



Statement of

Cheryl R. Cooper
Analyst in Financial Economics

Before

Committee on Financial Services
Subcommittee on Oversight and Investigations
U.S. House of Representatives

Hearing on

“How Invidious Discrimination Works and Hurts: An Examination of Lending Discrimination and Its Long-Term Economic Impacts on Borrowers of Color”

February 24, 2021

Congressional Research Service

<https://crsreports.congress.gov>

TE10060

Chairman Green, Ranking Member Barr, Members of the Subcommittee, thank you for the opportunity to testify today. My name is Cheryl Cooper, and I am an Analyst in Financial Economics at the Congressional Research Service (CRS) focusing on consumer finance markets and policy issues. CRS's role is to provide objective, nonpartisan research and analysis to Congress. CRS takes no position on the desirability of any specific policy. Any arguments presented in my written and oral testimony are for the purposes of informing Congress, not to advocate for a particular policy outcome.

My testimony will focus on racial, ethnic, and other disparities in access to financial products and services. In particular, I will focus on discussing disparities in access to bank and other payment accounts and disparities in inclusion in the credit reporting system. These areas are generally considered foundational for households to successfully manage their financial affairs, and graduate to wealth-building activities in the future, such as homeownership.¹

Consumers often rely on family or community connections to get their first bank accounts, establish a credit history, and gain access to affordable credit. However, research suggests that disparities in family wealth or in community relationships with financial institutions can potentially persist across generations.² A factor that may be influencing racial disparities is the intergenerational effects of discrimination—for example, historical redlining practices in the mortgage lending market.³ Moreover, violations in fair lending laws can cause harm to consumers who do not get access to financial services. This is important because safe and affordable financial services are an important tool for most American households to help them avoid financial hardship and build assets over the course of their lives.

Some U.S. households do not use banking services or have a robust credit history. Different barriers affect different populations. For some younger consumers, a lack of a co-signer might make it more difficult to build a credit report history, and a lack of knowledge or familiarity with financial institutions may be a barrier to obtaining a bank account. For consumers living paycheck to paycheck, a bad credit history or a lack of money could serve as barriers to obtaining affordable credit or bank accounts. For consumers living in rural areas, living further from bank branches or not having high-speed internet may make it more difficult to access quality banking services.

My testimony will first discuss the impact on consumers of access to financial products and services. Second, I will discuss racial, ethnic, and other disparities in access to financial services and then, lastly, potential policy interventions.

¹ Wealth-building activities include access to homeownership, education, and other financial investments, such as for retirement. For more information on homeownership, see CRS Report R42995, *An Overview of the Housing Finance System in the United States*, by Katie Jones, Darryl E. Getter, and Andrew P. Scott. For more information on education finance, see CRS Report R43351, *The Higher Education Act (HEA): A Primer*, by Alexandra Hegji. For more information on saving and investing for retirement, see CRS Report R46441, *Saving for Retirement: Household Decisionmaking and Policy Options*, by Cheryl R. Cooper and Zhe Li.

² For example, recent research studies suggest correlations between parent credit and wealth characteristics and children's future credit scores and homeownership status. See Andra C. Ghent and Marianna Kudlyak, "Intergenerational Linkages in Household Credit," *Federal Reserve Bank of San Francisco Working Paper Series*, Working Paper 2016-31, December 2016, <http://www.frbsf.org/economic-research/publications/working-papers/wp2016-31.pdf>; Rawley Z. Heimer and Nicholas Fritsch, "Intergenerational Homeownership and Mortgage Distress," *Economic Commentary*, Federal Reserve Bank of Cleveland, June 18, 2020, <https://www.clevelandfed.org/newsroom-and-events/publications/economic-commentary/2020-economic-commentaries/ec-202012-intergenerational-homeownership-and-mortgage-distress.aspx>; and Jung Hyun, Choi Jun Zhu, and Laurie Goodman, *Intergenerational Homeownership: The Impact of Parental Homeownership and Wealth on Young Adults' Tenure Choices*, Urban Institute, October 2018, https://www.urban.org/sites/default/files/publication/99251/intergenerational_homeownership_0.pdf.

³ Mehrsa Baradaran, *The Color of Money: Black Banks and the Racial Wealth Gap* (Harvard University Press, 2017).

The Impact of Access to Financial Products and Services⁴

In the United States, robust consumer credit markets allow most consumers to access financial services and credit products to meet their needs in traditional financial markets. For example, the vast majority of consumers have a bank account, a credit score, and a credit card. However, some consumers—who tend to be younger adults, low- and moderate-income (LMI) consumers, racial or ethnic minorities, and those who live in rural areas—can find gaining access to these products and services challenging. In addition, discrimination, such as violations in fair lending laws, can also prevent consumers from accessing financial services.

These consumers may find managing their financial lives expensive and difficult. Some households also use financial products and services outside of the banking system either by choice or due to a lack of access to traditional institutions. While products outside the banking sector may better suit some households' needs, these products might also lack consumer protections or other benefits that traditional financial institutions tend to provide.

Financial inclusion refers to the idea that individuals “have access to useful and affordable financial products and services that meet their needs—transactions, payments, savings, credit, and insurance—delivered in a responsible and sustainable way.”⁵ Access to financial products allows households to better manage their financial lives, such as storing funds safely, making payments in exchange for goods and services, and coping with unforeseen financial emergencies, such as medical expenses or car or home repairs.

