Addressing Traditional Credit Scores as a Barrier to Accessing Affordable Credit

by: Ying Lei Toh

June 22, 2023

Traditional credit scores do not always reflect a consumer's creditworthiness and may drive disparities in credit access.

Affordable credit enables consumers to better manage their finances, cope with unexpected emergencies, and pursue opportunities such as entrepreneurship or higher education. However, many consumers face difficulties obtaining the credit they need. A major impediment is lenders' reliance on traditional credit scores to assess consumers’ creditworthiness. These credit scores affect not only loan approval decisions but also the interest rates consumers pay on their loans. While credit scores are intended to help lenders make informed decisions about consumers’ risk of default, they do not always accurately reflect a borrower’s ability to repay. Traditional credit scores may also disproportionately punish consumers from economically disadvantaged groups.

Ying Lei Toh examines the barrier traditional credit scores pose to obtaining affordable credit in the United States and discusses efforts to address this barrier. Using data from the 2019 Survey of Consumer Finances, she finds that traditional credit scores may indeed hinder a sizeable share of consumers from obtaining the credit they desire. Further, disparities in credit access across several sociodemographic groups match the disparities in their likelihood of having high traditional credit scores, suggesting lenders’ reliance on traditional credit scores may drive disparities in credit access.
Author

Ying Lei Toh
Economist

Ying Lei Toh is an economist in the Economic Research Department at the Federal Reserve Bank of Kansas City. Ms. Toh joined the Bank in 2018, after earning her Ph.D. in Economics at Toulouse School of Economics (TSE), France. She also holds a M.Sc. in Economics from TSE and a B.A. (with Honors) in Economics from Nanyang Technological University, Singapore. Her research focuses on the digital economy—particularly, the issues of consumer privacy, data protection and cyber security—and the payments market.