INSIGHT
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THE RACIAL GAP IN DEBT AND CREDIT

Leveling the Playing Field: Credit and Racial and Ethnic Minorities

In order to save, invest and deal with economic shocks, every American should have equal access to financial services and equal opportunities to build credit and borrow at reasonable rates of interest based on their financial profile. Racial and ethnic gaps persist in the access to fair credit from responsible financial institutions, placing a burden on the ability of consumers of color to utilize consumer credit in a manner that advances asset building and maintains economic security.

Historically, communities of color have been denied access to fair and equal credit. Despite legislative initiatives to mitigate lending discrimination (Equal Credit Opportunity Act, Fair Housing Act and Community Reinvestment Act), consumers of color continue to experience subpar lending outcomes. Deregulation of the lending industry in the 1980s further eroded the quality of lending products available.

Lack of Access to Fair Lending Practices

Institutionalized credit discrimination in the form of redlining[1] remains prevalent in the financial markets as race often plays a factor in granting credit cards or setting limits. The Federal Reserve Bank of Boston released a paper in 2008 evaluating the presence of racial disparities in the issuance of consumer credit.[2] The research showed that consumers in Black neighborhoods have qualitatively poorer access to credit card borrowing than consumers in White neighborhoods, even after controlling for the influence of such other place-specific factors as crime, housing vacancy rates, and general population demographics.

Once borrowers of color obtain a credit card they are more likely to pay higher rates and fees, often regardless of their creditworthiness. A 2007 longitudinal study conducted by the Political Economy Research Institute which measured the access and cost of credit during the era of deregulation, indicated that differences in credit access did not decrease on a broad basis and that the cost of credit was greater for communities of color.[3] Innovative pricing mechanisms created the necessary conditions for predatory practices which targeted consumers of color for costlier terms of credit. Demos' extensive research on credit cards found that communities of color and low income consumers received disproportionally higher APRS – often 20 percent and higher- than similarly situated higher income households.[4] This gave rise to "reverse redlining" in which some lenders launched "affinity" campaigns or geographically based marketing of high cost products, including fee harvester cards, to minority communities. For example, a marketing company called Urban Television Network distributed the Freedom Card, a fee-harvester card that often had a credit limit of only $300, but which provided consumers with little spending power once fees and interest were drawn on the available credit limit.

The Impact on Communities of Color

Costly terms and subpar credit have a detrimental impact on a family of color's ability to build assets and maintain economic stability.

- In 2004, white households had a median of 15 cents of debt for every dollar of assets, while black and Latino households had a median of 23 and 24 cents of debt for every dollar of assets, respectively.[5]
- In 2004, of those with credit cards, 84 percent of African-American households and 79 percent of Latino households carried credit card debt compared to 54 percent of white households.[6]
- In 2002, more than twice the percentage of Black (32%) and Hispanic (26%) households had zero or negative net worth compared with white households (13.0%).[7]

Leveling the Credit Playing Field

Restoring fairness to the credit lender-borrower relationship would assist in diminishing the racial wealth gap that persists even today. The Credit Cardholders Bill of Rights Act signed into law by President Obama in May 2009 does away with many of the tricks and traps that kept consumers from paying off balances, ensnaring families in a cycle of debt. However, further action is needed to ensure that consumers are protected from future harm by creating policies that encourage the access of fair lending products to all Americans.