The Consumer Financial Protection Bureau (CFPB)⁶ defines *financial well-being* as:

1. having control over day-to-day, month-to-month finances,
2. having the ability to absorb a financial shock,
3. being on track to meet financial goals, and
4. being able to make choices that allow a person to enjoy life.⁷

Many Americans have low financial well-being and live paycheck to paycheck. National surveys suggest that about 40% of Americans find “covering expenses and bills in a typical month is somewhat or very difficult,”⁸ and they could not pay all of their bills on time in the past year.⁹ In addition, more than 35% of households did not set aside any money in the past year for emergency expenses.¹⁰ Therefore, a sizable portion of the adult population report they would have difficulty meeting an unexpected expense. If faced with a \$400 unexpected expense, 39% of adults say they would borrow, sell something, or not be able to

⁴ For more information on financial inclusion and credit access policy issues, see CRS Report R45979, *Financial Inclusion and Credit Access Policy Issues*, by Cheryl R. Cooper.

⁵ The World Bank's definition of *financial inclusion*. See World Bank, “Financial Inclusion,” October 2, 2018, <https://www.worldbank.org/en/topic/financialinclusion/overview>.

⁶ For more information on the Consumer Financial Protection Bureau (CFPB), see CRS In Focus IF10031, *Introduction to Financial Services: The Consumer Financial Protection Bureau (CFPB)*, by Cheryl R. Cooper and David H. Carpenter.

⁷ CFPB, *Financial Well-Being: The Goal of Financial Education*, January 2015, p. 5, https://files.consumerfinance.gov/f/201501_cfpb_report_financial-well-being.pdf.

⁸ CFPB, *Financial Well-Being in America*, September 2017, p. 72, https://files.consumerfinance.gov/f/documents/201709_cfpb_financial-well-being-in-America.pdf.

⁹ Financial Health Network (formerly CFSI), *U.S. Financial Health Pulse: 2018 Baseline Survey Results*, May 2019, p. 4, <https://finhealthnetwork.org/research/u-s-financial-health-pulse-2018-baseline-survey-results/>.

¹⁰ Federal Deposit Insurance Corporation (FDIC), *How America Banks: Household Use of Banking and Financial Services*, 2019 FDIC Survey, October 2020, p. 55, <https://www.fdic.gov/analysis/household-survey/2019report.pdf>.

cover the expense.¹¹ These financial struggles lead to real impacts on the health and wellness of these families; those with low financial well-being are more likely to face material hardship.¹²

Banking and Other Transaction Accounts

The banking sector provides valuable financial services for households that allow them to save, make payments, and access credit.¹³ Most U.S. consumers choose to open a bank account because it is a safe and secure way to store money.¹⁴ For example, the Federal Deposit Insurance Corporation (FDIC) insures up to \$250,000 per depositor against an institution's failure. In addition, consumers gain access to payment services through checking accounts, such as bill pay and paper checks. Frequently, a checking account includes access to a debit card, which facilitates payment transactions through the account. For most consumers, a bank account is less expensive than alternative ways to access these types of services. Some studies suggest that affordable access to payment transactions may be particularly important for consumers to manage their financial lives.¹⁵

For most consumers, opening a bank account is relatively easy. A consumer undergoes an account verification process and sometimes provides an initial opening deposit of money into the account. Many consumers open their first depository account when they get their first job or start post-secondary education. Bank accounts are often the first relationship that a consumer has with a financial institution, which can later progress into other types of financial products and services, such as loan products or financial investments. Financial institutions sometimes provide consumer loans to existing customers, even if the borrower lacks a credit history (e.g., a consumer with a checking account who is a student or young worker) to build long-term relationships.

Banking Account Alternatives

Some households use financial services outside of the banking system. Nonbank financial transaction products include check cashing, money orders, and bill payment services. These products can sometimes be less expensive, faster, and more convenient for some consumers.¹⁶ For example, although check cashing, money orders, and other nonbank transaction products might charge high fees, some consumers may incur higher or less predictable fees with a checking account. In addition, such nonbank financial transaction products might allow consumers to access cash more quickly, which might be valuable for consumers with tight budgets and little liquid savings or credit to manage financial shocks or other expenses. Lastly, nonbank stores often are open longer hours than banks, including evenings and weekends, which might be more convenient for working households. Although consumers may find benefits in using financial services outside of the banking system, these products may not always have all of the benefits of bank accounts, such as FDIC insurance or other consumer protections.

General-purpose prepaid cards are another popular alternative to a traditional checking account. These cards can be obtained through a bank, at a retail store, or online, and they can be used in payment networks such as Visa and MasterCard. General-purpose reloadable prepaid cards generally have features

¹¹ Federal Reserve, *Report on the Economic Well-Being of U.S. Households in 2018*, May 2019, p. 2, <https://www.federalreserve.gov/publications/files/2018-report-economic-well-being-us-households-201905.pdf>.

¹² CFPB, *Financial Well-Being in America*, p. 6.

¹³ The banking sector includes both banks and credit unions.

¹⁴ *Bank accounts* refer to checking, savings, and other accounts at all depository institutions, including banks and credit unions.

¹⁵ CFPB, *Financial Well-Being in America*, p. 57; and Dean Karlan et al., *Research and Impacts of Digital Financial Services*, National Bureau of Economic Research (NBER), Working Paper no. 22633, September 2016, p. 3.

