Racial Justice and Equal Economic Opportunity
National Consumer Law Center

Past Imperfect: How Credit Scores "Bake In" and Perpetuate Past Discrimination

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Bias Toward Ghetto Residents

One consequence of the present credit reporting system is to systematically exclude ghetto residents from the mainstream of the American credit economy. There is a vicious cycle element to the problem. Ghetto residents cannot get credit with the reputable downtown retailers because they have bad credit records. Therefore, they deal with the ghetto merchants who charge exorbitant prices for inferior and often defective merchandise. An FTC survey of retailing in the District of Columbia showed prices in ghetto stores averaged 60 percent more.

Sen. William Proxmire, 115 Cong. Rec. 2413, Jan.31, 1969, introducing the bill that would become the Fair Credit Reporting Act

Credit reports and scores reflect stunning racial disparities. Credit reporting and credit scoring are supposed to be entirely objective, with no room for flawed tools such as human judgment (and the biases built into human minds). Yet for the past three decades, study after study has found that Black and Latino communities have lower credit scores as a group than whites and Asians. In 2021, the median credit score from Vantage Score for Black consumers was 639, while for white consumers it was nearly 100 points higher at 730 and Asian consumers' median was 752. Latino consumers were in between with a median score of 673. (For a list of other reports and studies, see the Appendix at the end.)

Black and Latino consumers are also more likely to lack a credit history or have too scant a history to generate a credit score, referred to as being "credit invisible." The Consumer Financial Protection Bureau (CFPB) found that about 15 percent of Black and Latino consumers are credit invisible (compared to 9 percent of whites and Asians) and an additional 13 percent of Black and 12 percent of Latino consumers have unscorable records (compared to 7 percent of whites).

The racial disparities in credit scores are due to deep structural factors, created by centuries of intentional and legalized discrimination as well as present-day biases. These huge gaps stem from the very nature of judging humans based on past behavior. By doing so, credit scores necessarily incorporate elements of past and present inequality.

Income and Wealth Disparities

Communities of color have less income than white Americans – Black Americans earn only 76 cents for every dollar earned by whites, and Latinos earn only 73 cents. This difference is due to racial inequality in many settings, such as segregation in education, hidden biases in employment, and the collateral consequences of mass incarceration. But the disparity in wealth is even more stunning: the typical Black family has a median wealth of only about 15 percent ($44,900) of the typical white family ($285,000). The typical Latino family similarly has only about 20 percent of the wealth ($61,600) of the typical white family

The racial wealth gap has a very real impact on the ability of consumers to pay their bills. With fewer assets to draw on, people of color – and the friends and family who they might turn to – are far less able to cushion the blow of financial catastrophes, such as job losses, income reductions, sickness, or unplanned expenses. Less wealth also means that Black students borrow significantly more in student loans for higher education, which places greater financial stress on their budgets and also impacts their credit scores.

How Discrimination Lowered the Credit Scores of Communities of Color

This racial wealth gap didn't happen by accident. It was caused by centuries of discrimination, redlining, and exclusion. Housing discrimination, in particular, is responsible for much of the racial wealth gap. The practice of redlining was invented by the Federal Housing Administration, which refused to guarantee home loans made in Black communities, thus depriving them of the ability to accumulate wealth through homeownership. During the early years of Social Security, unemployment insurance, and the minimum wage, these programs did not cover domestic and agricultural workers — two of the most significant occupations for Black workers.

This discrimination continued into the 21st Century. In the years before the 2007-08 foreclosure crisis, homeowners of color were disproportionately targeted for predatory mortgages. These communities suffered grossly higher rates of foreclosure, wiping out nearly $400 billion of their wealth and having a devastating impact on their financial health and their credit scores.

