Credit Building in the Digital Age

Opportunities and Risks From Fintech Innovations

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FINANCIAL HEALTH NETWORK

Introduction

For most people in America, credit plays an important role in their financial lives, enabling them to weather occasional financial downturns and also to pursue long-term opportunities, such as home ownership or post-secondary education. For these reasons, the ability to access credit when needed is an integral part of what it means to be Financially Healthy.

Although there is growing interest in "cash flow underwriting" – which relies on transactional data from a consumer's checking or prepaid account to assess the consumer's ability to take on and repay a loan and on newly-developed cash flow credit scores – the reality is that most lenders today still largely rely on credit scores generated from data contained in consumer reports in determining to whom to extend credit and on what terms.[1, 2] As a result, consumers' ability to access affordable credit is still largely dependent on a credit score such as a FICO® score or VantageScore®.

Research by the Consumer Financial Protection Bureau (CFPB) indicates that as of 2010, 20% of consumers were either credit invisible, meaning they had no credit history, or unscorable, meaning that their credit history was too thin or too stale to generate a reliable credit score.[3] For many, this is a temporary condition; some people are able to obtain a credit score either with the help of parents – who guarantee a loan for their adult children or provide them with authorized user access to the parents' credit card account – or through the use of credit products geared toward students or recent graduates.[4] But the CFPB's research also shows that these paths to credit building are by no means universally available and that there is a sizable segment of people for whom credit invisibility is a persistent state.[5]

In addition to those who lack a credit score, recent research shows that another 20% of the population has a subprime credit score.[6] Again, for some – specifically those who are new to credit – this is a temporary state and their credit scores will naturally improve as they build credit history.[7] But for a large share of subprime consumers, their scores reflect negative credit experiences, which can be difficult to overcome since that negative history can remain in their credit reports for seven years.

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[1] For example, the Comptroller of the Currency has convened a Roundtable For Economic Access and Change (Project REAcH) which has established an alternative credit assessment workstream. This interest in cash flow underwriting reflects research demonstrating the approach's value, most notably by FinReg Lab.

[2] Petal, a pioneer in cash flow underwriting, created Prism Data in 2021, which now offers CashScore™.

[3] Kenneth Brevoort, Philipp Grimm, & Michelle Kambara, "Data Point: Credit Invisibles," CFPB Office of Research, May 2015.

[4] Kenneth Brevoort and Michelle Kambara, "Data Point: Becoming Credit Visible," CFPB Office of Research, June 2017.

[5] Kenneth Brevoort, Philipp Grimm, & Michelle Kambara, "Data Point: Credit Invisibles," CFPB Office of Research, May 2015.

[6] "The Consumer Credit Card Market," Bureau of Consumer Financial Protection, September 2021.

[7] The CFPB has found that roughly two-thirds of consumers experience at least a 100 point swing in their credit score over a period of years and of those roughly one-third see a 100 point increase with the group increasing the large increase being slightly younger than the group experiencing a 100 point decrease. Learn more here.

For tens of millions of people in the United States, their credit scores, or lack thereof, prevent them from accessing affordable, high-quality credit when they need it. In a survey of consumers who are credit visible, at least 30% reported that in 2021 they were either turned down for credit or were discouraged from applying because they believed they would be turned down.[8] Moreover, the percentage of consumers turned down or discouraged from applying was even higher for Black and Latinx consumers, reflecting the fact that such individuals are disproportionately represented among those with subprime credit scores.[9, 10] In fact, only 20% of Black individuals and 29% of Latinx individuals have a prime credit score as compared to 51% of White individuals.[11] (Black and Latinx individuals also are disproportionately represented among the credit invisible; thus, the survey of the credit visible likely understates the extent to which Black and Latinx individuals are underserved because of the emphasis lenders place on credit scores.[12])

For these reasons, there have been efforts to develop products designed to enable consumers to build credit since virtually the advent of credit scoring. (We use the term "credit building" in this report as a shorthand to encompass either establishing or repairing credit history.) Until recently, those products took two forms: secured credit cards and credit builder installment loans.

With secured credit cards, the consumer obtains a credit card with a line of credit equal to and secured by a deposit that the consumer makes into a locked savings account, whereas credit builder installment loans offer consumers a fixed sum repayable over a fixed term, but the loan amount is placed in a locked savings account that is unlocked on a pay-as-you-go basis or held until the end of the term. Some credit builder loans – most notably Twin Accounts, offered through the Local Initiatives Support Corporation Financial Opportunity Centers – include a feature that matches loan repayments on a dollar-for-dollar basis to enable consumers to enhance the savings-building potential of the credit builder loan.[13]

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[8] Scott Fulford, Samyak Jain, Greta Li, Elizabeth Saunders, & Eric Wilson, "Making Ends Meet in 2022," Consumer Financial Protection Bureau, December 2022. This survey was limited to those who are credit visible and thus likely understates the share of consumers turned down or discouraged from applying for credit.
[9] Ibid.
[10] Oliver Wyman, "Driving growth with greater credit access," Experian.
[11] Ibid.
[12] Kenneth Brevoort, Philipp Grimm, & Michelle Kambara, "Data Point: Credit Invisibles," CFPB Office of Research, May 2015.
[13] Learn more about Local Initiatives Support Corporation Financial Opportunity Centers credit-building initiatives here.

