

Credit Scores and Credit Reports: Problematic Uses and How They Worsen the Racial Economic Gap



RACIAL JUSTICE &
EQUAL ECONOMIC
OPPORTUNITY PROJECT
NATIONAL CONSUMER LAW CENTER

NFHA
National Fair Housing Alliance

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National Consumer Law Center

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This webinar is part of a series on "Rebuilding Wealth and Economic Opportunity in Communities of Color" sponsored by NCLC's initiative on Racial Justice & Equal Economic Opportunity.

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Racial Justice and Equal Economic Opportunity



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The project on Racial Justice and Equal Economic Opportunity seeks to address the abusive and exploitative practices in the marketplace that have decimated the finances of communities of color.

<http://www.nclc.org/issues/racial-justice.html>

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Presenter – Chi Chi Wu



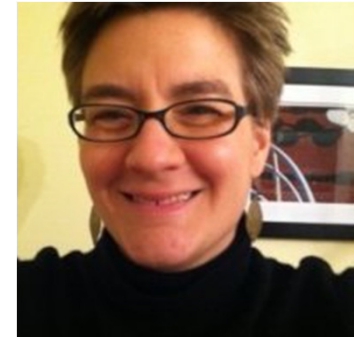
- Has been a staff attorney at NCLC for over a decade. Chi Chi focuses on consumer credit issues at NCLC, including legislative, administrative, and other advocacy.
- Chi Chi's specialties include fair credit reporting, credit cards, refund anticipation loans, and medical debt.
- Before joining NCLC, Chi Chi worked in the Consumer Protection Division at the Massachusetts Attorney General's office and the Asian Outreach Unit of Greater Boston Legal Services.
- Chi Chi is a graduate of Harvard Law School and The Johns Hopkins University.
- Chi Chi is co-author of the legal manuals Fair Credit Reporting Act and Collection Actions, and a contributing author to Consumer Credit Regulation and Truth in Lending.



Presenter – Deidre Swesnik



- Director of Public Policy and Communications at the National Fair Housing Alliance. Deidre represents the interests of NFHA and its members before Congress, federal agencies, and the media and coordinates efforts with advocacy and industry groups on housing and civil rights.
- She joined NFHA in 2003 as both its Public Policy Program Director and New Groups Project Coordinator. As New Groups Project Coordinator, she was responsible for the creation of a new full-service fair housing center in Mississippi.
- Prior to NFHA, Deidre was a Policy Associate with Rapoza Associates, a public interest lobbying and government relations firm in Washington, DC, where she focused on low-income housing and economic development, and was responsible for lobbying, membership support, and research on rural housing and water issues..



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May 20, 2014

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Importance of Credit Scoring and Reporting

- Financial “report card” for most Americans
- Gatekeeper to essentials
 - Home
 - Mortgage
 - Some landlords use
 - Car (affordable auto loan)
 - Education, small business
 - Increasing Non-Credit Use

What Is a Credit Report?

- “Traditional” credit report - record of an individual’s borrowing and repayment of debts
- FYI - Fair Credit Reporting Act covers much more:
 - credit worthiness, character, general reputation, personal characteristics, mode of living
 - used or expected to be used to establish eligibility for credit, insurance, employment, or other authorized purpose

The Players in Credit Reporting

- Consumer reporting agencies (CRAs) or Credit Bureaus
 - 3 major nationwide CRAs or “credit bureaus” (Equifax, Experian, Trans Union)
- Furnishers of information
- Subscribers or users of information

Types of Information in a Credit Report

- Basic info (Header)
 - Name
 - Current and former addresses
 - Birth date
 - SSN
 - Can include telephone numbers; spouse; Past and present Employers.

Types of Information in a Credit Report (cont.)