Current discriminatory practices that have an outsized economic impact include ongoing employment discrimination as well as biases in the criminal legal system. Black and Latino individuals are disproportionately targeted by law enforcement, which has a devastating economic impact, not only on the individuals but also on their families and communities. A study of 51 families Baltimore found that a history of incarceration heavily impacts the credit scores of both the incarcerated individuals and their families.

Black and Latino communities also disproportionately bear the financial burdens from the criminal legal system in the form of fines, fees, and debt. These practices drain precious dollars from families of color, making it a struggle to keep up with everyday bills, with one resulting risk being harm to credit histories. While criminal justice debt and resulting judgments should not end up on credit reports due to a settlement between the credit bureaus and state Attorneys General, there is a chance it could be reported if referred to debt collectors.

Using the Past to Judge Carries on its Biases into the Future

Credit scoring is a reflection of the racial economic divide and wealth gap in this country. As a measurement tool, credit scores work well, in that they reveal the trenchant inequality that current and historical discrimination has engendered. But the problem is when credit scores are used as a decision-making tool without consideration of these disparities, they perpetuate that same racial and economic inequality.

Credit history is a gatekeeper for many important necessities – employment, housing (both rental and homeownership), insurance, and of course, affordable credit. Because of poor or non-existent credit histories, consumers of color are disproportionately denied jobs, credit, insurance, housing and other services, or are forced to pay more. The drain on income affects their ability to pay their current bills, let alone build assets to move ahead. They are less likely to obtain loans on affordable terms to buy homes or start small businesses, while also being more likely to be targeted by predatory lenders who will drain away even more of their income. The historic and current discrimination that is reflected in credit histories causes communities of color to fall even further behind.

Challenging Economic Racism

In light of the troubling racial disparities reflected in credit reports and scores, they should not be used outside of the credit context absent the most compelling justification. For example, there is no evidence that credit history is a valid predictor of job performance and, with extremely limited exceptions, employers simply shouldn't use credit reports in employment.

With respect to insurance, insurers claim that there is a correlation between credit scores and insurance losses. However, there is no good explanation for *why* a person with a lower credit score is supposedly more likely to cause greater losses to insurers. Insurers inaccurately argue that this correlation is because someone "who is reckless with credit may also be reckless with driving or irresponsible about maintaining a home." But credit scores do not measure behavior or responsibility; they measure financial resources, as shown by the fact that credit scores rose during the COVID-19 pandemic due to significant government economic supports. Consumers with lower scores simply have fewer financial resources, and thus may be more likely to file a claim rather than absorbing the loss. Consumers shouldn't be penalized because they don't have resources to forgo filing a claim that they are legitimately entitled to file.

As many as 90% of landlords use credit history as part of tenant screening, often automatically rejecting applicants with low credit scores. According to Experian, a credit score of 620 is the starting point required by most landlords to qualify for an apartment. However, there are no quantitative or scientific studies showing that credit information accurately predicts a successful tenancy; in fact, credit scores are designed to predict the likelihood that a borrower will become 90 days late on a credit obligation—not rent, which is a different sort of obligation that consumers will pay before all other expenses, even groceries. The use of credit scores in tenant screening is incredibly harmful, forcing renters with low scores to turn to predatory landlords who charge above-market rates for low-quality housing (such as extended stay motels), and can even lead to homelessness.

With respect to lending, the quandary is that credit histories and scores are useful tools for lenders, but they perpetuate past inequalities. The issue for our society is whether we continue with these same tools knowing that it not only hurts communities of color, but that the disparate impact of this tool reflects and perpetuates centuries of discrimination, exclusion, and exploitation. A number of reforms, listed below, would reduce the harm.

Needed Reforms

Reducing the harm to Black and Latino communities from the racial disparities and history of discrimination baked into credit scores requires a multi-pronged approach, including:

- **Stop the Mission Creep.** Ban the use of credit information in rental housing and insurance. Severely restrict the use of credit history in employment.