¹⁶ Lisa Servon, *The Unbanking of America: How the New Middle Class Survives* (Mariner Books, 2017).

similar to debit and checking accounts, such as the ability to pay bills electronically, get cash at an ATM, make purchases at stores or online, and receive direct deposits. Prepaid cards often have a monthly maintenance fee and other particular service fees, such as for using an ATM or reloading cash.

Impact of Access to Banking and Other Transaction Accounts

Research has examined the impact of access to bank and other transaction accounts in achieving financial well-being. For example, a CFPB study found that not having a bank account and nonbank transaction product use (e.g., check cashing or money orders) is correlated with lower financial well-being.¹⁷ In addition, accumulating liquid savings¹⁸ is highly correlated with the CFPB's financial well-being scale.¹⁹

Other research suggests that emergency savings are crucial for a household's financial stability. The ability to meet unexpected expenses is particularly important, because within any given year most households face an unexpected financial shock.²⁰ For example, one study found that following a financial shock, families with even a relatively small amount of non-retirement savings (e.g., \$250-\$750) are less likely to be evicted or miss a housing or utility payment.²¹ These findings are consistent throughout the income spectrum, not only for lower-income families.²²

One barrier for building emergency savings may include not having a separate account dedicated to saving.²³ When money is kept in a transaction account intended for emergencies, it can be vulnerable to unintentional overspending.²⁴ In particular, debit accounts seem to help consumers save more by reducing money spent on financial services and monitoring costs.²⁵ Moreover, access to faster and more secure payment services has also been shown to provide benefits to consumers, including helping lower-income consumers better handle financial shocks.²⁶

The Credit Reporting System²⁷

The credit reporting industry collects information on consumers that is frequently related to their past financial performance and repayment history on traditional credit products. Lenders use the information

¹⁷ CFPB, *Financial Well-Being in America*, p. 57.

¹⁸ Liquid savings are financial assets, such as a savings account, from which the household can easily access funds. In contrast, illiquid wealth includes valuable items, such as a car or home that a household owns. For more information on U.S. households' balance sheet, see CRS Report R45813, *An Overview of Consumer Finance and Policy Issues*, by Cheryl R. Cooper.

¹⁹ CFPB, *Financial Well-Being in America*, pp. 49-53.

²⁰ According to a Pew Charitable Trusts survey, 60% of households face a financial shock within 12 months, such as a major car or home repair, a trip to the hospital, a pay cut, or another large expense. The median cost of a household's most expensive shock during a year is \$2,000. For more information, see Pew Charitable Trusts, *How Do Families Cope with Financial Shocks? The Role of Emergency Savings in Family Financial Security*, October 2015, pp. 4-5, https://www.pewtrusts.org/~media/assets/2015/10/emergency-savings-report-1_artfinal.pdf.

²¹ Signe-Mary McKernan et al., *Thriving Residents, Thriving Cities: Family Financial Security Matters for Cities*, Urban Institute, April 2016, p. 2, <https://www.urban.org/research/publication/thriving-residents-thriving-cities-family-financial-security-matters-cities>.

²² McKernan et al., *Thriving Residents, Thriving Cities*, pp. 6-9.

²³ Karlan et al., *Research and Impacts of Digital Financial Services*, p. 2.

²⁴ For more information on consumer financial biases, see CRS Report R45813, *An Overview of Consumer Finance and Policy Issues*, by Cheryl R. Cooper.

²⁵ Pierre Bachas et al., *How Debit Cards Enable the Poor to Save More*, NBER, Working Paper no. 23252, October 2018.

²⁶ Karlan et al., *Research and Impacts of Digital Financial Services*, p. 3.

²⁷ For more information on the credit reporting industry, see CRS Report R44125, *Consumer Credit Reporting, Credit Bureaus, Credit Scoring, and Related Policy Issues*, by Cheryl R. Cooper and Darryl E. Getter.

to estimate the probability of successfully repaying a loan or defaulting on it. Consumer files generally do not contain information on consumer income or assets or on nonbank financial services. Credit bureaus collect and store payment data reported to them by financial firms and others, and they or other credit scoring companies use this data to estimate individual consumers' creditworthiness, generally expressed as a numerical "score." The three largest credit bureaus—Equifax, Experian, and TransUnion—provide credit reports nationwide that include repayment histories.²⁸ Credit reports generally may not include information on items such as race or ethnicity, religious or political preference, or medical history.

Impact of Access to the Credit Reporting System

The credit reporting industry significantly affects consumer access to financial products, because lenders and other financial firms use consumer data or a credit score as a factor when deciding whether to provide credit or other products to an individual and under what terms. For this reason, inclusion in credit bureaus can have positive effects on consumers by reducing market information asymmetry and allowing some consumers to obtain better terms of credit.²⁹ Consumers with good credit histories may find it easy to access credit on good terms. Consumers who find it challenging to enter the traditional credit reporting system may face challenges accessing many consumer credit products, such as mortgages or credit cards. In this way, a limited credit history can serve as a barrier to obtaining affordable credit. Yet consumers also face challenges developing a credit history without access to credit products. This chicken-and-egg situation can make it difficult for some people to enter the credit reporting system.

Some consumers can access nonbank credit financial products for their credit needs without a credit history. Nonbank credit financial products include payday loans, pawn shop loans, auto title loans, and other types of loan products from nonbank providers.³⁰ Some argue that these products are expensive and are more likely than bank products to lead to debt traps. Bank credit may be less expensive for borrowers with good credit histories or relationships with banks. For other consumers, nonbank credit financial products might better serve their needs due to fee structure or less stringent underwriting.³¹

Disparities in Access to Financial Services

Racial, ethnic, and other disparities exist in access to bank and other payment accounts and in inclusion in the credit reporting system. One factor influencing these disparities is likely the intergenerational effects of discrimination. Some consumers face barriers that make it more difficult for them to open bank accounts, enter the credit system, and gain access to financial product and service offerings. These barriers can be significant because they may disadvantage these consumers from effectively managing their financial lives and achieving financial well-being.

