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The Role of Credit and Special Purpose Credit Programs in Building Wealth

Access to safe and sustainable credit is imperative to participate in today's mainstream financial economy. This rings particularly true when we consider credit's expanding role in everyday life. Nowadays, credit runs are done by prospective employers, landlords, and even health insurance companies—all using credit histories and scores as a yardstick to measure the level of risk and "creditworthiness." A credit score can determine access to employment, homeownership, small business loans, and even eligibility to federally subsidized housing. As a result, access to credit—or lack thereof—can be an important driver of wealth-building.

For instance, access to a small business loan can increase Latinos' incomes. Self-employed Latinos generate a median household wealth of $174,920, five times greater than that of the remaining Latino population.[*]

And homeownership remains a direct track to wealth-building. Before the Great Recession of 2008, Latino mortgage holders had 42% of their wealth tied up in home equity.[†] Today, increasing housing values for homeowners is a main contributor to homeowners' wealth.[‡]

Building Credit in the United States is not an Equitable Endeavor

The 1974 Equal Credit Opportunity Act (ECOA) provided protection from gender-based discrimination in lending, and later, expanded it to other protected classes, including race, national origin, creed, religion, and age. It provided a reprieve to the more informal credit system in place decades ago, in which a network of primarily white and male loan officers at banks had relied on their experiences and subjective assessments of an applicant's credit risk, which could include an applicant's race or ethnic background.[§]

Today's credit system is an improvement on this highly subjective lending system. Still, the work is far from done. Latinos continue to face longstanding challenges in connecting to the mainstream financial system and obtaining credit.

Indeed, today's credit system reflects and perpetuates structural, racial, and economic disparities. Latinos often have fewer financial assets and support systems to cushion the blow of economic hardships, such as loss of employment, medical emergencies, or a general economic recession.[**] In turn, missed rental payments, mounting

[*] https://nahrep.org/downloads/2021-state-of-hispanic-homeownership-report.pdf

[†] https://www.stlouisfed.org/on-the-economy/2017/july/homeownership-racial-wealth-divide

[‡] https://www.federalreserve.gov/publications/files/scf20.pdf

[§] https://www.federalreserve.gov/boarddocs/rptcongress/creditscore/creditscore.pdf

[**] https://www.epi.org/blog/racial-disparities-in-income-and-poverty-remain-largely-unchanged-amid-strong-income-growth-in-2019/

medical debt, or foreclosure can negatively and drastically impact a person's credit score and debilitate future access to credit.

What's more, innovative federal investments that underpinned the growing middle class were less accessible to people of color and limited their ability to build a traditional credit history.[*] This includes products like the 30-year mortgage, revolving credit, and Federal Deposit Insurance Corporation-backed bank accounts. In the 1970s, banks moved out of low-income neighborhoods to cut costs, following White families who were moving to the suburbs and away from racially mixed neighborhoods, an exodus now referred to as "white flight."[†]

Fifty years later, Latinos must continue to contend with inequitable access to the mainstream financial system, to building credit, and creating wealth:

- Latinos are more likely to live in neighborhoods with fewer bank and credit union branches.[‡]
- 30% of Latino adults are unbanked or underbanked, compared to 12% of White adults.[§] Unbanked adults are those who do not have a bank account and underbanked adults are those with a bank account who use alternative financial services because banking services are insufficient to meet their needs. These alternative services include money orders, check cashing services, payday loans, pawn shop loans, and auto title loans. Many of which do not report positive, on-time payments to credit bureaus.
- Latino adults are almost twice as likely to be denied on credit applications than White adults (36% for Latinos and 19% for Whites).[**]
- Latinos are twice as likely to be credit invisible than Whites.[††] A person is "credit invisible" when they do not have a record of credit with one of the three largest credit rating agencies in the country: Experian, Equifax, or TransUnion. For almost the 20% of Americans who are credit invisible, it's more difficult to buy a home, more expensive to turn on utilities, and harder to get a job.
- Latinos have an average credit score of 701—more than 30 points less than Whites' average credit score of 734.[‡‡]
- Latino mortgage applicants had a 12.5% denial rate for mortgages, compared to 9.7% for Asian and 6.9% for White applicants. [§§]
- Credit history is the second-biggest reason why Latino applicants were denied mortgages, followed by debt-to-income ratio.[***]

