



STUDENT BORROWER
PROTECTION CENTER

EDUCATIONAL REDLINING

Student Borrower Protection Center

February 2020

PROTECTBORROWERS.ORG

With new advances in financial products and services come age-old risks of discrimination. Without caution, the fintech revolution could perpetuate a system that has historically locked communities of color out of mainstream credit markets.

Table of Contents

Executive Summary	04
About this Report	06
Introduction	08
The Community College Penalty	11
The HBCU/HSI Penalty	15
Recommendations	20
Conclusion	25

Executive Summary

- Across the financial services sector, “alternative data” has been touted by established consumer lenders and new entrants alike as a tool to expand access to credit for historically underserved communities, including people of color. This report examines one subset of this data—education data, an umbrella term describing information related to a consumers’ higher education—when determining access to credit and the price of consumer financial products.
- The use of education data in underwriting raises significant fair lending concerns, and its widespread adoption could reinforce systemic barriers to financial inclusion for Black and Latinx consumers. Further, the use of education data can exacerbate inequality across the American economy. Where the effects of these practices have negative economic consequences for borrowers from historically marginalized communities, these practices are known as “Educational Redlining.”
- The following report, *Educational Redlining*, includes a detailed discussion of these practices and describes the specific risks posed to borrowers, communities, and the economy when consumer lenders rely on education data when determining access to credit and the cost of credit.
- This report features two case studies that examine the effects of these practices on hypothetical, similarly situated consumers using publicly available information about the lending practices at two consumer lenders—Wells Fargo and the financial technology company Upstart. These case studies show:
 - **Borrowers who take out private loans to pay for college may pay a penalty for attending a community college.** Wells Fargo charges a hypothetical community college borrower an additional \$1,134 on a \$10,000 loan when compared to a similarly situated borrower enrolled at a four-year college.
 - **Borrowers who refinance their student loans through a company using education data may pay a penalty for having attended an HBCU.** When refinancing with Upstart, a hypothetical Howard University graduate is charged nearly \$3,499 more over the life of a five-year loan than a similarly situated NYU graduate.

- **Borrowers who refinance student loans may pay a penalty for having attended an Hispanic-Serving Institution (HSI).** When refinancing with Upstart, a hypothetical graduate who receives a Bachelor's Degree from New Mexico State University, an HSI, is charged at least \$1,724 more over the life of a five-year loan when compared to a similarly situated NYU graduate.
- Based on this analysis, SBPC has issued the following recommendations to Congress, federal and state regulators, and the consumer lending industry to address potential violations of federal and state fair lending laws and to mitigate the effects of these practices on economic inequality:
 - **Congress must enhance oversight.** Congress should examine the use of education data by consumer lenders, including monitoring for potential disparities caused by this practice and its effects on economic inequality. Further, Congress should investigate regulators' oversight over the companies engaged in these practices. This should include scrutiny of the Consumer Financial Protection Bureau's handling of the No-Action Letter awarded to Upstart—a regulatory safe harbor that may be shielding the company from violations of federal fair lending laws.
 - **Federal and state regulators must take immediate action to halt abuses.** Federal and state regulators should prioritize oversight over lenders that use education data when underwriting or pricing consumer loans and take immediate action where industry practices violate fair lending laws.
 - **The financial services industry must strengthen transparency when lending based on education data.** Firms in the financial services industry that use alternative data should immediately publish data demonstrating the effects of such practices on individual borrowers, empowering lawmakers, regulators, and the public to understand the effects of these practices on consumers.

About this Report

Credit is a key ingredient in the generation of economic opportunity, and it plays a “remarkably consequential” role in the expansion of economic mobility among marginalized populations.¹ And yet, consumers of color continue to face obstacles when seeking access to affordable credit. Research shows that African American and Latinx consumers at every income bracket are more likely to either be offered

“As more financial services companies look to adopt this approach, policymakers, regulators, and fintech companies must heed caution. The use of alternative data may further marginalize the very communities it purports to help.”

less credit than requested or denied credit outright than their similarly situated white peers.² While racial disparities in credit can be traced back to systemic discrimination underlying American society and the U.S. financial system,³ evidence suggests that traditional credit scoring models perpetuate these disparities because “even the most basic lending standards . . . ‘impact’ racial and ethnic groups differently.”⁴

Financial technology (fintech) firms have touted the use of “alternative data” as a method for overcoming biases entrenched in traditional credit underwriting models that often exclude consumers with limited credit profiles.⁵

These companies assert that creditworthiness can be gauged through factors like social media use, educational attainment, and work history.⁶ After including these alternative inputs in underwriting models, companies market their products as providing expanded access to credit to marginalized communities.⁷ However, as this report demonstrates, such statements fail to present policymakers, regulators, and law enforcement officials with full context for the potential risks associated with using alternative data.

As more financial services companies look to adopt this approach, policymakers, regulators, and fintech companies must heed caution. The use of alternative data may further marginalize the very communities it purports to help.

In 2019, Student Borrower Protection Center (SBPC) fellow Aryn Bussey documented the risks associated

with one category of alternative variables for credit underwriting: education data.⁸ Companies using education data have looked to SAT scores, sector of the institution of higher education attended (e.g., for-profit, private nonprofit, public), college majors, and more as proxies for likelihood of repayment.⁹ Bussey's analysis reviewed the myriad of concerns of policymakers, academics, advocates, and law enforcement related to the use of education criteria in underwriting.¹⁰ This report builds on Bussey's work, further examining those risks, and provides two case studies highlighting disparities in outcomes when companies use education data in underwriting decisions.

Specifically, in this report, we examine the extent to which a consumer's choice of college, including attendance at a community college or Minority-Serving Institution (MSI), impacts their cost of credit. We analyze sample rate quotes from lenders that advertise the use of education criteria in credit decisions and provide case studies for two lending products: a newly originated private student loan from Wells Fargo and private student loan refinancing products offered by Upstart. Offered rates were compared across postsecondary institutions with all other inputs held constant.¹¹ Our findings from our broader analysis and the highlighted case studies are consistent: holding all else constant, borrowers who attend community colleges, Historically Black Colleges and Universities (HBCUs), and Hispanic-Serving Institutions (HSIs) will pay significantly more for credit because of people's assumptions and prejudices regarding those who sit next to them in the classroom.

