COMMENT

BORN IN THE RED: HOW AFFIRMATIVE ACTION COULD CURE THE RACE–CREDIT DIVIDE*

ABSTRACT

Existing academic literature has not directly addressed solutions for the race-credit disparity. Local, state, and federal agencies along with private organizations, have implemented various types of credit education programs. These programs have been largely unsuccessful. Federal legislation was passed to make loan terms more transparent and loans more accessible. While arguably helpful to sophisticated borrowers, data indicates that mandatory term disclosure does little to affect consumer behavior. More needs to be done in order to break the low credit score cycle. This Comment proposes an application of Affirmative Action principles to break the cycle and bring an entire underserved population into the modern banking and lending scheme, complete with reasonable interest rates, lower costs, and a decreased likelihood of default. Without significant and drastic changes, "the country is headed toward a kind of financial segregation."

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I. INTRODUCTION

> "Credit scoring . . . sort of sets in stone income and wealth disparities between minorities and whites . . . **The playing field was never level**."[1]

Being black or Hispanic in America means chances are good that you are paying more for your credit card, more for your car and home loans, and more for your insurance than the average white American.[2] Credit ratings are big business and a big deal. While ostensibly race-neutral in their mechanisms, credit scores and the attending availability of credit products cost black and Hispanic Americans big money every year.[3] On average, black and

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1. Ylan Q. Mui, *For Black Americans, Financial Damage from Subprime Implosion is Likely to Last*, WASH. POST (July 8, 2012), https://www.washingtonpost.com/business/economy/for-black-americans-financialdamage-from-subprime-implosion-is-likely-to-last/2012/07/08/gJQAwNmzWW_story.html?utm_term=.44189181f560 (emphasis added).

2. *See infra* Section II.B (describing costs associated with varying credit scores).

3. There is no shortage of examples. *See* SUSAN E. WOODWARD, U.S. DEP'T. OF HOUS. AND URBAN DEV., A STUDY OF CLOSING COSTS FOR FHA MORTGAGES 45 (2008) ("Looking at all nonsubsidized loans, Latino borrowers are charged $1,043 more and African American borrowers $756 more, on average, than nonminority borrowers."); Diana B. Henriques, *Review of Nissan Car Loans Finds That Blacks Pay More*, N.Y. TIMES (July 4, 2001), http://www.nytimes.com/2001/07/04/us/review-of-nissan-car-loans-finds-that-blacks-pay-

Hispanic Americans have lower credit scores than white and Asian Americans.[4] Lower credit scores mean limited access to credit products, less favorable terms when products are available, and higher overall credit costs.[5]

One report found that black borrowers were four times more likely than white borrowers to pay higher rates for a mortgage.[6] "Subprime"[7] mortgages, when factoring in interest and fees that are above what a competitive market would yield, cost U.S. consumers approximately $9.1 billion dollars per year.[8] $9.1 billion dollars works out to approximately $3,800 per year in additional costs per loan.[9] $3,800 is a steep price to pay when compared to the "median African-American household net worth of $7,500 as of the 2000 census."[10]

The problem is deeper than differences in skin color. Credit scores claim to be empirical and unbiased but in current form do not and cannot account for the borrower's cultural norms, for the borrower's level of knowledge of the credit rating system and its importance, or for the borrower's lack of access to traditional credit products which oftentimes yield spiraling lower scores.[11] These

more.html?_r=0 ("[B]lack customers in 33 states consistently paid more than white customers, regardless of their credit histories.").

4. BD. OF GOVERNORS OF THE FED. RESERVE SYS., REPORT TO THE CONGRESS ON CREDIT SCORING AND ITS EFFECTS ON THE AVAILABILITY AND AFFORDABILITY OF CREDIT, at S4 (2007), http://www.federalreserve.gov/boarddocs/rptcongress/creditscore/creditscore.pdf [https://perma.cc/YXY2-XRCT] ("Blacks, Hispanics, single individuals, those younger than age 30, and individuals residing in low-income or predominantly minority census tracts have lower credit scores than other subpopulations defined by race or ethnicity, marital status, age, or location.").

5. *See infra* Section II.B (describing costs associated with varying credit scores).

6. ASSOCIATED PRESS, *Study: Blacks, Latinos Pay More for Mortgages*, NBC NEWS (June 1, 2006, 3:43 PM), http://www.nbcnews.com/id/13081865/ns/business-real_estate/t/study-blacks-latinos-pay-more-mortgages/#.WAZ5-YWcHIU.
More alarmingly, the article goes on to say "[e]ven blacks with incomes above $100,000 a year were charged high rates more often than whites with incomes below $40,000 . . . ." *Id*. This paper does not attempt to address the implicit racial biases that evidently exist in the credit marketplace.

7. Subprime is defined as "referring to credit or loan arrangements for borrowers with a poor credit history, typically having unfavorable conditions such as high interest rates." *Subprime*, ENG. OXFORD DICTIONARY, https://en.oxforddictionaries.com/definition/us/subprime [https://perma.cc/P7EJ-XUTJ] (last visited Jan. 22, 2018).

8. Lauren E. Willis, *Decision-making and the Limits of Disclosure: The Problem of Predatory Lending: Price*, 65 MD. L. REV. 707, 733–34 (2006) (citing ERIC STEIN, COALITION FOR RESPONSIBLE LENDING, QUANTIFYING THE ECONOMIC COST OF PREDATORY LENDING 2–3 (Oct. 20, 2001), http://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/the-economic-cost-of-predatory-lending-2001.PDF [https://perma.cc/A55K-PSRD]).

9. *Id.* (citing Stein, *supra* note 8, at 14 n.49).

10. *Id.* (citing U.S. CENSUS BUREAU, U.S. DEP'T OF COM., NET WORTH AND ASSET OWNERSHIP OF HOUSEHOLDS: 1998 AND 2000, at 12 (2003)).

11. *See infra* Section II.A (discussing generally the problems that slip through the

factors lead to a toxic cycle of low credit, forcing low credit score holders into higher risk and higher cost credit products.[12] Those high-cost products ensure difficulty in repaying obligations, leading to an increased risk of default.[13] Because the risk of default is the metric credit ratings seek to numerically represent, credit scores then drop and the low score cycle continues.[14] This Comment will explain what harms are associated with limited credit access due to a low credit score, why alleviating the low-score burden from an entire demographic class is in our nation's best interest, and how to best accomplish that goal.

Existing academic literature has not directly addressed a solution for the race-credit disparity.[15] Local, state, and federal government agencies, along with private organizations, have implemented various types of credit education programs.[16] These programs have been largely unsuccessful.[17] Federal legislation was passed to make loan terms more transparent and loans more accessible. While arguably helpful to sophisticated borrowers, data indicates that mandatory term disclosure does little to affect consumer behavior. More needs to be done to break the low credit score cycle. This Comment proposes an application of Affirmative Action principles in order to disrupt the cycle and bring an entire underserved population into the modern banking and lending scheme, complete with reasonable interest rates, lower costs, and a decreased likelihood of default. Without significant and drastic changes, "the country is headed toward a kind of financial

cracks of a traditional credit scoring system).

12. *See infra* Section II.C (describing the low credit score cycle).

13. *See infra* Section II.C (discussing risk of default).

14. *See infra* Part II (discussing what a credit rating is and what it is used for).

15. Much literature has addressed race and credit in some capacity. *See e.g.*, John V. Duca & Stuart S. Rosenthal, *Borrowing Constraints, Household Debt, and Racial Discrimination in Loan Markets*, 3 J. FIN. INTERMEDIATION 77 (1994) (finding that minorities have lower debt limits and were more likely to be constrained by credit than white families); Willy E. Rice, *Race, Gender, "Redlining," and the Discriminatory Access to Loans, Credit and Insurance: An Historical and Empirical Analysis of Consumers Who Sued Lenders and Insurers in Federal and State Courts, 1950-1995*, 33 SAN DIEGO L. REV. 583, 583 (1996) (finding that "persistent unemployment is likely to develop among members of *any racial or socioeconomic group* when members of that group are regularly and systematically denied access to capital and credit. . .") (citations omitted). *But see* Sheila D. Ards & Samuel L. Myers, *The Color of Money: Bad Credit, Wealth, and Race*, 45 AM. BEHAV. SCIENTIST 223, 224 (2001) (arguing that data indicates that at the lowest and highest ratings, black and white households have similar credit ratings, and to the extent there is a difference in middle class families, the differences can be attributed to racial biases and different treatment between blacks and whites).

16. *See infra* Section III.B (discussing credit education implementation and shortcomings).

17. *Id.*

segregation."[18]

Part II of this Comment introduces the problem in greater detail, outlining the true costs of low credit scores on consumers while highlighting the disparate impact of low credit ratings on black and Hispanic Americans.[19] It also provides an overview of how credit scores are calculated and how those scores are utilized by lenders.[20] Part II also discusses the true effect of credit scoring and gives a detailed explanation of how low credit scores beget even lower credit scores—the low credit score cycle.[21] Here, the reader will begin to understand that the causes of low credit scores extend far beyond the "black-and-white" of the credit rating system and into the systemic lack of availability of "responsible" credit products due to low credit scores.[22]

Part III provides an overview of several governmental and private attempts to address the issue of credit availability and shows why they were unsuccessful.[23] The overview is brief, designed to show that for the particularly vexing problem of discrimination through credit rating, each of the discussed solutions has proven inadequate.[24]

Part IV proposes a solution to this serious problem. Because part of the problem is the cycle of poor credit and lack of available reasonable credit products, it makes sense that a proposed solution would include adjusting credit scores for those most affected. Part IV starts with an analysis of Affirmative Action, specifically discussing how race-based college admissions policies have been litigated. Taking that concept and applying it to the problem of race-credit availability, the proposed solution involves a wholesale approach to raising credit scores of those most affected by the empirically discriminatory credit rating system.[25] By analyzing the proposal through the framework of the most recent Supreme Court affirmative action case, *Fisher v. University of*

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18. Mui, *supra* note 1.

