The Secured Credit Card Pathway: Opportunities in Serving Key Demographics

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Introduction

Credit history is a critical passport in the U.S. economy. Increasingly, organizations require credit checks for various reasons including job applications, background checks, and underwriting for numerous products and services. However, 121 million Americans are credit challenged with subprime credit scores (68 million) or thin or no credit files (53 million). Our research shows that those without prime credit know the advantages of good credit, but are not sure about how to build it. We know that the secured credit card is an on-ramp to positive credit and a savings tool, but providers have a hard time marketing it and many consumers are not even aware it exists. Providers are missing out on a large portion of the U.S. market because consumers cannot qualify for their products given their current credit score. A secured card can help consumers to increase their credit score and establish a long-term relationship with a provider.

What is a Secured Credit Card?

Secured credit cards combine the flexibility of a credit card with a forced savings mechanism in the form of a security deposit. The security deposit enables issuers to offer a credit card to someone who otherwise has insufficient or poor credit history. The use of the secured card is reported to the credit bureaus, helping the consumer to build a credit score that will allow access to unsecured credit and other financial products in the future.

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Reaching Consumers

We pose several segments that are a good fit for the secured credit card: recent immigrants, people of color, those living in rural communities, military service members and veterans. Each segment faces credit-building challenges that a secured card could address and put users on a path to improved financial health.

Secured cards could benefit millions of Americans, especially those with limited or damaged credit:

» Nearly 10 million Hispanic individuals and 8 million African-Americans who are credit invisible or unscoreable due to lack of sufficient credit history
» Over 1 million military servicemembers and recent veterans have fair to poor credit scores or lack a credit card
» 10 million, nearly a third of adult Americans living outside metropolitan areas, have poor to fair credit scores
» Over 6 million immigrants have fair to poor credit scores or lack a credit card

Recommended Reading

Secured Credit Cards: Innovating at the Intersection of Savings and Credit

In 2016, CFSI released an in-depth look at new consumer research on secured credit cards. Its purpose was to explore how innovation in secured credit cards can help consumers build credit and savings at the same time.

The paper explores:

» Findings from a secured card user survey
» Four key challenges to the secured card market growth
» Four recommendations to grow the market
» An opportunity for prepaid cards

Despite their many benefits, secured credit cards are underutilized by the population that would most benefit from the opportunity to build credit. Secured credit cards make up only a small fraction of the credit card market at nearly six million active lines. At the same time, there are an estimated 108 million consumers whose credit score, or lack thereof, prevents them from accessing affordable, high quality credit when they need it. The potential market for secured credit cards is huge.
When immigrants leave their countries to come to the United States, one thing they usually cannot bring is their credit history. Losing credit history negates any creditworthiness already established by many immigrants, and as a result, recent immigrants more resemble younger Americans, who also have thin to no credit files.\(^1\) Limited credit history is one reason why immigrants report having lower credit scores than native born Americans.\(^2\) No or low credit scores also limit immigrants’ ability to secure assets, such as access to mortgages to own homes, loans to start businesses, or auto loans to purchase vehicles for their families.

Low or nonexistent credit scores reduce financial health and the ability to access high-quality financial services. \(^3\) Immigrants in the U.S. have only a quarter of the total wealth of households headed by US-born individuals.\(^4\) This is true despite the fact that immigrants have high rates of savings and value the importance of saving.\(^5\) Immigrants are more likely to use informal savings accounts, like lending circles, rotating savings groups used by cultures around the world, also known as tandas, susus, lun-hui, and paluwagan.\(^6\) Therefore, the question is not how to incentivize better financial habits but how do immigrants gain access to the benefits of the U.S. financial system.

### Barriers Include Mistrust and Documentation

Many barriers obstruct immigrants from complete integration into the U.S. financial system. When applicable, the most hindersome are the identification, tax and proof of income documentation that is required by traditional financial institutions. Many institutions do not have the customer identification programs that accept alternative forms of identification that most immigrants use, such as the Matricula Consular, an identification card issued by the government of Mexico through its consulates,\(^7\) and Individual Tax Identification Numbers (ITIN), an identification number that allows individuals without a social security number to report and pay taxes.\(^8\) Furthermore, it is common for immigrants to have fluctuating income streams due to their employment in sectors with variable wages and seasonal employment- making it difficult to document consistent income. Meanwhile, immigrants are shut out of mainstream credit products because credit scoring models used by many lending institutions are not structured to account for limited formal credit history.