- Credit card and payday lenders interest rate caps – While we applaud the passage of the Credit Cardholder Bill of Rights Act, we call for a national interest rate cap on lending products such as credit cards and payday lenders. In the case of credit cards, because card companies can export interest rates from the state in which they are based, consumers are left unprotected from excessive rates, fees and capricious changes in account terms. Low-income, Latino, African-American and single female consumers suffer most from this lack of protection.[8] As a result, these groups in effect subsidize low introductory APRs, the nearly 8 billion credit card offers sent out each year, and the estimated $30 billion generated profits.
- The Consumer Financial Protection Agency proposed by Professor Elizabeth Warren, Chair of the Congressional Oversight Panel, would set guidelines and require modifications for financial products such as mortgages, credit cards, car and other loans to ensure that these products do not pose unacceptable risks to consumers.[9] Proposed polices for achieving this include: the disclosure of the true costs of financial products, the collection and reporting of data about the uses of different financial products, a review of new products for safety, and a requirement to modify dangerous products before they can be marketed to the public. The work of this commission would be greatly augmented by collecting financial lending data including type of loan, terms of the loan, duration, race and ethnicity of the lenders similar to the Home Mortgage Disclosure Act for credit cards, auto loans, payday loans, rent to own and other known predatory products.
- Reform auto lending practices. Cars are essential in today's society; without one, access to jobs is severely curtailed. Low-income people of color are more likely to buy used cars, where predatory pricing is the norm. Excessive fees and mark ups should be banned, disclosure of the car's actual value should be required, and car title lending should be better regulated.
- Curtail payday lending - Banks should obtain credit under the Community Reinvestment Act (CRA) for offering appropriately structured, low-cost small loan alternatives to payday loans (e.g., low-cost, small credit lines, and bounced check protection).

- Collect financial service data by race as was required of the home lending industry by the Home Mortgage Disclosure Act.

The Insight Center for Community Economic Development is a national research, consulting and legal organization dedicated to building economic health in disenfranchised communities.

This factsheet was produced as part of our Closing the Racial Wealth Gap Initiative, a national effort to close the racial wealth gap for the next generation by injecting over 140 members of the Experts of Color Network into the national debate on America's future. Experts on this issue include: Jose Garcia, Mark Winston Griffith, Darrick Hamilton, Ph.D., Janis Bowdler, and Miguel Soto-Class, all members of the Experts of Color Network.

For more information please visit www.racialwealthgap.org and www.expertsofcolor.org.

[1] Redlining is a term that describes the illegal practice of denying banking, housing, insurance or other services in certain areas or communities based on race. Decades ago, lenders were said to draw a red line on a map around areas targeted for differential treatment, hence the term redlining.

[2] Cohen-Cole, Ethan, Credit Card Redlining (2008). FRB of Boston Quantitative Analysis Unit Working Paper No. QAU08-1. Available at SSRN: http://ssrn.com/abstract=1098403

[3] Christian E. Weller, 2007. "Have Differences in Credit Access Diminished in an Era of Financial Market Deregulation?" Working Papers wp144, *Political Economy Research Institute*, University of Massachusetts at Amherst. http://ideas.repec.org/p/uma/periwp/wp144.html

[4] Tamara Draut and Jennifer Wheary, "Who Pays? The Winners and Losers of Credit Card Deregulation." New York: Demos. August 1, 2007. http://www.demos.org/pubs/whopays_web.pdf

[5] Garcia, J.A. (2008). In the Red or in the Black: Understanding the Relationship between Household Debt and Assets. New York: Demos. http://demos.org/publication.cfm?currentpublicationID=3779D044-3FF4-6C82-5404DB3CA047170C

[6] Garcia, J.A. (2008). In the Red or in the Black: Understanding the Relationship between Household Debt and Assets. New York: Demos. http://demos.org/publication.cfm?currentpublicationID=3779D044-3FF4-6C82-5404DB3CA047170C

[7] Kochar, R. (2004). *The Wealth of Hispanic Households: 1996 to 2002.* Washington, DC: Pew Hispanic Center. http://pewhispanic.org/files/reports/34.pdf

[8] Tamara Draut and Jennifer Wheary "Who Pays? The Winners and Losers of Credit Card Deregulation," New York: Demos. August 1, 2007. http://www.demos.org/pubs/whopays_web.pdf

[9] Elizabeth Warren, "Making Credit Safer: The case for regulation" May-June 2008, Harvard Magazine. http://harvardmagazine.com/2008/05/making-credit-safer.html