> The private companies that calculate credit scores say they do not consider race in their formulas. Lenders also say it is not a factor when deciding who qualifies for a loan; federal laws prohibit the practice. Still, studies have shown a persistent gap between the credit scores of white and black Americans, and many worry that it is only getting wider.

Id.

19. *See infra* Section II.B (describing the costs associated with varying credit scores).

20. *See infra* Section II.A (describing how credit scores are created and utilized).

21. *See infra* Section II.C (describing the low credit score cycle).

22. *Id.*

23. *See infra* Part III (describing various unsuccessful attempts at addressing the race-credit divide).

24. *Id.*

25. *See infra* Part IV (discussing the proposed solution).

Texas, Part IV seeks to show how reasonable the goal of racial credit equality is while providing a constitutionally permissible precedent.[26]

I find it unlikely that the United States' political climate would be amenable to a government action requiring the raising of credit scores by mandating private credit reporting agencies to adjust how they provide their product (i.e., their credit scoring systems). However, government action seems more likely when considering the changing voter demographics and sensibilities of the American public, as evidenced by the rise of independent, nonparty affiliated candidates like Bernie Sanders and by the passage of wealth-redistributive legislation like the Affordable Care Act.

Part V, concludes with a review of the problem and the proposed solution.[27]

II. Credit Rating & the Race-Credit Divide

Credit reporting is a significant factor in many aspects of life in America and can dictate the availability and terms of not only credit, like mortgages and credit cards, but also insurance, rental housing, and employment.[28] Credit scoring uses algorithms to predict with startling accuracy the likelihood consumers are going to pay back their loans and make payments in a timely fashion.[29]

26. *Id*. (discussing the solution to the race credit divide within the framework of constitutionality provided by the *Fisher* court); Fisher v. Univ. of Texas at Austin, 136 S. Ct. 2198, 2207–08 (2016).

27. *See infra* Part IV (discussing the proposed solution and concluding).

28. *See* Chi Chi Wu, Nat'l Consumer Law Ctr., Solving the Credit Conundrum: Helping Consumers' Credit Records Impaired by the Foreclosure Crisis & Great Recession 2 (2013), https://www.nclc.org/images/pdf/credit_reports/report-credit conundrum-2013.pdf [https://perma.cc/97QQ-SHXX]; *see also* Charlene Crowell, *Credit Check Can be Barrier to Job or Promotion*, Daytona Times (Mar. 21, 2013), http://daytonatimes.com/2013/03/credit-check-can-be-barrier-to-job-or-promotion/. Crowell describes how credit ratings lead to discriminatory hiring outcomes. Because black Americans often have lower credit scores, "standard operating procedure[]" credit checks are increasingly "disproportionately screening people of color out of jobs . . . lead[ing] to discriminatory hiring." *Id.*

29. *See* VantageScore, *VantageScore Fact Sheet*, https://www.vantagescore.com/pdf /VS30-FactSheet.pdf. [hereinafter VantageScore, *VantageScore Fact Sheet*]. VantageScore is a joint venture between the three largest, national credit reporting companies (Equifax, TransUnion, and Experian). VantageScore, *Meet VantageScore: Why We Were Founded,* https:www.vantagescore.com/meet-vantagescore [https://perma.cc/42VK-L33J]. Together, the three companies created VantageScore, which provides increased accuracy, advanced modeling, "patented, and patent-pending techniques" to analyze consumer credit data. All told, VantageScore provides detailed credit scoring for up to 35 million more Americans than the older systems provided by the three credit reporting companies alone. *Id.*; *see also* VantageScore, *VantageScore Fact Sheet*, *supra* note 29.

Computer capacity allows such modeling to use millions of data points mined from

While the specific methods and numerical scales that result vary between the three major credit rating agencies, the output serves the same purpose: an easy-to-evaluate, 3-digit number that seeks to objectively describe a potential borrower's risk of default.[30] Lower-risk borrowers (those with numerically higher credit scores) have more options in the credit marketplace and obtain more favorable terms, including lower interest rates and longer repayment periods.[31] Likewise, higher-risk borrowers (those with numerically lower credit scores) have fewer options in the marketplace and obtain less favorable terms, including higher interest rates and shorter repayment periods.[32] Despite the groundswell of negative sentiment towards banks and other lenders, the current business model of lending money only functions when risk is factored into the equation: higher risk lending should come with higher interest rates to account for the higher likelihood of default.[33]

A. How Credit Ratings Work

Credit rating algorithms vary between the three major credit rating agencies ("CRAs"), but all reporting and credit rating agencies use numerous factors to calculate credit scores. These factors include the number of open credit accounts, types of accounts (revolving, mortgage, auto), ratio of available credit to

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> past borrowers, their loans, and their personal and collateral characteristics to generate a constantly updated predictive tool that is more accurate and more sensitive to the interactions among variables. Each small change in one variable can be met by a change in another variable; for example, a high debt-to-income ratio that might have led to a per se rejection in the old underwriting method can now be "outweighed" by a low LTV and a strong credit history.

Willis, *supra* note 8, at 720

30. *See* VANTAGESCORE, *VantageScore Fact Sheet*, *supra* note 29. The "big three" credit reporting agencies are typically identified as Equifax, Transunion, and Experian. Brooke Niemeyer, *Who Are the Major Credit Reporting Agencies?* (Oct. 26, 2016), https://www.credit.com/credit-reports/credit-reporting-agencies/ [https://perma.cc/6QJ2-WJZC].

31. Kate Ashford, *6 Perks a Sparkling Credit Score Will Earn You*, TIME (June 16, 2015), http://time.com/money/3922108/6-perks-a-sparkling-credit-score-will-earn-you/. The longer-term compounding benefits of a "better" credit score are even more impressive: "[A] 35-year-old woman living in Illinois with a credit score in the mid-600s will pay $269,033 in interest over a lifetime between her mortgage, auto loans and credit cards. If her credit score was in the upper 600s/low 700s, that figure would go down to $229,085. With a score above 740, it drops to $208,491. Translation: Having an excellent score potentially saves her $60,542 compared to having a fair one—and that's no chump change." *Id.*

32. *Id*.

33. Mehrsa Baradaran, *It's Time for Postal Banking*, 127 HARV. L. REV. 165, 167 (2013). "The poor pay more for credit than the middle class because they are more likely to default and lenders must be compensated for assuming this risk. In other words, those least likely to be able to pay their debts are charged a premium for that inability." *Id.*

outstanding debt, and repayment history.[34] Payment history is the most significant factor in the credit score, accounting for one-third of the numerical score.[35] It is not easy for even sophisticated credit consumers to understand the effects of certain behavior on their credit scores. According to Fair Isaac Corporation (more commonly known by their famous "FICO" score), the effects of various negative credit events, like foreclosure, short sale, bankruptcy, or late payment, vary based on starting credit score, the type of account in default, the circumstances of the foreclosure or short sale, the number of late payments, and other factors.[36] Adding to the difficulty of determining the impact of negative events on credit scoring is the element of time.[37] For even a single 30 day delinquency on a mortgage payment, a consumer with a 680 FICO Score (just below the national average of 695) will see an immediate 60 to 80 point drop.[38] Assuming the delinquency is corrected and no additional credit slip-ups take place, it will take approximately 9 months to see the consumer's score return to the pre-delinquency level.[39]

For all the complications, many consumers in the United States have likely benefitted from the addition of these credit scoring models. By being able to create a statistically generated

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34. EQUIFAX, *How Are Credit Scores Calculated?*, https://www.equifax.com/personal/education/credit/score/how-is-credit-score-calculated [https://perma.cc/3KTT-DJJQ]. Equifax describes the factors and what percentage they weigh into the score calculation: payment history (35%), used credit compared to available credit (30%), type of credit used (15%), new credit (10-12%), and length of credit history (5-7%). *Id.* What is not readily available is the complex system which takes the above listed factors, quantifies them, and yields a 3-digit score. Most online credit-score calculators give a best guess regarding how adjusting the inputs will affect the credit score output.

35. *Id*. Things do get stranger on the fringes of credit rankings. While FICO scores are generally based on behavioral data, like payment history, credit use, and so on, other scores "use other factors, such as where you went to school, SAT scores and whether you have dropped a phone number." Meta S. Brown, *Credit Scores: Everyday Predictive Analytics*, FORBES (Aug. 31, 2015), http://www.forbes.com/sites/metabrown/2015/08/31/credit-scores-everyday-predictive-analytics/#123e790267e6.

36. FICO BLOG, *Risk & Compliance: Research Looks at How Mortgage Delinquencies Affect Scores*, http://www.fico.com/en/blogs/risk-compliance/research-looks-at-how-mortgage-delinquencies-affect-scores/ [https://perma.cc/74M3-7BPE] (last visited Mar. 7, 2018). Some credit score models use "many different pieces of credit data" to determine the risk score. MYFICO, *What's in My FICO Scores?*, https://www.myfico.com/credit-education/whats-in-your-score/ [https://perma.cc/NJC3-92UH] (last visited Mar. 7, 2018).

