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Making Justice Real: Fixing Credit Scoring

HOW TO MAKE CONSUMER CREDIT REPORTING FAIRER, BETTER, AND MORE SUSTAINABLE FOR ALL OF US

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When I was growing up, my grandmother used the “envelope” method to brilliantly manage all household expenses without ever incurring a dollar of debt. She had one envelope for housing, and others for food, utilities, household needs, insurance and so forth. Each month, she placed the appropriate amount in each envelope, and there it stayed, until time to make payment. Meanwhile, my grandfather traded months of carpentry work for the down payment on a ramshackle house; one of several owned by the man he often did such work for. The man got the better deal. But my grandfather, on evenings and weekends, gradually turned this decrepit place into a home.

My grandparents weren’t unusual. Working-class people of their era did this regularly. It’s essentially how one had to live; especially as Negros in a place like 1930s, Birmingham. Credit cards weren’t coming in the mail. They couldn’t walk into a bank and get a mortgage. The closest thing to installment payments they had was lay-a-way. They even knew of families who had had all their funds seized by the bank; based solely on the groundless claim that they owed money to a white person. This was in addition to what the Great Depression took. So, banks were, quite naturally, suspect. But despite this, not one thing ever went unpaid.

I find it interesting that after nearly a century of legislation, that the lived experience of minorities and their relationship with America’s financial institutions has hardly changed. My grandparents, who were extraordinary financial managers and never had a single late payment, would be treated no more kindly by banks today than they were then. The question I find myself asking is, how, after so much effort and activism, is that even possible? In many ways, we have the evolution of the credit score market to thank for that.

Founded in 1956 by Bill Fair, an engineer and Earl Isaac, a mathematician, Fair Isaac, conceived as a data systems company, has been publicly traded since 1986; essentially, since its application of credit reporting to people, instead of corporations. Fair Isaac built an industry out of selectively collecting private, unverified information on individuals without their consent, and selling it to credit reporting companies. Long before any of us knew what data mining was, this burgeoning industry was mastering it. And monetizing it. They’d created a financial instrument out of thin air, then embedded it so deeply in the economy that we, at least the non-wealthy among us, can’t make a move without it. Those companies, though they call themselves “agencies”, are no such thing, nor are they, in any way, affiliated with the government. The four, Experian (formerly TRW Information Systems & Services and the CCN Group), Equifax, TransUnion, and latecomer, Innovis (which was purchased from First Data Corporation in 1999 by CBC Companies), are all for-profit businesses; three of which, like Fair Isaac, are publicly traded.

Virtually overnight, this business idea would balloon into a massive industry: In 2017 alone, the four largest companies had revenues of over $10 billion. Experian made $4.66 billion, with 10% or roughly $457 million coming from what it calls “marketing services;– selling, again, without their permission, collected consumer data to companies looking to target their products to specific demographics. Though competitors, these companies are members of a trade organization called the Consumer Data Industry Association (CDIA), which lobbies on their behalf in Washington, DC. As a result, FICO scores, and the range of for-profit entities that make money off them have, in many ways, become the gravitational center around which the entire

consumer segment of the American economy revolves. If derivatives, which we'll get to later, are the tail wagging the dog, then credit profiteering is the dog walking the owner.

Take the process of applying for a home loan. First, one has to provide extensive documentation, such as bank statements or tax records; data that the prospective lender can turn around and sell. Next, the hopeful borrower submits to a financial strip search, i.e., credit report; one that includes personal data that's already been sold or submitted by other companies. But what's worse is that the borrower is charged for it. Add to this, the borrower, if they request a copy of the report that led to the lender's decision, is issued an "educational" version; one that contains only a subset of the information the lender has about this person. This information, which the borrower can't see, let alone contest, can greatly affect one's credit profile. The lender can use this report to do anything from engaging in redlining (rejecting the applicant outright), to offering them subprime mortgages and unfavorable terms. Further, that lender has the power to sell or share information of their denial with secondary market lenders, marketers, etc.; perpetuating the cycle.

The problem with credit scores is that it is an instrument that preys on the poor. A person of inherited wealth doesn't need a mortgage to participate in the American dream of homeownership. They buy their multi-million-dollar flats with a Central Park view the way the rest of America buys takeout. But for those who can't buy a home this way, the only real path forward is a home loan. And the only way to do that is by establishing credit. And the only way to do that is by incurring debt. That leads to the next problem. About half of our full-time workforce earns less than $15/hr. That's $600/wk, or $2,500/mo, gross and $2,300/net. If they're a family of three (a parent and two children), that's what they have to live on. Yet, rent alone for a one-bedroom (where the parent sleeps in the living room and the kids share the bedroom), in say, Seattle, is $2,335; more than their entire take-home pay. This is impossible math; no matter how good they are with their money.