“ Our findings from our broader analysis and the highlighted case studies are consistent: holding all else constant, borrowers who attend community colleges, Historically Black Colleges and Universities (HBCUs), and Hispanic-Serving Institutions (HSIs) will pay significantly more for credit, because of people's and prejudices regarding those who sit next to them in the classroom. ”

Introduction

The fintech industry is rapidly changing the way that consumers participate in credit markets. Researchers estimate that the credit market excludes 45 million consumers because classic underwriting models deny credit to those with little or no scorable credit history.¹² Fintech companies increasingly seek to serve this population by incorporating new forms of data into underwriting models. In doing so, these companies claim they can offer lower cost products that are more widely available.¹³

Should this claim be realized, this approach would be encouraging, as expanded access to affordable credit is critical to improving economic opportunity and creating fairer financial markets for traditionally marginalized consumers. However, as this report shows, the use of alternative data in underwriting to predict credit risk may ultimately do just the opposite—disparately affecting marginalized consumers and exacerbating economic inequality.

Traditional underwriting algorithms use a consumer's past payment performance to predict repayment behavior and determine creditworthiness.¹⁴ As a result, these models are somewhat limited in their ability to assess the creditworthiness of young consumers and others who lack extended payment histories.¹⁵ Additionally, critics contend that classical score-based credit models overlook consumers with repayment histories concentrated outside of mainstream credit products.¹⁶ Fintech companies have sought to fill this gap and expand their base of potential customers by looking beyond these extant input variables. Fintech lenders use new input variables—commonly referred to as alternative data—in underwriting algorithms to process data “in ways that reveal correlations between seemingly irrelevant data points about a borrower and that borrower’s ability to repay.”¹⁷

This report focuses on one specific class of input variables increasingly used by fintech lenders—education data. Education data includes a range of variables tied to a consumer's postsecondary education, including institutional sector and selectivity, college major, and even assessment scores. As University of Oklahoma College of Law professor Christopher Odinet explains, fintech firms “are ever-expanding their online lending activities to help students finance or refinance educational expenses. These online companies are using a wide array of alternative, education-based data points—ranging from applicants’ chosen majors, assessment scores, the college or university they attend, job history, and cohort default rates— to determine

creditworthiness.”¹⁸

However, while the fintech industry argues that education data allows for expanded and more inclusive underwriting, this report illustrates how its use may lead to disparate outcomes for certain consumers.¹⁹ Specifically, the use of education data in underwriting risks discriminating against borrowers of color and exacerbating income equality across the population at large. As National Consumer Law Center staff attorney Chi Chi Wu testified before Congress:

The use of education and occupational attainment reinforces inequality, given that a consumer’s educational attainment is most strongly linked with the educational level of his or her parents. Use of educational or occupational attainment would probably top the list of mobility-impeding data, and would ossify the gaping racial and economic inequality in our country.²⁰

With new advances in financial products and services come age-old risks of discrimination, thereby perpetuating a system that has historically locked communities of color out of mainstream credit markets. Accordingly, non-individualized input variables that risk reinforcing systemic disparities and discrimination demand greater scrutiny from policymakers and law enforcement. Education data is no exception.

For example, people of color have historically been and continue to be denied equitable access to higher education, particularly at elite institutions.²¹ By considering the college or university attended by the consumer, a lender may capture disparate patterns in college attendance across class and race, thereby introducing bias in the underwriting process.²² The resulting credit decision risks producing discriminatory results. As Bussey explains:

[A]lthough degree attainment is on the rise for many racial and ethnic groups, research shows there is a shortage of minority students, particularly African-American and Latino students, at selective institutions of higher education. Only nine percent of Black students, eight percent of Indigenous American students, and twelve percent of Latino students attend America’s most elite public universities. When credit terms are tied to attendance at supposedly “elite” institutions, it can unfairly impact borrowers of color. Widespread adoption of educational criteria to determine creditworthiness will further stratify socioeconomic barriers to economic opportunity and mobility for Black and Brown consumers.²³

Education Data Use Risks Redlining

Discrimination resulting from the use of education data in underwriting is not new. For the last century, borrowers of color have been subjected to discriminatory credit terms simply because of where they live.²⁴ Despite fair lending laws prohibiting this type of practice, modern-day redlining based on geography continues to stymie economic opportunity for consumers of color.²⁵ Similar to the effects of discrimination based on geography, the use of educational data in underwriting risks redlining people of color out of the American Dream once again.

For example, in 2007, then-New York Attorney General Andrew Cuomo launched an inquiry to determine whether lenders' use of certain criteria discriminated against student loan borrowers based on their enrollment at a specific institution of higher education.²⁶ Cuomo noted the potential for educational redlining when warning that students attending minority-serving institutions (MSIs), such as historically black colleges and universities (HBCUs), may pay much higher interest rates.²⁷ Cuomo's investigation into one large lender found that its use of education data in underwriting led to interest rate spreads of up to six percent when compared to similarly situated borrowers simply because of the school attended by the applicant.²⁸

Since Cuomo's inquiry, regulators and researchers have further documented how the use of education criteria in underwriting decisions is likely to disproportionately affect protected classes.²⁹ This outcome is particularly troublesome where lenders consider the selectivity of an institution in underwriting. First, despite perceptions of institutional prestige and future earnings, researchers have repeatedly found that institutional selectivity does not broadly correspond with increased earnings, finding only a "slight effect, if any at all."³⁰ Second, as previously discussed, the use of education data risks perpetuating the deep-rooted discrimination that pervades America's higher education system. And finally, potentially discriminatory factors are unjustified where "nondiscriminatory [factors] . . . are already highly predictive of likelihood of repayment."³¹

Accordingly, it is imperative to understand and protect against the potential for discrimination against subsets of borrowers.³²

The Community College Penalty

Community colleges play a critical role in the higher education ecosystem by providing a local pathway to postsecondary learning for a broad range of students, particularly low-income, first generation, and underrepresented minority students.³³ For example, while 37 percent of Latinx college students attend a public four-year or private nonprofit four-year institution, 56 percent of Latinx students attend public two-year institutions.³⁴ Similarly while only 39 percent of white students attend a two-year public college and 56 percent attend a four-year institution, 44 percent of black students attend a two-year public college, a proportion larger than the percent of black students attending a four-year institution.³⁵

In theory, affordable, accessible post-secondary education should help mitigate the racial wealth gap and improve economic mobility. However, the increased use of education data in underwriting models threatens to do the opposite. As the following case study illustrates, rather than providing community college students with affordable credit, consumer lenders instead enforce a community college penalty. Our case study shows that, in one example of a private student loan product marketed by a large bank, borrowers attending community colleges might be charged higher interest rates and offered shorter repayment terms than otherwise identical peers at four-year schools. This penalty risks disparately impacting borrowers of color and necessarily involves judging people's individual creditworthiness based on nonindividualized factors.