- Payment History on Credit Accounts
 - Mortgages; auto loans
 - Revolving accounts (credit cards)
 - Collection agency entries
- Inquiries
- Public record information
 - Bankruptcies
 - Foreclosures, tax liens
 - Court judgment and filings

Sa

Experian credit report prepared for
JOHN Q CONSUMER
Your report number is
1562064065
Report date:
01/24/2005

Index:

- [Potentially negative items](#)
- [Accounts in good standing](#)
- [Requests for your credit history](#)
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- [Important message from Experian](#)
- [Contact us](#)

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Potentially Negative Items

Public Records

Credit grantors may carefully review the items listed below when they check your credit history. Please note that the account information connected with some public records, such as bankruptcy, also may appear with your credit items listed later in this report.

MAIN COUNTY CLERK

Address: 123 MAINTOWN S BUFFALO , NY 10000	Identification Number: 1	Plaintiff: ANY COMMISSIONER O.
Status: Civil claim paid.	Status Details: This item was verified and updated on 06-2001.	
Date Filed: 10/15/2000	Claim Amount: \$200	
Date Resolved: 01/04/2001	Liability Amount: NA	
Responsibility: INDIVIDUAL		

Credit Items

For your protection, the last few digits of your account numbers do not display.

ABCD BANKS

Address: 100 CENTER RD BUFFALO, NY 10000 (555) 555-5555	Account Number: 1000000....	
Status: Paid/Past due 60 days.		
Date Opened: 10/1997	Type: Installment	Credit Limit/Original Amount: \$523
Reported Since: 11/1997	Terms: 12 Months	High Balance: NA
Date of Status: 01/1999	Monthly Payment: \$0	Recent Balance: \$0 as of 01/1999
Last Reported: 01/1999	Responsibility: Individual	Recent Payment: \$0
Account History: 60 days as of 12-1998 30 days as of 11-1998		

Poll #1: How often do you check your credit report?

- Ummm...I haven't checked it.
- Only before I enter into a credit transaction, e.g., car loan or mortgage.
- Once a year, using my free annual report.
- More than once a year but less than monthly.
- Every month or more.

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Credit Scores

- Computer model that translates information in credit report into a number.
 - Supposedly predicts how likely it is that a consumer will repay a loan and make the payments when due.
- Most popular type is FICO score
 - Usually between 300 and 850. A higher number is considered a better score.
 - Other scores: VantageScore, specialty scores
- Use in insurance underwriting and ratesetting

Factors in a FICO Credit score

- 35% - payment history
- 30% - ratio of credit used to credit available
- 15% - length of credit history
- 10% - “new credit”
 - This is where inquiries hurt
- 10% is “mix” of credit
 - so need a home and mortgage

Racial Disparities

Study after study finds certain minority communities have lower scores as a group

- 2012 CFPB Report
 - Median FICO score for majority minority areas was 34 - vs. 52 for low minority areas
- 2009 Woodstock Institute report
- 2007 Federal Reserve Board report to Congress.
 - Mean score of African Americans was half that of whites (54.0 out of 100 for whites versus 25.6 for African Americans) with Hispanics mean of 38.2.
- 2007 Federal Trade Commission study
 - African Americans and Hispanics strongly over-represented in the lowest scoring categories.

Racial Disparities (cont.)

- 2006 Brookings study
- 2004 Study by Federal Reserve researchers
- 2004 Harvard Joint Center for Housing Studies study
- 2004 Texas Department of Insurance study
- 1997 Fair Isaac analysis
- 1996 Freddie Mac study
 - African-Americans were three times as likely to have FICO scores below 620 as whites.
 - Hispanics are twice as likely as whites to have FICO scores under 620.

Questions??