And poor people are, despite our suggestions otherwise, extraordinarily financially responsible and expert money managers; tracking their spending far more attentively than the rest of us. I remember visiting my late sister, Josie, in Atlanta, and taking her to the grocery store. On the spot, she mentally calculated the entire bill down to the penny; tax included; determined to not spend more than $30. And this was of my money; not hers. This extraordinary feat amazed me, but for her, this was what going to the store meant. I, on the other hand, am embarrassed to admit how carelessly I punch in my PIN code at the checkout stand with little awareness of how much I've actually spent. Yet, society considers people like me financially responsible.

My sister had renal failure, which she survived for over a decade. She was 49 when she died. Throughout that time, she worked as a trucking dispatcher; work she could do from home. But we, as a society, have not made survival easy for people in her position. We've created a system that pays almost half the workforce wages that they can't possibly live on, then we use credit reports to punish them for it. In this game, like John Henry vs the steam engine, they may win in the short term, but it will cost them their life. They will eventually be late on a payment; there's simply not enough money for them not to be. This triggers both late fees, and predictably, a lower credit score; which then disqualifies them from housing (both purchasing and renting), employment, and other needed services; essentially, trapping them in this life forever.

All of these problems stem, in one form or another, from the overuse and misuse of an instrument that was never designed to be used as we're using it today. Nor does it have anywhere near appropriate checks and balances, accountability or safeguards against discrimination, defamation and exploitation. But instead of stepping back, we're going further, wanting to include even more information in credit reports; building even more extensive data files on those who can't financially opt out, and tracking even more elements of their lives. Credit scores prey on the poor and exacerbate poverty. And though they're dressed up to look like a public service, serving the public is not why they exist. Below are seven limitations of the industry and ways we can make it better:

1. Credit reports have a validity issue. The reason the poor have lower scores is not because they are less honest, trustworthy or good with their money. The issue is one of economic sufficiency – i.e. – no rational person would blame someone working for subsistence wages for, when forced to choose, prioritizing putting food on the table over paying down medical debt. Instead, we can make exclusions for all essentially necessary debt, including hospital bills, student loans and mortgages for modest, owner-occupied homes. We can also limit penalties that can be applied and interest that can be accrued and institute income-based repayment terms.

For all other forms of debt, we can limit the time that negative items can remain on one's credit report to three years, as Alaska, Delaware, Maryland, Mississippi, New Hampshire, North Carolina, South Carolina have done, and make the start-clock clear and consistent; for instance, starting from the date of last payment by the customer, rather than date of "last communication" by the company.

2. Credit scores penalize people who have exercised extraordinary financial discipline by paying for everything they have without incurring any debt. No one should have to "build credit" to qualify for a home loan. People like my grandparents should have perfect credit, rather than "no credit". We can also process essential debt (medical care, student loans, mortgages for modest, owner-occupied homes, and basic auto loans) by different rules that make it accessible to the people who need it most. This includes making them credit score non-contingent, reducing payments to levels anyone working full-time can afford, and pegging interest to the rate of inflation.

3. Credit scoring is inherently discriminatory. The businesses that submit credit information treat their poor and "preferred" customers differently; even when the latter violates the same terms. For them, courtesy phone calls are made, fees are waived, rules are bent, and often, apologies issued. Imagine the company brave enough to ding Jeff Bezos' or Oprah's credit. But that's not the "unpreferred" customer's experience.

For them, exorbitant fees are levied instantly, and those not immediately paid have a domino effect, compounded by high interest rates, putting the original infraction – the same lapse that, when committed by people who can well afford to pay, was forgiven – quickly growing beyond what any lower wage worker could ever hope to pay. Based almost solely on the added on fees and interest, these customers are subjected to everything from denials of service to suspended drivers licenses, from harassment from collection agencies, to, of course, badly damaged credit reports. Two ways of

addressing this would be capping penalties that can be added via interest and fees, and outlawing the reporting of such added-on fees to credit reporting companies.