On the consumer end, there is an unease and general mistrust about U.S. financial institutions. Although they trust U.S. financial institutions more than those in their countries of origin, immigrants have lower trust than native-born consumers in U.S. banks and insurance companies,\(^9\) and a greater percentage of immigrants than native-born consumers believe that credit cards can get them into trouble.\(^10\) This mistrust is compounded by the lack of good financial materials available in immigrants’ native languages.\(^11\) Twenty-two percent of immigrants claim that they don’t have a checking account because bank employees don’t speak their native language.\(^12\)
How Secured Credit Cards Can Help

Secured cards are designed to help people transact, establish credit histories or rebuild damaged credit, and save money. Immigrants with thin credit histories can use secured credit cards to build their credit and raise their credit scores, leveraging their savings to open the door to credit. Creating a continued and long-term relationship with a credit card provider also helps to reduce financial mistrust. If immigrants’ credit scores and financial trust both increase, they can expand their use of high-quality financial products.

What Secured Card Issuers Can Do

In addition to addressing the challenges in validating identify and income by accepting ITINs and the Matricula Consular, as well as verifying income in a variety of ways, the following marketing and product design improvements may help attract those ready to build credit. First, offer interest on the deposit so that it can more mirror the benefits of a savings account, and include messaging around the deposit should emphasize the advantages of these dual credit and savings aspects. Second, transparent messaging in multiple languages can be used to build trust through clear communication. Most importantly, marketing campaigns should be built around the card to show the needs and benefits of having a credit score, including how it can contribute to concrete short and long term goals, such as homeownership.

Provider Spotlights

Mission Asset Fund, a non-profit in San Francisco, CA, formalizes the practice of lending circles used by immigrants by reporting the repayment data to U.S. credit bureaus, thus building credit history for participants.13

Mission Economic Development Agency (MEDA) works with their clients to begin to build credit with a secured card, often using their tax refund to fund the security deposit.

“We find that secured cards are the first step in the journey to building robust and healthy credit.”
— Jaqueline Marcelos, Financial Capability Manager, Mission Economic Development Agency

Neighborhood Trust Federal Credit Union assists members in applying for their ITIN and Neighborhood Trust members can then use the ITIN to open a credit card. The secured credit card is a natural fit for those just establishing an ITIN and formal credit history.

Some for-profit providers already exist to help recent immigrants access credit by using alternative underwriting data. SelfScore and ModernLend are two companies that underwrite credit cards to student and working immigrants by using factors like education and future employability, even for applicants without Social Security numbers.14,15 To bring foreign credit histories to the U.S. market, Nova Credit provides lenders with access to credit data from international credit bureaus, providing a full credit history across borders.16
Only 23% of African-Americans and 22% of Hispanics are financially healthy, compared to 50% of white individuals. Many factors contribute to this stark gap, including a long period of discriminatory practices in the U.S. that stripped wealth from communities of color and policies that continue to advantage wealthier Americans, who tend to be white. At their current rates of income growth, it will take the average African-American family 228 years and average Latino family 84 years to attain the level of wealth that their white counterparts currently hold. Credit scores and history play a critical role in an individual’s ability to achieve economic security and build wealth in the U.S., but that opportunity is not easily attainable for communities of color.

Over a quarter of African-Americans (28%) and Hispanics (27%) have insufficient formal credit history. About 15% of African-Americans and Hispanics, compared to 9% of whites, are credit invisible, meaning that they have no reported data at the three national credit bureaus. An additional 13% of African-Americans and 12% of Hispanics have unscorable records, due to old and limited data, compared to only 7% of whites. In both situations, a consumer is unscoreable and not able to be underwritten using traditional processes, making it difficult to obtain high-quality credit.

When they do have credit history, African-Americans and Hispanics report lower credit scores compared to whites: 43% of African-Americans and 47% of Hispanics report having good to excellent credit scores compared to 70% of whites. Similar to lacking a credit score, a lower credit score will also impact the price a consumer pays for credit and access to high-quality credit products. A low credit score can cost thousands of dollars in additional interest. For example, the difference between a prime and subprime five-year auto loan would be $3,000, assuming $16,000 borrowed at 2.5% and 9.7% respectively. With less wealth to pay for this expensive credit, African-Americans and Hispanics fall further behind their counterparts in terms of total wealth and overall financial success.

The Opportunity to Serve People of Color

43 million African-Americans and 57.5 million Hispanics or Latinos, according to US Census

23% of African-Americans and 22% of Hispanics are financially healthy

The length of time it would take an African-American family to attain the wealth of a white counterpart

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Note on Terminology

The terms used to label race and ethnicity are imperfect and limiting. The authors aim to use inclusive language when possible, while maintaining the integrity and specificity of external research cited.
How Secured Credit Cards Can Help Overcome Liquidity and Trust Challenges

Being prepared for financial emergencies is crucial for maintaining financial health and requires savings and planning, yet many Americans lack the resources and liquidity to weather financial shocks. For those who make less than $40,000, only 20% of African-Americans and 27% of Hispanics would be able to cover an emergency $400 expense. Secured cards can provide both an emergency line of credit and a savings vehicle via the security deposit—thus creating the opportunity for many African-American and Hispanic families to build a safety net for future financial shocks.