In the following case study, we use publicly available information about the terms and conditions of Wells Fargo's private student loan offerings, comparing hypothetical Wells Fargo customers enrolled at select community colleges with similarly situated Wells Fargo customers enrolled at select four-year institutions. The findings of this case study highlight how this approach to pricing can adversely affect students at community colleges, and in turn, students of color.

Case Study: Wells Fargo

Wells Fargo Bank offers a series of private student loan products for higher education financing.³⁶ The following study analyzes two of these product offerings: the *Wells Fargo Collegiate* student loan, a private student loan available to all undergraduate students attending four-year schools,³⁷ and the *Wells Fargo Student Loan for Career & Community College*, a private student loan available specifically to students attending two-year schools, career-training programs, and other non-traditional schools.³⁸

Methodology

To determine how community college attendance affects private student loan product pricing, we modeled hypothetical applicants attending community colleges and four-year colleges. Applicants are identical in every respect, except for the institution of higher education attended.

Using input information for each hypothetical applicant, we submitted inquiries for private student loan product offers using Wells Fargo's publicly available "Today's Rates" tool.³⁹ We then compared the terms presented in the respective outputs from Wells Fargo. Because Wells Fargo reports a range of interest rates for each of its various student loans, we based our analysis on the average of the interest rates quoted for each credit product. We applied those averages to a model paydown sequence for a \$10,000 loan to find implied monthly payments and total payments across the loan term. We assumed that the loan has no origination fee, that the loan was disbursed in equal halves in August and January of the student's final year of study, and that a six-month grace period followed the student's graduation.

In the example below, we highlight the outputs for hypothetical applicants attending two institutions: Chapman University, a four-year university in Orange, California, and Los Angeles ORT College, a community college in Los Angeles, California. We opted to highlight these two institutions based on their proximity,⁴⁰ but note that the findings were consistent across hypothetical applicants.

Findings

This section explores the rate and cost variation offered to borrowers of a *Wells Fargo Collegiate Loan* and *Wells Fargo Career & Community College Loan*.

Bank Lender: Wells Fargo
Product: Private Student Loan

**LOAN
AMOUNT
\$10K**

Borrower Profile

Chapman University

(Private 4-Year University)

Major: Computer science
Occupation: Financial analyst
Annual income: \$50,000

LOAN OFFERS

Loan Interest Rate:
8.22%

**Total Cost:
\$19,171**

Los Angeles ORT College

(Community College)

Major: Computer science
Occupation: Financial analyst
Annual income: \$50,000

LOAN OFFERS

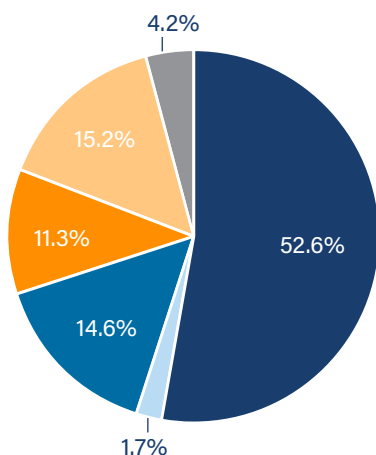
Loan Interest Rate:
10.87%

**Total Cost:
\$20,305**

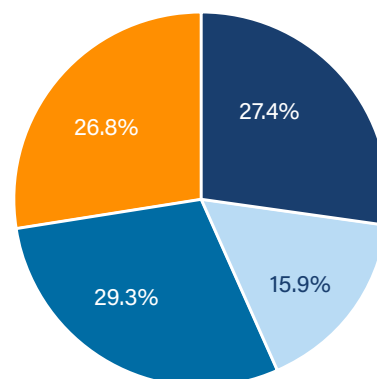
Community College Penalty: +\$1,134

Student Populations

Chapman University



Los Angeles ORT College



■ White ■ Black/African American ■ Latinx/Hispanic ■ Asian ■ Other/Unknown ■ Non-Resident Alien

Demographic data from the U.S. Dep't of Education

- **Wells Fargo charges higher interest rates on its community college loan than its four-year undergraduate loan for similarly situated borrowers.** Using the average of reported rates, a borrower with a community college loan would pay \$1,134 more on a \$10,000 loan than a borrower with the four-year undergraduate loan. Over the life of a \$10,000 loan, a community college borrower would pay approximately \$16,829 with the lowest rate offering and \$24,200 with the highest rate offering. In comparison, a four-year undergraduate loan borrower would pay \$14,749.40 with the lowest rate offering and \$24,335 with the highest rate offering. Even with identical credit profiles, community college borrowers would pay a higher price for credit than students at four-year institutions.
- **Wells Fargo offers shorter loan repayment terms, regardless of the borrower's creditworthiness, for its community college loans.** Wells Fargo offers a 12-year repayment term on its Career & Community College Loan. In contrast, Wells Fargo offers a 15-year repayment terms on its Collegiate Loan. However, a borrower with the community college loan would still pay more overall due to the higher interest rates they face. Both loan products offer the same terms for in-school deferment and grace periods.

The HBCU/HSI Penalty

Minority-Serving Institutions (MSIs), including Historically Black Colleges and Universities (HBCUs) and Hispanic-Serving Institutions (HSIs), play a significant role in expanding access to higher education. For example, in addition to serving underrepresented minorities, HBCUs and HSIs are also more likely to enroll women and older students.⁴¹ However, as one researcher notes, these institutions “exist at the intersection where the American Dream of unbridled possibilities meets the American Nightmare of persistent racial-ethnic subordination.”⁴²

HBCUs, HSIs, and the students they serve face obstacles that make student debt almost an inevitability for attendees. For example, these institutions notably receive less funding than non-minority serving institutions.⁴³ Additionally, students attending HBCUs and HSIs take on more student debt, on average.⁴⁴

As the following case study illustrates, fintech lenders’ use of education data may impose an “HBCU/HSI penalty” on borrowers—a financial burden that has measurable, immediate economic consequences even for graduates who have already managed to overcome the obstacles described above. Our case study shows that borrowers who graduated from HBCUs or HSIs may be charged higher interest rates and origination fees than borrowers who graduated from non-minority serving institutions, thereby risking disparately impacting borrowers of color.