The digital revolution and the growth of the fintech market has affected this landscape in two fundamental ways:

1

Use of Alternative Data: Some fintechs and even one of the national consumer reporting agencies (NCRAs) have pioneered incorporating what is often referred to as "alternative data" – including payment history with respect to rent, utilities, or telecom bills – into the credit reporting system. This has enabled modelers to analyze the power of such data in predicting credit performance and to develop credit scoring algorithms that consider payment history on different types of obligations.

We discuss this in Part One of this brief, offering a set of recommendations designed to build on the successes that have been achieved.

2

Increased Options for Building Credit: A number of fintechs are experimenting with how to expand access to credit builder products. Some of these fintechs have partnered with banks to offer credit builder installment loans – previously available on only a limited basis to narrowly defined populations, such as members of particular credit unions or community organizations – on a nationwide or near-nationwide basis. Other fintechs have developed different types of credit building payment products that build on the secured credit card, line-of-credit model but are designed for consumers who cannot (or prefer not to) fund a security deposit. These developments have not yet received the attention they warrant.

In Part Two of this brief, we seek to summarize the evolving landscape of credit builder products. We find, not surprisingly, that these emerging products offer opportunities for, but also pose risks to, consumers' financial health. We further find that, while the research to date suggests that these products are more likely to benefit those who are new to credit than those with damaged credit, the data with respect to the outcomes for consumers using these products is quite limited and the unanswered questions correspondingly large.

Accordingly, we offer a set of recommendations designed to ensure that consumers receive the information they need to make informed choices as to whether to utilize a credit builder product and that providers of these products take steps to mitigate the risks by evaluating consumers' repayment ability before offering even a fully secured loan or line of credit.

Part One

Using Alternative Data To Build Credit Within the Credit Reporting System

As noted at the outset, innovation from fintechs has spurred an increasing interest among many financial institutions to assess creditworthiness using data outside of the credit reporting system, most importantly transactional data with respect to transactional accounts. At the same time, there is also a growing movement to expand the types of data contained in consumer reports and used to generate credit scores. We discuss here these latter developments.

Traditionally, most of the data maintained by the NCRAs has come from lenders and loan servicers and thus pertains to consumers' borrowing history. With quite limited exceptions, the NCRAs have not maintained data with respect to payment history on other recurring, monthly obligations largely because the firms that maintain such data – telecommunication providers, utilities, and property owners and managers – have been unwilling or unable to furnish those data to the NCRAs for a variety of reasons. (Many telecoms and some utilities do furnish data to a specialty credit bureau managed by Equifax, and some property owners furnish data to a specialty credit bureau managed by Experian, but those data are segregated from the data Equifax and Experian make available to lenders.[14, 15])

However, in principle, evidence that a consumer has consistently made rent payments would seemingly be as indicative of the consumer's creditworthiness as a history of consistently making mortgage payments. Similarly, there is good reason to believe that a consumer's history of paying their monthly telecom or utility bills when due would be as relevant as a consumer's history in making, for example, minimum credit card payments, although there is some complexity with respect to utility payment history.[16] Yet, as the consumer reporting system has generally functioned, history of on-time payments of rent, utility, or telecom bills has rarely found its way into the main credit files maintained by the NCRAs.

In contrast, many debt collectors do report to the NCRAs with respect to delinquent or charged-off accounts referred to them or purchased by them, including not only past-due loans but also past-due payments on these other types of accounts, as well as past-due medical bills. (As of April 2023, the NCRAs will no longer include past-due medical bills of under $500 in their credit files, thus limiting the potential for unpaid medical bills to damage consumers' credit scores.)

[14] Learn more about National Consumer Telecom & Utilities Exchange credit reporting here.
[15] Learn more about Experian's solutions for renters here.
[16] This is due, in part, to the volatility of utility bills and is a function of the varying forms of government assistance available in different states for utility bill payments and the eligibility criteria. Learn more here.

This means that, until recently, only negative payment history (i.e., non-payment) for recurring non-credit obligations entered into consumers' reports and was regularly used for credit scoring, driving scores down. For example, between 2013 and 2018, over 20% of consumer reports – and almost 60% of reports for consumers with a subprime score – contained at least one telecom-related item, and 95% of those items were reported by debt collectors or debt buyers.[17] Consumers with positive payment history on such bills generally have not derived any benefit from that history in terms of their credit score.

However, this practice is changing as a result of evolutions in the fintech marketplace. There are upwards of 15 fintechs working directly with landlords and property managers to report, or to allow tenants to authorize reporting, of their rental payments and, in some cases, their past payment history (including Financial Solutions Lab Accelerator company Esusu).[18] In some instances, the landlord is the source of the data. In other cases, the landlord verifies payment information derived from other sources, and, in still other cases, rental payments are made via a platform the fintech provides so the fintech itself can verify the payment. Some of these services report only to one NCRA, some to two, and some to all three.

