Doing Special Purpose Credit Programs Right: Why Programs to Assist Black Communities Should Avoid Conventional Use of Traditional Credit Scores

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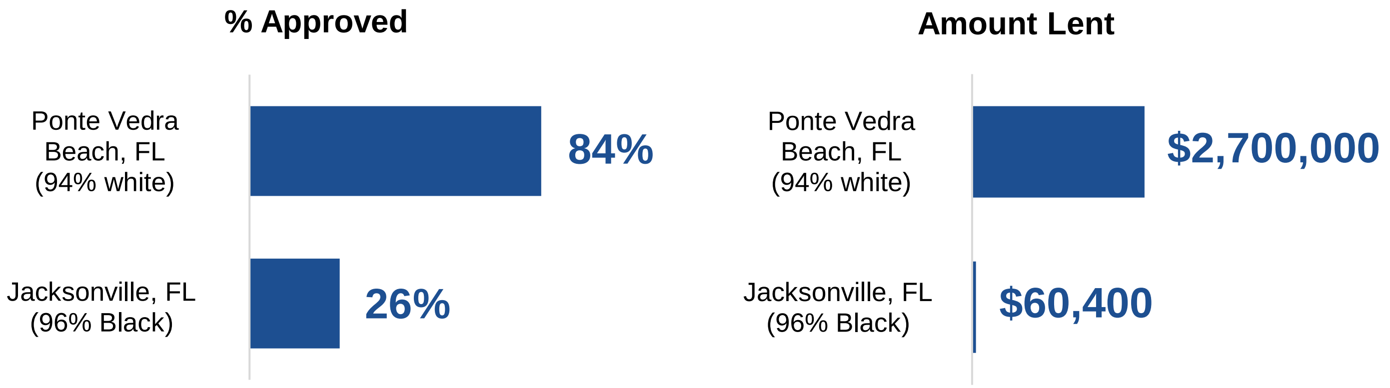
After racial justice protests and Black Lives Matter activism last summer, advocates and policymakers have proposed a number of programs for lessening the yawning racial disparities in Black-white homeownership and wealth. These include proposals for downpayment assistance, homeownership counseling, and special lending programs for Black borrowers. The latter are referred to as "special purpose credit programs" (SPCPs) under the Equal Credit Opportunity Act (ECOA), which allows SPCPs that explicitly consider race or other protected classes if certain criteria are met.

SPCPs have the potential to address or the legacy of discrimination that have resulted in the massive racial wealth gap. Much of the racial wealth gap is rooted in homeownership disparities – not only do far fewer Black households own their homes (41.8% of Black households own their homes versus 71.9% of white households), but bias and residential segregation result in lower property values for Black-owned homes. We strongly support the creation of SPCPs, but they must be done right to effectively boost Black homeownership.

One important question is what type of screening or eligibility criteria will be required for SPCPs. We urge the developers of these programs to be especially cautious in the use of credit scores. As discussed in this policy brief and a recent Urban Institute report, credit scores reflect immense racial disparities. The policy brief lists over a dozen studies finding that Black consumers, as a group, have lower credit scores than whites, likely due to centuries of historical discrimination as well as current racial bias. Furthermore, research from the CFPB has found that Black and Latinx consumers are less likely to even have a credit score.

The use of credit scores could significantly undermine the ability of SPCPs to help boost Black homeownership. Examples from other government lending programs intended to help those most in need are instructive. For instance, a June 2020 study by E&E News found credit scores kept many Black consumers in Florida from obtaining Small Business Administration disaster relief loans in the aftermath of Hurricane Matthew. The following chart shows the extent of how using credit scores disadvantaged Black consumers.

Small Business Administration Disaster Loans



Source: E&E News, June 2020

OPTIONS FOR SCREENING APPLICANTS WITHOUT USING TRADITIONAL CREDIT SCORES

Here are some ideas to avoid the negative impact that conventional use of traditional credit scores for SPCPs, such as hard credit score cut-offs, would ironically have on the very Black communities that the programs are designed to benefit. These options could be further explored, either in conjunction or separately:

1. Test the use of the more promising forms of alternative data and scores.

Alternative data and scores can be a mixed bag, with some forms (such as gas & electric utility data) posing risks to consumers. Other forms, such as cash-flow data and second chance scores, seem promising. While even the more promising forms of alternative data will still exhibit some racial disparities given the unequal economic positions of Black and white households, research indicates that cash-flow data in particular holds promise for helping borrowers who might otherwise face constraints on their ability to access credit.

2. Develop scoring models that explicitly reduce the impact of race.

One way to reduce racial disparities is to develop credit scoring models that actively seek to reduce the impact of race. An example of this sort of effort could be the process known as adversarial debiasing or adversarial learning. However, model developers could be concerned that explicitly considering race may run afoul of the ECOA. One way to address this problem is to develop the model in the context of a SPCP, where consideration of race is acceptable.

3. Don't use credit scores as gatekeepers in SPCPs that seek to assist disadvantaged Black communities.

The racial disparities in homeownership and wealth are the result of wholesale exclusion of Black borrowers from the massive government programs that created middle-class homeownership in the 20th Century, such as those from the Federal Housing Administration, Homeowners Loan Corporation, and the G.I. Bill. None of these programs used credit scores, as they predated scoring. If trillions of white wealth was created by these government programs without credit scoring, then as a matter of justice, reparations for the Black communities shut out from these programs should avoid exclusionary use of a tool that we know would significantly reject large numbers of them. SPCP lenders should rely on broader underwriting tools instead. This might mean the use of manual underwriting.

4. Establish a public credit registry with a mission to reduce racial disparities in credit scoring.

As part of the public option credit registry proposed by Demos, there should be efforts to develop a credit scoring model that actively takes past and present discrimination into account and is intentionally designed to reduce racial disparities.

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