KIRWAN INSTITUTE for the Study of Race and Ethnicity

THE FUTURE OF FAIR HOUSING and FAIR CREDIT

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Extending Credit to Marginalized Communities

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The **Kirwan Institute for the Study of Race and Ethnicity** is a university-wide interdisciplinary research institute. We generate and support innovative analyses that improve understanding of the dynamics that underlie racial marginality and undermine full and fair democratic practices throughout Ohio, the United States, and the global community. Responsive to real-world needs, our work informs policies and practices that produce equitable changes in those dynamics.

<u>Extending Credit to Marginalized Communities</u>

The true test of success for an economy is not just jobs and income. It is the opportunity for <u>all</u> participants to save for the future and acquire assets of lasting and potentially growing value, such as post-secondary education, a home, a small business, or a well-invested retirement account. By this test, the United States is faring even worse than the normal figures on poverty suggest. While 13% of American households have incomes below the federal poverty line, 22% of them live in "asset poverty", defined as lacking enough assets to survive three months at the poverty line if their income suddenly vanishes, due, for example to job loss or family dissolution. Fully 14.3 % of all households -- and 37.2% of minority ones -- live in "extreme asset poverty," defined as having no savings or assets whatsoever.

We have learned that with the right facilitating structures, the poor can save. Yet, saving is extremely difficult if one has debts. In fact, savings and credit are linked in important ways. If one has savings, even just $500 or $1,000 in the bank, one has a cushion to deal with emergencies. On the other hand, if one has no savings, as is the case for millions of Americans, and has to borrow to fix a car, pay a medical bill, or pay the rent after loss of a job, it is extremely important to have access to credit on reasonable terms. Otherwise, there is a high risk of getting caught in the payday lender's debt trap, making it truly difficult to pay off one's loans and begin saving.

Unfortunately, forty million American households – 106 million individuals -- lack access to mainstream credit and affordable small-dollar loans. Why? According to the Center for Financial Services Innovation, they "have little credit history, lack a credit score altogether, are unbanked or under-banked, or have impaired credit." The current recession and credit tightening has exacerbated this situation, with the result that "millions of working Americans can no longer build a credit file or improve their scores, and are relegated to high-cost options for getting small loans."

Twenty-five to forty million of these individuals lack access to mainstream credit because they lack any credit history, not because of bad credit. To help them, CFED is advocating federal legislation that would encourage utilities to report payment records to credit bureaus. Recent studies show that the reporting of customer payment data would disproportionately benefit lower-income Americans and members of minority groups. They also show that the use of non-financial customer payment data in credit scoring models increases their predictability and accuracy, enabling better and smarter lending. Borrowers thus benefit from improved terms and a reduced probability of over-extension. The attached CFED document provides details on the proposed legislation.

Other ways to improve the credit situation of marginalized communities include:

- Tightening regulation of payday lending and credit/ debit card overdraft fees

- Extending credit union services into underserved communities
- Facilitating achieving scale by nonprofit programs like Progresso Financiero; challenge for such non-depositary institutions is raising sufficient capital and obtaining a federal license that allows operation in several states
- Convincing employers to facilitate savings by their employees (e.g. AutoSave)
- Incenting employers to offer pay advances, as United Way of Chittenden Co., VT does in partnership with credit unions, via its "Working Bridges Project
- Providing financial counseling at key transaction points (home purchase etc.)
- Passage of the proposed federal Consumer Financial Protection Act, which would do some of the above

In seeking to improve the access of low-income communities to credit, it is important to keep in mind the real costs of providing low-dollar loans, the importance of convenience and relationships, and the limits to the effectiveness of financial literacy courses and disclosure regulations. Fortunately, there is a good deal of thoughtful experimentation taking place around innovative financial products that would better meet the needs of the underserved, including at the FDIC.

CFED applauds all this experimentation, and stands ready to help in any way it can. Its mission is to expand economic opportunity by facilitating asset building -- earning, saving, and investing in appreciable assets. Yet, saving is what is left after subtracting from one's earnings all necessary expenses and loan repayments. Thus, ensuring affordable credit is an important part of CFED's efforts to help low-income Americans enter the economic mainstream.

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