People of color may have also received unequal treatment in applying for loans. In one study, African-American applicants were denied for small business loans 62% of the time, Hispanic applicants 50%, Asian applicants 52%, and white applicants only 24%. This is reflected in the expectations of borrowers of color, as 43% of African-Americans, 32% of Hispanics, 49% of other non-whites without credit cards report that they do not have one because they do not believe they could qualify for one. A secured card is a way for those who are otherwise shut out to gain a foothold into the consumer credit mainstream as the underwriting criteria are straightforward to allow issuers to grant access to more individuals.

Secured credit cards can help people of color make incremental advances toward building a savings and credit history. For those with little to no formal credit, adding a secured card can raise credit scores by building a positive credit history and raise their total amount of available credit at lower interest rates.

What Secured Card Issuers Can Do

Given the difficulty that many Americans have in accessing even $400, providing the option for a partial deposit, or payment of the deposit in installments, could help those with limited funds to make the initial security deposit. Our research finds that African-American individuals are more likely than whites to receive financial information from credit unions, faith-based organizations, and financial seminars. Therefore, partnerships with CDFIs, credit unions, nonprofits, and even faith-based organizations, can leverage these groups’ relationships to reach potential secured card customers.

Provider Spotlight

Several mission-based lenders utilize secured credit cards in their credit building programs. For example, The Intersect Fund, a CDFI based in New Brunswick, NJ that serves entrepreneurs of color, recommends secured cards in their credit builder program after four to five months of repayment on a credit builder loan in order to establish multiple lines of credit, accelerating rising credit scores.

For a minority business entrepreneur, building a personal credit score is the best piece of advice that we can share. A personal credit score will be checked at the beginning or at the end of any major financial transaction.”
— Luis De La Hoz, Vice President at The Intersect Fund
Those serving our country make many sacrifices; at times these sacrifices include their mental and physical health. Unfortunately, their financial health is also suffering. Compared to 44% of civilians, only 35% of active military service members are financially healthy.¹ Those active in the military have more consumer debt and lower self-reported credit scores than civilians.² Additionally, they are more likely than civilians to juggle bills and run out of money at the end of the month.³ Yet when it comes to savings behavior and overall asset accumulation, active duty military actually fare just as well or even better than civilians.⁴ This paints a complex picture where military members appear to be financially better off than their credit histories may indicate. Defaults and other credit issues then follow veterans as they look for civilian employment. Careers that require security clearance and background checks include a veteran’s credit history, and credit issues can prohibit access to career prospects for veterans.

“‘It can be a vicious cycle. They need to get a good job to pay off their debts but due to damaged credit, they are denied the income.’”
— S.L., financial coach in Norfolk, Virginia

Their credit behaviors might only be the result of being financially inexperienced at their average military age of 28.6,⁵ but some factors which limit their financial success, including the challenges of deployment, cannot be explained by age alone.

High Cost Lenders Take Advantage of Servicemembers

Frequent deployments across the globe are common occurrences for active servicemembers, and each deployment limits their financial stability, making them more likely to experience financial problems.⁶ Additionally, life inside military bases can limit soldiers’ financial experience and education. While on base, most financial needs are met without servicemembers’ direct involvement; however once they are off base or off duty, servicemembers and veterans must navigate a complicated financial marketplace with limited financial experience they were never forced to attain on base.⁷ This inexperience can be preyed upon by many in the alternative financial services marketplace. For example, there are more payday lending businesses by military bases than anywhere else in the country, and active duty servicemembers are three times more likely to take out payday loans.⁸
How Secured Credit Cards Can Help

Because secured cards serve a variety of functions, from the ease of transacting electronically, to credit building, they have the potential to address many financial challenges of servicemembers. Secured cards can help soldiers and veterans reduce their need for costly products like payday loans by giving them access to credit equal to their deposits. When the product is used optimally, such as paying in full and not exceeding 30% of the total credit line, secured cards can help veterans raise their credit scores and establish positive credit history. In short, secured cards can be an effective vehicle through which individuals rebuild their credit, apply healthy financial habits, and avoid costly financing alternatives.