37. FICO BLOG, *supra* note 36.

38. *Id.*

39. *Id.* Things look more stark when you consider those borrowers with average credit scores. The FICO study found that a consumer with a 720-credit score could drop nearly 100 points due to one 30-day mortgage delinquency and would take 2.5 years to return to the consumer's previous score. *Id.* More significant events, like short sales, foreclosures, and bankruptcies can drop scores upwards of 200 points, sending borrowers from prime lending eligibility into the depths of the subprime market. *Id.* Even worse, it can take 7 to 10 years for a borrower to fully recover. *Id.*

model of risk evaluation, credit scoring has allowed lenders to inexpensively, quickly, and easily "gauge credit risk and expand their reach to consumers beyond the limits" of the old-fashioned local office investigation into individual creditworthiness.[40] This greater accuracy and reach of credit risk modeling "suggests that credit scoring has increased the availability and affordability of credit."[41] What most reports do not say, however, is that the benefits have been generally confined to those with reasonable credit scores and reported credit history.[42] Those consumers who do not use traditional lending options (like payday loans, which usually do not report consumer performance to credit rating agencies) or have troubled lending histories are left with only costly borrowing options.

B. Credit Scoring in America

A low credit score can be very costly, the effects of which can ripple outwards dramatically, determining what jobs people can get, what apartments they can rent, and what price they pay for their cell phone plans and car insurance.[43] Lenders in America operate under the general model of "risk-based pricing."[44] Risk-based pricing means borrowers with a higher numerical credit rating are assessed as low risk, opening up a gamut of products with favorable terms.[45] Lower scoring borrowers are deemed higher risk, leading to less-favorable terms and a greater likelihood of default.[46] The picture that develops from the study of the credit market is unsettling: credit scores play a very significant role in the way we live our lives, and a low score means the deck

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40. BD. OF GOVERNORS OF THE FED. RESERVE SYS., REPORT TO THE CONGRESS ON CREDIT SCORING AND ITS EFFECTS ON THE AVAILABILITY AND AFFORDABILITY OF CREDIT, O-1 (Aug. 2007), http://www.federalreserve.gov/boarddocs/rptcongress/creditscore/creditscore.pdf [https://perma.cc/54JN-AVV6].

41. *Id.* at S-3.

42. *See infra*, Section II.C (explaining the costs associated with a low credit score).

43. Wu, *supra* note 28, at 3. ("Credit reporting has become the determining factor for many essentials in a consumer's financial life—not only credit (mortgages, auto loans, credit cards) but insurance, employment and rental housing.").

44. CONSUMER FINANCIAL PROTECTION BUREAU, *Ask CFPB: What is Risk-Based Pricing?*, https://www.consumerfinance.gov/ask-cfpb/what-is-risk-based-pricing-en-767/ [https://perma.cc/6W5L-8PZQ] (last visited Jan. 20, 2018). The Consumer Financial Protection Bureau discusses risk-based pricing: "[L]enders will generally offer a higher interest rate to you if they view you as a higher risk borrower – say, because you recently declared bankruptcy, lost a job, or are several payments behind on a mortgage. For the same exact loan, lenders will generally offer a lower interest rate if they view you as a lower risk[—]say, because you have a good credit score and are employed." *Id*.

45. *Id*.

46. *See* Wu, *supra* note 28, at 2.

is stacked against you.[47]

In order to improve your credit score, you must be perceived as a lower-risk borrower over an extended period of time.[48] This means you need to make your various payments on time, have a relatively low debt-to-credit ratio, have a steady income, and you must recognize the significance of your credit behavior.[49] Without an awareness of the far-reaching implications of missing a payment, it is hard to expect the average, relatively unsophisticated credit user to be able to improve their score in a meaningful way.[50] Add the burden of unfavorable loan terms and a costly payday loan into the mix and the hole seems deeper and deeper.[51] Blacks and Hispanics, on average, have lower credit scores than whites and Asians.[52] Specifically, one study by Freddie Mac found that blacks were three times as likely to have a FICO score below 620 as were whites, while Hispanics were twice as likely.[53] Another study found:

> [T]he median credit score for whites increased significantly during the 1990s, from 727 to 738, while the median credit score for African Americans dropped from 693 to 676. The median score dropped even more for Latinos, from 695 to 670. The percentage of African Americans with credit scores under 660 (which is considered the cut off for "good credit")

47. *See id.* Furthermore, "about half of employers look at credit reports as part of the hiring process." Kathy Kristoff, *Bad Credit Ratings Sinking Job Hunters,* CBS MONEY WATCH (Feb. 6, 2013, 5:38 PM), https://www.cbsnews.com/news/bad-credit-ratings-sinking-job-hunters/; *see also* Fair Credit Reporting Act, 15 U.S.C. 1681b(a) (2012) (listing the permissible uses of consumer credit reports: court orders, credit transactions, employment purposes, insurance underwriting, government benefit or liability assessments, investor evaluations, "legitimate business need[s]," government travel cards, child support evaluations, and more).

48. *See supra* Section II.A (describing the typical credit scoring model).

49. *Id.*

50. *See* CONSUMER FINANCIAL PROTECTION BUREAU, *I Heard That Taking Out a Payday Loan Can Help Rebuild My Credit or Improve My Credit Score. Is This True?*, https:www.consumerfinance.gov/ask-cfpb/i-heard-that-taking-out-a-payday-loan-can-help-rebuild-my-credit-or-improve-my-credit-score-is-this-true-en-1611, (last visited Feb. 2, 2018) [https://perma.cc/4PT3-KKKY] ("Payday loans generally are not reported to the three major national credit reporting companies, so they are unlikely to impact your credit scores."). The implication here, of course, is that even with responsible use of payday loans, or even with responsible repayment history, that history would never be reported to the CRAs, leaving those users out of the benefits of responsible behavior (namely, a higher credit score).

51. Overall, few consumers understand or recognize the far-reaching implications of their credit score. Only 36% of consumers surveyed by the Government Accountability Office "knew that a credit history can affect insurance coverage or premiums." Chi Chi Wu, *Credit Scoring and Insurance: Costing Consumers Billions and Perpetuating the Economic Racial Divide,* NAT'L CONSUMER L. CTR. 5 (June 2007), https://www.nclc.org/images/pdf/pr-reports/report-insurance-scoring-2007.pdf [https://perma.cc/ND6R-MR4Y].

52. *Id.* at 16.

53. *Id.* at 12.

grew from 27% to 42% and for Latinos it grew from 29% to 49%, while among whites it rose only slightly from 17% to 19%.[54]

There are serious and frightening implications with those facts. "[C]redit scoring . . . sort of sets in stone income and wealth disparities between minorities and whites . . . The playing field was never level."[55]

C. The Low Credit Cycle

While this Comment does not seek to fully explain credit rating models, a few relevant inputs into the equation are necessary to understand the implications and long-term effects of a low credit score. The negative effects are magnified when paired with a lack of credit sophistication or, as this Comment explores, implicit racial biases that manifest themselves as significant empirical disadvantages.

As discussed above, a lower credit score means fewer (quality) credit product offerings and disadvantageous terms.[56] These costs disproportionately harm those with the least amount of money.[57] Credit scoring does not help matters. Consumer credit rating agencies are governed in part by the Fair Credit Reporting Act ("FCRA"), which seeks to "insure consumer reporting agencies exercise their grave responsibilities with fairness, impartiality, and a respect for the consumer's right to privacy."[58] Per the FCRA, accounts placed into collections, paid tax liens, civil suits and judgments, and other adverse data are able to remain on a consumer's credit report for seven years.[59] Bankruptcies stay for ten years.[60] The results of the government-mandated periods of reporting for the various negative credit performance elements are potentially disastrous for consumers, as we have seen above.[61] By allowing credit reporting for employment, insurance, and all types of consumer credit applications, the FCRA has potentially trapped those consumers with negative history—even as old as ten years—into a ghetto of limited credit availability, limited employment

54. *Id.* at 13 (citing Raphael W. Bostic et al., *Hitting the Wall: Credit as an Impediment to Homeownership*, JOINT CTR. FOR HOUS. STUD. OF HARVARD UNIV. (Feb. 2004), http://www.jchs.harvard.edu/research/publications/hitting-wall-credit-impediment-homeownership [https://perma.cc/M9WY-298A]).

55. Mui, *supra* note 1 (statement by Chi Chi Wu).

56. *See supra* Section II.B (describing the typical credit scoring model).

57. *See supra* Section II.B (describing the costs associated with lower credit scores).

58. Fair Credit Reporting Act, 15 U.S.C. § 1681(a)(4) (2012).

59. *Id.* § 1681c(a).