²⁸ For a list of consumer reporting agencies, see "List of Consumer Reporting Agencies," issued by CFPB, at https://files.consumerfinance.gov/f/documents/cfpb_consumer-reporting-companies-list.pdf.

²⁹ Karlan et al., *Research and Impacts of Digital Financial Services*, pp. 4-5.

³⁰ For more information, on nonbank alternative credit products, see CRS Report R44868, *Short-Term, Small-Dollar Lending: Policy Issues and Implications*, by Darryl E. Getter; and CRS Insight IN11059, *CFPB Finalizes New Payday Lending Rule, Reversing Prior Regulation*, by Cheryl R. Cooper.

³¹ The extent to which borrowers' financial situations would be harmed by using expensive credit or having limited access to credit is widely debated. Credit is an important way households pay for unexpected expenses and compensate for emergencies, such as a car or home repair, a medical expense, or a pay cut. Research suggests that access to this type of short-term credit can help households during short-term emergencies, yet unsustainable debt can harm households. Consumer groups often raise concerns regarding the affordability of small-dollar loans. Some borrowers may fall into *debt traps*, situations where borrowers repeatedly roll over existing loans into new loans and find it difficult to repay outstanding balances.

Disparities and Barriers to Bank Accounts and Transaction Services³²

According to the FDIC's 2019 survey, 5.4% of households in the United States were *unbanked*, meaning that these households do not have a bank account.³³ Unbanked consumers tend to be lower-income, younger, have less formal education, of a racial or ethnic minority, disabled, and have incomes that varied substantially from month to month compared with the general U.S. population.³⁴ Urban and rural households were more likely to be unbanked compared to suburban households.³⁵ Unbanked persons may be electing not to open a bank account due to costs, a lack of trust, or other barriers. According to the survey, these households report that they do not have a bank account because they do not have enough money, do not trust banks, are concerned about privacy, and want to avoid high and unpredictable bank fees.³⁶ Prepaid card use was more prevalent among unbanked households.³⁷ Moreover, unbanked households are much more likely to report not saving for unexpected expenses and emergencies (74%) than banked households.³⁸

In addition, 17.2% of households used nonbank financial transaction services in the past year.³⁹ Nonbank financial transaction services include money orders, check cashing, and bill payment services. Households using nonbank financial transaction services tend to be lower-income, younger, have less formal education, of a racial or ethnic minority, and have incomes that varied substantially from month to month compared with the general U.S. population.⁴⁰ These households are more likely to be unbanked; however, 15% of banked consumers used nonbank financial transaction services in the past year as well.⁴¹

Consumers with low bank account balances or who are less creditworthy may generally be less profitable for banks to serve. Lower-balance consumers provide banks minimal funds to lend out and earn interest. Moreover, less creditworthy consumers may be less likely to develop profitable relationships with banks if they are not in a position to obtain loans. Therefore, bank fees allow banks to recoup the costs associated with providing accounts for these consumers. Because of the way bank fees are structured, consumers with lower balances using checking and savings accounts tend to incur more fees than consumers with higher balances.

The availability of free or low-cost checking accounts has reportedly diminished in the past decade or so, and fees associated with checking accounts have grown.⁴² In addition to certain minimum account balance and other service fees, the most common fees that checking account consumers incur are overdraft and nonsufficient fund fees.⁴³ Overdraft services can help consumers pay bills on time, but fees can be costly,

³² For more information on access to bank accounts, see CRS In Focus IF11631, *Financial Inclusion: Access to Bank Accounts*, by Cheryl R. Cooper.

³³ FDIC, *How America Banks*, p. 1.

³⁴ FDIC, *How America Banks*, pp. 1-2.

³⁵ FDIC, *How America Banks*, p. 2.

³⁶ FDIC, *How America Banks*, p. 3.

³⁷ FDIC, *How America Banks*, p. 6.

³⁸ FDIC, *How America Banks*, p. 56.

³⁹ FDIC, *How America Banks*, p. 6.

⁴⁰ FDIC, *How America Banks*, p. 6.

⁴¹ FDIC, *How America Banks*, p. 39.

⁴² CFPB, *CFPB Study of Overdraft Programs: A White Paper of Initial Data Findings*, June 2013, pp. 15-17, https://files.consumerfinance.gov/f/201306_cfpb_whitepaper_overdraft-practices.pdf; and FDIC, *FDIC Quarterly Banking Profile: Quarterly Income Time-Series Data*, 2019, <https://www.fdic.gov/bank/analytical/qbp/>.

⁴³ Trevor Bakker et al., *Data Point: Checking Account Overdraft*, CFPB, July 2014, p. 5, https://files.consumerfinance.gov/f/201407_cfpb_report_data-point_overdrafts.pdf.

particularly if used repeatedly.⁴⁴ For consumers living paycheck to paycheck, maintaining bank account minimums and avoiding account overdrafts might be difficult, leading to unaffordable account fees. In addition, unpaid fees can lead to involuntary account closures, making it more difficult to obtain a bank account in the future.

