The Use (and Overuse) of Credit History

Credit-based ID verification creates barriers to ACA access

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Credit reports are used for a range of purposes beyond accessing credit

Credit history is a key determinant of who can get ahead financially and who cannot. While it was originally intended to be used by lenders to assess whether or not to approve a consumer for new credit, credit history is now used for many nonlending purposes. Although credit reports can be a good source of information regarding loan repayment and borrowing history, there are few links between credit history and some of its more recent applications, such as getting a job, renting a home, or obtaining medical insurance.

Credit history verification is required for enrollment through most of the marketplaces created by the Affordable Care Act (ACA). The Federally-facilitated Marketplace (FFM) is where consumers shop for insurance plans that fit their needs. Some marketplaces are state-run, while other states use the FFM.[1] Individuals who wish to purchase insurance for themselves or for a family member through most state exchanges and the FFM[2] must undergo an identity verification process to create an online account. This verification process relies heavily on an individual's credit history.

Pulling credit reports for noncredit purposes creates hardship for millions of Americans. A growing number of Americans are paying the price for having poor or no credit history, not only through higher interest rates, but also through reduced economic opportunity. This has long-term consequences for low- and moderate-income households that are struggling to get their financial footing. Individuals and families with no, thin, or poor traditional credit histories have fewer opportunities to access affordable credit products. Moreover, denying such opportunities to individuals with no or poor credit history creates a cycle of lost chances to stabilize their families through employment, housing, and health care.

Having no credit history can lead to a loss of wealth-building opportunities

Credit history is now used frequently as a screener for a variety of nonlending purposes; this includes housing, employment, insurance rates, utility services, security clearances, and insured health services. This can lead to a significant loss of wealth-building opportunities, in conjunction with an increase of wealth-depleting events, such as higher use of alternative financial services or health related debt.

Many employers use credit history as a way to screen potential employees. The Society for Human Resource Management found 47% of employers conduct credit checks on job applicants.[3] A wide range of positions, from high-level financial positions to jobs doing maintenance

Source: Demos, 2013

work, may require a credit check. Employers may eliminate applicants with credit problems from hiring consideration, even though there is no evidence of a link between poor credit and poor job performance.[4] Demos's 2012 National Survey on Credit Card Debt in Low- and Middle-Income Households found that 1 in 10 survey respondents who were unemployed had been informed that they would not be hired for a job because of the information in their credit report.[5] Similarly, many landlords conduct a credit screening before renting to a potential tenant. However, this seems like an extraneous screening tool that does more to burden a potential tenant than give valuable and relevant information to the landlord.

Without stable employment and housing, families struggle to build emergency and long-term savings. CFED found that nearly half (44%) of households in the United States are "liquid asset poor," meaning they have less than three months' worth of savings—conservatively measured at $5,887 for a family of four, or three times the monthly income at the poverty level. Barriers to employment and housing, such as credit checks, perpetuate this vulnerability.[6]

Vulnerable populations are negatively affected by no or limited credit histories

Millions of Americans are "credit invisible." The Political and Economic Research Council (PERC) found that there are 35 to 54 million Americans currently outside the credit mainstream because they have a thin credit file or no credit file at all.[7] For these individuals, the consumer credit bureaus lack sufficient records to generate a credit score. Additionally, CFED has found that 56% of Americans have a subprime credit score, indicating that even those with sufficient credit history are frequently relegated to more expensive borrowing options or miss out on employment and housing opportunities.[8]

Having no credit or poor credit usually brings individuals to the same place: application denial. Vulnerable populations, such as low-income households, households of color, and immigrants, are more likely to have no or low credit histories, compounding their existing vulnerabilities. Oftentimes this is because they are not connected to the financial mainstream with a savings or checking account, which makes it much tougher to get a traditional credit card or bank loan.