60. *Id.*

61. *See supra* Section II.C (discussing the harm arising from a low credit score).

prospects, and increased costs for many necessary aspects of modern life.[62]

Payday loans, a commonly used credit product by the highest-risk borrowers, have been shown to be disproportionately utilized by black Americans.[63] Studies have shown that payday lenders disproportionately target poor and minority neighborhoods.[64] "White borrowers tend to be served by banks and other conventional institutions in the prime market. In contrast, people of color, women, and the elderly are targeted by high-cost lenders."[65] Payday loan products are short-term (along the lines of two weeks), high annual percentage rate (APR) loans designed to provide quick access to funds for those most in need.[66]

Typically, those most lacking access to traditional forms of credit, the poor and minority communities (often times synonymous with "consumers with below average credit scores"), turn to the readily available "fast cash" of payday loans.[67] Payday lenders typically require no credit check, instead asking for a driver's license, proof of employment, and a utility bill.[68] These short-term loans are usually payable in full after two weeks, with the lender typically having access to directly withdraw money from the borrower's postdated check, paycheck, or similar.[69] By having such leverage over the borrower, payday lenders can nearly compel repayment, or as is more likely to happen, force the borrower into another payday loan. Because payday loans require a balloon payment at the end of the term, the most common period

62. *See* Kenneth P. Brevoort & Cheryl R. Cooper, *Foreclosure's Wake: The Credit Experiences of Individuals Following Foreclosure*, FIN. AND ECON. DISCUSSION SERIES, Nov. 18, 2010, at 16. This Federal Reserve staff working paper presents a longer term negative outlook associated with negative credit score characteristics. While this paper discusses foreclosure, it finds that even after the "point at which information about a foreclosure is removed from a credit record," low credit scores persist. *Id.* at 16.

63. *See* Baradaran, *supra* note 33; *see also* Pew Charitable Trusts, *Press Release: Nationwide Pew Survey Challenges Conventional Wisdom on Payday Loans* (July 18, 2012), http://www.pewtrusts.org/en/about/news-room/press-releases/2012/07/18/nationwide-pew-survey-challenges-conventional-wisdom-on-payday-loans [https://perma.cc/5G6V-DWJT] ("Most borrowers are employed, white, female, and 25 to 44 years old. However, consumers who disproportionately use these products are those who lack a four-year college degree, are home renters, African-American, earn less than $40,000 per year, or are separated or divorced.").

64. *See* Nikitra S. Bailey, *Predatory Lending: The New Face of Economic Injustice*, 32 HUM. RTS. 14 (2005) (describing the overabundance of predatory lending operations in poor and minority communities).

65. *Id.* at 14.

66. Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending*, 87 MINN. L. REV. 1, 2, 10 (2002).

67. *Id.* at 8, 11.

68. *Id.* at 9.

69. *Id.* at 10.

of time between successive payday loans is one day or less, "consistent with the explanation that payday borrowers, unable to both repay their payday loan and meet other expenses, are effectively locked in a cycle of debt."[70] Three-fourths of all payday loan volume is attributed to repeat borrowers locked in this debt cycle.[71] There is debate in academic circles as to the benefits and harms associated with payday lending, but it is evident there is a demand for loans in the high-risk borrower community.[72] It is also likely true that payday loans are, for almost every consumer (particularly the repeat, rollover users), a terrible financial decision.[73] Data indicates that repeat payday lending costs American families $3.5 billion dollars in fees annually, with the average payday loan borrower taking out nine payday loans per year.[74]

Regardless of one's position on payday loans, it is true that a growing section of the American population needs access to credit and their needs are being met—usuriously or not—through high-cost payday lending.[75] By reducing or eliminating the need for

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70. Leslie Parrish and Uriah King, *Phantom Demand: Short-term Due Date Generates Need for Repeat Payday Loans, Accounting for 76% of Total Volume*, CTR. FOR RESPONSIBLE LENDING (2009), http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf [https://perma.cc/C8HU-MKVR].

71. *Id.* at 3.

72. Christine L. Dobridge, *For Better and for Worse? Effects of Access to High-Cost Consumer Credit*, FIN. & ECON. DISCUSSION SERIES, July 2016, at 2, http://dx.doi.org/10.17016/FEDS.2016.056 [https://perma.cc/754E-5YFR] ("Proponents of payday lending maintain that it is an important backstop for families facing emergencies that lack access to other credit options . . . . Critics of payday lending . . . charge that lenders trap poorly informed individuals in a cycle of repeated borrowing at usurious interest rates and exacerbate financial distress."). For more reading regarding payday loans, *see generally* Zoe Elizabeth Lees, *Payday Peonage: Thirteenth Amendment Implications in Payday Lending*, 15 SCHOLAR: ST. MARY'S L. REV. ON RACE & SOC. JUST. 63 (2012) (equating payday loan debt as perpetuating the badges and incidents of slavery); Carmen M. Butler & Niloufar A. Park, *Mayday Payday: Can Corporate Social Responsibility Save Payday Lenders*, 3 RUTGERS J. L. & URB. POL'Y 119 (2006) (describing payday loans as a useful product that is under-regulated and in need of reform and suggesting that increased corporate responsibility in conjunction with Congressional legislative action may cure the predatory behavior of many payday lenders); Ronald J. Mann & Jim Hawkins, *Just until Payday*, 54 UCLA L. REV. 855 (2007) (describing payday lending and stating "if the [payday loan] market is to exist, we believe it is better for it to be populated by highly visible national providers than by mom-and-pop providers."); Paige Marta Skiba, *Regulation of Payday Loans: Misguided*, 69 WASH. & LEE L. REV. 1023 (2012) (describing the value and usefulness of payday loans while analyzing which regulations are misguided (e.g., outright bans on payday lending) and what current and proposed regulations would and would not work to properly regulate the market).

73. *See* Christine Dalton, *John Oliver's 14 Greatest Takedowns On the First Season Of 'Last Week Tonight'*, HUFFINGTON POST (Nov. 11, 2014, 10:26 AM) ("Payday loans are like the Lay's Potato Chips of finance. You can't have just one and they're TERRIBLE for you.").

74. Parrish, *supra* note 70, at 3, 5.

75. Johnson, *supra* note 66, at 99.

high-cost payday loans (through increasing availability of more traditional and less expensive forms of credit), higher risk consumers could potentially break out of the payday lending cycle of increasing fees, debts, and servicing costs on a necessary loan. "[T]hose who filed bankruptcy in 2012 were, on average, just $26 per month short of meeting their expenses."[76]

Overall, evidence suggests that once you have a low credit score, it is likely that you will continue having a low credit score, even beyond the expiration of FCRA's mandated reporting period for adverse data.[77] "For example, while approximately 10 percent of borrows with prime pre-delinquency credit scores were delinquent on a credit obligation five years before the foreclosure period, the delinquency rate eight to ten years after the foreclosure was about twice this level."[78] This conclusion makes sense in light of the significant role credit scores play in consumers' lives.[79]

There is undeniable evidence that the current system of credit availability based on credit scoring and reporting leaves black and Hispanic Americans at a significant disadvantage.[80] The current system costs black and Hispanic Americans billions of dollars a year in additional fees and interest on mortgages, auto loans, insurance, and more, while potentially limiting their employment and housing opportunities. Considering the wide-reaching implications of reduced credit access and the potential for lifelong and generational harm, this disparate effect needs to be addressed.

III. WHAT HAS NOT WORKED

To address the disparate effects found in the modern credit rating and availability scheme in America, the government has attempted to educate consumers, passed legislation designed to procedurally protect borrowers from complicated or unfair lending practices and substantively protect borrowers by limiting types and terms of various loan products, and using monetary policy to attempt to control lender behavior. Unfortunately, these corrective efforts have been largely unsuccessful as evidenced by the

76. Baradaran, *supra* note 33, at 167.

77. Brevoort & Cooper, *supra* note 62, at 15.

78. *Id.* at 16.

79. Brevoort and Cooper provide a possible explanation in line with this paper's: the shock to the borrower's credit score (in that instance, due to foreclosure) "thereby reduc[ed] access to credit or increase[ed] the costs of access." *Id.* at 24. They also suggest that having a low credit score generally "may reduce the incentive for making on-time payments" causing borrowers to "perceive lower costs of delinquency in the future." *Id.* at 24–25.

80. *See supra* Section II.B–C (providing statistics and costs associated with low credit scores).

continued and growing problem of the race-credit divide.

A. Low Interest Rates

An interesting real-world study of a massive credit score crisis came in the wake of the housing price collapse.[81] Post-collapse, the Federal Reserve ("the Fed") worked to keep interest rates low to "spur the economy and remedy the aftereffects of the borrowing boom."[82] The rate drop helped, just not the people most in need.[83] Pre-collapse, half of all new mortgages went to borrowers with average credit scores. Post-collapse, nearly 90% of all new mortgages went to high-scoring borrowers.[84] Despite the low interest rates set by the Fed, lenders "remain reluctant to extend credit to households with even a hint of financial problems."[85] The ultimate result of low interest rates was a boon for those borrowers who need the least assistance; "[h]ouseholds with credit scores above 760 saw a sevenfold increase in refinancing after the Fed launched a $1.25 Trillion mortgage-purchase program, while refinancing doubled among households with scores below 700."[86] Studies have shown that the average credit score required to qualify for a federally-backed mortgage (like the FHA) is approximately 50 points higher than before the housing price collapse, further widening the gap between credit-haves and credit-have-nots.[87]

In short, lowering interest rates did not encourage lenders to extend credit to more people or make credit cheaper for those who need the most help. Instead, lowering interest rates encouraged

81. I use the term "housing price collapse," but it has been called many things: Great Recession, foreclosure crisis, mortgage crisis, and so on. While only tangentially related to this paper, the housing price collapse hit black and Hispanic Americans particularly hard. *Report Shows African Americans Lost Half Their Wealth Due to Housing Crisis and Unemployment*, NAT'L LOW INCOME HOUS. COAL. (Aug. 30, 2013), http://nlihc.org/article/report-shows-african-americans-lost-half-their-wealth-due-housing-crisis-and-unemployment [https://perma.cc/J6CB-R988] ("Since 2007, nearly 8% of African American and Latinos have lost their homes to foreclosure compared to 4.5% of non-Hispanic whites at similar income levels. The disparity ratio shows that African Americans are more than 70% more likely to have been foreclosed upon than non-Hispanic whites.").