In the following case study, we use publicly available information about the rates offered to applicants seeking to refinance student loan debt with Upstart Network (Upstart), comparing hypothetical Upstart customers who graduated from HBCUs or HSIs, with similarly situated Upstart customers who graduated from select four-year institutions and non-minority serving institutions. The findings of this case study highlight how the use of alternative data in underwriting can adversely affect certain consumers of color in the education finance market even after they have already graduated.

Case Study: Upstart

Upstart is an online lending platform that provides financing for a range of personal loans.⁴⁵ According to the company, its platform is intended to “improve access to affordable credit while reducing the risk and cost of lending” to its partners.⁴⁶ In addition to using traditional underwriting criteria, Upstart also incorporates nontraditional factors such as educational attainment and employment history.⁴⁷ As with most fintech lenders, Upstart’s underwriting algorithm is proprietary, but Upstart has publicized its use of alternative data in lending decisions.⁴⁸

In September 2017, the Consumer Financial Protection Bureau (CFPB) issued its first No-Action Letter (NAL) to Upstart.⁴⁹ The NAL “signifies that [the CFPB] has no present intent to recommend initiation of supervisory or enforcement action against Upstart with respect to the Equal Credit Opportunity Act.”⁵⁰ In accordance with the NAL, Upstart has reported lending and compliance information to the CFPB, such as approval decisions, mitigation of consumer harm, and expansion of access to credit for underserved populations.⁵¹

Methodology

To determine how the choice of institution attended affects the pricing of private student loan refinancing products, we modeled hypothetical applicants with degrees from schools across various institutional sectors, including two- and four-year colleges with HBCU, HSI, and non-MSI designations. Inputs for prospective applicants were identical in every respect, except for the institution attended by the applicant.

Each hypothetical applicant is a 24-year-old New York City resident with a bachelor’s degree.⁵² Each applicant works as a salaried analyst at a company not listed among those offered by Upstart. Applicants have been employed by their current employer for five months, earn \$50,000 annually, and have \$5,000 in savings. Applicants have no investment accounts or additional compensation and have not taken out any new loans in the past three months. Each applicant requested a \$30,000 student loan refinancing product.

Using the above input information for each hypothetical applicant, we submitted inquiries for a private student loan refinancing product using Upstart’s publicly available rate comparison tool.⁵³ We then compared the terms presented in the respective outputs.

In the example below, we highlight the outputs for hypothetical applicants attending three institutions: New York University (NYU), a non-MSI; Howard University, an HBCU; and New Mexico State University-Las Cruces (NMSU), an HSI. We opted to highlight these three institutions based on their varied MSI designations,⁵⁴ but note that the findings were consistent across hypotheticals.

Findings

This section explores the rate and cost variation offered for private student loan refinancing products to otherwise identical borrowers who attended different colleges. Results are based on applicants seeking \$30,000 to refinance student loans, to be repaid over three- or five-year terms.

Holding all other inputs for prospective applicants constant, we find that a hypothetical refinancing applicant who attended Howard University, an HBCU, would pay more than an applicant who happened to have attended NYU. In this example, borrowers who attended the HBCU pay higher origination fees and higher interest rates over the life of their loans. Similar results are observed for applicants who attended NMSU, an HSI. In effect, borrowers who attend certain MSIs are penalized simply because of where they went to college.

Fintech Lender: Upstart Network, Inc.

Product: Private Student Loan Refinance

**LOAN
AMOUNT
\$30K****Borrower Profile****New York University***(Non-MSI)*

Major: Computer science
Occupation: Financial analyst
Annual income: \$50,000

LOAN OFFERS

Loan interest rate: 16.34% APR

Origination fee: \$1,231

**Total Cost:
\$42,288****Howard University***(HBCU)*

Major: Computer science
Occupation: Financial analyst
Annual income: \$50,000

LOAN OFFERS

Loan interest rate: 21.29% APR

Origination fee: \$1,960

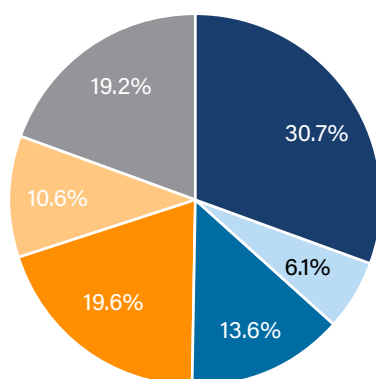
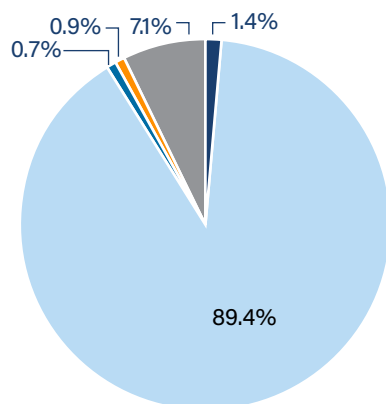
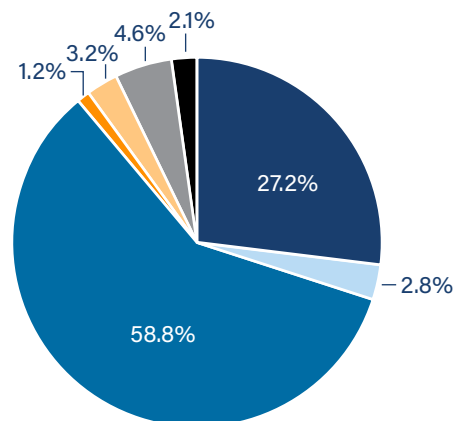
**Total Cost:
\$45,785****New Mexico State University***(HSI)*

Major: Computer science
Occupation: Financial analyst
Annual income: \$50,000

LOAN OFFERS

Loan interest rate: 19.23% APR

Origination fee: \$1,862

**Total Cost:
\$44,011****HBCU Penalty: +\$3,499****HSI Penalty: +\$1,724****Student Populations****New York University****Howard University****New Mexico State University**

White Black/African American Latinx/Hispanic Asian Other/Unknown Non-Resident Alien Native American

Demographic data from the U.S. Dep't of Education

- **Howard University graduates are charged \$3,499 more than similarly situated NYU graduates.** Over a three-year repayment term, the NYU graduate would pay \$35,093, while the Howard graduate would pay \$35,676. The disparity increases over a five-year repayment term (another repayment term offered by Upstart), with the NYU and Howard borrowers paying \$42,287 and \$45,785, respectively.
- **Howard University graduates are charged an additional \$729 in origination fees than similarly situated borrowers who attended NYU.^I** In this example, Howard borrowers would pay \$1,960 to originate a loan with a five-year repayment term, whereas the NYU borrowers would pay \$1,231 to originate a loan for the same repayment term. Likewise, for a three-year loan term, Howard borrowers would pay \$1,624 in origination fees, as compared to \$1,292 for NYU borrowers.
- **New Mexico State University (NMSU) graduates are charged nearly \$1,724 more than otherwise identical NYU graduates.** Over a five-year repayment term, a NMSU graduate with a \$30,000 student loan refinancing product would pay \$44,011 in lifetime loan costs, while the otherwise identical NYU graduate would pay \$42,287. This includes the NMSU graduate being charged \$632 more in origination fees.