- **Restrict Risk-Based Pricing.** One simple reform is to restrict the practice of risk-based pricing, in which lenders charge higher rates to consumers with lower credit scores. While lenders argue that higher prices are justified as compensation for the risk of lending to lower-scoring borrowers, expensive loan terms can make the loan much more onerous and difficult to repay. Given that consumers of color have historically been targeted for predatory lending, credit scores should not be used to justify high-rate loans. Interest rates should not exceed 36% for small loans and lower for larger ones,[1] as higher rates exacerbate racial injustices by placing borrowers in a debt trap that only worsens their economic situation.

- **Expand Special Purpose Programs**. Another straightforward reform is to expand the use of special purpose programs. These programs are specifically aimed at increasing access to credit for underserved communities, especially communities of color, and are explicitly permitted under the Equal Credit Opportunity Act.

- **Reduce Time Limits on Negative Information.** Another option is to reduce the time limits on negative information in credit reports to three years as a way to minimize the vicious cycle aspect of low credit scores. There is nothing special about the current time limits of seven years for most information and 10 years for bankruptcies, and some countries have shorter limits.

- **Develop Intentionally Improved Algorithms.** A promising reform is the development of algorithms designed to reduce racial disparities, using techniques such as adversarial debiasing or adversarial learning. This technique uses two adversarial models to maximize the ability of the first model to predict a desired factor (e.g., probability of defaulting on a loan), while the second model that predicts the sensitive attribute (e.g., protected class) minimizes its disparities in the first. In general, scoring models and algorithms need to be refined and improved with an intentional focus on reducing racial disparities. Intentionality is key - the income disparities and wealth gaps reflected by credit scores were the product of centuries of intentional discrimination. They cannot and will not be reduced or resolved without the same level of intentionality.

- **Create a Public Credit Registry.** Finally, one of the boldest reform proposals for credit reporting is the idea of a public credit registry based in the CFPB. A public credit registry could develop credit scoring model that actively takes past and present discrimination into account and is intentionally designed to reduce racial disparities.

A cautionary note on alternative data:

Alternative data is often promoted as a solution to credit invisibility and the racial credit score gap. However, while alternative data can sometimes be helpful to some consumers, it can also be extremely harmful to other consumers. The benefit versus harm depends on the type of data, how it is supplied, and how it is used. For example, rent payment reporting has been aggressively promoted, but unless it is positive-only data, it can create enormous harms for struggling renters. Bank account transaction data has shown great promise in reducing racial disparities. More importantly, alternative data will not eliminate racial disparities in credit scores, and is not a panacea for credit inequities. Any data that relies on financial information will still reflect racial disparities given the unequal economic positions of households of color and white households.

As Senator William Proxmire, considered the “father” of the Fair Credit Reporting Act, concluded over 50 years ago:

> What we need is a credit reporting system that is more socially oriented – one that serves the needs of consumers and particularly low-income consumers as well as creditors. We need to develop more precise methods of credit evaluation in order to establish the credit worthiness of the many ghetto [sic] residents capable of meeting their obligations.
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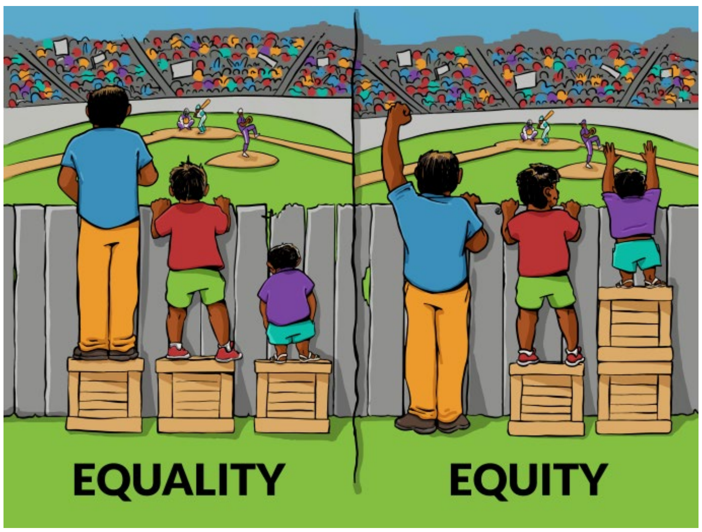
> 115 Cong. Rec. 2413, Jan.31, 1969