Bank access may also have a geographic component, as some observers are concerned that *banking deserts*—areas without a bank branch nearby—exist in certain communities. Branch offices are still important to many consumers, even as mobile and online banking has become more popular. For example, most banked households visit a bank branch regularly, and over a quarter of banked households visit 10 or more times in a year.⁴⁵ Older and rural households were more likely to visit bank branches more frequently than other banked households.⁴⁶ However, in the past decade, the number of bank branch offices has declined in the United States due to many causes, such as bank consolidations and the rise of online banking.⁴⁷ Some argue that this has left some communities without any nearby bank branches, making it more difficult to access quality banking services, particularly in lower-income, non-urban areas.⁴⁸ Yet others argue that banking deserts are not a major issue in the United States because they have been stable over time, and minority areas are less likely to be affected than other areas of the country.⁴⁹

Disparities and Barriers to Entering the Credit Reporting System

According to the CFPB, credit scores cannot be generated for approximately 20% of the U.S. population due to their limited credit histories.⁵⁰ The CFPB categorizes consumers with limited credit histories into several groups. One category of consumers, referred to as *credit invisibles*, have no credit record at the three nationwide credit reporting agencies and, thus, do not exist for the purposes of credit reporting. Credit invisibles represents 11% of the U.S. adult population, or 26 million consumers. Another category of consumers have a credit record and thus exist, but they cannot be scored or are considered *unscorable*. Unscorable consumers either have insufficient (short) histories or stale (outdated) histories. The insufficient and stale unscorable groups, each containing more than 9 million individuals, collectively represent 8.3% of the U.S. adult population, or approximately 19 million consumers.⁵¹

⁴⁴ For more information on overdraft, see CRS In Focus IF11460, *Overdraft: Payment Service or Small-Dollar Credit?*, by Andrew P. Scott.

⁴⁵ FDIC, *How America Banks*, p. 23.

⁴⁶ FDIC, *How America Banks*, p. 24.

⁴⁷ Although some traditional banks have tried to compete in digital banking to provide cheaper products to consumers, banks have not always been successful with the online product channel. See Penny Crosman, “Where Did JPMorgan Chase’s Finn Experiment Go Wrong?,” *American Banker*, June 6, 2019.

⁴⁸ Drew Dahl and Michelle Franke, “Banking Deserts” *Become a Concern as Branches Dry Up*, Federal Reserve Bank of St. Louis, July 25, 2017, <https://www.stlouisfed.org/publications/regional-economist/second-quarter-2017/banking-deserts-become-a-concern-as-branches-dry-up>; Donald Morgan, Maxim Pinkovskiy, and Bryan Yang, *Banking Deserts, Branch Closings, and Soft Information*, Federal Reserve Bank of New York, March 7, 2016, <https://libertystreeteconomics.newyorkfed.org/2016/03/banking-deserts-branch-closings-and-soft-information.html>; and Francisco Covas, *Some Facts About Bank Branches and LMI Customers*, Bank Policy Institute, April 4, 2019, <https://bpi.com/notes-papers-presentations/some-facts-about-bank-branches-and-lmi-customers/>.

⁴⁹ Morgan, Pinkovskiy, and Yang, *Banking Deserts, Branch Closings, and Soft Information*; and Covas, *Some Facts About Bank Branches and LMI Customers*.

⁵⁰ Kenneth P. Brevoort, Philipp Grimm, and Michelle Kambara, *Data Point: Credit Invisibles*, CFPB, May 2015, p. 6, http://files.consumerfinance.gov/f/201505_cfpb_data-point-credit-invisibles.pdf.

⁵¹ Brevoort, Grimm, and Kambara, *Data Point: Credit Invisibles*, p. 6.

Limited credit history is correlated with age, income, race, and ethnicity. Many consumers that are credit invisible or unscorable are young. For example, 40% of credit invisibles are under 25 years old.⁵² Moreover, consumers who live in lower-income neighborhoods or are Black or Latino are also disproportionately credit invisible or unscorable compared with the U.S. population.⁵³ Credit invisibility is higher in rural areas as well as areas where fewer households have high-speed internet.⁵⁴

Most young adults transition into the credit reporting system in their early 20s—80% of consumers transition out of credit invisibility before age 25, and 90% do so before age 30.⁵⁵ For young consumers, the most common ways to become credit visible are through credit cards, student loans, and *piggybacking* (i.e., becoming a joint account holder or authorized user on another person's account, such as a parent's account).⁵⁶ Young adults in LMI neighborhoods tend to make the transition to credit visibility at older ages than do young adults in higher-income neighborhoods. In urban areas, consumers over 25 years old from LMI neighborhoods have higher rates of credit invisibility than those in middle- and upper-income areas.⁵⁷ In addition, the highest rates of credit invisibility for consumers over 25 years old are in rural areas, and these rates do not vary much based on neighborhood income.⁵⁸ Credit invisible consumers in LMI and rural areas are less likely to enter the credit bureaus through a credit card than credit invisible consumers in other parts of the country,⁵⁹ possibly because piggybacking is notably less common in LMI communities.⁶⁰ Moreover, using student loans to become credit visible is also less common in LMI areas.⁶¹

Over 27% of households do not have access to bank credit products,⁶² generally because they are either unscorable or have a blemished credit history. These households tend to be lower-income, have less formal education, of a racial or ethnic minority, and disabled compared with the general U.S. population.⁶³ Moreover, less than 5% of households used nonbank credit financial products, such as payday or pawn shop loans, in 2019.⁶⁴ These households also tend to be lower-income, have less formal education, of a racial or ethnic minority, and disabled compared with the general U.S. population.⁶⁵ Rural households were more likely to use nonbank credit products than suburban and urban households, as well as households in the South.⁶⁶

⁵² Brevoort, Grimm, and Kambara, *Data Point: Credit Invisibles*, p. 14.

