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STATEMENT OF MR. HILARY SHELTON
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on the
FAIR CREDIT REPORTING ACT AND HOW IT AFFECTS ETHNIC MINORITY AMERICANS
before the
HOUSE FINANCIAL AFFAIRS COMMITTEE
July 9, 2003

Thank you for inviting me to be here today Chairman Oxley, Ranking Member Frank, and ladies and gentlemen of the committee. My name is Hilary Shelton and I am the Director of the Washington Bureau of the National Association for the Advancement of Colored People (NAACP).

The NAACP is the oldest, largest and most widely-recognized civil rights organization in the United States, with more than 2,200 membership units across our country, I am pleased and proud to report that we have members in all 50 states, as well as representation in Europe and Asia. The Washington Bureau is the federal policy arm of the NAACP, and I have served as its Director for six years.

Credit, and the ability to obtain credit, is crucial in our nation today. Thus, I was especially pleased to be invited by the Committee to address you regarding the unique problems faced by ethnic minority Americans in obtaining and maintaining a solid credit rating.

Despite years of civil rights progress, laws, and education, racial bias and discrimination are still crucial problems in the United States today. People in our country continue to be limited by who they are and what they look like, rather than what they do or their genuine potential. It is in our nation’s financial arena that this is especially true: race, national origin and gender continue to control the type and terms of credit available to an individual.

It is hard to imagine any individual living in this country who does not want financial security. For some, this may mean a vacation home or several latemodel cars in the garage. For others, financial security simply means a home in a safe neighborhood with food on the table and a means to raise our families.

As we all know, there are three basic means of establishing financial security today: homeownership, business ownership and consistent, persistent savings and investment. Yet in order to purchase a home, or to become a successful entrepreneur or in some cases to buy a car to get to work or to put food on the table or a coat on your child's back in the winter you need to either inherit money or to have a solid credit history.

Since very few ethnic minority Americans are inheriting much wealth, they must have a solid credit record in order to survive, economically let alone prosper, in America today. I am not saying this cannot be done: indeed, hundreds of thousands of racial and ethnic minority Americans are buying homes, starting business, and making ends meet. Yet there seems to be a quiet acknowledgement and acceptance on the part of the credit report providers, the credit scorers, the lenders and the regulators that racial and ethnic minorities, on average, have significantly worse credit reports and lower credit scores than their Caucasian counterparts. This in turn means that lenders today disproportionately reject racial and ethnic minority applicants or, on the whole, racial and ethnic minority Americans end up paying more for credit[1].

In fact, while it is impossible to know for sure, it seems to be a commonly accepted assumption that the credit score of one-third of all African Americans in this country today falls below the 620 necessary to be accepted for a mortgage by most traditional lending institutions.

In the Spring 2000 edition of the Federal Reserve of Boston's newsletter, Peter McCorkell, the Executive Vice President and General Counsel of Fair, Isaac and Company was asked if credit scoring resulted in higher reject rates for certain racial and ethnic minorities than for whites.

His response was "yes". He then went on to justify this response by stating that "Unfortunately, income, property, education and employment are not equally distributed by race or national origin in the United States. Since all of these factors influence a borrower's ability to meet financial obligations, it is unreasonable to expect an objective assessment or credit risk to result in equal acceptance and rejection rates across socioeconomic or race/national origin lines."[2]

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[1] For specific examples, see "Insurance Credit Scoring in Alaska," February 2003, Alaska Department of Community and Economic Development Division of Insurance and
The Final Report of the Florida Task Force on The Use of Credit Reports in Underwriting Automobile and Homeowners' Insurance, January 2002

[2] Statement of Peter L. McCorkell, Executive Vice President & General Counsel, Fair, Isaac and Company, Inc., "*Communities and Banking*", Spring, 2000, pp.15-17, published by the Federal Reserve Bank of Boston

This assumption, that low-income and racial and ethnic minority Americans are less likely to meet their financial obligations because they do not have the income, property, education and employment history of their white counterparts flies in the face of several studies that have been conducted as well as anecdotal evidence supplied by the NAACP Financial Empowerment Initiative, which provides business, homeownership and wealth-building counseling to low-income and racial and ethnic minority individuals.

Mr. McCorkell's acceptance of this racial bias, furthermore, also fails to recognize the fact that many middle and upper income African Americans are subject to predatory lending at a rate higher than low-income white Americans regardless of the fact that they may well have the "income, property, education and employment" that Fair, Isaac is looking for. These African Americans are targeted by predatory lenders simply because of their race, and the resulting loan is a blemish on their record.