82. Jon Hilsenrath, *Fed Wrestles with How Best to Bridge U.S. Credit Divide*, WALL ST. J. (June 19, 2012, 9:50 AM), http://www.wsj.com/articles/SB10001424052702303505504577403970826823032.

83. *See id.* (stating that the percentage of new mortgages going to houses went up forty points after the financial crisis).

84. *Id.*

85. *Id.*

86. *Id.*

87. Jim Parrott & Mark Zandi, *Opening the Credit Box*, MOODY'S ANALYTICS, INC., & THE URBAN INSTITUTE (2013), https://www.urban.org/research/publication/opening-credit-box/view/full_report [https://perma.cc/B3R8-7CLK].

lenders to offer more to those low-risk borrowers that would have qualified for loans regardless of the economic circumstances. Higher-risk borrowers, the ones with the most to benefit from an increased availability of affordable credit products, found no such benefits. Instead the most vulnerable found even stricter lending criteria and fewer options in the wake of the housing price collapse.

B. Credit and Financial Literacy Education Initiatives

Consumer credit education is a difficult proposition. Who will implement it? No lender would want to spend the time and money educating potential borrowers of the pitfalls of the very same products they are trying to sell. This leaves interested third parties , either the government or consumer protection groups, as possible sources of education. While it seems obvious that financial education should yield more rational consumer choices, "[s]tudies repeatedly show little long-term positive effect of financial education on consumer behaviors."[88]

Because of the difficulty in implementing educational programs and the lack of significant improvement in consumer behavior, the "single most important source of learning is a difficult financial experience."[89] However, because many borrowers in the higher risk categories are "flipped" from unfavorable loan to unfavorable loan (payday loans, refinancing, auto title loans, pawn shops, and so on), the "ultimate bad outcome is delayed by refinancing," making it "difficult for the borrower to attribute the problem to any particular aspect of the loan choice."[90]

Financial literacy rates have been dropping since at least 2009.[91] This drop occurred despite the vast array of potential credit education programs provided by the federal government, state governments, and private parties.[92] There is a multitude of

88. Willis, *supra* note 8, at 813–14. Willis goes on to describe that only "[s]mall positive effects in the home loan education area have only been shown for in-person pre-loan counseling—even telephone counseling was ineffective." *Id.* at 813.

89. *Id.* at 813–14.

90. *Id.* at 814.

91. *See* JUDY T. LIN, ET AL., FIN. INDUS. REGULATORY AUTH., FINANCIAL CAPABILITY IN THE UNITED STATES 28 (2016), http://www.usfinancialcapability.org/downloads/NFCS_2015_Report_Natl_Findings.pdf [https://perma.cc/J4NJ-3W4J].

92. Examples of sources of credit education found via a simple Google search include: MyMoney.gov, 1-800-FED-INFO, various state departments of education financial literacy pages, the FDIC's Financial Education Program, the National Endowment for Financial Education, the National Financial Educators Council, and the Jump$tart Coalition for Personal Financial Literacy. *See* MYMONEY.GOV, *Feed the Pig*, https://www.feedthepig.org/toolbox/on-the-web/mymoney.gov#.WnNUGKinHZs [https://perma.cc/59AC-VMBZ] (last visited Feb. 4, 2018) (labeling MyMoney.gov the "[s]tarting point for information intended

reasons identified as possible explanations for why borrowers' decision-making is relatively unaffected by consumer credit education.[93] The reasons are beyond the scope of this Comment, but the results are not: credit education does not appear to be working.[94]

Financial education programs do not significantly affect the ways consumers make decisions. Furthermore, it does not help a borrower to know that their payday loan is bad for them if they are out of options. Consumer education is not a useful policy proposal to cure the credit availability gap and at best offers a clearer view of the problem to those consumers harmed most. Perhaps as a response to the poor results of consumer education initiatives, the government enacted legislation to address credit reporting standards to smooth the appearance of consumer risk profiles and, in a sense, forgive debtors for their past transgressions. One piece of such legislation is the Fair Credit Reporting Act.

C. The Fair Credit Reporting Act [95]

The Fair Credit Reporting Act ("FCRA") limits the time periods that certain negative credit use behavior can stay on a credit report.[96] While the statutory time periods are very long, ranging between seven to ten years for most transgressions, the very fact that the FCRA limits the time period of reporting negative data indicates a Congressional policy desire to "forgive" past credit mistakes to help consumers move past their previous credit slip-ups. As we have seen post-foreclosure, even after the statutory reporting period has expired and the foreclosure is no

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by the US government to help improve the financial literacy and education of persons in the United States."); *Resource Center*, U.S. DEP'T OF THE TREASURY, https://www.treasury.gov/resource-center/financial-education/Pages/commission-index.aspx [https://perma.cc/SE3E-W22B] (last visited Jan. 16, 2018) (directing readers to 1-800- FED-INFO for "question[s] about federal agencies, programs, benefits or services related to financial literacy"). There are literally hundreds of other state, federal, and private entities providing some degree of financial literacy education.

93. Some of the explanations are compelling, but all are beyond the scope of this paper. S*ee generally* Willis, *supra* note 8, at 766–89 (providing additional explanation as to why consumers may select unfavorable loans against their own self-interest). Willis proposes that the loan application process can be "ego-threatening." *Id.* at 772. Specifically, she discusses that higher-risk borrowers are persuaded by "The Power of Yes." *Id.* "[The Power of Yes] exploits the ego threats experienced by borrowers who believe they have poor credit or fear discrimination. Second, it stresses the immediate tangible reward to be had, thus taking advantage of cognitive tendencies to discount over time and certainty." *Id.*

94. *See generally id.* at 766–89 (describing the negative effects of various decision-making heuristics on mortgage selection by low-income borrowers).

95. *See* Fair Credit Reporting Act, 15 U.S.C. § 1681 (2012).

96. *See supra* Section II.C (discussing the FCRA's 7 and 10-year credit reporting limitations).

longer reported by credit agencies, consumers' behavior indicates a greater likelihood of default on their debt obligations.[97] This greater risk is no longer calculated in their credit score, effectively showing the borrower as a lower risk than they actually are. While risk-shifting does in effect shift costs by masking higher-risk borrowers in the marketplace, it is evidently insufficient to correct the systemic race-credit divide.[98]

D. The Equal Credit Opportunity Act[99]

The Equal Credit Opportunity Act ("ECOA") prohibits discrimination in issuing credit based on race.[100] In his note on behavioral credit scoring, Nate Cullerton described the process required and proof needed in order to present a successful discrimination claim under ECOA.[101] The first component of the three-part test used to evaluate ECOA claims requires plaintiffs to "demonstrate that the use of a certain factor has a disproportionately negative impact on a protected group."[102] Proving this component is nearly impossible , ironically as a result of other legislation designed to promote a color-blind credit reporting process, such as the Federal Reserve's Regulation B which was issued during implementation of the ECOA.[103] Though Regulation B now makes gathering race information optional, it originally barred creditors from gathering information on race from their applications, making records incomplete with respect to race.[104] Furthermore, the FCRA does not allow credit reporting agencies to include race in their credit reports, complicating the

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97. *See supra* Section II.C (discussing study results showing an increase in post-delinquency default rates). *See also* David K. Musto, *What Happens When Information Leaves a Market? Evidence from Postbankruptcy Consumers*, 77 J. BUS. 725, 747 (2004) ("That is, the reporting limit artificially boosts the apparent creditworthiness of past filers. In the longer run we find that the score increase dissipates in a year, and that by 18 months post-removal the scores are lower than initial scores, those calculated with the bankruptcy information, predict. We also find that the debt and delinquency of the affected consumers are higher than their initial debt and scores predict, and that the extra delinquency is greater in states with higher property exemptions from creditors.").

98. *See* Richard Hynes, *The Social Costs of Credit Reporting Errors*, 11 J.L. ECON. & POL'Y 329, 340–42 (2015). Hynes argues that mistakes in risk determination (including the FCRA-mandated time limitations despite their risk determination value) can benefit high-risk consumers by shifting the benefit of affordable credit products from low-risk to high-risk borrowers, "thus provid[ing] offsetting benefits to the truly high-risk consumers." *Id.*

99. Equal Credit Opportunity Act, 15 U.S.C. § 1691 (2012).

100. *Id.* § 1691(a). The Act also prohibits credit discrimination "on the basis of color, religion, national origin, sex or marital status, or age" *Id.*

101. *See* Nate Cullerton, *Behavioral Credit Score*, 101 GEO. L.J. 807, 828–29 (2013).

102. *Id.* at 828.

103. *Id.* at 828–29 (discussing the difficulty of satisfying the ECOA's three-part test caused by the requirements of Regulation B).