A handful of other fintechs offer direct-to-consumer services through which consumers can opt in to reporting ongoing payments on rent, utility, and telecommunications bills, as well as other recurring obligations in some cases. A recent report by FinReg Lab and the Urban Institute identified three different approaches these fintechs take to furnishing data with respect to such transactions, the most common of which is to obtain permission from the consumer to access the consumer's checking account in order to identify payments on recurring obligations and report them to one or more of the NCRAs. These services vary in terms of their pricing models and cost, the number of NCRAs to which they report (ranging from one to all three), and whether they mine historical transactional data to report past payments or offer reporting only on a going-forward basis.[19]

Additionally, Experian, one of the three national NCRAs, now offers consumers the opportunity, at no cost, to enroll in Experian Boost™ and authorize Experian to access the consumers' checking account data in order to identify on-time payments of certain types of monthly payments. Once verified by the consumer, these payments get added to the consumer's credit report with Experian and considered in generating certain credit scores when they are calculated using Experian's files.[20]

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[17] Brian Bucks, Susan Singer, & Nicholas Tremper, "Collection of Telecommunications Debt," Bureau of Consumer Financial Protection, August 2018. These percentages may have declined since 2018, as the total number of collections tradelines has declined by 33% and the share of consumers with a collection tradelines by 20% from the first quarter of 2018 to the first quarter of 2022. Learn more.
[18] A recent report by FinReg Lab and the Urban Institute contains a compendium of such services. Read the report here.
[19] View a complete list of these services here.
[20] Learn more about how Experian boosts credit scores here.

Research indicates that using alternative data to assess borrowers' creditworthiness results in broader credit access as compared to traditional underwriting, with the borrowers most positively affected being those who have short credit histories but low propensity to default.[21]

Opportunities and Risks

By bringing data from these types of payments into the credit reporting system, these fintechs enable consumers to reap the benefits of positive payment history when lenders use the more recent credit scoring models – or algorithms of their own – that already take such data into account when it is available.[22]

Further, as coverage of these types of data expand, the modelers who build scoring algorithms may be able to adjust their models to reflect nuances in the data, especially in light of the growing evidence of the value and predictiveness of such alternative data.[23] Indeed FICO, which produces the most widely used scoring algorithm, now offers consumers the opportunity to sign up for UltraFICO™ and permission FICO to access checking account data to generate an alternative FICO score that FICO has built and validated. Lenders can purchase and use this alternative score if a consumer is denied credit based on their "regular" FICO score.[24]

To the extent these services report only positive payment history – or, in the case of UltraFICO™, use data only to provide a "second look" for consumers who do not meet a creditor's standard credit criteria – there does not appear to be any downside for consumers (although the absence of any negative data may make it more difficult for modelers to assess the predictiveness of these data). Similarly, services that require the consumer to opt in to reporting and that allow consumers to withdraw their permission at any time enable consumers to control whether negative information is reported.

However, some consumers may authorize reporting and, while the authorization is in force, fall behind on their payments, in which case the reporting could adversely affect the consumer's credit profile. And that risk is necessarily inherent in services that are controlled by landlords or property managers and do not depend on consumers' consent.

But especially for consumers who are credit invisible or unscorable, the potential benefits of credit building through these forms of voluntary reporting of alternative data are large, especially if the

[21] Jennifer Chasseur, Kelly Thompson Cochran, Sarada Dhulipala, Aaron Milner, Stephen Stolzenberg & Jared Yee, "The Use of Cash-Flow Data in Underwriting Credit," FinRegLab, July 2019.
[22] In a report, FICO noted that its models have always credited telecom and utility payments when the data is available, and models released since 2014 also credit rental data when available. VantageScore reports that all its models consider rent, telecom and utility payments. Learn more about VantageScore here.
[23] Read three such reports here, here, and here.
[24] Learn more about UltraFICO™ here.

data is reported to all three of the NCRAs so that the benefit to consumers does not depend on which NCRA a particular lender uses. Those benefits can be realized, however, only if consumers are aware of these services, understand both the potential upside and downside, and are able to access the services if they so desire. To these ends, we offer the following recommendations:

- **Fintech platforms that facilitate the reporting of alternative data should clearly and transparently disclose what information they furnish and to whom**, including any risks to consumers from reporting of negative information.

- **Banks, credit unions, and prepaid-card providers should promote the opportunity for transaction-account customers to authorize the use of their data to report payment history** to the NCRAs. They should also explore opportunities to partner with fintechs to offer such reporting as an optional feature of their transaction accounts at low or no cost to their customers.

- **Lenders – including banks, credit unions, independent mortgage companies, finance companies, and fintech lenders – should deploy scoring models that take into account payments on recurring bills** and should prominently promote the availability of services that enable reporting of alternative data on their websites and in their marketing materials. Lenders, likewise, should promote the availability of a second look using alternative data via adverse action notices sent to applicants declined for credit.