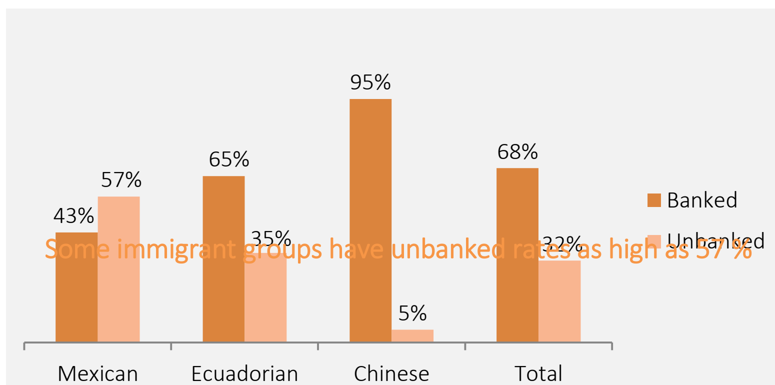
- **LOW-INCOME HOUSEHOLDS.** Low-income consumers are more likely than other consumers to be renters rather than homeowners. Although paying a mortgage on time can burnish your credit, paying rent on time usually does not.[9]
- **RACIAL AND ETHNIC MINORITIES.** Black (21.4%), Hispanic (20.1%), and American Indian (14.5%) households have some of the largest unbanked populations. This is compared to significantly smaller proportions of white and Asian households (4.0 % and 2.7 %, respectively) who are unbanked.[10]
- **RURAL HOUSEHOLDS.** More than one in five borrowers in a typical Southern county has scores that suggest they are very risky borrowers.[11]
- **YOUNGER CONSUMERS.** Nearly 1 in 6 heads of household under age 24 is unbanked, creating huge barriers to building mainstream credit.[12] These young families have less experience in the financial market and are therefore vulnerable as they attempt to build savings and make sound investments.
- **IMMIGRANTS.** Recently arrived immigrants are more likely to be unbanked and less likely to have established a credit history. The problem is worse for undocumented immigrants, who often have no access to the identity documents required to open a bank account.

Credit history impacts access to coverage through the Affordable Care Act

Credit-based ID verification blocks access to the ACA marketplaces for many eligible consumers. The Department of Health and Human Services (HHS) and many state-run marketplaces contract with a third-party credit bureau, Experian, to perform the electronic identity-proofing function. Using its database to access a person's credit history, Experian generates a series of "out-of-wallet" questions that the consumer must answer correctly in order to verify his or her identity. For example, a question might ask the consumer to identify an existing or previous credit line, mortgage, or personal loan.

If the consumer cannot answer the questions correctly, or if Experian does not have sufficient credit history information to generate questions, the consumer is not allowed to proceed with the online application process. Instead, the consumer may validate his or her identity by submitting supporting documentation, which creates significant delays in the application and enrollment process. In addition, individuals with thin or no credit files are often unable to provide one of the limited types of supporting documents required, such as a property deed, property title, or a driver's license, leaving them unable to access Marketplace coverage online. Additionally, Experian and other major credit reporting agencies have been found to have inaccurate data leading to more expensive products for consumers. The Federal Trade Commission found that 5% of consumers had material errors on one of their three major credit reports that could lead to them paying more for products such as auto loans and insurance.[13]

Credit-based ID verification creates barriers for many immigrant families



Source: NYC Office of Financial Empowerment, 2013

Many immigrant families were left without coverage because of the ID verification process. These barriers kept lawfully present[14] immigrants from exercising their statutory rights to purchase health insurance through the Marketplace and from receiving any income-based subsidies for which they were eligible. These barriers also had a disproportionate effect on mixed–immigration status families containing one or more family members who are not lawfully present. Even if they are ineligible themselves, parents are required to apply on behalf of, and purchase insurance for, their eligible children. For example, an undocumented parent, who is ineligible for all ACA and Marketplace programs, may purchase a health plan for an eligible child, but must complete the ID verification process in order to complete the Marketplace application.

Recent immigrants, including refugees, asylum applicants, and newly arrived visa-holders, are more likely to be unbanked and less likely to have established the credit history needed to complete the identity verification process. As a result of ID proofing, an untold number of eligible immigrants and their U.S.-citizen family members have been left uninsured.

Whether accessing employment, housing or health insurance, using and overusing credit history hurts many families**.** Immigrant families are at a particular disadvantage because they often struggle with having government-issued documentation to verify their identity. What is worse, HHS has indicated that it will soon require all health insurance marketplaces to adopt this credit-based ID proofing.