104. *Id.*

ability of a plaintiff to demonstrate the "disproportionate negative impact on a protected group" as required by Title VII of the Civil Rights Act.[105] As a final blow to the ECOA as a corrective measure for the systemic race-credit divide, the plaintiff must "point to a specific policy that is leading to the disparate effect."[106] This is a near impossibility, as the true source of disparate impact is not a specific policy but rather an entire system's methods of calculations that yield discriminatory results. Identifying a defendant adds to the complication. Because of the difficulty in making an ECOA claim and the continued problems of credit availability, ECOA has been proven ineffective at addressing the growing race-credit divide.

E. Procedural and Substantive Protections

In effort to protect consumers from unscrupulous lenders or perhaps to protect some consumers from themselves, the government mandated disclosures of loan prices, of annual percentage rates ("APR"), and other key terms. These disclosures were mandated primarily by the Truth in Lending Act ("TILA"), a 1968 federal law designed to make evident to consumers the costs associated with borrowing money.[107] Making shopping for loans based on costs and key terms was one major goal of standardized disclosures.[108] Despite these efforts, "borrowers are agreeing to these overpriced and overly risky home loans against their own self-interest and despite federally mandated disclosures."[109]

While the potential reasons are numerous, studies have shown that with an increase of computer-powered, data-heavy credit risk modeling and the ebb and flow of various regulations, the loan marketplace has been left with a "bewildering array" of potential products with a likewise bewildering array of terms,

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105. *See* 15 U.S.C. §§ 1681a–1681b (2012) (providing some restrictions on the sharing of demographic data in credit reports); Wu, *supra* note 28, at 18 (noting that "under civil rights law," an employer may be liable for treating employees differently on the basis of race, leading to "a disproportionate negative impact on a protected group."); *cf*. Sandra K. Lauro, *The Science of Discrimination: Genetics in the American Workplace*, GPSOLO MAG. (Sep. 2006), https://www.americanbar.org/newsletter/publications/gp_solo_magazine_home/gp_solo_magazine_index/2006_sep_tips.html [https://perma.cc/5GC8-65HD] (noting that employers may be liable under Title VII for treating people differently on the basis of a genetic screening if it leads to a disproportionate negative impact for a protected group).

106. Cullerton, *supra* note 101, at 829.

107. *See* Truth in Lending Act, 15 U.S.C. § 1601(a) (2012).

108. CFPB LAWS AND REGULATIONS, *TILA: Truth in Lending Act* 1, 6 (Apr. 2015), http://files.consumerfinance.gov/f/201503_cfpb_truth-in-lending-act.pdf [https://perma.cc/8RCQ-C8AJ].

109. Willis, *supra* note 8, at 712. Willis goes on to say "the content of disclosures had little to do with borrower decision-making in taking the loan." *Id*.

conditions, and costs.[110] While this is undoubtedly a benefit for the most sophisticated consumer, this "bewildering" amount of products leaves minority groups at a disadvantage.[111] Data has shown that blacks and Hispanics are significantly disadvantaged with respect to general financial literacy.[112] Because of the array of available products, there exists an information gap between consumers and lenders which leads to poor decision-making.[113] Credit education programs do little to close this information gap.[114] Because of the complexity of the modern credit market, disclosure does little to assist the least sophisticated consumers to navigate the quagmire of terms and conditions necessary to make informed and rational credit decisions.

As a final strike against disclosure requirements as an effective way to help consumers make better borrowing decisions, some scholars have identified common lender behavior that mitigates any potential gain.[115] While perfectly legal, lenders respond to disclosure requirements by adjusting the product in a way to make the disclosure less valuable, by undermining the importance of the disclosure documents during the loan process, and by using "big data to reach the consumers who are most likely to be receptive to advertising at the precise moments when they are most likely to be receptive and most likely to ignore disclosures."[116] Together, it appears evident that lenders are a step ahead of legislators. In the alternative, it appears that broad legislative action cannot sufficiently address the increasingly broad and complicated credit marketplace in the face of innovative lenders.

Disclosure requirements have proven ineffective at protecting consumers.[117] Additionally, as the credit market becomes increasingly complicated, lenders will continue to respond to legislation designed to change their behavior. The current

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110. *Id.* at 726–27.

111. LIN. ET AL., *supra* note 91, at 30; *See also* RICHARD H. THALER & CASS R. SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS 134 (2008) (explaining that the information gap is in large part due to the increasing complexity of the market).

112. *See* LIN ET AL, *supra* note 91, at 30.

113. Thaler & Sunstein, *supra* note 111, at 134 ("When markets get more complicated, unsophisticated and uneducated shoppers will be especially disadvantaged by the complexity.").

114. It also does not help that studies have shown that levels of financial literacy have been dropping since 2009. *See* LIN ET AL, *supra* note 91, at 29.

115. *See* Lauren E. Willis, *Performance-Based Consumer Law*, 82 UNIV. CHI. L. REV. 1309, 1311 (2015).

116. *See id.* at 1322.

117. *Id.* at 1321.

procedural and substantive rules in place limiting lender behavior has not proven sufficient at narrowing the race-credit divide.

F. Other Government Programs

The government has implemented numerous assistance, subsidy, and "leg up" programs designed to increase credit access to historically discriminated-against groups. These programs include some designed to increase home ownership amongst minority groups, like Fannie Mae and Federal Housing Administration ("FHA") loan programs. Fannie Mae and the FHA offer mortgage products designed to help minority applicants afford and qualify for mortgages. Because Fannie Mae and the FHA have lower underwriting standards in order to qualify, these entities were able to increase home ownership rates for poor and minority borrowers in America.[118] Critics have pointed out that the lower underwriting standards of organizations like Fannie Mae and the FHA contributed to the mortgage crisis by engaging in increasingly risky lending practices.[119] As discussed in Part II, the ramifications of a foreclosure are truly disastrous to a credit score.[120] Furthermore, while these government programs have increased minority home ownership, they have evidently not narrowed the ever-widening race-credit divide.

Other government programs, like the U.S. Small Business Administration's Business Development Program, helps "qualifying minority-owned firms develop and grow their businesses" through counseling, training, and "access to [favorable] government contracting opportunities."[121] These

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118. Ronald Brownstein, *Minorities' Home Ownership Booms Under Clinton but Still Lags Whites'*, L.A. TIMES (May 31, 1999), http://articles.latimes.com/1999/may/31/news/mn-42807.

> Between 1993 and 1997, home loans grew by 72% to blacks and by 45% to Latinos, far faster than the total growth rate." *Id.* The article goes on to say "Fannie Mae, in particular, has been aggressive and creative in stimulating minority gains. . . . Most importantly, Fannie Mae has agreed to buy more loans with very low down payments—or with mortgage payments that represent an unusually high percentage of a buyer's income. That's made banks willing to lend to lower-income families they once might have rejected.

Id.

119. *See* Ben S. Bernanke, Chairman, Cmty. Aff. Res. Conf., The Community Reinvestment Act: Its Evolution and New Challenges (Mar. 30, 2007) https://www.federalreserve.gov/newsevents/speech/bernanke20070330a.htm [https://perma.cc/8B9P-TZ7B]..

120. *See supra* Part II (describing the costs of a foreclosure on credit availability long-term).

121. U.S. SMALL BUS. ADMIN., *Small Business Audiences*, https://www.sba.gov/about-sba-navigation-structure/small-business-audiences [https://perma.cc/5EEY-TNWY] (last visited Jan. 30, 2018).

programs are an outstanding step towards mitigating generations of discrimination, but for the types of consumers taking payday loans and living paycheck to paycheck, they do little.[122]

The Community Reinvestment Act "is intended to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods, consistent with safe and sound operations."[123] Results of the Community Reinvestment Act have been debated. A 2003 Federal Reserve research paper found that "[r]esults [of a study of the effects of the Community Reinvestment Act] are mixed and difficult to interpret."[124] Some studies have shown evidence of increased Community Reinvestment Act lending, while others (and sometimes even the same studies) have indicated no evidence of a favorable impact related to the Act.[125] While a review of the conflicting reports is confusing, the overall impact of the Community Reinvestment Act appears to be increased lending in low-income and minority neighborhoods.[126]

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122. *See* Emily Badger, *When Work Isn't Enough to Keep You Off Welfare and Food Stamps*, WASH. POST: WONKBLOG (Apr. 14, 2015), https://www.washingtonpost.com/news/wonk/wp/2015/04/14/when-work-isnt-enough-tokeep-you-off-welfare-and-food-stamps/?utm_term=.1459c6fb4a6b. Another example of government assistance specifically targeting minority groups is the U.S. Department of Commerce's Minority Business Development Agency (providing numerous incentives and advantages to minority-owned business operations). *See* Chris Garcia, *MBDA 101: A Guide to MBDA Programs and Performance*, MINORITY BUS. DEV. AGENCY, https://www.mbda.gov/sites/mbda.gov/files/mbda101_aguidetombdaupdated0517.pdf [https://perma.cc/N5PQ-KT8C].

123. *Community Reinvestment Act*, BD. OF GOVERNORS OF THE FED. RESERVE SYSTEM, (Feb. 11, 2016), https://www.federalreserve.gov/consumerscommunities/cra_about [https://perma.cc/9U6T-3Q73]; *See also* Community Reinvestment Act, 12 U.S.C. 2901(b) (2012).