- **The Consumer Financial Protection Bureau should move forward expeditiously with the rulemaking it has commenced to implement Section 1033 of the Dodd-Frank Act.** That section obligates financial institutions to make available to a consumer or their designated representatives, on request, information about the consumer's accounts with the financial institution, including transactional information. The CFPB should issue a regulation that ensures that consumers can exercise that right without cost and through processes that avoid unnecessary friction or delay. Separately, the CFPB should consider whether negative-only reporting (i.e., reporting only delinquent accounts) is consistent with the Fair Credit Reporting Act and the Consumer Financial Protection Act.

Part Two

Credit Builder Loans and Lines of Credit

Credit builder products have certain features in common that differentiate them from traditional extensions of credit and, consequently, make it economically viable for financial institutions to offer this form of credit to those without credit history or with damaged history. In contrast to traditional loans, in which the lender provides borrowers with funds that they can use as they desire and where the lender is at risk if the borrowers are unable to repay the amount borrowed, credit builder products neither extend liquidity to borrowers nor place credit risk on lenders unless and until the consumer demonstrates positive payment behavior.

With a secured credit card, rather than obtaining liquidity through the credit card, the consumer is required to fund a deposit into a savings account that is placed beyond the reach of the consumer so long as the credit card is active. This creates a barrier to access for many consumers in need of credit building, as noted in prior research by the Financial Health Network.[25] For a consumer who is willing and able to make a deposit, the lender issues a credit card with a credit line equal to the deposit, precluding the consumer from making purchases that would bring the balance above that amount. If the consumer is unable to make the required payments, the consumer is reported as being delinquent, and, at a certain point, the card issuer can access the security deposit to cover the outstanding balance. With some secured credit cards, once the consumer exhibits positive payment behavior, the credit line may be increased above the amount on deposit, creating a partially secured card. Eventually, the consumer may graduate to an ordinary (i.e., unsecured) credit card.

Credit builder loans do not require consumers to make an upfront deposit but function instead as "forced savings" products. Although structured like a traditional installment loan with a loan amount and a payment schedule, with a credit builder loan the loan proceeds are placed into a savings vehicle beyond the reach of the borrower. As the borrower makes monthly payments, the payment (less any finance charge) is attributed to principal repayment. With some products, these principal payments accumulate so that, at the conclusion of the loan, when the savings vehicle is unlocked, the borrower has access to an amount equal to the principal payments the borrower has made; with other products, money can be released to the consumer as payments are made. With many credit builder loans, if the borrower is unable to continue making payments, the borrower can terminate the loan – thereby avoiding negative reporting to the NCRAs – and the borrower can obtain from the savings account the amount of principal the borrower has repaid, with the remainder reverting to the lender.

The growth of the fintech market has led both to the introduction of a number of credit building payment products that bear a family resemblance to secured credit cards, and also to a substantial expansion of the availability of credit builder loans. We discuss these developments below and then consider the opportunities and risks they pose.

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[25] Rob Levy, Laura Cummings, Jeanne Hogarth, Kaitlin Asrow, & Tanya Ladha, "Secured Credit Cards: Innovating at the Intersection of Savings and Credit," Center for Financial Services Innovation, May 2016. At the time this report was written, the Financial Health Network was known as the Center for Financial Services Innovation.

Credit Builder Line-of-Credit Payment Products

As previously noted, the Financial Health Network's prior research on secured credit cards found that, for many consumers in need of credit building, coming up with the money for the deposit required to open a secured card posed a significant challenge. Our research also found that, for many borrowers, keeping their utilization of their credit line below 30% – which is recommended to optimize the credit-building effect – was quite challenging.[26] For better or potentially for worse, as we discuss further below, a number of fintechs have developed products designed to mitigate these challenges, reducing the risk that the consumer will be unable to make the required payments and, consequently, build negative credit history as a result of using the product.

Based on our review of the market, we can place these new credit building payment products into four categories; we do so descriptively, without attempting to offer judgments as to the relative benefits and risks of these different categories:

- **Charge Cards with Flexible Spending Limits:** At least four fintechs offer secured credit-building payment products without a minimum-required security deposit and that allow consumers to add to, or subtract from, the deposit at any time by depositing or withdrawing money from the secured account. Although sometimes referred to by these companies as secured credit cards, these products are more accurately classified as charge cards because the consumer is required to repay the full balance each month. As a result, there is neither interest charged nor an opportunity to revolve a balance (with the risks that entails, especially for consumers new to credit or who have struggled with revolving credit in the past). These products allow – indeed, encourage – consumers to automatically have their monthly bill paid out of whatever security deposit they have provided (in which event the credit line would be reduced until the deposit is replenished), but the products also give consumers the option to make manual monthly payments either out of the secured account or out of another account.

  Chime (in collaboration with Stride Bank) offers this type of product to its deposit customers at no cost, and Varo Bank does the same for its deposit customers.[27] Cleo (in collaboration with WebBank) offers this as one of the features of its Cleo Plus membership that has a monthly subscription fee of $14.99, and Step (in collaboration with Evolve Bank & Trust) provides a secured charge card at no cost. Because the credit line on these products can vary from day to day based on changes in the security deposit, the companies do not report

[26] Ibid.