When minority Americans are blocked out of receiving loans or are charged more in interest they have less to invest and their wealth-building capacities are diminished. Thus, not only is the current system blatantly unfair to ethnic minorities, but it is self-perpetuating as well.

Mr. McCorkell's ready acceptance of the fact that credit scoring is unfair towards racial and ethnic minority Americans, and the fact that Fair, Isaac and Company, the nation's leading credit scorer, has no intention of addressing this problem, is extremely troubling to say the least. Perhaps more troubling, however, is that the people who are meant to be watching over the financial markets, the regulators and Congress, also appear ready to turn a blind eye to the fact that today, in the twenty-first century, it is still harder to have a solid credit rating or an acceptable credit score in this country if you are a racial or ethnic minority or if you come from a low-income community.

Perhaps we should look for a moment at just two of the reasons behind this phenomenon.

First, studies as well as legal actions[3] continue to demonstrate that African Americans, Hispanics and elderly women are not treated the same as similarly qualified white males when attempting to purchase products such as cars, secure mortgage loans or homeowners insurance. In fact, as I mentioned earlier, several studies[4] have shown that middle- and upper-income African Americans are more likely to be subjected to predatory lending than their low-income Caucasian counterparts.

[3] See USA v. Long Beach Bank; NFHA et. al. v. Prudential Insurance Company
[4] Center For Community Change, "Risk or Race: Racial Disparities and the Subprime Refinance Market", May 2000

Similarly, many racial and ethnic minority and low-income Americans may go to financing companies for car loans, home improvement loans or first mortgages. While traditional financial institutions may charge less and have more reasonable terms, they are oftentimes conspicuously absent from the low-income areas or from areas with high concentrations of racial or ethnic minorities. It only makes sense that individuals are going to use finance companies for their loans when they appear to be the only game in town, or at least in the area of town where you live and work.

Yet people are penalized on their credit report for using finance companies and for paying higher interest rates. This means that many racial and ethnic minority Americans may be penalized on their credit reports and by the credit scorers simply because they paid more for a previous loan than they should have. It is important to note that in many cases, these individuals are penalized even if they have paid off the loan in full, making every payment on time.

This is especially important when you consider that credit reports and credit scoring are being used increasingly for more than just mortgages: they are also being used now to determine if homeowners' or automobile insurance will be underwritten, and if so at what rate; for car loans; house or apartment rentals; utilities and in some cases even hiring decisions.

A second contributing factor to the existing bias against racial and ethnic minorities is that credit reports and credit scoring may use variables that are, on the surface, neutral, and these variables may be applied evenly to all applicants. However, closer inspection of the variable may show that its use disproportionately adversely affects African Americans or other ethnic minority Americans. One example may be education. Some reports or scoring systems could conceivably take into account an individual's education level. While higher education in America is, in theory, equally accessible to all, in practice it is still disproportionately available for white Americans.

Lastly, while I was invited here today to primarily discuss the impact of credit reporting and credit scoring on ethnic minority Americans as well as some of the reasons behind the unfairness, the NAACP would also like to make a recommendation for improving the process.

It has long been the contention of the NAACP, in several arenas, that openness, transparency and sunlight help us understand what we are up against; it also tends to inspire companies to be more sensitive to the needs of racial and ethnic minority communities.

Thus, the NAACP would love to see the process behind credit scoring more open, better regulated and better understood by the American public – the people being scored. Specifically, the NAACP joins other groups such as the Center for Community Change in recommending that Congress establish an effective federal oversight process of all statistical scoring systems. Such oversight should be conducted on a regular basis and should focus on the fairness and the validity of all systems.

As we near the celebration of the fiftieth anniversary of the landmark Supreme Court decision in Brown v. Topeka Board of Education, many of us are pausing to look at the strides that our nation has taken since that time and at how much we still have to do. One of the on-going problems that plagues us as a nation is the persistent segregation of our communities. Too many African Americans and other racial and ethnic minority-Americans are disproportionately finding it hard, if not impossible, to escape from low-income communities, especially those in our urban areas. These communities, in turn, remain underserved in terms of education, employment, police protection, access to capitol and in some cases basic civil services.

If we as a nation are going to meet our full potential we need to move beyond this, and we need to begin to more fully integrate our society. This will require ensuring that opportunities are made available to all Americans, regardless of their race, national origin, gender or age. Ensuring that they have access to credit would be a big start.

I would like to again thank the Committee for the opportunity to be here today and to discuss the impact that credit reports and credit scoring has on ethnic minority Americans. I join with the leadership, the staff, and the general membership of the NAACP in offering my assistance to develop national policy that will help all Americans, regardless of their age, gender, race or ethnic background, obtain a solid credit rating.

I also welcome your questions at this time.