124. Robert B. Avery, et al., *The Effects of the Community Reinvestment Act on Local Communities*, BD. OF GOVERNORS OF THE FED. RES. SYS.: DIV. OF RES. AND STATISTICS (Mar. 20, 2003), https://www.federalreserve.gov/communityaffairs/national/CA_Conf_SusCommDev/pdf/cannerglen.pdf [https://perma.cc/YGB8-93FJ]. The report also notes: "there is evidence of an elevated level of CRA-related lending in the lower-income census tracts." *Id.* The report's data indicated findings "inconsistent with a favorable impact of the CRA." *Id.* After changing their methods and testing specifications, they "failed to resolve this inconsistency." *Id.*

125. *Id.* Some reports are wholly negative on the results of the Community Reinvestment Act. *See* Michelle Minton, *The Community Reinvestment Act's Harmful Legacy: How It Hampers Access to Credit*, COMPETITIVE ENTER. INST. (Mar. 20, 2008), https://cei.org/studies-point/community-reinvestment-act%E2%80%99s-harmful-legacy [https://perma.cc/LLP3-UM8D]. Other reports are wholly positive on the results. *See* Alex Schwartz, *From Confrontation to Collaboration? Banks, Community Groups, and the Implementation of Community Reinvestment Agreements*, 9 HOUS. POL'Y DEBATE 631, 649–50 (1998).

126. Michael S. Barr, *Credit Where it Counts: The Community Reinvestment Act and Its Critics*, 80 N.Y.U. L. REV. 513, 513 (2005) ("Using recent empirical evidence, I demonstrate that over the last decade CRA has enhanced access to credit for low-income, moderate-income, and minority borrowers at relatively low costs, consistent with the theory that CRA is helping to overcome market failures.").

Ben Bernanke echoed this sentiment when he said in a 2007 speech that "[r]esearch on the CRA has tended to find positive net effects, but the results are not uniform."[127] However, because the Community Reinvestment Act does not extend to nonbank providers—like payday lenders and check cashers—it does little to address the products most commonly available and most commonly used by the most disadvantaged groups. Furthermore, in the same 2007 speech, Bernanke suggested that the central premise of the Community Reinvestment Act—more lending is good—should not be considered dogmatic: "This greater access [due to the Community Reinvestment Act] has had tangible benefits, . . . However, recent problems in mortgage markets illustrate that an underlying assumption of the CRA—that *more* lending equals *better* outcomes for local communities may not always hold."[128] In conclusion, because of the mixed results of the Community Reinvestment Act, and the Act's inability to directly impact the race-credit divide in a substantial way, the Act has proven insufficient. This is not to say, however, that the Act is not a strong and important step in the right direction: more credit availability for those who need it.

Government programs have great intentions and inconsistent results. The above outlined programs were implemented to do many things besides or in addition to addressing the race-credit divide. While legislation like FCRA, TILA, and the Community Reinvestment Act have undoubtedly produced some positive, pro-borrower results in certain arenas, they have not done enough. While it is encouraging to consider the purposes behind the various programs, the empirical, real-world results leave much to be desired. The real-world points strongly towards a steady or widening disparity between credit scores and availability of inexpensive credit products for minority and nonminority borrowers. The current legislative and social agents of change have proven insufficient at addressing the problem.

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127. Ben S. Bernanke, Chairman, Cmty. Aff. Res. Conf., The Community Reinvestment Act: Its Evolution and New Challenges (Mar. 30, 2007) https://www.federalreserve.gov/newsevents/speech/bernanke20070330a.htm [https://perma.cc/8B9P-TZ7B].

128. *Id.*

IV. SOLVING THE RACE–CREDIT DIVIDE VIA AFFIRMATIVE ACTION[129]

"Affirmative action policy regulates the allocation of scarce positions in education, employment, or business contracting so as to increase the representation in those positions of persons belonging to certain population subgroups."[130] Affirmative Action seeks to reverse generations of systemic racism in order to "further compelling governmental interests."[131] While Affirmative Action has been implemented in government contracting, employment, and other arenas, one of the most recent areas the concept has been applied is race-based college admissions.[132] Race-based college admission standards were recently challenged at the Supreme Court.[133] Ultimately, the Court found that a narrowly tailored and specifically focused race-based admissions program was constitutionally permissible.[134] Much as college admissions seeks to look "beyond the numbers" to assess the likely success of a candidate as well as their value and contribution to the greater community, so too should credit scores. Credit reporting and scoring should look "beyond the numbers" in order to promote the compelling governmental interest of fair and equal credit access for all Americans, regardless of skin color.

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129. For an excellent perspective on the benefits and necessity of Affirmative Action policies, *see* BARBARA R. BERGMAN, IN DEFENSE OF AFFIRMATIVE ACTION (1996). Bergman does Affirmative Action much more justice than I could hope to muster. Bergman eloquently describes Affirmative Action as:

> [P]lanning and acting to end the absence of certain kinds of people—those who belong to groups that have been subordinated or left out—from certain jobs and schools. It is an insurance company taking steps to break its tradition of promoting only white men. . . . It is the admissions office . . . seeking to boost the numbers of blacks in the freshman class . . . who may not have learned to do well on multiple choice tests but are nevertheless very smart . . . . Affirmative action can be a formal program with a written, multipart plan and a special staff to carry it out, or it can be the activities of one manager who has consulted his conscience and decided to do things differently.

Id. at 7–8. Bergman goes on, most germane to this paper, to say:

> A third motive for affirmative action is to reduce the poverty of certain groups marked out by race or gender. Those who advocate this reason for affirmative action are sometimes derided as wanting equality of results rather than equality of opportunity. . . . [T]he United States is now experiencing how dysfunctional and divisive the concentration of poverty in the African American community is.

Id. at 10.

130. Roland Fryer & Glenn Loury, *Working Paper 11464: Affirmative Action and Its Mythology*, NAT'L BUREAU OF ECON. RESEARCH 1 (June 2005), http://www.nber.org/papers/w11464.pdf [https://perma.cc/6343-SCPM].

131. Grutter v. Bollinger, 539 U.S. 306, 326 (2003).

132. Fisher v. Univ. of Texas at Austin, 136 S. Ct. 2198, 2206 (2016).

133. *Id.* at 2205.

134. *Id.* at 2214.

Race should be a factor in credit scoring just as race is a factor in college admissions at the University of Texas. The diversity objective that gave rise to race-based college admissions has much in common with the race-credit divide. In the most recent of a series of cases involving race and college admissions, *Fisher v. University of Texas*,[135] a white woman filed suit against the University of Texas after she was denied admission. In her suit, the woman alleged the University of Texas discriminated against her based on her race by admitting "less qualified" minority applicants (based on grade point average, SAT scores, etc.).[136] The University of Texas's admission process uses a numerical "Academic Index" which includes grade performance and standardized test scoring in conjunction with a "Personal Achievement Index", which involves many factors including race.[137]

The University of Texas justified their use of race as a necessary means of promoting the racial diversity of their incoming classes.[138] While the admissions process is complicated, the Court articulated race as a "factor of a factor of a factor" which was not a "mechanical plus factor for underrepresented minorities."[139] Other factors considered included "the socioeconomic status of the applicant's family, the socioeconomic status of the applicant's school, the applicant's family responsibilities, whether the applicant lives in a single-parent home, the applicant's SAT score in relation to the average SAT score at the applicant's school, [and] the language spoken at the applicant's home."[140]

The Supreme Court ultimately ruled in favor of the University of Texas and their race-based admissions program. Notably, the Court determined that under the Equal Protection Clause, the University of Texas's admissions program was constitutional because it was able to "withstand strict scrutiny," which meant it was able to show its "purpose or interest [was] both constitutionally permissible and substantial, and that its use of classification [was] necessary."[141] Because the University of Texas

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135. *Id.* at 2207.

136. *Id.* at 2206–07.

137. *Id.* at 2205, 2240.

138. *Id.* at 2222.

139. *Id.* at 2207.

140. *Id.* at 2206.

141. *Id.* at 2207–10. In an older Supreme Court case, it was determined that "the attainment of a diverse student body [was] clearly a constitutionally permissible goal for an institution of higher education." Regents of Univ. of California v. Bakke, 438 U.S. 265, 311–12 (1978).

was able to strongly and clearly articulate their purpose for including race in their numerical determination of acceptance into their incoming classes, because the use of race was narrowly tailored to achieve those objectives, and because there were no reasonable, workable alternatives to achieve those articulated diversity goals, the Court concluded race was an acceptable factor in the University of Texas's admissions calculus.[142]

Race should be a factor in credit scoring just as race is a factor in college admissions at the University of Texas. While the mechanics of implementation are beyond the scope of this Comment, the FCRA and other federal legislation controls what goes into credit reports, how long the information stays, and how it can be used.[143] It is not a stretch to suggest that federal legislation, in "insur[ing] that consumer reporting agencies exercise their grave responsibilities with fairness, [and] impartiality. . .," should be expanded to include which factors are utilized in determining a credit score or creditworthiness.[144] This is particularly evident when the empirical evidence suggests such a strong disparate impact on certain minority populations. Much like the University of Texas uses race as a "factor of a factor of a factor" in order to promote their clearly articulated objectives of racial diversity in the student population with its attending benefits, why would mandating race as a factor in credit risk calculations be any less viable?