Why Credit Scores Have a Disparate Impact on People and Communities of Color

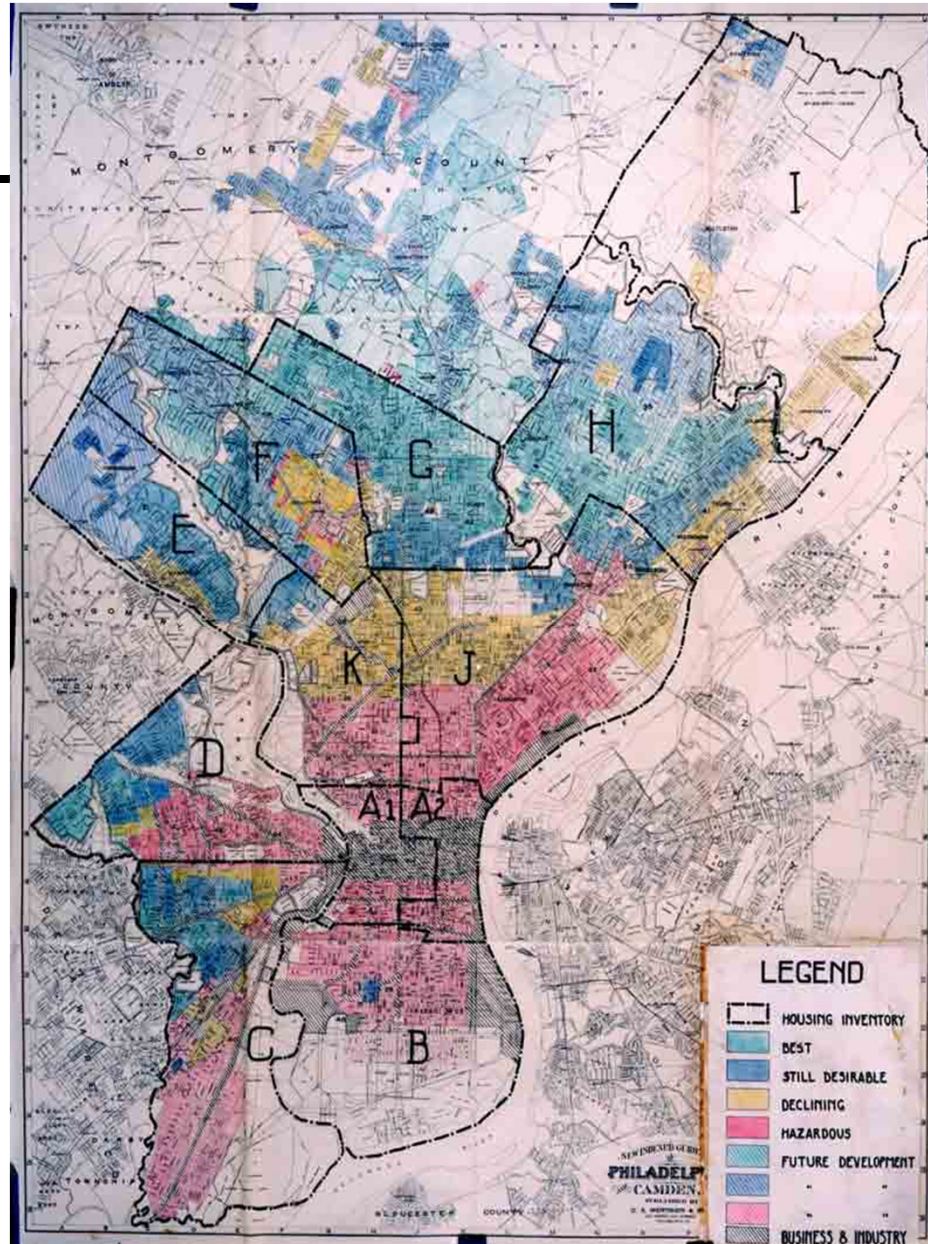
Overt Historical Discrimination

McMichael's Appraising Manual, 4th Edition 1951

Ranking of race and nationality by impact on real estate values (in order of preference):

1. English, Germans, Scotch
2. North Italians
3. Bohemians or Czechs
4. Poles
5. Lithuanians
6. Greeks
7. Russians, Jews (lower class)
8. South Italians
9. Negroes
10. Mexicans

1936 Residential Security Map – Philadelphia



“Red-Lining”

A.....Red (Hazardous), north of main business section to North Philadelphia at Lehigh Avenue between Broad Street and Delaware River, also including Kensington. This area is very old, mainly obsolete and consisting almost entirely of two, three and four story brick row houses, averaging in age from fifty years or more. Demolition has been heavy particularly in Ward 20 and the number of structures unfit for habitation is large. In addition to the water front being all industry, there are a substantial number of small plants engaged in light manufacturing scattered throughout the section.

