Grand Challenges for Social Work

Build financial capability for all

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Policy Recommendations for Financial Capability and Asset Building by Increasing Access to Safe, Affordable Credit

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Strong personal financial credit is a modern necessity for financial well-being. A positive credit report and high credit score can unlock opportunities for housing, employment, health insurance, and access to safe, affordable loan products.[1] The need to access loan products—both short-term and long-term, for consumption and asset-building purposes—is ubiquitous in contemporary society. Current options for accessing safe, affordable credit with adequate consumer protections are limited for a large portion of U.S. consumers, and policy is needed that facilitates expansion of options. This brief summarizes recommendations for policies that (a) enable households to build and maintain personal financial credit and (b) ensure the availability of appropriate loan products with adequate consumer protections.

Recommendation 1: Expand options for consumers to build credit

Given the importance of credit in today's world, financially vulnerable consumers need opportunities to build positive credit histories and high credit scores. An estimated 26 million Americans are "credit invisible," meaning that they lack a credit record, and another 19 million have unscored credit records. Both groups find it very difficult to borrow money on good terms. Over half of all credit users have low credit scores. Many credit-constrained individuals have low incomes, yet their credit scores (or lack of scores) may not truly reflect their current payment history or level of repayment risk.[2]

Fully utilize the capacity of existing institutions

Using policy mechanisms to expand the role of regulated financial providers with a community development mission—both nonprofit and for-profit providers—could make a significant, positive impact on consumers with low or no credit. Advocates recommend increasing the capacity of credit unions, Community Development Financial Institutions, and nonprofit organizations to deliver small-dollar, unsecured consumer loans at low cost, which would significantly expand their capacity to assist consumers in building credit while accessing needed funds.[3] Expanding the ability of mission-driven financial institutions to provide credit-building loans, which are loans made for the express purposes of reporting repayment and building credit, can also be helpful, especially for consumers without existing installment-credit obligations.[4] Toward these ends, the National Federation of Community Development Credit Unions advocates for growth of federal appropriations to the Community Development Financial Institution Fund.[5] The Woodstock Institute suggests that banks could make additional contributions to strong consumer credit if the Community Reinvestment Act were modernized.[6] The act should be updated to ensure that the service test includes consideration of whether banks meet the needs of low- and moderate-income consumers for a range of financial products and services, including unsecured consumer loans that meet the criteria for low-cost lending.

Invest in research to explore alternative data sources and modeling methods

Advocates recommend that policy encourage the three large national credit reporting agencies—Experian, Equifax, and TransUnion—to consider new types of repayment data. Early research evidence suggests that the inclusion of utility, rent, and telecom payments within credit scoring models increases the credit scores of consumers with low credit scores.[7] Some lenders are experimenting with using data beyond credit scores. They have adopted alternative modeling techniques for assessing risk and pricing offerings for unbanked, unscored, and low-credit consumers.[8] Nonprofit organizations have experimented with reporting repayment among consumers in lending circles. Consumers in the circles lend and borrow from one another. These efforts have shown promising results for credit building.[9] However, caution is advised for policy initiatives that promote the reporting of alternative data. The Credit Access and Inclusion Act of 2015 (H.R. 3035) is an example of such an effort. If it had been enacted, it would have allowed the three national agencies to report on a wider array of data, including data on rent, utility, and telecommunications payments. Before such measures are adopted, more research is needed to understand the impact of alternative reporting on credit access.[10] The Consumer Financial Protection Bureau (CFPB) is well positioned to facilitate research in this area.

Recommendation 2: Protect consumers who access loan products

In recent years, the CFPB has used its regulatory powers to advance consumer protections on a range of loan products that were previously unregulated at the federal level. Such products include pawnshop, payday, vehicle-title, "checking-overdraft," and some high-cost-installment loans.[11] Policy regulating predatory financial products and services must continue to protect consumers.

Several specific policy actions are recommended. First, a federal cap should be imposed on interest rates for all types of small-dollar loans. Many states have adopted such caps. A federal measure would create uniformity across states and help consumers to avoid excessive indebtedness.[12] Second, improvements should be made to the CFPB's rule concerning payday, vehicle-title, and certain high-cost installment loans (first issued in June 2016). The rule requires lenders to determine whether a consumer can repay a loan but identifies exceptions. Eliminating the ability-to-repay exceptions would strengthen the rule. In addition, policymakers should amend the rule to strengthen protections against flipping loans and close loopholes.[13] Third, policymakers should oppose all efforts to weaken the CFPB, including the Financial CHOICE Act of 2017. In particular, policymakers should oppose the provision that strips the CFPB of its authority to fine financial institutions for unfair, deceptive, or abusive acts and practices. In providing a vital, unreplicated, consumer-protection service to U.S. consumers, the CFPB helps to level the financial playing field and gives consumers a fair opportunity to achieve financial well-being.

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Notes

[1] Getter (2017).

[2] Brevoort, Grimm, and Kambara (2016).

[3] Swack, Hangen, and Northrup (2014). Low cost lending has five features: (a) The borrower has the ability to repay the loan while meeting other expenses without reborrowing or entering into a cycle of debt; (b) the maximum annual percentage rate, including fees, is 36%; (c) the minimum loan term is 90 days, with even longer terms for larger loans; (d) the loan is repaid through equal, amortizing installment payments, rather than balloon payments; and (e) there is no check holding or automated repayment requirement for the loan (National Consumer Law Center, 2014).

[4] Burke, Jamison, Karlan, Mihaly, and Zinman (2016).

[5] Mathon (2017).

[6] Rand (2015).

[7] Chenven and Schulte (2015).

[8] Request for Information (2017).

[9] Reyes, López, Phillips, and Schroeder (2013).

[10] Brevoort et al. (2016); National Consumer Law Center (2015).

[11] Payday, Vehicle Title, and Certain High-Cost Installment Loans (2017).

[12] Center for Responsible Lending (n.d.).

[13] Robnett (2016).

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About the Grand Challenges for Social Work

The 12 Grand Challenges for Social Work are the targets of a groundbreaking effort to champion social progress powered by science. Initiated by the American Academy of Social Work and Social Welfare, this effort seeks to address society's toughest social problems through the concerted work of many. Additional information on the Grand Challenges may be found at GrandChallengesforSocialWork.org.

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