[27] The cardholder agreement for the Chime Secured Credit Card denominates the card as a charge card.

a credit line (or utilization level) to the NCRAs, but rather report only the amount owed and payment status.

- **Unsecured Charge Cards With Rapid Repayment:** Tomo (in collaboration with Community Federal Savings Bank) offers an unsecured, credit building charge card that is underwritten based on Tomo's analysis of data from the consumer's checking account, to which the consumer must provide access. Full payment is due at the end of each month, but Tomo encourages its customers to activate a feature that enables Tomo to pull payments from the linked checking account on a weekly basis. Tomo reports the monthly payments to all three NCRAs. It is unclear whether Tomo also reports the credit line. Tomo does not charge any fees and reports that its revenue is derived solely from interchange.

- **Limited Purpose Charge Cards or Lines of Credit:** Three other fintechs have created products designed to enable consumers to build credit through charge cards or lines of credit that can only be used for limited purposes.

  Grow Credit (in partnership with Dwollo, which in turns partners with financial institutions) and Altro each offer a charge card that can be used only to pay monthly subscription or membership fees from a defined group of merchants or service providers, such as streaming services, newspapers, and magazines.[28] Each establishes a monthly spending limit (between $17 and $150 for Grow and $75 for Altro) which may be reported to the NCRAs as an annual spending limit, i.e., as 12 times the monthly limit). The consumer then links the charge card to the services to which the consumer subscribes so that the monthly payments flow through the charge card. Each requires a link to the customer's checking account, and each at least encourages customers to authorize auto-debit to repay the balance on the charge card each month.

  Grow offers a no-cost plan with a $17 monthly fee and higher limits for consumers who agree to pay monthly fees to Grow (on top of their monthly balance on the charge card). Altro does not vary its limit and does not charge a monthly fee. For those who cannot qualify for its no-cost plan, Grow offers a secured charge card that requires a $17 security deposit and a $1.99 monthly fee in return for a $17 monthly line.

  Kikoff offers what it denominates as a $750 revolving line of credit that can be used to make purchases from Kikoff, which sells e-books on personal finance, wellness, and other topics. The minimum purchase amount is $10 and minimum monthly payment is $5.

[28] Altro currently is available in only ten states.

- **Credit Building via Debit Cards:** Two other fintechs are offering products designed to enable consumers to build credit through their debit card purchases.

  Credit Sesame (in collaboration with Community Federal Savings Bank) offers its checking account (called Sesame Cash) customers the opportunity to move a portion of their checking account balance into a secured account. As with a secured credit card, that amount establishes the limit for the secured account. But unlike a secured card, the consumer is free to change the amount (and the limit) at any time by moving money back into the Sesame Cash account. (In this respect, the product parallels the secured charge cards previously described.) The consumer also establishes a maximum utilization level that the consumer does not want to exceed. Each month, Credit Sesame then identifies debit card purchases from the Sesame Cash transaction account that do not exceed the utilization limit and reports these as draws upon and repayment of the secured credit line. Credit Sesame states that, "This all happens behind the scenes, while you use your Sesame Cash debit card." Thus, unlike the secured charge cards that require a monthly payment at the end of the month either manually or via auto-pay, the Credit Sesame product essentially operates on a pay-as-you-go basis and does not require a monthly payment.

  Extra (in collaboration with Evolve Bank & Trust) similarly offers consumers what it terms the opportunity to build credit through debit card purchases. To use Extra, a consumer must link their bank account through data aggregator Plaid. Using some form of cash flow underwriting, Extra determines a "Spending Limit" for the consumer and opens a transaction account at its partner bank, which in turn provides the consumers with a debit card that can be used to access up to 80% of the Spending Limit. Each time the consumer uses the debit card, Extra initiates an ACH transaction from the consumer's linked banking account in the amount of the debit card transaction. Extra reports the sum of the debit card transactions each month as "credit-worthy payments" to two of the three NCRAs. Extra charges a monthly fee of $20.

- **Property-Backed Secured Credit Card:** Yendo (in collaboration with Cross River Bank) offers a secured credit card for consumers that does not require an upfront deposit, but instead requires the consumer to pledge their title to an automobile or other motor vehicle. Yendo establishes a credit line based upon the value of the vehicle and then provides a secured credit card with the usual features and pricing in line with other secured cards ($40 annual fee, 24.99% APR). However, if a consumer fails to make required minimum payments, Yendo has the right to exercise its car title lien to recover the unpaid balance, meaning that the consumer can lose their car. Also, unlike most traditional secured credit cards, Yendo reports only to two of the three NCRAs.