North of Fairmount to York between Broad and Front Streets is occupied by Polish, Italians, Jewish and Negro with the latter predominating from Broad to 8th Streets. East of Front Street is Kensington and while it is densely populated, it is essentially an industrial area, including a number of textile mills. Population is mixed laboring class, including a large Polish colony along the water front.

C.....Yellow area (Definitely Declining) - North of Lehigh and Kensington to Wingohocking and east of Broad Street. This area is heavily dotted with light industries. The tracks of both the Pennsylvania Railroad and the Reading Railroad are lined with miscellaneous plants. In addition, this section contains a large number of the city's textile and hosiery mills. Consequently, its residents are mainly workers in these industries, most of which require skilled workers - largely women - who are normally well paid.

Houses are practically all of substantial age and of very modest two story brick row type.

D.....Blue areas (Still Desirable) - Frankford and Bridesburg. Houses are chiefly modern and fairly modern five and six room, brick, row type. Inhabitants are mostly native whites of white collar and skilled mechanic class.

E.....Green area (Best) at extreme north eastern end of section - really a part of the Roosevelt Boulevard development. New since 1926 - 1928. Modern semi-detached and row, porch-front houses which are small but of good type. The inhabitants are of good class native whites with modest incomes.

Federal Housing Administration Policy (1940s - 1960s)

“If a neighborhood is to remain stable, it is necessary that properties shall continue to be occupied by the same racial and social classes. Changes in social or racial occupancy contribute to neighborhood instability and the decline of value levels.”

Subprime Lending Discrimination

The Justice Department has settled cases (2011 – 2013) against:

- Countrywide Financial Corporation
- SunTrust Mortgage, Inc.
- Wells Fargo, N.A.
- Plaza Home Mortgage
- Chevy Chase Bank
- Southport Bank

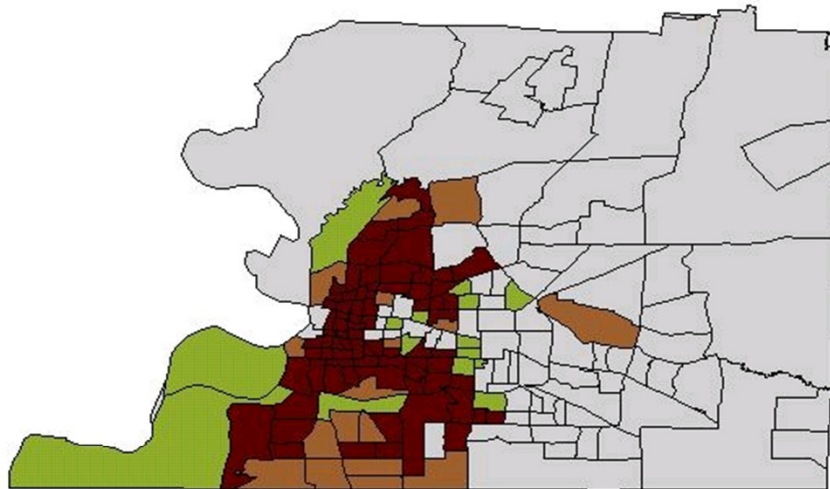
Subprime Lending Discrimination

- *City of Baltimore vs. Wells Fargo*
 - Specifically targeted African-American communities for subprime loans
 - Targeted African-American churches
 - Used derogatory language to refer to African-American consumers and neighborhoods
 - Gave employees substantial financial incentives for steering borrowers to subprime mortgages