⁵³ Brevoort, Grimm, and Kambara, *Data Point: Credit Invisibles*, pp. 16-23.

⁵⁴ Kenneth P. Brevoort et al., *Data Point: The Geography of Credit Invisibility*, CFPB, September 2018, p. 11, 20, <https://www.consumerfinance.gov/data-research/research-reports/data-point-geography-credit-invisibility/>.

⁵⁵ Kenneth P. Brevoort and Michelle Kambara, *Data Point: Becoming Credit Visible*, CFPB, June 2017, pp. 5 and 8, https://files.consumerfinance.gov/f/documents/BecomingCreditVisible_Data_Point_Final.pdf.

⁵⁶ Brevoort and Kambara, *Data Point: Becoming Credit Visible*, p. 13; and CFPB, *Building a Bridge to Credit Visibility: A Report on the CFPB's September 2018 Building a Bridge to Credit Visibility Symposium*, July 2019, p. 12, https://files.consumerfinance.gov/f/documents/cfpb_building-a-bridge-to-credit-visibility_report.pdf.

⁵⁷ Brevoort et al., *Data Point: The Geography of Credit Invisibility*, pp. 10-11.

⁵⁸ Brevoort et al., *Data Point: The Geography of Credit Invisibility*, pp. 11-12.

⁵⁹ Brevoort et al., *Data Point: The Geography of Credit Invisibility*, p. 13.

⁶⁰ Brevoort and Kambara, *Data Point: Becoming Credit Visible*, p. 6.

⁶¹ Brevoort and Kambara, *Data Point: Becoming Credit Visible*, p. 17.

⁶² FDIC, *How America Banks*, p. 8.

⁶³ FDIC, *How America Banks*, p. 48.

⁶⁴ FDIC, *How America Banks*, p. 8.

⁶⁵ FDIC, *How America Banks*, p. 8.

⁶⁶ FDIC, *How America Banks*, pp. 9, 49.

Possible Policy Responses

Expanding access to banking services and the credit reporting system could reduce racial, ethnic, and other disparities that currently exist, and help more consumers achieve higher financial well-being and graduate to wealth-building activities in the future, such as homeownership. Some research suggests that consumers may particularly benefit from (1) access to affordable electronic payment system services and a safe way to accumulate and hold emergency savings, for example, through a traditional bank account; and (2) access to the credit reporting system and affordable credit. The government, the private sector, and the nonprofit sector may all be in a position to help increase access to these types of financial products for the underserved.

Bank Regulation Changes. Some propose changes to bank regulation to try to increase access to bank accounts and bank credit products. For example, bank regulators have considered changes to the Community Reinvestment Act (CRA; 12 U.S.C. §§2901-2908) to give banks more credit for bank account outreach activities in underserved communities.⁶⁷ In addition, bank regulators have considered their guidance to banks interested in offering small-dollar lending products.⁶⁸ However, policymakers often face a trade-off between consumer protection and access to credit when regulating the banking sector.

Payment System Improvements.⁶⁹ Payment system improvements, either by the government or by the private sector, may also have the potential to improve welfare for unbanked consumers or consumers who use nonbank transaction products. Many of these consumers choose nonbank transaction products such as check cashers to access their funds quickly.⁷⁰ These consumers might not require such products if bank payment systems operated faster than they currently do. Both the private sector and the government are currently working on initiatives to make the bank payment system faster.⁷¹ For example, the Federal

⁶⁷ See U.S. Department of the Treasury, “Memorandum for the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation,” April 3, 2018, <https://home.treasury.gov/sites/default/files/2018-04/4-3-18%20CRA%20memo.pdf>; and Federal Reserve, *Perspectives from Main Street: Stakeholder Feedback on Modernizing the Community Reinvestment Act*, June 2019, p. 9, <https://www.federalreserve.gov/publications/files/stakeholder-feedback-on-modernizing-the-community-reinvestment-act-201906.pdf>. For more information on the Community Reinvestment Act (CRA), see CRS Report R43661, *The Effectiveness of the Community Reinvestment Act*, by Darryl E. Getter.

⁶⁸ Before 2013, some banks offered *deposit advance* products to consumers with bank accounts, which were short-term loans paid back automatically out of the borrower’s next qualifying electronic deposit. In 2013, the Office of the Comptroller of the Currency (OCC), FDIC, and Federal Reserve issued supervisory guidance advising banks to make sure deposit advance products complied with consumer protection and safety and soundness regulations. In October 2017, the OCC rescinded the 2013 guidance and in May 2018 issued a new bulletin to encourage their banks to enter this market. In November 2018, the FDIC solicited advice about how to encourage more banks to offer small-dollar credit products. See OCC, “Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products,” 78 *Federal Register* 70624, November 26, 2013; FDIC, “Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products,” 78 *Federal Register* 70552, November 26, 2013; Federal Reserve, *Statement on Deposit Advance Products*, CA 13-7, April 25, 2013, <https://www.federalreserve.gov/supervisionreg/caletters/CA13-07attachment.pdf>; OCC, *Core Lending Principles for Short-Term, Small-Dollar Installment Lending*, May 23, 2018, <https://www.occ.gov/news-issuances/bulletins/2018/bulletin-2018-14.html>; OCC, “Rescission of Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products,” 82 *Federal Register* 196, October 12, 2017; and FDIC, “Request for Information on Small-Dollar Lending,” 83 *Federal Register* 58566, November 20, 2018, <https://www.govinfo.gov/content/pkg/FR-2018-11-20/pdf/2018-25257.pdf>.