Fintech Credit Builder Loans

Whereas the credit builder payment products described above all differ in material respects from secured credit cards, the credit builder loans offered by fintechs mostly follow the design of forced-savings credit builder products that have long been offered by some credit unions or other organizations to their members (i.e., products in which the loan proceeds are placed in a locked savings vehicle and monthly payments create savings which the consumer can access at the conclusion of the loan or at specified intervals). The credit builder loans offered by various fintechs differ primarily based on the loan terms, including the minimum and maximum size and duration of the loans and the pricing structure.

Table 1 shows some of these differences for a number of leading products to the extent the terms can be determined from the websites of the fintechs offering these products.

Table 1. Terms and conditions of fintech credit builder loans.

<table>
<tr><th>Provider</th><th>Min. loan size</th><th>Min. monthly payment</th><th>Annual % rate</th><th>Min. required interest</th><th>Other fees</th><th>Notes</th></tr>
<tr><td rowspan="3">Self</td><td rowspan="3">$520</td><td rowspan="3">$25 for 24 months</td><td rowspan="3">15.92%</td><td rowspan="3">$80</td><td>$9 enrollment fee</td><td>Consumer can close account at any time</td></tr>
<tr><td>Debit card fee varies with size of loan</td><td rowspan="2">Consumers can move money from CBL to open a secured credit card</td></tr>
<tr><td>Late fee if 15 days late</td></tr>
<tr><td rowspan="2">Credit Strong</td><td rowspan="2">$1,100</td><td rowspan="2">$28 for 48 months</td><td rowspan="2">15.61%</td><td rowspan="2">$244</td><td>$15 enrollment fee</td><td>Consumer can close account at any time</td></tr>
<tr><td>Late fee if 15 days late</td><td>Option of illiquid $500 credit line for $99 per year</td></tr>
<tr><td rowspan="2">MoneyLion</td><td rowspan="2" colspan="4">Unspecified</td><td rowspan="2">$19.99 monthly fee</td><td>No cancellation right</td></tr>
<tr><td>Immediate access to a portion of loan</td></tr>
<tr><td>Loqbox</td><td>None</td><td>None</td><td>0%</td><td>$0</td><td>$40 fee at termination unless savings deposited with a partner bank</td><td>12 month term but consumer can close account at any time</td></tr>
</table>

All of the products listed above in Table 1, by establishing monthly fixed payment obligations that are reported to the NCRAs, carry the risk that the failure to make payments will result in negative reporting. With the exception of MoneyLion, however, all of the other providers allow consumers to terminate their credit building loan at any time, in which event the loan will be reported as closed rather than delinquent.

Two fintechs have sought to go further and offer credit builder loans with unique features to further mitigate the risk of negative reporting. As part of its "Brigit Plus" membership (for which it charges a $9.99 monthly fee), Brigit (in partnership with Coastal Community Bank) offers a credit builder loan, for which monthly payments can be made from the loan proceeds that are placed in a locked savings vehicle. This means that as long as the consumer makes a monthly payment of $1, Brigit will report that the full monthly payment has been made. (To the extent payments are made from the locked savings account, this will, of course, reduce the amount that the consumer is saving and eventually will receive.)

Credit Karma (in partnership with Cross River Bank) goes further still and offers its Credit Karma Money Spend transaction customers a no-cost credit builder product, which appears to mitigate the risk of negative outcomes by positioning the product as a SeedFi credit line with no required minimum monthly payment. As the consumer makes payments, money is pulled from the credit line and placed into a SeedFi deposit account, and the payments are reported as repaying the draw on the credit line.[29]

Opportunities and Risks

From a financial health perspective, the most important question posed by all of these products – both the credit builder payment products and the credit builder loans – is whether they, in fact, enable consumers to build or repair their credit in a sustainable manner.

For secured cards and the more conventional forms of credit builder loans, the products' underlying premise is that a consumer's ability to make regular monthly payments in agreed-upon amounts sends a signal with respect to the consumer's creditworthiness similar to the signal sent by consumers' repayment of traditional loans. The corollary is that a consumer's failure to make regular payments also sends a signal, albeit a negative one, regarding the consumer's creditworthiness. That means that, in principle, a secured card or credit builder loan can lead consumers to build either positive or negative credit history – although, as we have seen, credit builder loans seek to mitigate that risk by allowing consumers to terminate the loan at any time.

[29] SeedFi was acquired by Intuit, Credit Karma's parent, in December 2022. SeedFi offers its products in partnership with Cross River Bank.

A number of studies have attempted to assess the extent to which consumers using secured cards or credit builder loans succeed in building positive credit. But, as the Government Accountability Office (GAO) recently concluded, "data on credit score improvement are limited."[30] In a 2015 Financial Health Network survey of secured card users, over 70% of respondents reported that the secured card had been at least somewhat helpful in enabling them to build credit. Among those who were relatively new to their secured card, between 54% (for those with less than six months of experience) and 60% (for those with six to 12 months of experience) expected to be able to graduate to an unsecured card, which is an indicator of their creditworthiness.[31]

However, a more recent study by economists from the Federal Reserve Bank of Philadelphia using administrative data from large secured card issuers found that the two-year graduation rate – that is, the percentage of consumers who had graduated to an unsecured card within two years of opening a secured card – ranged from 16.7% to over 30%, depending upon the year in which the card was opened, with the more recent vintages showing the strongest results.