Overreliance on credit history is putting vulnerable families at further risk

It's tough to build wealth with no or low credit. Individuals and households caught in this situation face challenges that those with access to affordable credit don't encounter. Many people with thin or no credit files are low-risk consumers who regularly pay rent, utility, and mobile phone bills on time, but these payments are not included in their credit score. Alternative data credit reporting, which includes full payment histories for major recurring expenses, has been found to increase credit-building access for many vulnerable groups.[15]

Congress can support alternative data credit reporting by providing incentives to consumer credit bureaus. The Credit Access and Inclusion Act (H.R. 2538, sponsored by Rep. Michael Fitzpatrick [R-PA], and S. 1613, sponsored by Sen. Mark Kirk [R-IL] and Sen. Joe Manchin [D-WV]), would take steps toward this goal by supporting full reporting of rent, utility, and telecommunications (television, internet, and mobile phone) payments.[16]

As for the ACA, credit history–based ID proofing was not part of the original statute or subsequent regulations. HHS has failed to offer a clear justification for instituting this ID-proofing policy with procedures that rely exclusively on an individual's credit history. HHS can make the policy changes needed to eliminate this barrier for immigrant families and others who are "credit invisible." HHS should allow for alternative methods to verify identity, expand the types of documents accepted for identity verification, and allow the 16 states that have established their own marketplaces to have flexibility over their ID verification processes. HHS should also allow individuals to complete an application and enroll in coverage while HHS verifies applicants' alternate proof of identity.

Using credit history to approve services or opportunities beyond lending creates disadvantages for millions of Americans trying to get ahead. Employment, affordable housing, and insurance play a big role in whether low- or moderate-income families are able to climb up the economic ladder. Public policy should protect families against being locked out of these opportunities simply because they lack credit history.

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[1] Currently, 27 states use the Federally-facilitated Marketplace, 16 states and DC have established their own State-based Marketplaces, and 7 states use federal-state Partnership Marketplaces.

[2] Some State-based Marketplaces also use the FFM's process for ID proofing (e.g., Illinois' marketplace).

[3] *SHRM Survey Findings: Background Checking – The Use of Credit Background Checks in Hiring Decisions*, Society of Human Resources Management, July 19, 2012.

[4] Ruetschlin, Catherine & Asante-Muhammad, Dedrick, *The Challenge of Credit Card Debt for the African American Middle Class*, Demos & NAACP, December 2013.

[5] Traub, Amy, *Discredited: How Employment Credit Checks Keep Qualified Workers Out of a Job*, Demos, March 2013.

[6] Brooks, Jennifer, Wiedrich, Kasey, Sims Jr., Lebaron, & Medina, Jennifer, *Treading Water in the Deep End*, CFED, January 2014.

[7] Turner, Michael A., Walker, Patrick, Varghese, Robin, & Chaudhuri, Sukanya, *The Credit Impacts of Low-Income Americans from Reporting Moderately Late Utility Payments*, PERC, August 2012.

[8] Brooks, Jennifer, et al., *Treading Water in the Deep End*, CFED, January 2014.

[9] Kim, Anne, *What's Your Number? Credit Scores and Financial Security,* CFED, January 2013.

[10] Burhouse, Susan & Osaki, Yazmin, *2011 FDIC National Survey of Unbanked and Underbanked Households,* FDIC, September 2012.

[11] Fellowes, Matt, *Credit Scores, Reports, and Getting Ahead in America*, The Brookings Institution, May 2006.

[12] Burhouse, Susan, et al., *2011 FDIC National Survey of Unbanked and Underbanked Households,* FDIC, September 2012.

[13] *In FTC Study, Five Percent of Consumers Had Errors on their Credit Reports that Could Result in Less Favorable Terms for Loans*, FTC Press Release, February 11, 2013; Turner, Michael A., Varghese, Robin, Walker, Patrick, & Chaudhuri, Sukanya, *Comparing FTC and PERC Studies on Measuring the Accuracy of U.S. Consumer Credit Reports*, PERC, April 2013.

[14] As defined under 45 CFR 152.2.

[15] Political and Economic Research Council & Brookings Institution, *Give Credit Where Credit is Due*, 2006.

[16] Lucas Mckay, Katherine & Atkinson, Alicia, *Alternative Data Helps Families Build Credit and Wealth*, CFED, April 2014.