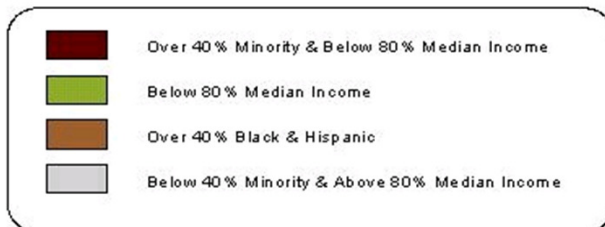
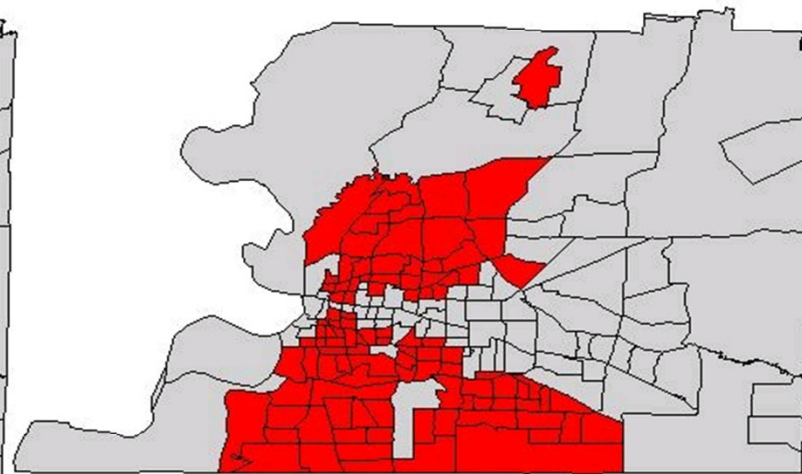
Subprime Loans & Non-White Communities