Further, in each vintage, the graduation rate was highest for those who did not have a credit score at the time their secured card account was opened and lowest for those with deep subprime scores at the point of origination. Among the former group – who comprised just under half of the secured card population – the median credit score upon graduation put them squarely in the prime credit category and, even among those who started without credit scores and did not graduate within two years, the median credit score (639) put them in the near-prime category. The study did not report on how, if at all, credit scores changed for those who were scorable when opening their secured card account, but the fact that such a small percentage of those consumers graduated to unsecured credit cards implies that they may not have succeeded in establishing a positive payment history.[32]

In a similar vein, while some evaluations of credit builder loans have reported positive results, albeit based on limited data, the most recent and most robust study, commissioned by the CFPB, found that the credit builder loan "worked as intended for people without existing debt, but not for consumers who already had debt," most of whom already had a credit score when they obtained the credit builder loan.[33] For this latter group – who comprised a large share of the participants – the study suggested that the credit builder loan did not lift, and may even have slightly depressed, credit

[30] "Financial Technology: Products Have Benefits and Risks to Underserved Consumers and Regulatory Clarity is Needed," United States Government Accountability Office, March 2023.
[31] Rob Levy, Laura Cummings, Jeanne Hogarth, Kaitlin Asrow, & Tanya Ladha, "Secured Credit Cards: Innovating at the Intersection of Savings and Credit," Center for Financial Services Innovation, May 2016.
[32] Larry Santucci, "Moving into the Mainstream: Who Graduates from Secured Credit Card Programs?," Federal Reserve Bank of Philadelphia, May 2019. We interpret a credit score below 620 as being subprime.
[33] Targeting Credit Builder Loans: Insights from a Credit Builder Loan Evaluation," Consumer Financial Protection Bureau, July 2020.

scores.[34] This was true even though the product in that study provided the consumer immediate access to each monthly payment once made so that the payments did not require the consumer to forego any liquidity. (We summarize the published research studies in the Appendix to this report.)

This study, then, is broadly consistent with the secured card research. Read together, these studies suggest that, at least for those who are credit invisible, credit builder products produce positive results on average but are less beneficial for those with prior negative credit experience. Indeed, for some consumers with a damaged credit history and existing debts, a credit builder loan can actually add to the consumers' challenges in making payments and thus lead to negative outcomes. Identifying and developing solutions that are helpful to, and appropriate for, those with damaged credit history and existing debts, while beyond the scope of this brief, is therefore important follow-up work for the field to explore.

As we have seen, the newer forms of credit builder products have sought to mitigate the risks of negative outcomes in various ways, including, for example, by reporting debit card transactions, transactions that are repaid in near-real time, or optional payments, as if they were repayments of monthly obligations. Whether these products are more effective in enabling consumers to improve their credit score is an open question that merits careful research.

Further, to the extent these products succeed by blurring the signal sent by payment history, the value and sustainability of any resulting credit score gains may be open to question. If the gains from these products prove to be short-lived – or, worse yet, if the gains prove to be illusory and enable consumers to access more debt than is manageable for them – consumers' financial health may actually suffer. Indeed, some experts in credit risk management have expressed concern that these newer credit-builder products may be "giving other lenders a distorted view of the credit quality of the consumers using them."[35]

Given the limited research available with respect to the more traditional credit builder products and the questions surrounding the newer products, additional research is clearly needed before definitive conclusions can be reached regarding the short-term and longer-term efficacy of these newer forms of credit-builder products as tools for building or repairing credit and their impact on consumers' financial health. In light of this uncertainty, the Financial Health Network recommends the following:

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[34] Ibid.; because this was an "intent-to-treat" study, most results are reported with respect to those credit union members who expressed interest in obtaining a credit builder loan of whom approximately 20% actually obtained a loan. Among the broader group of those expressing interest, 70% already had an existing loan and nearly all of those also had a credit score.
[35] Alex Johnson and Kevin Moss, "Fintech Is Breaking the Credit Bureaus," Workweek, August 2022.

- **Lenders offering credit builder products – whether traditional secured cards and credit builder loans or more novel products – should track the experiences of their customers** over a meaningful period of time and should study, or partner with researchers to study, the outcomes their customers experience after using their product.
- **Lenders should clearly and conspicuously disclose the risks associated with such products and the outcomes experienced by customers** using their product, including not only the experience of those who succeed with the product but also information regarding the success rate.
- To the extent that a credit builder payment product creates the potential for negative credit reporting, **providers should engage in underwriting to assess whether an applicant has the ability to repay the obligation and still be able to cover existing obligations and basic needs,** even if the product is fully secured, so that the lender is not at risk.
- **Regulators should closely monitor these products to assure that they are disclosed transparently** in a manner free from misleading statements or impressions.

Conclusion

Although cash flow underwriting holds the promise of increasing financial inclusion, a strong credit history is integral to financial health in today's world – a world in which most lenders continue to base decisions about whether to extend credit on credit scores or on other models using the data contained in credit reports.