4. Credit scores are inappropriately utilized far beyond their scope. A vast range of entities use this instrument to make decisions that are not at all credit-related. They're lending the person nothing. There is no credit involved. In fact, it would be more appropriate for public libraries to run credit reports on book-borrowers than most of the situations in which they're used today. Imagine, for instance, that the grocery store or gas station required an examination of one's credit score in order to purchase their products.

Makes no sense, right? But that's essentially what we do with any number of transactions that are simple exchanges of goods for money, including cell phone service, apartment leases and gym memberships, all of which have the audacity to do the exact opposite of the way credit works; locking people into payments for services yet to be received. Credit reports shouldn't be involved in any transaction that does not actually involve credit.

One simple step we can take is making it illegal to pull someone's credit report for any non-credit transaction including employment, rental housing, utilities (which, as COVID revealed, must include internet and cell phones) and core banking services. New York State is considering a bill that is already law in New York City, one that bans credit checks for employment decisions. This kind of legislation needs to be vastly expanded to cover all non-credit-based transactions.

5. No one is held accountable for wrong data. Negative report data is sold and submitted by various companies with no penalties for inaccuracies or damage caused; a process that creates no incentive to make corrections. Companies can sell or circulate this information without customers having any recourse, any say, or even knowledge. They can do this even for transactions in which there is no credit involved, including fees they unilaterally levy. Instead, companies that traffic in consumer credit data should be held financially accountable for inaccurate, damaging information, as well as required to pay the affected customer a per-day fee for all false information not corrected or expired negative items not removed.

6. There are significant data rights issues. While information on a person's credit report can be added by anyone who desires to do so, the affected person has no power to contest items, remove them or even see their full information. Nor can they opt out of the data-collection process.

We can correct this, first, by giving individuals complete power and ownership over their data, including full access. They should be able to determine which credit reporting company can issue a report on them, or, if they choose, to opt out of credit report data-gathering altogether. Data rights reforms will incentivize credit reporting companies to treat people as valued customers and compete for the opportunity to serve them. Second, credit reporting companies must compensate individuals, in the form of either cash or equity, for use of their data. Third, we must make immediate and full disclosure of all data breaches mandatory, as well as commensurate payouts to the affected class to offset potential damages.

7. The widespread use of credit reports as a proxy protocol can be all but eliminated by doing two things; first, shifting the financial burden. The agencies requiring these reports, not the applicant, should be paying. Doing so would eliminate the practice of, say, apartment rental agents who accept payments for credit reports from applicants and never run them, or who claim that they ran the reports and rejected the applicant because of some discrepancy or other; as was the case in the 2011 study conducted by the City of Seattle's Office for Civil Rights. The study found that African American housing applicants with otherwise identical profiles were, in almost 70% of the cases, racially penalized; being quoted higher rates and required to pay for credit reports.

Second, make disclosures reciprocal. Nothing about our history gives us reason to believe that lending entities are any more ethical and trustworthy than people on the other side of the transaction, and that's exactly what it is – a transaction. The person buying the home or car is at risk too; of everything from companies who misrepresent their product to discrimination, to renting properties that are in financial distress.

The core challenge with personal credit scoring as it currently stands is this: The industry's business model is inextricably tied to the financial suffering of the average American; the worse their credit profile becomes, the more money the industry makes; a textbook definition of perverse incentives. Money is made off of the very people who have the least of it, and who are victims of an economic trap that their own society laid for them.

Take, for example, my own experience. I just renewed my auto insurance. When I asked my agent why the price had gone up, he told me that the governor had disallowed the use of credit scoring in insurance price-setting, and as such, the discount I'd gotten for having good credit was cancelled and that rates for people with poor credit had gone down. He wasn't sure how to respond when I said, "Great!" The only reason I have good credit is because I have more money, and if I have more money, I'm not the one who needs the discount.

Conceptually, there's a legitimate place for credit scoring and for information-sharing that leads to better decisions for all involved. But practically, what we have is a system that allows for-profit companies to selectively and inconsistently solicit data from other for-profit companies, then, with no accountability, package it into reports that they require individuals to pay for, but that give those individuals no say over what's recorded, nor full visibility into what's reported (making the instrument the perfect cover for discrimination), and no share of the profits.

We can do credit reporting better, but only if we're clearer and more honest about what we need from instruments like this and reform them accordingly. By doing so, we not only bolster the sector and strengthen the economy; we better the lives of the average American; the very people on which our economic vitality depends.

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