⁶⁹ For more information, see CRS Report R45927, *U.S. Payment System Policy Issues: Faster Payments and Innovation*, by Cheryl R. Cooper, Marc Labonte, and David W. Perkins.

⁷⁰ Aaron Klein, “The Fastest Way to Address Income Inequality? Implement a Real Time Payment System,” Brookings Institution, January 2, 2019, <https://www.brookings.edu/research/the-fastest-way-to-address-income-inequality-implement-a-real-time-payment-system>.

⁷¹ Several private sector initiatives are underway to implement faster payments. For an overview, see Nacha, *Faster Payments 101*, https://www.nacha.org/system/files/2020-12/FasterPayments101_Nacha_Alliance.pdf. Notably, the Clearing House introduced its real-time payment network (with real-time settlement) in November 2017. According to the Clearing House, it

Reserve plans to introduce a real-time payment system called FedNow in 2023 or 2024, which would allow consumers access to funds quickly after initiating the transfer.⁷²

Financial Technology.⁷³ New technology could potentially provide more affordable financial products to underserved consumers. Whereas bank products may be expensive to provide to lower-income or less creditworthy consumers, technology may be able to reduce the cost. For example, internet-based or mobile financial products could provide access to payment services or lower the cost to provide loans for underserved consumers.⁷⁴

Alternative data could potentially be used to expand access to credit for current credit invisible or unscorable consumers, but it could also create data security risks or consumer protection violations.⁷⁵ *Alternative data* generally refers to data that the national consumer reporting agencies do not traditionally use (e.g., information other than traditional financial institution credit repayments) to calculate a credit score. New products that use alternative data on prospective borrowers—either publicly or with the borrower’s permission—may be able to better price lenders’ default risk, which could expand credit access or make credit cheaper for some consumers.⁷⁶ Recent findings suggest that some types of alternative data—such as education, employment, and cash-flow information—might be promising ways to expand access to credit.⁷⁷ Yet these technologies also create risks for consumers. For example, new digital technology exposes consumers to data security risks. Some prospective borrowers may be unaware that alternative data has been used in credit decisions, raising privacy and consumer protection concerns.⁷⁸ In addition, lenders’ alternative data used to make credit decisions could result in disparate impacts or

currently “reaches 50% of U.S. transaction accounts, and is on track to reach nearly all U.S. accounts in the next several years.” For more information, see the Clearing House, *The RTP Network: For All Financial Institutions*, <https://www.theclearinghouse.org/payment-systems/rtp/institution>.

⁷² The Federal Reserve stated that “it will likely take longer for any service, whether the FedNow Service or a private-sector service, to achieve nationwide reach regardless of when the service is initially available.” Board of Governors of the Federal Reserve, *Federal Reserve Actions to Support Interbank Settlement of Faster Payments*, August 5, 2019, Docket No. OP-1670, <https://www.federalreserve.gov/newsevents/pressreleases/files/other20190805a1.pdf>.

⁷³ For more background on financial technology policy issues, see CRS Report R46332, *Fintech: Overview of Innovative Financial Technology and Selected Policy Issues*, coordinated by David W. Perkins.

⁷⁴ For more information, see CFPB, *Mobile Financial Services: A Summary of Comments from the Public on Opportunities, Challenges, and Risks for the Underserved*, November 2015, p. 7, https://files.consumerfinance.gov/f/201511_cfpb_mobile-financial-services.pdf.

⁷⁵ For more information, see CRS In Focus IF11630, *Alternative Data in Financial Services*, by Cheryl R. Cooper.

⁷⁶ See Julapa Jagtiani and Catharine Lemieux, *The Roles of Alternative Data and Machine Learning in Fintech Lending: Evidence from the LendingClub Consumer Platform*, Federal Reserve Bank of Philadelphia, Consumer Finance Institute, Working Paper no. 18-15, <https://www.philadelphiafed.org/-/media/frbp/assets/working-papers/2018/wp18-15r.pdf?la=en>.

⁷⁷ For example, initial results from the Upstart Network’s credit model, which uses alternative data to make credit and pricing decisions, shows that the model expands the number of consumers approved for credit, lowers the rate consumers pay for credit on average, and does not increase disparities based on race, ethnicity, gender, or age. See Patrice Ficklin and Paul Watkins, *An Update on Credit Access and the Bureau’s First No-Action Letter*, CFPB, August 6, 2019, <https://www.consumerfinance.gov/about-us/blog/update-credit-access-and-no-action-letter/>. Moreover, another recent study suggests that cash-flow data may more accurately predict creditworthiness, and its use would expand credit access to more borrowers while meeting fair lending rules. See FinRegLab, *The Use of Cash-Flow Data in Underwriting Credit: Empirical Research Findings*, July 2019, https://finreglab.org/wp-content/uploads/2019/07/FRL_Research-Report_Final.pdf.