Fintech is not only opening the door to underwriting that does not rely on such data and scores, but it has also created new opportunities for consumers to build healthy credit reports and credit scores. Fintech providers of credit building products should ensure that their products are transparently disclosed and offered only to those with the ability to repay the obligations they undertake.

Banks, credit unions, and mainstream lenders should assure that their customers are aware of opportunities to build their credit through reporting of rent, utility, and telecom payments. Finally, the CFPB should move promptly to complete the data rights rulemaking it has begun so as to secure the infrastructure on which many of the credit building opportunities depend.

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The Financial Health Network is a trusted resource for business leaders, policymakers, and innovators united in a mission to improve the financial health of their customers, employees, and communities. Through research, advisory services, measurement tools, and opportunities for cross-sector collaboration, we advance awareness, understanding, and proven best practices in support of improved financial health for all.

The Financial Solutions Lab (FSL) was established in 2014 to cultivate, support, and scale innovative ideas that help improve financial health. FSL focuses on solutions addressing acute and persistent financial health challenges faced by low- to moderate-income individuals, Black and Latinx communities, and other underserved consumers.

The Financial Health Network manages the Financial Solutions Lab in collaboration with founding partner JPMorgan Chase and with support from Prudential Financial.

Appendix – Evaluations of Credit Builder Loans

This Appendix summarizes published research into the effect of credit builder loans in building or repairing credit.

CFPB, *Targeting Credit Builder Loans*

This study was commissioned by the CFPB in partnership with a St. Louis credit union offering $600, 12-month credit builder loans requiring monthly payments of $54. The study involved 1,531 credit union members who, in response to a survey, expressed an interest in such a loan. Half of these participants were immediately offered the opportunity to apply for the loan, and the other half were required to first complete a 50-minute online financial education course before applying. Among the first group, 30% obtained a loan and, among the second group, 12% did, for a total of 325 borrowers. Most of the results from this study are reported for all participants, including those who did not take out a loan, making it somewhat difficult to assess the impact on actual borrowers.

Nearly all those entering the study with existing debt had a credit score, and the availability of a credit builder loan had a slight negative effect on the likelihood of having a credit score 18 months later and a small negative effect (-3.1 points) on those scores. For those without existing debt at the start of the study, the availability of a loan increased the likelihood of having a score by 24% and increased the score (for those who had a credit score at the start of the study) by 8.9 points. The CFPB estimated that those participants who actually took out a loan and who did not have pre-existing debt but did have a credit score when the study began experienced a 60-point increase in their credit scores. On a blended basis, borrowers saw a score increase of approximately 15 points.[36]

Wolff, *Providing a Fresh Start: An Analysis of Self-Help Federal Credit Union's Fresh Start Product (2016)*[37]

Self-Help offers credit builder loans in varying amounts and terms, with the most common loan being for $500 and the average term being 14 months, although borrowers are free to terminate the loan at any time. This study examined changes in credit scores for 598 borrowers who obtained a credit builder loan from Self-Help Federal Credit Union over a 14-month period in 2014-15. Data were obtained with respect to these borrowers' credit scores when they obtained the loan and in

[36] The study results are reported in an academic paper prepared by the researchers contracted to do the study and in a separate CFPB report.
[37] Sarah Wolff, "Providing a Fresh Start: An Analysis of Self-Help Federal Credit Union's Fresh Start Product," Self-Help Credit Union, February 2016.

July 2015. Over 70% of the loans were still active as of the time of the study and, of those that were closed, a majority were paid off early.

The study found that of those who had no credit scores when they took out a loan, 100% obtained a credit score, with an average score of 643. Of those who entered with a credit score under 640, 70% experienced a score increase, with average increases of 38 points for those with an entry score between 580-639 and 70 points for those with a lower entry score. The average gains for these groups, taking into account those who experienced a score decrease, was 17 and 45 points, respectively. Less than half of those with an entry score above 640 experienced a credit score increase and, on average, those with credit scores above 640 experienced a credit score decrease ranging from -3 points for those with scores between 640-694 to -32 points for those with entry scores above 750 (a very small share of those taking out these loans).

Chenven, *The Power of Credit Building: Credit Building Strategies for Funders* (2014)[38]

This report describes two credit builder loan programs. In one, the Local Initiative Support Corporation added a $300 credit builder loan, with a $300 match for those who repaid the loan, to the offerings of Financial Opportunity Centers in Chicago. The report states that, within six months, those who were unscored “typically generate FICO scores in the high 600s” and that those with low scores at entry see an average increase of 30-60 points. In the second program, the Kentucky Domestic Violence Association provided no-interest credit builder loans to domestic violence survivors; the report states that borrowers “increased credit scores (many by 50 to 100 points).[39]

[38] Sarah Chenven, “The Power of Credit Building: Credit Building Strategies for Funders,” Asset Funders Network, 2014.
[39] The report describes positive results from two other programs but it is unclear from the description whether these programs provided loans that followed the credit builder loan model.