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FACT FILE
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The Importance of Credit Reports & Credit Scores for Building Financial Security

In many ways, a credit report is the gateway to financial opportunity, determining who has the chance to build wealth and security and who does not. A poor credit score or a lack of documented credit history can create a vicious cycle, shutting consumers out of opportunities for lending, housing or even employment, thereby making it harder or even impossible to purchase the assets that lead to long-term financial well-being.

FACT: More than half of Americans are either "credit invisible" or have poor credit.

Nearly one in five consumers have no credit history or credit score. A report by the Consumer Financial Protection Bureau found that 26 million U.S. adults were "credit invisible" in 2010, meaning that they had no established credit history with any of the three major credit reporting agencies.[1] An additional 19 million adults were "unscorable," meaning they lacked a sufficient or recent enough credit history to be given a credit score.

Though Americans' average credit score (for those who have established credit history) has been slowly improving since the Great Recession, most consumers have credit that is less than stellar. Fifty-one percent of the nation's credit users have subprime credit scores (under 720), while one in three has a score lower than 620.[2]

Furthermore, m**any subprime credit scores may be inaccurate.** A Federal Trade Commission study discovered that one in four consumers found errors on their credit reports that may affect their credit scores.[3]

Building wealth with little to no credit can be challenging, if not impossible. A lack of access to credit means higher rates on mortgage loans, small business financing, auto loans and the like. Moreover, credit-invisible consumers and consumers with subprime credit are more likely to experience difficulty weathering income volatility or other financial hardships.

NUMBERS TO KNOW:

Nearly **one in five** consumers have no credit history or credit score.

51% of credit users have "subprime" credit scores.

Source: Brevoort et al. (2016);
CFED Assets & Opportunity Scorecard (2016)

FACT: Poor credit strongly correlates with race and gender.

The effects of discriminatory policies like redlining and predatory lending persist in a number of ways, including in the form of missing or subprime credit. African Americans report a much higher rate of subprime credit scores than do whites and are more likely to find errors on their credit reports that negatively impact their borrowing capabilities.[4] Black and Hispanic individuals are also significantly more likely than white individuals to be credit invisible or unscored.

Perhaps even more troubling, reports have shown that subprime loan products that can further damage credit history are foist upon women and communities of color, even when such borrowers have strong credit and could otherwise qualify for prime loans.[5] In February 2016, the Consumer Financial Protection Bureau and the U.S. Department of Justice reached a $21.9 million settlement with Toyota Motor Credit, which had targeted minority borrowers with higher rates for auto loans, irrespective of good credit.[6]

FACT: A small change in credit score can cost a consumer thousands of dollars in loan interest payments.

Credit scores determine whether consumers can get a loan and, if so, how much they will pay in interest. According to FICO's loan calculator, even minor changes in credit scores can result in large differences in interest paid over the life of a mortgage or other loan.[7]

The difference between prime and subprime credit—more than $33,000 over a 30-year mortgage—is enough to pay for two years at a public university or to buy a new car.[8] [9]

Source: National Center for Education Statistics, 2016, Kelley Blue Book, 2016, Blue Cross Massachusetts, FICO Loan Calculator (Interest Rates as of 2016)

FACT: Credit reports have become the gateway to non-lending opportunities.

Credit scores and reports were originally intended for use by lenders deciding whether or not a consumer was likely to repay a loan.[10] However, credit reports have increasingly been used for non-lending purposes. Credit checks are done by landlords, home and auto insurance companies, cell phone and utility providers, and even employers. In other words, those with no credit history or poor credit aren't just being excluded from the lending market—they're losing out on a range of other avenues for wealth building.