From healthcare to criminal justice to employment, we have seen numerous examples of how purportedly objective algorithms producing biased results because they use an equality framework that fails to account for the existing and historical discrimination baked into current societal structures. As the following graphic illustrates, treating people equally when barriers affect people differently is a formula for perpetuating inequality.



Source: Interaction Institute for Social Change | Artist: Angus Maguire
interactioninstitute.org and madewithangus.com

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[1] For more, see National Consumer Law Center’s reports and recommendations on small dollar and installment lending.

Appendix

Studies Showing Racial Disparities in Credit Scores

- A 2022 report (with 2021 data) from the Urban Institute noted that the median credit score for Black consumers was 639, while for white consumers it was nearly 100 points higher at 730, and Latino consumers were in between with a median score of 673. Source: Urban Inst., *Atlanta Market: Keys Unlock Dreams Initiative* 12 (June 2022).

- A 2019 report (with 2016 data) from the Urban Institute found that over 50 percent of white households have credit scores over 700, but only 20 percent of Black households do. Source: Urban Inst., *Explaining the Black-White Homeownership Gap: A Closer Look at Disparities across Local Markets* 8 (Nov. 2019).

- A 2012 study by the CFPB examining credit scores for about 200,000 consumers found that the median FICO score for consumers in majority minority zip codes was in the 34th percentile, while it was in the 52nd percentile for zip codes with low minority populations. *Source:* Consumer Financial Protection Bureau, *Analysis of Differences Between Consumer- and Creditor-Purchased Credit Scores*, at 18, Sept. 2012.

- A 2010 study by the Woodstock Institute found that in predominately African American zip codes in Illinois, over 54.2% of the individuals had a credit score of less than 620. In comparison, 20.3% of Illinois residents statewide had a credit score of less than 620, and only 16.8% of individuals in predominately white zip codes had a credit score of less than 620. In white zip codes, 67.3% of residents had a better than a 700 credit score, while 25% of individuals in predominantly African-American zip codes had credit scores above 700. In zip codes that were majority Latino, 31.4% of individuals had a credit score of less than 620, and only 47.3% had credit scores greater than 700. *Source:* Sarah Duda & Geoff Smith, Woodstock Institute, *Bridging the Gap: Credit Scores and Economic Opportunity in Illinois Communities of Color* 8 (Sept. 2010).

- A 2007 Federal Reserve Board report to Congress on credit scoring and racial disparities, which was mandated by the 2003 Fair and Accurate Credit Transactions Act of 2003 (FACTA), analyzed 300,000 credit files matched with Social Security records to provide racial and demographic information. While the Federal Reserve's ultimate conclusion was to support credit scoring, its study found significant racial disparities. In one of the two models used by the Federal Reserve, the mean score of African Americans was approximately half that of white non-Hispanics (54.0 out of 100 for white non-Hispanics versus 25.6 for African Americans) with Hispanics fairing only slightly better (38.2). *Source:* Board of Governors of the Federal Reserve System, *Report to the Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit* 80-81 (Aug. 2007).

- A 2007 study by the Federal Trade Commission (FTC) on racial disparities in the use of credit scores for auto insurance, also mandated by the 2003 FACTA amendments, found substantial racial disparities, with African Americans and Hispanics strongly over-represented in the lowest scoring categories. *Source:* Federal Trade Commission, *Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance* 3 (July 2007).