^I Note that all loan applicants are modeled as requesting a \$30,000 loan refinancing product, which includes all relevant origination fees already added to the loan amount. These origination fees vary across applicants, with Upstart quoting different fee amounts for different applicants. This variance implies that while the overall loan amounts compared here are the same, the proportion of the refinancing product actually applied to underlying student loans differs, with borrowers who face higher origination fees applying less of their \$30,000 refinancing product to their outstanding student loans. The present estimates of disparities in the cost of refinancing are floor estimates, and students charged higher origination fees (that is, borrowers at HBCUs and HSIs) would need to take out larger loans to refinance the same dollar value of student loans.

Recommendations

The following recommendations to Congress, regulators, and industry highlight opportunities to address the issues outlined in this report. The industry practices discussed in detail above potentially violate a range of federal and state fair lending and consumer protection laws. More broadly, these practices may further perpetuate inequality, creating new barriers to building wealth for families across the country.

By taking immediate action, stakeholders can address the serious legal issues and far-reaching economic consequences presented by the use of education data in consumer lending.

Recommendation 1: Congress should scrutinize the use of education data in consumer lending and the No-Action Letter issued by the Consumer Financial Protection Bureau to Upstart.

In 2007, then-New York Attorney General Andrew Cuomo explained to Congress that the use of education data in consumer lending posed significant risks to borrowers of color, warning that the specter of “educational redlining” warranted immediate attention from lawmakers.⁵⁵

The findings of this report demonstrate the prescience of Cuomo’s warning. Big banks and fintech “innovators” are embracing education data when making new consumer loans. In doing so, these companies may be unlawfully discriminating against people of color and exacerbating economic inequality. Given the economic consequences potentially posed by a market-wide embrace of education data in consumer lending, Congress should deploy its full suite of investigatory, oversight, and legislative tools to protect consumers.

As part of this coordinated, market-wide oversight, Congress should investigate the CFPB’s handling of the 2017 No Action Letter awarded to Upstart. As described above, in 2017 the CFPB issued its first No-Action Letter (NAL) to fintech lender Upstart, pledging not to enforce federal fair lending laws so long as the company provides regular data about the company’s business practices to the Bureau. The preceding

case study, constructed using Upstart's own marketing materials, plainly illustrates the potential for racial disparities in credit pricing as a result of Upstart's lending practices. As Upstart expands the licensing of its underwriting algorithm to other financial services companies, scrutiny of these practices is even more important.

Congress should immediately demand the following historical data from Upstart to assess whether CFPB's 2017 NAL is consistent with the law and meets the needs of consumers, industry, and the marketplace:^{III}

- Upstart's overall loan approval (expressed in dollars lent as well as consumers served) and denial rates for loans made using non-individualized education data (e.g., school, school sector, major) in the underwriting process.
- Upstart's loan approval and denial rates where a consumer indicates that he or she attended an institution of higher education enrolling populations with significant percentages of undergraduate minority students.⁵⁶
- Upstart's loan approval and denial rates where a consumer indicates that he or she attended an institution of higher education other than one enrolling populations with significant percentages of undergraduate minority students.⁵⁷
- Upstart's loan approval and denial rates where a consumer indicates that he or she attended a community college.
- Upstart's loan approval and denial rates where a consumer indicates that he or she attended an institution of higher education other than a community college.
- Upstart's interest rate spread (25th percentile, median, 75th percentile) for loans made using non-individualized education data (e.g., school, school sector, major) in the underwriting process.
- Upstart's interest rate spread (25th percentile, median, 75th percentile) where a consumer indicates that he or she attended an institution of higher education enrolling populations with significant percentages of undergraduate minority students.⁵⁸

III To date, little public information has been produced by the CFPB about Upstart's disclosures to the Bureau under its NAL agreement. The limited disclosures made by the CFPB appear to have been based on a simulation, comparing Upstart's approach to underwriting and pricing against a hypothetical model that relies on FICO score. This approach is seriously flawed. It fails to isolate the effects of educational data on protected classes of borrowers when similarly-situated Upstart customers are compared to one another. The flaws in this design suggest a path forward for Congressional investigators—by demanding the production of data that allows for an apples-to-apples comparison across Upstart's existing portfolio of customers, including data on approvals and denials specific to each college or university attended by an Upstart customer, Congress can more accurately assess whether Upstart's approach to underwriting or pricing loans has a disparate impact. See Consumer Financial Protection Bureau, *An update on credit access and the Bureau's first No-Action Letter* (August 2019), <https://www.consumerfinance.gov/about-us/blog/update-credit-access-and-no-action-letter>.

- Upstart's interest rate spread (25th percentile, median, 75th percentile) where a consumer indicates that he or she attended an institution of higher education other than one enrolling populations with significant percentages of undergraduate minority students.⁵⁹
- Upstart's interest rate spread (25th percentile, median, 75th percentile) where a consumer indicates that he or she attended a community college.
- Upstart's interest rate spread (25th percentile, median, 75th percentile) where a consumer indicates that he or she attended an institution of higher education other than a community college.

Should information produced by Upstart demonstrate that the company's practices have a disparate impact on protected classes with respect to the cost of credit, or offer evidence that Upstart's approach to consumer lending perpetuates economic inequality, Congress should immediately clarify to the CFPB that these outcomes are inconsistent with the intent behind the No-Action Letter Program. Further, Congress may wish to consider new legislation to prohibit the CFPB from waiving the Equal Credit Opportunity Act (ECOA) for any companies seeking a No-Action Letter in the future, narrowing the scope of CFPB's authority to issue these types of letters.