Subprime Lending Patterns Memphis (Shelby Co.), TN

Minority & Low-Income Tracts

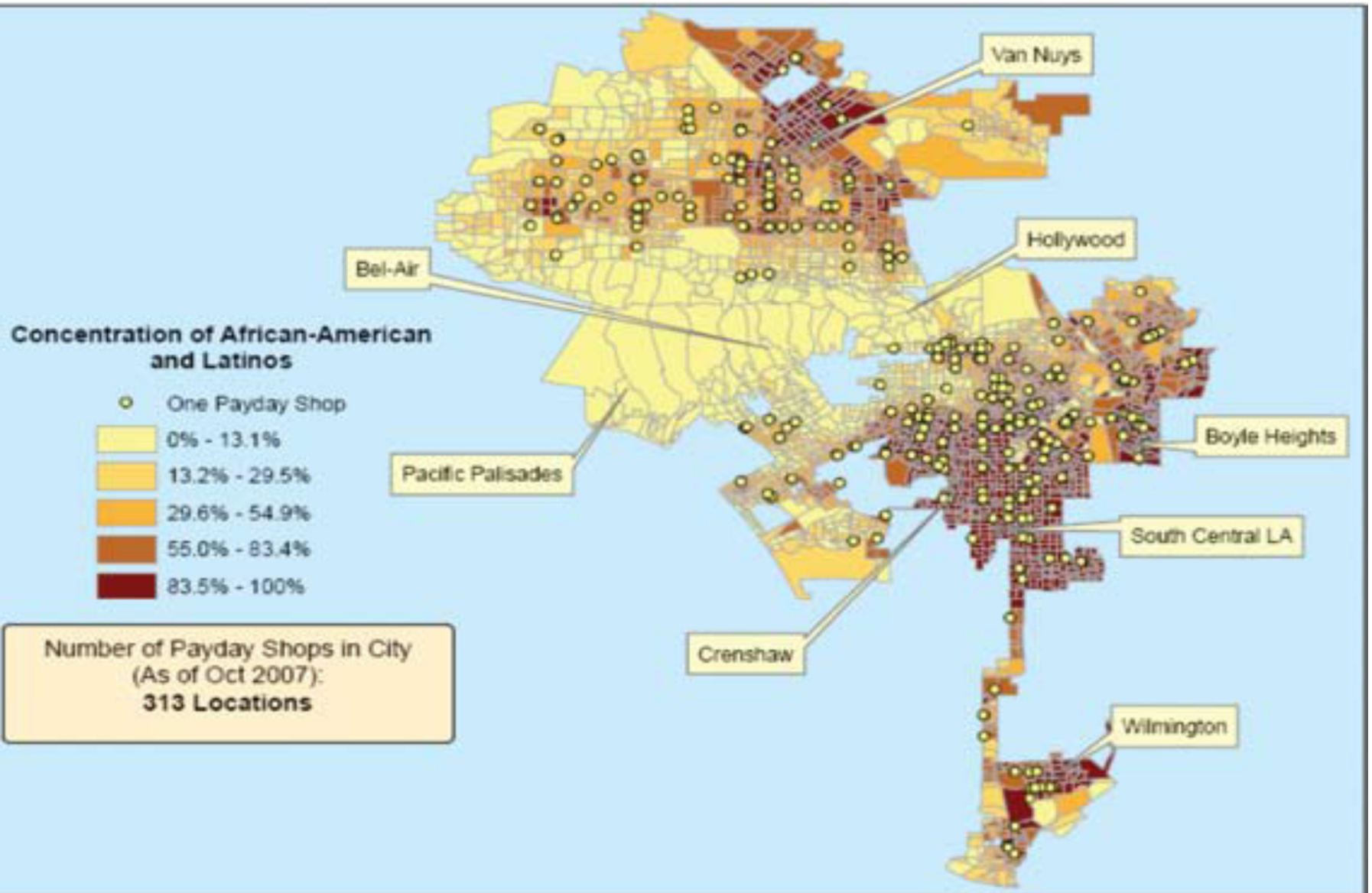


Subprime Lending Concentration



Sources: 2000 U.S. Census; 2002 Home Mortgage Disclosure Act data

Fringe Lenders in Communities of Color

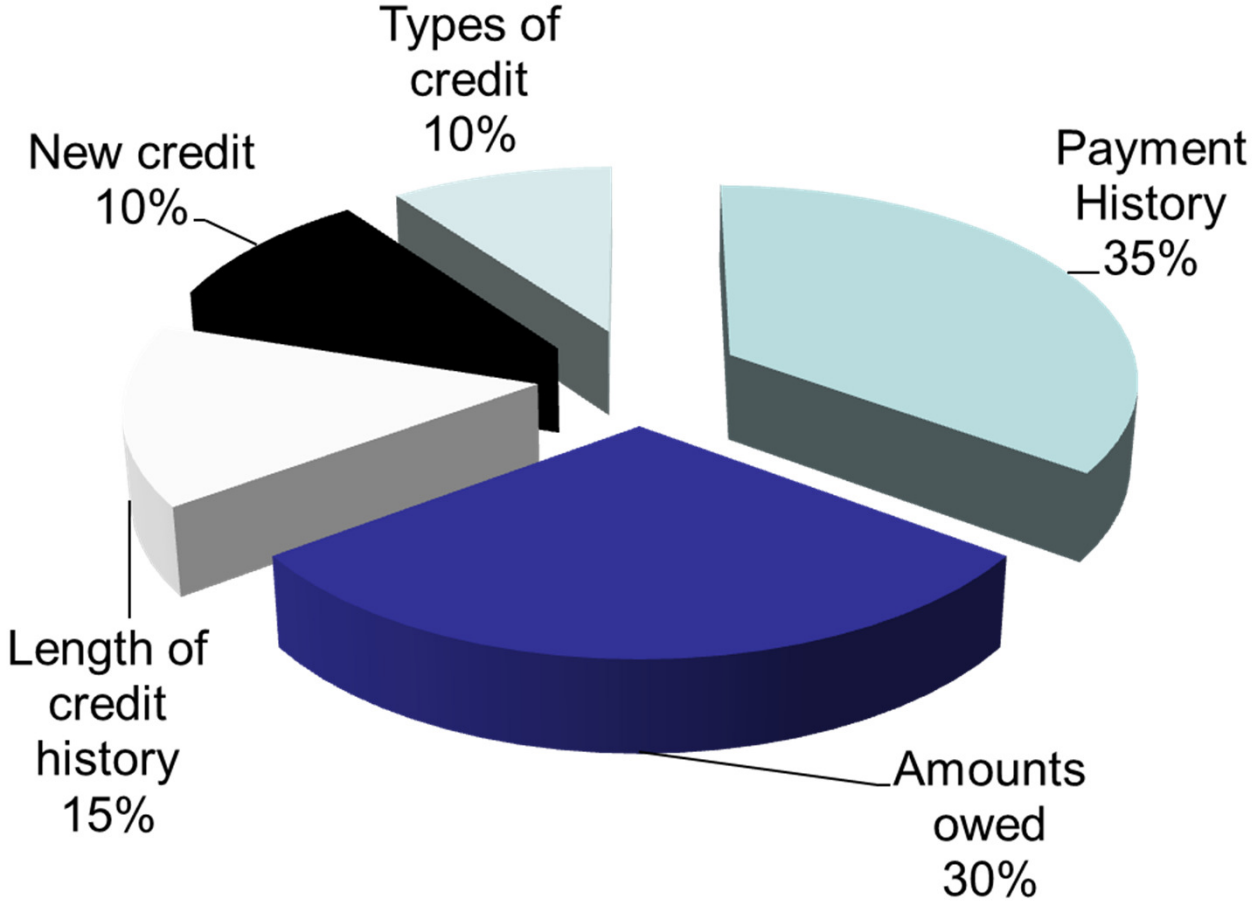


Limited Scope, Quality, and Transparency of Credit Information



*“Hey there,
what’s your
sign?”*

Elements of a FICO Score



Poll #2: Do you think past discrimination has any impact on current credit scores?

- Yes, an un-level playing field will impact a consumer's financial health
- No, credit scores only reflect the responsibility of the individual consumer
- I'm not sure

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Questions??

Non-Credit Uses of Credit Reports

- Insurance
- Employment screening
- Other: tenant screening, hospitals

Insurance Scoring

- Used by insurers for the vast majority of personal auto and residential property insurance markets.
- Insurers rely on correlation between scores and “loss ratios”
- Permitted in many states, prohibited in a handful (Mass., Hawaii, Maryland, California)
- Cost consumers billion in excess premiums – estimate of \$67 billion from 2003 to 2006.

Criticisms of Insurance Scoring

- Seen as unfair - What does a consumer's credit score have to do with how well they drive or upkeep of home?
- Undermines the core public policy goals of insurance
 - Undermines the goal of universal coverage