Provider Spotlight

The Military Saves program at America Saves leads a campaign to incentivize savings among servicemembers and enrollments in automatic savings plans. Military Saves members who take the pledge to save also receive a free FICO score and educational materials on how to improve their finances. Combining savings and credit monitoring tools with a product, such as a secured credit card, would allow servicemembers to put their savings and knowledge of credit-building behaviors to work for them.
Many rural residents lag their metropolitan counterparts in their overall financial health. Over 62% of individuals who live in rural communities are financially struggling and 26% have subprime credit scores, compared to 55% and 21% respectively for urban residents.\(^1\) Rural Americans also take home smaller paychecks; individuals living in rural areas take home only seventy-five cents of every dollar that metropolitan workers make.\(^2\) Widespread and persistent poverty is also more common. Of the 703 high-poverty counties in the United States from 2007 to 2011, 81% were located in rural areas.\(^3\)

With declining populations\(^4\) and some 50% of households with less than $5,000 in total assets,\(^5\) banks are leaving rural communities,\(^6\) causing more families to live in pervasive rural “bank deserts”.\(^7\) Community banks are typically the only source for rural financial services and credit,\(^8\) as regional and national banks have stayed away from small markets.

Lower-quality, higher-cost financial service providers fill coverage gaps in rural communities as banks and other financial providers leave,\(^9\) and this has made rural residents more vulnerable to products that can harm their financial health.\(^10\) Payday lenders, although more numerous in urban counties, can be found in higher per capita concentrations in many rural counties,\(^11\) and they can have negative impacts on consumers’ debt levels. Of the top ten counties with the highest per capita payday loan fees collected in Kentucky in 2008, nine had populations of less than 50,000,\(^12\) and rural counties also bore the most payday loan debt per capita.\(^13\)

The financial hardships of reduced access to traditional credit have been seen to varying degrees throughout rural America. One powerful example is the rural Mississippi Delta. Of the 25 micropolitan areas with the highest percentage of credit invisible and unscorable consumers in the US, six are located in the Delta.\(^14\) With no credit history, many Delta residents cannot finance new businesses, obtain a mortgage, or purchase vehicles. Some Delta residents have felt financially discouraged to the point where they do not apply for credit anymore due to a fear of being denied loans.\(^15\) This fear of credit echoes across many communities in rural America where individuals believe that credit cards can get them into trouble.\(^16\)

**Note on Terminology**
Rural can be defined many ways. For this brief, rural is defined as any county outside of a US Census Metropolitan Statistical Area (MSAs). Rural counties typically have less than 50,000 in population and do not have large commuting flows to or from an adjacent MSA county. According to USDA data, about 14% of Americans, an estimated 46.2 million in 2015, live in rural communities across the United States.
Secured Cards Can Restore Rural America’s Access to Credit and Increase Credit Scores

Access to credit, personal credit scores, and overall financial health can improve when credit products address the specific financial challenges faced by rural America, and secured cards can be a strong tool in the journey towards financial health for those communities.

Secured credit cards typically start with low credit limits, providing users with a degree of control that could be a way to calm the fears that some rural consumers have of credit cards. Individuals who are new to credit, or attempting to rebuild their credit, can achieve a higher credit score with the addition of the secured card tradeline, provided they maintain a low credit utilization rate. Once these individuals achieve higher credit scores and are eligible for unsecured credit, the graduation to unsecured credit can be done without visiting the bank branch. 78% of rural residents, just seven percent less than in urban areas, use the internet, providing a conduit to the consumer that does not rely on geography. Reaching potential customers online is an untapped opportunity, as secured credit cards significantly lag behind unsecured credit cards in online account openings.

Provider Spotlight

The Farmers Bank, an Indiana community bank, and Hope Credit Union, located throughout the Mississippi Delta, both provide cards that are secured by savings accounts, earning interest while serving as a security deposit.

Provider Spotlight

For those who live in rural bank deserts, lacking access to financial service providers, online loan providers serving low credit score consumers such as Ascend and Lending Point provide personal loans with rates much lower than payday lenders.

Provider Spotlight

Green Dot uses retail locations, including Walmart, 7-11, and Dollar General, to accept cash for the deposit and to make payments on its secured credit card, in addition to its online servicing site.

Provider Spotlight

Rural Dynamics, a nonprofit organization in six states throughout the Midwest and West, offers a credit builder loan which gets repaid automatically once a client deposits $300 into an interest-earning savings account. The automatic and secured loan payments are then reported to the credit bureaus after the loan is completely paid back, and credit builder loans typically result in measurable increases in clients’ credit scores.

Provider Spotlight

Online credit builder loans from Self Lender can help those living in rural bank deserts build credit and establish savings, even for clients with sub-550 credit scores or none at all.
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