Recommendation 2: Federal and state financial regulators should prioritize oversight of the use of education data in underwriting to ensure lenders comply with fair lending laws.

Federal and state financial regulators supervise compliance with and enforce fair lending laws. Regulated financial institutions include both large banks like Wells Fargo and nonbank specialty consumer lenders like Upstart. Based on the findings of this report, federal and state financial regulators should prioritize the oversight of consumer lending where regulated entities use education data in underwriting or pricing credit.

Federal financial regulators, including prudential regulators and the CFPB, should examine the use of education criteria in lending decisions by big banks and nonbank consumer lenders. Federal regulators, including the Office of the Comptroller of the Currency (OCC), the Federal Reserve Board, the Federal Deposit Insurance Corporation (FDIC), the Federal Trade Commission (FTC), and the CFPB, oversee or enforce laws that may apply to the use of education data in consumer lending. In particular, these regulators may enforce ECOA, which prohibits certain types of discrimination in the extension of credit.⁶⁰ As the first case study in this report demonstrates, large regulated financial institutions may use education data when determining access to credit or pricing financial products, despite the fair lending compliance

risks it creates for these financial institutions.⁶¹ This report offers ample evidence to suggest Wells Fargo's consumer lending practices, in particular, create risks for protected classes of consumers.

There is recent precedent for the CFPB and other regulators to consider the use of non-individualized education data as a fair lending compliance risk for financial institutions. In 2012, the CFPB studied the use of schools' Cohort Default Rate (CDR) in private student lending, finding that, "[g]enerally . . . lenders' consideration of CDR in either school eligibility or underwriting and pricing criteria may reduce credit access and increase costs disproportionately for minority borrowers."⁶²

Following publication of the 2012 report, the CFPB incorporated this finding into its examination procedures by instructing examiners to consider the use of CDR when evaluating both bank and nonbank private student lenders for compliance with ECOA. Shortly thereafter, the FDIC took an enforcement action against Sallie Mae Bank for violating ECOA by using this particular piece of education data in underwriting and pricing private student loans.⁶³

Based on the evidence presented in this report, other regulators should adopt the same approach as the FDIC—prioritizing scrutiny of these practices across the financial services sector and taking enforcement actions where appropriate.

States should prioritize action to stamp out educational redlining when overseeing consumer lending by banks and nonbanks. Since 2017, the CFPB has ceased to bring new enforcement actions policing discrimination in the financial sector, drawing criticism from state law enforcement officials, civil rights groups, and Members of Congress for failing to appropriately administer the nation's fair lending laws.⁶⁴ Fortunately for consumers, the Dodd-Frank Act empowers state attorneys general and state banking regulators to enforce these laws with respect to the companies they regulate. This authority presents an opportunity for state officials to scrutinize the use of education data in consumer lending within their states, stepping in where the CFPB has recently failed to act.

In addition, states may enforce and administer a wide range of state civil rights and anti-discrimination statutes. Evidence suggests that some states are already beginning to scrutinize these entities for violations of state law. As part of any expanded state oversight effort, state regulators and law enforcement should scrutinize Upstart's practices for compliance with these state fair lending laws in the context of the CFPB's Upstart No-Action Letter.

Recommendation 3: Consumer lenders, including banks and fintech specialty lenders, should regularly publish information on underwriting decisions and pricing that relies on education data.

Banks and specialty lenders such as Wells Fargo and Upstart that use education data in their underwriting decisions should make available data on the impact of these criteria on access to credit (including both approvals and denials) and on pricing of loans for consumers. This information should track access and pricing both for borrowers who attend minority-serving institutions and for borrowers who attend non-minority serving institutions. This additional information about credit decisioning and pricing should be made available to the public at large, including stakeholders inside and outside of government, through publication on the lender's website and disclosure at the time of application. For this public disclosure to be effective, it should include data that allows for comparison across a company's existing portfolio of customers, including data on approvals and denials specific to each college or university attended by an applicant for credit.

By embracing new transparency with respect to the effects of education data on lending, market participants can empower borrowers to shop for financial products with an accurate understanding of the costs and risks associated with each product. Further, such transparency efforts will empower federal and state regulators to perform more effective oversight over the industry.

Conclusion

Communities of color have historically been locked out of mainstream credit markets. But while companies tout the use of education-based criteria in underwriting as a means to broaden credit access for marginalized consumers, the use of such factors may actually undermine equitable access to credit. Indeed, by creating situations where protected classes of consumers are offered less favorable credit terms, the use of education data in credit underwriting decisions can reinforce systemic barriers to economic opportunity.

Discrimination in consumer credit markets is not new. But as this analysis shows, the use of education data in underwriting could charge borrowers more for a loan simply for choosing the most accessible path for pursuing the American Dream. Is this what is meant by a mission of 'innovation'? Access to credit should not simply mean 'more people getting more loans.' It is imperative to examine the variance in the cost of those loans. Otherwise, expanded access to credit will not expand equity.

With mortgage redlining, borrowers are given worse loans simply because of who their neighbor is. Now, with educational redlining, borrowers are given worse loans simply because of who is sitting next to them in the classroom. Just as law enforcement took action against mortgage redlining, they must do the same with education redlining. Innovation should not re-package age-old discrimination. Rather, true innovation should provide a means to equitably broaden credit access for historically marginalized communities.

