the use of creative terminology to describe common industry policies and practices. These recommendations would help to facilitate comparison shopping, making it easier for consumers to differentiate between credit card offers.
- ▶ **Stop double-billing on foreign conversion fees and highlight the fee in Spanish-language credit card offers.** Consumers should not be subject to double-billing on purchases made

outside the U.S. or pay more than what it cost the lender to convert foreign currency into dollars. Regulators should require credit card issuers to highlight the foreign conversion fee in all non-English-language credit card offers. Regulators should also encourage financial institutions to develop and market credit cards with a country-specific waiver of all foreign conversion fees.

- ▶ **Fix the credit reporting and collection system.** Credit card issuers should be required to report credit information to the major credit bureaus. Additionally, the Federal Reserve should develop and test a single tri-merge credit score, which would combine and average credit scores from the three major credit bureaus which lenders could use to more accurately determine a consumer's creditworthiness. Finally, a commission made up of consumer advocates, credit bureaus, and financial institutions should be formed to evaluate and improve credit reporting and accuracy standards, develop a process for conducting accuracy audits, and develop reporting requirements.
 - ▶ **Create a financial counseling network.** Policy-makers should create a financial counseling infrastructure at the community level. Resources would be used to hire and train community-based financial counselors, develop software to track client progress, and build capacity. The goal of such a program will be to reach Hispanic consumers before they accumulate unmanageable debt or develop characteristics that could harm their credit score, and educate them on abusive practices in the credit card industry and how to identify and avoid credit card-related scams.
 - ▶ **Eradicate targeted credit card-related scams.** Federal agencies need to be more proactive in their efforts to eradicate credit card-related scams that strip wealth from Hispanic communities. This would require funding initiatives that involve partnering with community-based organizations, local consumer protection agencies, and the media to highlight and address abusive practices in the community. Many of these community-based agencies have already built the necessary trust with consumers to be effective. Furthermore, agencies need to improve their ability to address consumer complaints and collect data by race/ethnicity to detect trends within segments of the population.
 - ▶ **Increase regulatory oversight.** The OCC should work proactively to increase its efforts to identify and eliminate abusive practices in the credit card industry. This would include recognizing harmful trends more quickly, increasing investigations on issuers, and applying penalties when issuers are found to engage in harmful practices. Additionally, the OCC should develop and implement a plan to increase awareness in the Latino community of its Consumer Assistance Group. The plan should include developing partnerships with community-based organizations that have built the trust of the community. Further, the OCC should market its consumer complaint toll-free hotline in both English and Spanish on all materials sent by credit card issuers to consumers. The OCC should also advertise the hotline on Spanish-language radio and television.
- The OCC should also conduct formative research of English-speaking and non-

English-speaking consumers to determine the types of consumer problems that are not reflected in the complaints it receives and to determine why many Hispanic consumers who have been victimized do not file complaints against their credit card issuer.

CONCLUSION

Although modest, the recommendations outlined above would go a long way in protecting vulnerable consumers. In addition to these recommendations, big ideas are needed to reform the credit card industry and shift the balance of power into the hands of consumers.

With household debt adversely impacting Americans' ability to save for their retirement or education, or simply to make ends meet, policy-makers must elevate credit card reform to the top of their agenda and work to find meaningful solutions.

METHODOLOGY

Our objective was to describe how the structure of the credit card market and industry policies and practices impact Hispanic access to affordable credit and to analyze regulatory oversight in the market. Before drafting our analysis, NCLR conducted the following activities:

- ▶ **Reviewed formative qualitative research (focus groups).** In an effort to inform its 2005 household debt survey, Demos first conducted focus groups including several with Hispanic English- and Spanish-speaking participants. Demos graciously provided NCLR with the summary of these focus groups, which NCLR staff used as a baseline for developing moderator questions and
- ▶ **Organizing a roundtable on the experience of Latinos with credit cards.**
- ▶ **Convened a roundtable discussion.** NCLR staff convened a roundtable, "Latino Credit Card Use: Documenting the Latino Experience," at the 2006 NCLR Annual Conference in Los Angeles, California. The purpose of the roundtable was to identify the most pertinent credit card-related issues that Hispanic consumers face, share credit-related consumer complaint information and knowledge about existing efforts to protect consumers and to address grievances, and discuss ways to improve Hispanic access to affordable credit. Participants included regulators, credit counselors, and individuals who collect Hispanic consumer complaint information. (A transcript of the roundtable discussion, *A Conversation on Latino Credit Card Use*, is available at www.nclr.org/creditcards)
- ▶ **Interviewed scholars, experts, and consumer advocates.** NCLR staff interviewed experts in the field to gather information and perspectives on the credit card industry. The following individuals were among the experts NCLR consulted: Elizabeth Warren, Leo Gottlieb Professor of Law at Harvard Law School; U.S. PIRG; the National Consumer Law Center; Demos; Consumers Union; and Consumer Action.
- ▶ **Conducted a site visit.** NCLR staff visited the Office of the Comptroller of the Currency's Consumer Assistance Group in Houston, Texas. The purpose of the visit was to develop a better understanding of the consumer complaint process, including receiving, addressing, and documenting

complaints made by Hispanic consumers. The visit also provided an opportunity to learn about the Consumer Assistance Group's marketing efforts.

- ▶ **Compiled and reviewed the research.** NCLR conducted a thorough assessment of authoritative research in the field, including reports published by the federal government, consumer advocacy organizations, and academics, and articles in newspapers, trade journals, and business magazines.
- ▶ **Conducted data analysis.** Staff from the Federal Reserve Board Consumer Education and Research Section, Division of Consumer and Community Affairs tabulated data for NCLR from the 2004 Survey of Consumer Finances (SCF), the Survey of Consumers by the Survey Research Center at the University of Michigan, and a household survey designed by Demos and the Center for Responsible Lending (CRL) for use in NCLR's report. These data sets were chosen because they are generally widely accepted as leading sources of household financial information and include data by race and ethnicity. The race and ethnicity sample sizes varied considerably between these surveys. Although the information could have been useful, NCLR chose not to use data from the Survey of Consumers because of its limited Hispanic sample size. Although not perfect, the SCF and the Demos Hispanic sample offered the best quality data available at the moment.

The SCF is a triennial survey conducted by the Federal Reserve Board with the cooperation of the Statistics of Income Division of the Internal Revenue Service. The survey is designed to provide information on U.S. household balance sheets, pensions, income, use of financial services, and other demographic characteristics. The 2004 SCF included 4,519 respondents. More information about SCF content and weighting methods is available at www.federalreserve.gov/scf/.

The Demos/CRL survey was conducted over the telephone between February and March 2005 and included 1,150 respondents. The purpose of the survey was to determine how American households are using credit cards and how they are managing their debt. Respondents were low- to middle-income heads of households who had at least three months of credit card debt. For more information on the Demos/CRL survey, please see *The Plastic Safety Net: The Reality Behind Debt in America*, Demos and the Center for Responsible Lending, October 2005, available at www.demos.org.

- ▶ **Submitted a draft of the paper for external peer review.** Gail Hillebrand, Consumers Union, and Ed Mierzwinski, U.S. PIRG, reviewed a draft of the report for accuracy and style.

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