⁷⁸ For more information on data privacy and data protection law, see CRS Report R45631, *Data Protection Law: An Overview*, by Stephen P. Mulligan, Wilson C. Freeman, and Chris D. Linebaugh.

other consumer protection violations.⁷⁹ In terms of using new technology and alternative data in consumer lending, questions exist about how to comply with fair lending and other consumer protection regulations.⁸⁰

Government Providing Consumer Financial Products. Other policy proposals include the government directly providing accounts or credit to retail customers—for example, offering banking services through postal offices⁸¹ or providing banking services online to the public through the Federal Reserve, which already provides accounts to banks.⁸² Providing credit to consumers is more risky than providing bank accounts or other banking services, because some consumers will default on their loans. Opposition to these proposals often argue that the government should not be competing with the private sector to provide these services to consumers, especially in the competitive banking market.⁸³

Financial Education. Financial education programs or outreach initiatives coordinated by the government, nonprofit organizations, and financial institutions could support financial inclusion as well.⁸⁴ For example, the “Bank On” movement—a coalition of city, state, and federal government agencies; community organizations; financial institutions; and others—aims to encourage unbanked consumers to open and use bank accounts.⁸⁵ In addition, financial education and partnerships between financial services providers and nonprofit groups may help consumers learn how credit reporting works, develop a credit history, and become scorable.⁸⁶ For example, financial wellness programs at workplaces are a growing way to deliver these types of programs.⁸⁷ Yet financial education, coaching, and counseling can be expensive and difficult to provide to consumers.⁸⁸

⁷⁹ For example, a Charles River Associates report suggests that “geographic location, use of banking services, educational attainment, college or university attended and use of nonprime credit tend to be correlated with race and ethnicity.” Bank regulatory agencies have not made it clear whether using this information is a *legitimate business justification*. (Using credit bureau information is generally a legitimate business justification.) For more information, see Marsha J. Courchane and David M. Skanderson, *Fair Lending in the Brave New World of Big Data*, Charles River Associates, May 2017, p. 5, <https://www.crai.com/sites/default/files/publications/FE-Fair-Lending-whitepaper-050317.pdf>.

⁸⁰ For example, the Equal Credit Opportunity Act (ECOA; 15 U.S.C. §§1691-1691f) generally prohibits discrimination in credit transactions based upon certain protected classes, including sex, race, color, national origin, religion, marital status, age, and “because all or part of the applicant’s income derives from any public assistance program.” ECOA has historically been interpreted to prohibit both intentional discrimination and disparate impact discrimination, in which a facially neutral business decision has a discriminatory effect on a protected class. However, the Supreme Court’s reasoning in a June 2015 decision involving the Fair Housing Act, another federal antidiscrimination law, has sparked debate about whether disparate impact claims are covered under ECOA. For background on disparate impact claims, see CRS Report R44203, *Disparate Impact Claims Under the Fair Housing Act*, by David H. Carpenter.

⁸¹ Mehrsa Baradaran, “It’s Time for Postal Banking,” *Harvard Law Review Forum*, vol. 127 (February 2014), pp. 165-175; and Mehrsa Baradaran, *How the Other Half Banks: Exclusion, Exploitation, and the Threat to Democracy* (Cambridge, MA: Harvard University Press, 2015).

⁸² Morgan Ricks, John Crawford, and Lev Menand, “A Public Option for Bank Accounts (or Central Banking for All),” *Vanderbilt Law Research Paper 18-33 & UC Hastings Research Paper No. 287*, January 26, 2019.

⁸³ Eric Grover, “Return to Sender: Here’s What’s Wrong with Postal Banking,” *American Banker*, May 17, 2018.

⁸⁴ Adele Atkinson and Flore-Anne Messy, *Promoting Financial Inclusion through Financial Education: OECD/INFE Evidence, Policies and Practice*, Organization for Economic Co-operation and Development (OECD), OECD Working Papers on Finance, Insurance and Private Pensions no. 34, 2013, <https://www.oecd-ilibrary.org/docserver/5k3xz6m88smp-en.pdf>.

⁸⁵ Heather Hennerich, *A Look at the Affordable Banking Movement*, Federal Reserve Bank of St. Louis, January 23, 2019, <https://www.stlouisfed.org/open-vault/2019/january/affordable-banking-movement>.

⁸⁶ CFPB, *Building a Bridge to Credit Visibility*, p. 9.

⁸⁷ CFPB, *Financial Wellness at Work: A Review of Promising Practices and Policies*, August 2014, https://files.consumerfinance.gov/f/201408_cfpb_report_financial-wellness-at-work.pdf; and Diana Elliott, Christine Heffernan, and Adaeze Okoli, *Credit Building at the Workplace: Assessing Outcomes for Participants in Working Credit NFP*, Urban Institute, June 20, 2019, <https://www.urban.org/research/publication/credit-building-workplace-assessing-outcomes-participants-working-credit-nfp>.

⁸⁸ CFPB, *Building a Bridge to Credit Visibility*, pp. 22-23.

Disclaimer

This document was prepared by the Congressional Research Service (CRS). CRS serves as nonpartisan shared staff to congressional committees and Members of Congress. It operates solely at the behest of and under the direction of Congress. Information in a CRS Report should not be relied upon for purposes other than public understanding of information that has been provided by CRS to Members of Congress in connection with CRS's institutional role. CRS Reports, as a work of the United States Government, are not subject to copyright protection in the United States. Any CRS Report may be reproduced and distributed in its entirety without permission from CRS. However, as a CRS Report may include copyrighted images or material from a third party, you may need to obtain the permission of the copyright holder if you wish to copy or otherwise use copyrighted material.