 - Undermines the loss mitigation role of insurance by placing emphasis on a rating factor which has no ability to promote loss mitigation by policyholder
- Disparate Impact on minority consumers

Employment Use of Credit Reports

- Growing practice – about 50% of employers use for some of their positions, up from 19% in 1996 (source: Society of Human Resource Management)
- Problems
 - Create a fundamental “Catch-22” for unemployed applicants.
 - Prevent economic recovery for millions of Americans.
 - Discriminates against African American and Latino job applicants.
 - Does not predict job performance.
 - Inaccuracies in credit reporting

Questions??

Policy and Enforcement Recommendations

Evaluate the System

- Asses the impact of credit scoring mechanisms
- Make the system more transparent

Policy and Enforcement Recommendations

Fix the System

- Broaden the scope of financial data
- Improve the quality of the data
- Repair credit scores for victims of discrimination

Policy and Enforcement Recommendations

Change the System

- Reduce the over-reliance on credit scoring systems
- Evaluate product risk

Solutions cont.

- Prohibit insurers, employers, and landlords from considering credit reports
- Create exceptions or models to consider extraordinary life circumstances
- Capacity should count more than credit score.
- Alternative methods to judge creditworthiness
 - Net cash flow analysis
 - Voluntarily submitted information

Questions??

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