As of 2012, nearly half (47%) of employers surveyed conducted credit checks on job candidates.[11] A Demos survey of low- and middle-income households found that one in four respondents has gone through a credit check during a job application process, while one in seven unemployed job applicants were explicitly told that they were not hired because of their credit. These statistics are troubling given that there is no evidence of a relationship between a bad credit history and poor job performance.[12]

Credit reports were not designed for non-lending purposes like employment. One of the dangers of using credit reports for employee screening is that, unlike lenders, employers look at a report subjectively. Thus, small errors or blemishes that shouldn't have much of an effect on a credit card application—and may even be due to errors —could still cost someone a job. In most cases, credit checks are an improper tool for assessing employee liability and constitute an unfair barrier to employment for those with poor credit histories — those who are often most in need of a good job. Even credit-reporting companies like Credit Karma oppose such checks for employment.[13]

Source: Demos, 2016

So far, only eleven states have banned pre-employment credit checks, and federal law still allows employers to use bad credit history as a reason to deny employment to an otherwise qualified candidate.[14]

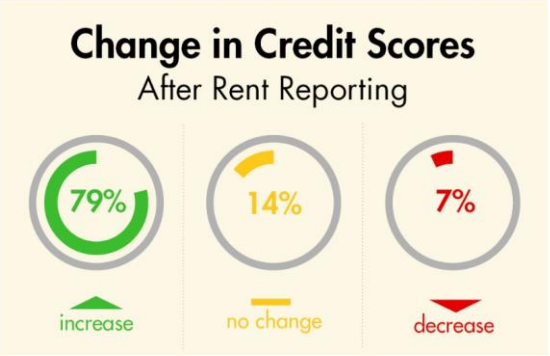
Credit reports also serve as a gatekeeper to accessing health insurance through the Affordable Care Act's (ACA) insurance marketplaces. The remote identity proofing (RIDP) process confirms an applicant's identity based on their credit information. This process has a success rate of only 78%, and applicants with little or no credit history and the millions of victims of identity theft cannot complete an RIDP. A Government Accountability Office audit of the ACA marketplaces found significant problems with the online credit-based identification process, which can create legitimate barriers for applicants and delay access to insurance.[15] Applicants who face these barriers are disproportionately likely to be uninsured.[16]

RIDP is also being used in some states for social services like Medicaid or the Supplemental Nutrition Assistance Program (SNAP). Using credit histories for identity confirmation may create an additional barrier to those programs for those who need them the most.

FACT: "Alternative data" reporting shows promising results for helping build credit and household wealth.

Credit agencies and other practitioners are starting to see the benefits of including data that has previously gone unreported in credit histories. After all, millions of Americans with no credit or poor credit scores still pay rent and utility bills consistently, on time every time. But until recently, none of that information was being captured and used to inform a consumer's credit score. When a consumer's credit history only includes negative reporting—collections, late payments and delinquencies—a credit report can portray that consumer as financially irresponsible, even despite the steps they've taken to prove otherwise.

Credit Builders Alliance, a national nonprofit organization, conducted a pilot study in partnership with Experian RentBureau and several affordable housing providers to measure the impact of "positive rent reporting."[17] All of the participants who were "credit invisible" before the pilot earned either high nonprime or prime (601+) scores when rental payments were included in their credit history. For nearly every other participant, rent reporting helped build a thicker file with the credit agency and almost universally improved the consumers' credit scores.



Source: Credit Builders Alliance, 2015

Other kinds of positive reporting are being explored as a means of bringing the many families who operate primarily on a cash basis into the financial mainstream.[18] Bipartisan legislation is being considered in both the House and the Senate to expand credit reporting to include phone bill and utility payments, as well as rent payments.[19] Current federal law does not clearly address the limits of alternative data, which leaves agencies and other firms unsure of how they may legally use such data.[20]

Credit bureaus are also developing new ways of calculating credit scores with alternative data—like FICO's Score XD—which predicts borrowers' ability to repay as accurately as credit bureau data scores.[21]

Though developing new ways of scoring consumers will not make credit reports any better suited for assessing employment or other non-lending-related decisions, alternative scores can help consumers break the vicious cycle of financial insecurity caused by poor credit or credit invisibility.

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