Using race as a factor for credit risk determinations provides the kind of direct and necessary solution needed for the pervasive and discriminatory problem of credit availability in the United States. While race should not be a "mechanical plus factor" or blindly provide an increase in credit score, it should be considered as a general plus factor to be tempered or magnified by other relevant factors. These factors would be of the same type as those used by the University of Texas's admissions program, and could include socioeconomic circumstances and conditions of the borrowers' family and neighborhood, family and business responsibilities of the borrowers, and so on. The goal is to identify those most disadvantaged by the current discriminatory system and use appropriately weighted variables, including race, to provide the "numerical" boost in credit rating necessary to bridge the gap between credit-haves and credit-have nots.

Surviving strict scrutiny would require a purpose that is constitutionally permissible and substantial while also showing

142. *Fisher*, at 2212–15.

143. *See supra* Section III.C.

144. 15 U.S.C. 1681(a)(4) (2012).

that race was a necessary component.[145] Here, the use of race is perhaps the strongest and most necessary component of identifying and correcting the race-credit problem. As the above data indicates, skin color may be the strongest proxy for the current systems' credit scoring model.[146] The purpose is even more compelling than the University of Texas' classroom diversity argument: millions of Americans are paying billions of dollars in excess fees and interest due to below-average credit scores and a lack of cost-effective credit products, and no current or past legislative, governmental, or private actions have effectively addressed the issue. The diversity of debtors makes little sense from a short-term risk-based lending perspective, but the more encompassing and broadly defined goal of the lifting of a disenfranchised element of our nation is most strongly served by leveling the credit playing field. Much like college admissions uses a complicated math-based approach of inputting numerous data points and calculating the likelihood of success or the risk of failure, so too should the credit scoring system function. Much like in college admissions, there is or should be more to a credit rating than pure numbers, particularly when pure numbers lead to disparate impacts on minorities. These disparate impacts are seen in colleges that use race-blind admissions standards: fewer black and Hispanic students are admitted, undermining the broader diversity objective.[147] These disparate impacts are seen in credit marketplaces that use race-blind rating standards: fewer products, lower quality products, and a bleak outlook for minority borrowers. By requiring race to be factor in credit ratings, the purely numerical inputs of a credit report can be augmented in a realistic and positive way to promote a goal beyond pure numbers, a goal of racial equality and equal opportunity and access to the wealth of credit products currently available only to a limited number of high-scoring borrowers.[148]

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145. *Fisher*, 136 S. Ct. at 2207–08.

146. Willis, *supra* note 8, at 773–74.

147. For an interesting discussion of race-neutral college admissions and the difficulties such standards present, *see* Richard Sander & Aaron Danielson, *Thinking Hard About Race-Neutral Admissions*, 47 U. MICH. J.L. REFORM 967, 1000–01 (2014). Sander and Danielson describe various difficulties in a race-neutral standard. First, they describe that a race-neutral standard is not as efficient as using race itself when targeting specific racial makeups of classes. *Id.* at 975–76. Secondly, they describe socioeconomic diversity as an incomplete and relatively unpredictable proxy for race. *Id.* at 981–84. Finally, they discuss that even in race-neutral systems showing positive improvements towards diversity objectives, a "growing body of research suggests that compliance with race-preference bans is irregular; "race-neutral" universities often do appear to give weight—sometimes substantial weight—to race." *Id.* at 969. Added up, race-neutral admissions standards seem inadequate at advancing diversity objectives.

148. Brevoort, *supra* note 62, at 16–17. The idea of requiring race as an input into

Another consideration of the *Fisher* Court was the narrow tailoring and results of the race-based admissions program.[149] Using race in a credit rating system should be equally tailored, and the results should be carefully monitored. Ideally, by allowing race to be a generally positive factor in a credit scoring model, this would increase the availability of lower-cost credit products to currently low-scoring minority groups. By increasing the availability of lower-cost credit products, there is at least the possibility of escaping the low credit score cycle. As positive results—or negative, or neutral—are realized, the statistical value assigned to race and other relevant factors could be adjusted, providing the narrow tailoring and result-oriented process of concern to the *Fisher* Court. Our current system of credit has created distinct credit-haves and credit-have nots, and something must give.

It may be argued that by allowing or requiring race as a factor to be considered when determining credit-worthiness, there will be a shifting of cost as previously higher-risk borrowers are now classified as lower risk, ostensibly defaulting at a higher rate than their numerical categorization would suggest. While this is a legitimate concern, it discounts the value—both economic and social value—of the higher objective of breaking millions of Americans from the low credit score cycle.[150] While there would undoubtedly be some statistically higher amount of default at first, there is a strong argument that lower cost products when finally available to those for whom the market has been historically foreclosed will provide the break in the high-cost, payday loan style borrowing that keeps nontraditional lenders rich and minority groups poor. The social value far exceeds the potential monetary losses to lenders. Furthermore, it is most likely that lenders would not suffer losses due to higher default rates but would instead pass on those costs to all consumers, therefore negating the losses due to miscalculated pure risk.

There is much historical precedent for the government adjusting the computation of risk for Americans: the FCRA's time limits on reporting certain information and the complete barring

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credit rating is somewhat radical, but not outlandish. I also do not propose it be an automatic "mechanical plus factor," but rather to be included with factors much like the University of Texas uses, including family socioeconomic background, credit scores in the borrower's neighborhood, payday loan payment history, employment history, family history of credit use, and so on.

149. *Fisher*, 136 S. Ct., at 2214.

150. *See* Hynes, *supra* note 98, at 342–43. Hynes describes the social value of risk-shifting legislation, saying there is an "offsetting benefit" when higher-risk borrowers are miscategorized as lower risk. *Id.* at 341.

of reporting other types are two examples.[151] Another example is the Affordable Care Act, which completely eliminates the concept of pre-existing conditions as a factor to be considered when issuing insurance.[152] The FCRA and ACA are two examples of legislation designed to artificially reduce the perceived risk or eliminate it from the equation in order to advance a compelling governmental and social interest.

Opponents of Affirmative Action have "three basic grounds" upon which they argue Affirmative Action's unconstitutionality.[153] The three grounds are: (1) harm to society; (2) injury to "racial minorities to whom preferences are extended; and (3) []injury to whites or others excluded from its benefits."[154] The third concern is simply absent here, as unlike traditional venues for Affirmative Action policies—employment and education—there is no limit to the number of credit scores in a certain range or to the number of available loans. The risk of "giving away" a white American's "spot" is absent.[155] The first two grounds are like each other. By giving benefits to a certain group, society may "promote notions of racial inferiority and lead to a politics of racial hostility."[156] This is an important consideration and undoubtedly the same opponents of race-based college admissions would argue that a modified race-oriented credit rating system would "promote notions of racial inferiority and lead to politics of racial hostility."[157] This argument discounts two significant points by failing to balance benefits with harms. First and perhaps most difficult to quantify: to what extent do current "notions of racial inferiority" and "racial hostility" stem from the pervasive and consistent economic misfortune and harm perpetrated upon black and Hispanic Americans under the current credit rating system? Secondly, how would the benefits—economic, social, cultural—of increasing credit availability and reducing costs compare to the stigmatization and "politics of racial hostility"? These are difficult questions, but the empirical evidence presented above suggests strongly that the current path of credit-rating-fueled discrimination leads only to the destruction and

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151. *See supra* Section III.C.

152. 8 C.F.R. 147.108(a) (2016).

153. Jed Rubenfeld, *Affirmative Action*, 107 YALE L.J. 427, 445–46 (1997). I am not going to go through a full analysis of the constitutionality of my proposal but will discuss and address the three basic grounds from which opponents often attack.

154. *Id.*

155. *See* Bergman, *supra* note 129, at 125–26 (explaining why the notion of unfairness described by Affirmative Action opponents should be instead considered from the perspective of continued systemic foreclosure of access to certain groups).

156. Rubenfeld, *supra* note 153, at 446 (quoting City of Richmond v. J.A. Croson Co., 488 U.S. 469, 493 (1989) (plurality opinion)).

157. *Id.*

subjugation of a large percentage of our fellow Americans.

V. CONCLUSION

Credit scoring and rating are complicated and data-intensive processes. Credit ratings are used when deciding when and how to extend credit for mortgages, auto loans, and credit cards. Ratings are also used in making employment and housing rental decisions. Credit scores are empirically discriminatory as evidenced by the data. Without correcting this discriminatory effect, black and Hispanic Americans will continue to be injured by the low credit cycle, paying billions in excessive fees and interest due to an inherently discriminatory credit rating system. Because low credit scores mean decreased access to favorable loans and reasonable terms, millions of Americans are stuck paying too much for the credit products necessary in our modern world. The government and private organizations have attempted to address the effects of the race-credit divide. To date, no corrective actions have produced meaningful results.

Credit reporting agencies should be required to include race as a factor in credit scores to break the low credit cycle. Because of the demonstrated disproportionate negative impact on black and Hispanic Americans, it makes sense that race be used to target and eliminate disparate impacts.[158] There are many problems with such a proposal, including how to account for irresponsible borrowing behavior, how to treat people who continue to default but still need loans, and so on. However, there needs to be a discussion of the race-credit divide and the proposed solution in this Comment is hopefully provocative enough to start that conversation.

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158. Data indicates that using race as a factor when the target is specific diversity and representation of particular races is the most efficient model. *See* Sander & Danielson, *supra* note 147, at 999–1000. Furthermore, data indicates that race-neutral factors do not work as advertised if the true goal is racial diversity. *Id.* at 1000. Data also indicates that proxies like socioeconomic status do not work in lieu of race if the objective is racial diversity. *Id.*