Endnotes

- ¹ Charles Davidson, *Lack of Access in Financial Services Impedes Economic Mobility*, Fed. Res. Bank of Atlanta Economy Matters (Oct. 18, 2018), <https://www.frbatlanta.org/economy-matters/community-and-economic-development/2018/10/16/lack-of-access-to-financial-services-impedes-economic-mobility>; see also Christopher K. Odinet, *The New Data of Student Debt*, 92 S. Cal. L. Rev. 1617, 1673 (Dec. 2019).
- ² *Report on the Economic Well-Being of U.S. Households in 2016-May 2017*, Fed. Res. Bank (June 14, 2017), <https://www.federalreserve.gov/publications/2017-economic-well-being-of-us-households-in-2016-banking-credit.htm>.
- ³ Lori Teresa Yearwood, *Many minorities avoid seeking credit due to generations of discrimination. Why that keeps them back*, CNBC (Sept. 6, 2019), <https://www.cnbc.com/2019/09/01/many-minorities-avoid-seeking-credit-due-to-decades-of-discrimination.html>; Lisa Rice, *Missing Credit: How the U.S. Credit System Restricts Access to Consumers of Color*, Nat'l Fair Hous. All. (Feb. 26, 2019), <https://financialservices.house.gov/uploadedfiles/hhrg-116-ba00-wstate-ricel-20190226.pdf>; Bradley L. Hardy et al., *The Historical Role of Race and Policy for Regional Inequality*, The Hamilton Project, at 8 (Sept. 2018), https://www.hamiltonproject.org/assets/files/PBP_HardyLoganParman_1009.pdf; Tracy Jan, *Redlining was banned 50 years ago. It's still hurting minorities today*, Wash. Post (Mar. 28, 2018), <https://www.washingtonpost.com/news/wonk/wp/2018/03/28/redlining-was-banned-50-years-ago-its-still-hurting-minorities-today>; Danyelle Solomon et al., *Systemic Inequality: Displacement, Exclusion, and Segregation: How America's Housing System Undermines Wealth Building in Communities of Color*, Ctr. for Am. Progress, 4-10 (Aug. 2019), <https://cdn.americanprogress.org/content/uploads/2019/08/06135943/StructuralRacismHousing.pdf>.
- ⁴ Paul Hancock et al., *Supreme Court vs. HUD: The Race to Decide "Impact or Intent"*, K&L Gates (Nov. 17, 2011), <http://www.klgates.com/em-supreme-court-vs-hudem--the-race-to-decide-impact-or-intent-11-17-2011>; see also Lisa Rice & Deidre Swesnik, *Discriminatory Effects of Credit Scoring on Communities of Color*, Suffolk L. Rev. (Dec. 19, 2013), http://suffolklawreview.org/wp-content/uploads/2014/01/Rice-Swesnik_Lead.pdf.
- ⁵ See, e.g., Upstart, *Upstart Receives First No-Action Letter Issued by Consumer Financial Protection Bureau* (Sept. 14, 2017), <https://www.upstart.com/blog/upstart-receives-first-no-action-letter-issued-consumer-financial-protection-bureau> [hereinafter *Upstart Release*].
- ⁶ See Aryn Bussey, *Educational Redlining? The use of education data in underwriting could leave HBCU and MSI graduates in the dark*, Student Borrower Prot. Ctr (July 24, 2019), <https://protectborrowers.org/educational-redlining>.
- ⁷ See, e.g., *Upstart Release*, *supra* note 5.
- ⁸ See Bussey, *supra* note 6.
- ⁹ See *id.*
- ¹⁰ See *id.*
- ¹¹ A series of lenders were examined for their use of education-based data in underwriting decisions. In particular, Wells Fargo Bank and Upstart were selected for the availability of their products' rate calculation without a credit check (Wells Fargo) and only a soft credit inquiry (Upstart).
- ¹² See *Who are the credit invisibles?*, Consumer Fin. Prot. Bureau (CFPB) (Dec. 2016), https://files.consumerfinance.gov/f/documents/201612_cfpb_credit_invisible_policy_report.pdf [hereinafter *Credit Invisibles*].
- ¹³ See, e.g., *Upstart Release*, *supra* note 5.

- 14 See Brian Kreiswirth et al., *Using alternative data to evaluate creditworthiness* (Feb. 16, 2017), <https://www.consumerfinance.gov/about-us/blog/using-alternative-data-evaluate-creditworthiness/>.
- 15 See *Credit Invisibles*, *supra* note 12, at 5.
- 16 See Dowse B. Rustin IV et al., *Pricing without Discrimination: Alternative Student Loan Pricing, Income-Share Agreements, and the Equal Credit Opportunity Act*, Am. Enter. Inst. (Feb. 2017), <https://www.aei.org/wp-content/uploads/2017/02/Pricing-Without-Discrimination.pdf>.
- 17 Odinet, *supra* note 1, at 1644-1648.
- 18 Odinet, *supra* note 1, at 1645.
- 19 See, e.g., *Upstart Release*, *supra* note 5.
- 20 *Examining the Use of Alternative Data in Underwriting and Credit Scoring to Expand Access to Credit: Hearing Before the H. Task Force on Financial Technology*, 116th Cong. 7 (2019) (statement of Chi Chi Wu, Staff Attorney, National Consumer Law Center).
- 21 See Jeremy Ashkenas et al., *Even with Affirmative Action, Blacks and Hispanics are More Underrepresented at Top Colleges Than 35 Years Ago*, N.Y. Times (Aug. 24, 2017), <https://www.nytimes.com/interactive/2017/08/24/us/affirmative-action.html>.
- 22 See, e.g., Daniel Aaronson et al., *The Effects of the 1930s HOLC “Redlining” Maps*, Fed. Res. Bank of Chicago (Feb. 2019); see also Hannah Fry, *Lori Loughlin’s daughters remain at USC amid college admissions scandal*, L.A. Times (Mar. 26, 2019), <https://www.latimes.com/local/lanow/la-me-ln-college-cheating-giannulli-20190326-story.html>.
- 23 Bussey, *supra* note 6.
- 24 Despite a half-century ban, redlining based on geography persists in cities across the country. In the early 1930s, the federal government made efforts to steady the nation’s housing market by making changes to valuation assessments. Aaronson et al., *supra* note 22, at 3. The government classified neighborhoods by their relative lending risks; in addition to housing-based characteristics such as price, housing age, and quality, homes were also classified by race and ethnicity. *Id.* Predominantly black neighborhoods were the lowest-rated, and thus those neighborhoods were denied access to credit. *Id.* Although the Fair Housing Act of 1968 bars housing discrimination, redlining and the residual effects of residential segregation persist. Sam Fullwood III, *The United States’ History of Segregated Housing Continues to Limit Affordable Housing*, Ctr. for Am. Progress (Dec. 15, 2016) <https://www.americanprogress.org/issues/race/reports/2016/12/15/294374/the-united-states-history-of-segregated-housing-continues-to-limit-affordable-housing>. Residential segregation of African Americans remains high, particularly in large urban areas. Douglas S. Massey, *American Apartheid: Segregation and the Making of the Underclass*, Am. J. of Sociology, Vol. 96, No. 2, 329-357, 354 (Sept. 1990).
- 25 A 2018 analysis by the Center for Investigative Reporting found race-based lending disparities in 61 metropolitan areas across the country. Aaron Glantz & Emmanuel Martinez, *Modern-day redlining: How banks block people of color from homeownership*, Chicago Tribune (Feb. 17, 2018) <https://www.chicagotribune.com/business/ct-biz-modern-day-redlining-20180215-story.html>.
- 26 See Kevin Drawbaugh, *Lawmakers Quiz Student Lenders on ‘redlining’*, Reuters (June 7, 2007) <https://www.reuters.com/article/us-studentloans-congress/lawmakers-quiz-student-lenders-on-redlining-idUSN0724029120070607>.
- 27 See Assoc. Press, *Cuomo charges ‘redlining’ in student loan probe*, NBC News (June 19, 2007), http://www.nbcnews.com/id/19316230/ns/business-personal_finance/t/cuomo-charges-redlining-student-loan-probe/#.Xjhm9GhKhPY.
- 28 See Drawbaugh, *supra* note 26.
- 29 See, e.g., Kreiswirth, *supra* note 14; Rustin, *supra* note 16.
- 30 George Kuh et al., *What Matters to Student Success: A Review of the Literature* at 77, Nat. Postsecondary Educ. Coop. (July 2006), https://nces.ed.gov/npec/pdf/kuh_team_report.pdf.
- 31 Rustin, *supra* note 16.
- 32 See also Drawbaugh, *supra* note 26.
- 33 See Jennifer Ma & Sandy Baum, *Trends in Community Colleges: Enrollment, Prices, Student Debt, and Completion*, College Bd. Research (Apr. 2016), <https://research.collegeboard.org/pdf/trends-community-colleges-research-brief.pdf>.