[*] https://www.urban.org/urban-wire/closing-homeownership-gap-will-require-rooting-systemic-racism-out-mortgage-underwriting

[†] https://www.hup.harvard.edu/catalog.php?isbn=9780674983960#:~:text=Mehrsa%20Baradaran%20examines%20how%20a,1970s%20and%20continues%20decades%20later

[‡] https://libertystreeteconomics.newyorkfed.org/2016/03/banking-deserts-branch-closings-and-soft-information/#.Vt5LhtBYG53

[§] https://www.federalreserve.gov/publications/2021-economic-well-being-of-us-households-in-2020-banking-and-credit.htm

[**] https://www.federalreserve.gov/publications/2021-economic-well-being-of-us-households-in-2020-banking-and-credit.htm

[††] https://www.unidosus.org/blog/2019/03/19/credit-scoring/

[‡‡] https://www.investopedia.com/average-credit-scores-by-race-5214521

[§§] https://files.consumerfinance.gov/f/documents/cfpb_2020-mortgage-market-activity-trends_report_2021-08.pdf

[***] https://ncrc.org/2020-hmda-preliminary-analysis/

Special Purpose Credit Programs (SPCPs): An Impactful, but Underused Tool to Address Systemic Barriers in Financial System

The 1974 ECOA and its implementing regulation, Regulation B, prohibits discrimination on a prohibited basis in credit transactions. An example of this can be when a creditor requires a minority applicant to provide greater documentation to obtain a loan than a similarly situated non-minority applicant; or, when a creditor waives or relaxes credit standards for a non-minority applicant, but not for a similarly situated non-minority applicant. When ECOA was amended to expand its coverage of protected classes to include race, national origin, and other classes, it also authorized special purpose credit programs (SPCPs) to allow creditors to extend credit to eligible applicants.

This 45-year-old provision of the ECOA is defined as “credit assistance programs” for economically or socially disadvantaged consumers and commercial enterprises. At its core, it is a vehicle to deliver on ECOA’s promise that a person should not be denied credit because of their race, gender, or other identities. This can look like a government-sponsored housing credit subsidy targeted at the aged or the poor; or programs offering credit to a limited clientele such as credit union programs and educational loan programs.

Despite the potential of SPCPs to increase access to credit for communities that have been typically shut out of the financial system, creditors have used SPCPs very sparsely and limitedly. Key concerns listed by creditors include regulatory uncertainty and how to determine that an SPCP will benefit a class of persons who, if not for an SPCP, would otherwise be denied credit or receive it on less favorable terms (such as higher fees). But a broad swath of work of legal precedent, legislation, and regulations make it clear that SPCPs are a powerful tool that aligns with anti-discrimination goals.[*]

Equitable access to credit can be a transformational economic path for Latinos. If Latino entrepreneurs were given the same leg up from the financial system as their White counterparts, Latino-owned businesses could create $2.3 trillion in annual revenue.[†] Latinos aspiring to become homeowners and who can access a sustainable mortgage loan can be a driving force of the housing market.[‡]

Leveraging SPCPs as a Wealth-Building Tool

As the youngest and fastest-growing segment of the nation’s population, Latinos’ economic opportunities will have a significant role in shaping the nation’s economic future. Increased access to credit is an important component of ensuring that Latinos can unlock the wealth-building opportunities tightly linked to credit, such as homeownership and entrepreneurship.

Implicit in ECOA’s purpose, and by extension SPCPs, is the assumption that credit should be a helpful—not debilitating—tool, that it serves as a ladder—not pit—for consumers, and that it builds—not destroys—wealth. SPCPs are an important opportunity for the financial system to deliver on its promises.

[*] https://nationalfairhousing.org/wp-content/uploads/2020/11/NFHA_Relman_SPCP_Article.pdf

[†] https://www.mckinsey.com/~/media/mckinsey/featured%20insights/sustainable%20inclusive%20growth/the%20economic%20state%20of%20latinos%20in%20america%20the%20american%20dream%20deferred/the-economic-state-of-latinos-in-america-the-american-dream-deferred-executive-summary.pdf?shouldIndex=false

[‡] https://www.cnbc.com/2021/06/26/the-future-of-home-ownership-is-latino.html