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Fed issues warning on credit scoring system post-pandemic

Article

The Federal Reserve Bank of New York said credit scoring systems—which issuers use to determine consumer creditworthiness—may have become less reliable during the pandemic as a result of COVID-19 relief programs, per Bloomberg. The Fed's analysis found that homeowners who participated in a mortgage relief program saw their credit scores rise an average of 14 points during the pandemic—a much larger jump compared with borrowers who didn't take forbearance on their loans and only saw a 7-point increase on average. Regarding forbearance takers, Fed researchers said that "although they were not making payments, their credit reports are treated as if they're making continued payments for credit-scoring purposes and account histories." This comes as issuers look to capture more customers for credit cards as acquisition interest grows.

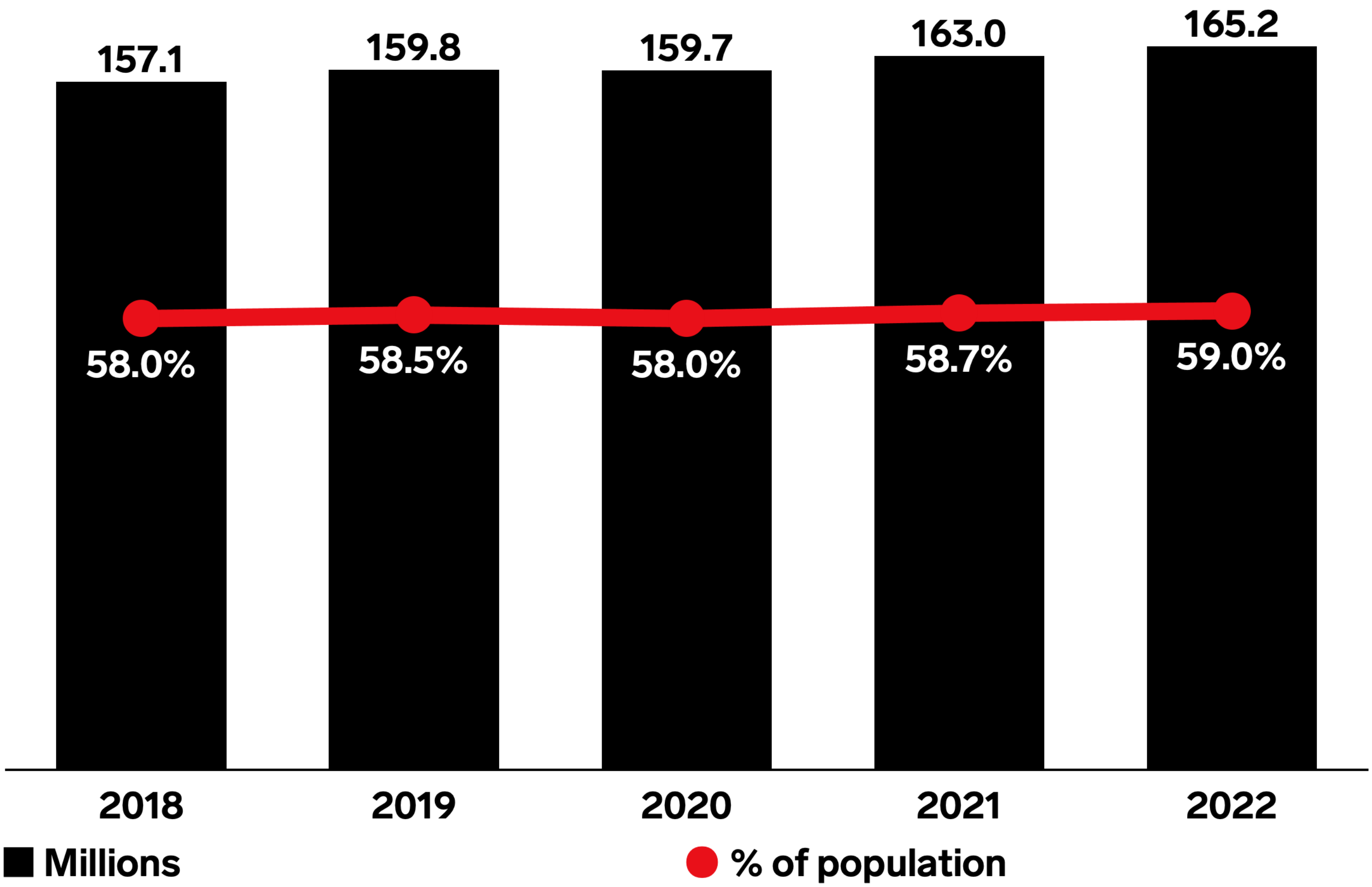
Credit scores are the main metric issuers use to make decisions about offering credit—but opposition has been mounting:

- **Opponents argue that credit scores can be inaccurate.** During a 2019 hearing to discuss Equifax's 2017 data breach, members of Congress from both parties spoke out against the credit scoring system, calling it "broken." Representatives said credit reports often contain errors, which can negatively affect access to credit: A study from the Federal Trade Commission found that 1 in 5 consumers had an error on their credit report.
- **Others say the system limits credit access to certain groups.** Recent immigrants, young consumers, and people recovering from financial hardship are some of the groups that make up the 53 million US adults without access to traditional credit scores, according to FICO. Without access, it's harder for these consumers to get approved for credit cards. Racial and economic inequities also exist, with Black and Hispanic consumers and those living in low-income neighborhoods having higher credit invisibility rates, per the Consumer Financial Protection Bureau.

Alternative financial health measures could gain steam if credit scoring loses ground. JPMorgan and Wells Fargo are reportedly among a growing list of issuers planning to share customers' account deposit data to determine consumer creditworthiness as part of a government-backed initiative. And fintechs like Petal, Varo Believe, and TomoCredit are becoming increasingly popular as they give consumers more ways to build credit. As the movement against using credit scores as a financial health measurement builds, these sorts of initiatives and companies can gain more traction by providing a more accurate and well-rounded depiction of a consumer's financial situation while extending credit access more equitably. This can help issuers cast a wider net for potential customers to help further their pandemic recovery.

In-Store Credit Card Users

US, 2018–2022



Note: ages 14+; consumers who make an in-store purchase at least once per month using a credit card; includes purchases at retail stores and food services and drinking places; excludes proximity mobile payment transactions
Source: Insider Intelligence, December 2020
Methodology: Estimates are based on the analysis of data from the US Department of Commerce and the Federal Reserve, estimates from other research firms, reported company revenues, historical trends, consumer buying trends, and macro-level economic conditions.

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