- A 2006 study from the Brookings Institution found that counties with high minority populations are more likely to have lower average credit scores than predominately white counties. In the counties with a very low typical score (scores of 560 to 619), Brookings found that about 19% of the population was Hispanic and another 28% is African American. On the other hand, the counties that have higher typical credit scores tended to be essentially all-white counties. *Source:* Matt Fellowes, Brookings Inst., *Credit Scores, Reports, and Getting Ahead in America* 9-10 (May 2006).

- A 2004 study by Federal Reserve researchers found that fewer than 40% of consumers who lived in high-minority neighborhoods had credit scores over 701, while nearly 70% of consumers who lived in mostly white neighborhoods had scores over 701. *Source:* Robert B. Avery, Paul S. Calem, & Glenn B. Canner, *Credit Report Accuracy and Access to Credit,* Federal Reserve Bulletin (Summer 2004).

- A 2004 study published by Harvard's Joint Center for Housing Studies found that the median credit score for whites in 2001 was 738, but the median credit score for African Americans was 676 and for Hispanics was 670. *Source:* Raphael W. Bostic, Paul S. Calem, & Susan M. Wachter, Joint Ctr. for Hous. Studies of Harvard Univ., *Hitting the Wall: Credit As an Impediment to Homeownership* (Feb. 2004).

- A 2004 study conducted by the Texas Department of Insurance on insurance scoring found that African American and Hispanic consumers constituted over 60% of the consumers having the worst credit scores but less than 10% of the consumers having the best scores. *Source:* Tex. Dep't of Ins., *Report to the 79th Legislature--Use of Credit Information by Insurers in Texas* (Dec. 30, 2004).

- A 2004 study conducted by the Missouri Department of Insurance found insurance credit scores were significantly worse for residents of high-minority zip codes. The average consumer in an "all minority" neighborhood had a credit score that fell into the 18th percentile, while the average consumer in a "no minority" neighborhood had a credit score that fell into the 57th percentile. *Source:* Brent Kabler, Missouri Department of Insurance, *Insurance-Based Credit Scores: Impact on Minority and Low Income Populations in Missouri* (Jan. 2004).

- A 1997 analysis by FICO showed that consumers living in minority neighborhoods had lower overall credit scores. *Source:* Fair, Isaac & Co., *The Effectiveness of Scoring on Low-to-Moderate Income and High-Minority Area Populations* 22, Fig. 9 (Aug. 1997).

- A 1996 Freddie Mac study found that African-Americans were three times as likely to have FICO scores below 620 as whites. The same study showed that Hispanics were twice as likely as whites to have FICO scores under 620. *Source:* See Freddie Mac, *Automated Underwriting: Making Mortgage Lending Simpler and Fairer for America's Families* (Sept. 1996).

Other Resources

- National Consumer Law Center, Digital Denials: How Abuse, Bias, and Lack of Transparency in Tenant Screening Harm Renters, September 2023.

- National Consumer Law Center, Even the Catch-22s Come With Catch-22s: Potential Harms & Drawbacks of Rent Reporting, October 2022.

- National Consumer Law Center, Mission Creep: a Primer on Use of Credit Reports & Scores for Non-Credit Purposes, August 2022.

- National Consumer Law Center, No Silver Bullet: Using Alternative Data for Financial Inclusion and Racial Justice, June 2022.
- Richard Rothstein, The Color of Law: A Forgotten History of How Our Government Segregated America (Norton 2017).
- Debbie Gruenstein Bocian, Wei Li, and Keith S. Ernst, Center for Responsible Lending, Foreclosures by Race and Ethnicity: The Demographics of a Crisis, June 18, 2010.
- National Consumer Law Center, Solving the Credit Conundrum: Helping Consumers' Credit Records Impaired by the Foreclosure Crisis and Great Recession (Dec. 2013) (discussing bluntness of credit scoring and arguing for shorter time limits for negative information).
- Meizhu Lui, et al., The Color of Wealth: The Story Behind the U.S. Racial Wealth Divide (The New Press 2006).