- 34 See *id.*
- 35 See *id.*
- 36 See *Wells Fargo Private Student Loans*, Wells Fargo, <https://www.wellsfargo.com/student/> (last visited Feb. 3, 2020).
- 37 See *Wells Fargo Undergraduate Private Student Loans*, Wells Fargo, <https://www.wellsfargo.com/student/collegiate-loans/> (last visited Jan. 30, 2020).
- 38 See *Wells Fargo Private Loans for Community College*, Wells Fargo, <https://www.wellsfargo.com/student/community-college-loans/> (last visited Jan. 30, 2020).
- 39 See *Today's Rates*, Wells Fargo, <https://wfefs.wellsfargo.com/terms/TodaysRates> (last visited Feb. 3, 2020).
- 40 See also Ellen Wexler, *Geography Matters*, Inside Higher Ed (Feb. 3, 2016), <https://www.insidehighered.com/news/2016/02/03/when-students-enroll-college-geography-matters-more-policy-makers-think> ("At public four-year colleges, the median distance students live from home is 18 miles. That number is 46 miles for private nonprofit four-year colleges, and only eight miles at public two-year colleges.").
- 41 See U.S. Dep't of Ed., *Characteristics of Minority-Serving Institutions and Minority Undergraduates Enrolled in These Institutions*, Nat'l Ctr. for Ed. Statistics, U.S. Dep't of Ed. (Nov. 2007), <https://nces.ed.gov/pubs2008/2008156.pdf>.
- 42 Walter R. Allen, *Foreword to Understanding Minority-Serving Institutions*, xv-xvi, xv-xix (Marybeth Gasman et al. eds., State University of New York Press) (2008).
- 43 See Alisa Cunningham et al., *Issue Brief: Minority-Serving Institutions Doing More with Less*, Inst. for Higher Ed. Policy (Feb. 2014), <https://vtechworks.lib.vt.edu/bitstream/handle/10919/83120/MinorityServingInstitutions.pdf?sequence=1&isAllowed=y>.
- 44 See Josh Mitchell & Andrea Fuller, *The Student-Debt Crisis Hits Hardest at Historically Black Colleges*, Wall St. J. (Apr. 17, 2018), <https://www.wsj.com/articles/the-student-debt-crisis-hits-hardest-at-historically-black-colleges-11555511327>.
- 45 See Upstart Network, <https://www.upstart.com/about#who-we-are> (last visited Jan. 15, 2020).
- 46 See *id.*
- 47 See *Upstart Release*, *supra* note 5.
- 48 See *id.*
- 49 See *CFPB Announces First No-Action Letter to Upstart Network*, Consumer Fin. Prot. Bureau (Sept. 14, 2017), <https://www.consumerfinance.gov/about-us/newsroom/cfpb-announces-first-no-action-letter-upstart-network/>.
- 50 *Id.*
- 51 *Id.*
- 52 See generally Kenneth P. Brevoort & Michele Kambara, *CFPB Data Point: Becoming Credit Visible*, Consumer Fin. Prot. Bureau (June 2017), https://files.consumerfinance.gov/f/documents/BecomingCreditVisible_Data_Point_Final.pdf (finding that the majority of consumers are credit visible by age 25).
- 53 *Compare Rates With Our Loan Calculator*, Upstart, <https://www.upstart.com/blog/compare-rates-loan-calculator> (last visited Feb. 3, 2020).
- 54 See *United States Department of Education Lists of Postsecondary Institutions Enrolling Populations with Significant Percentages of Undergraduate Minority Students*, U.S. Dep't of Educ. (accessed Feb. 3, 2020), <https://www2.ed.gov/about/offices/list/ocr/edlite-minorityinst.html> [hereinafter *MSI List*].
- 55 See *Drawbaugh*, *supra* note 26.
- 56 See *MSI List*, *supra* note 54.
- 57 See *id.*
- 58 See *id.*
- 59 See *id.*
- 60 See 15 U.S.C. §§ 1691 et seq.; see also *Equal Credit Opportunity Act*, CFPB Consumer Laws and Regulations, Consumer Fin. Prot. Bureau, https://files.consumerfinance.gov/f/201306_cfpb_laws-and-regulations_ecoa-combined-june-2013.pdf.
-

- 61 See e.g., *Equal Credit Opportunity Act*, CFPB Consumer Laws and Regulations, Consumer Financial Protection Bureau, https://files.consumerfinance.gov/f/201306_cfpb_laws-and-regulations_ecoa-combined-june-2013.pdf.
- 62 *Fair Lending Report of the Consumer Financial Protection Bureau*, Consumer Fin. Prot. Bureau (Dec. 2012), https://files.consumerfinance.gov/f/201212_cfpb_fair-lending-report.pdf.
- 63 See *FDIC Announces Settlement with Sallie Mae for Unfair and Deceptive Practices and Violations of the Servicemembers Civil Relief Act*, Fed. Deposit Ins. Corp. (May 13, 2014), <https://www.fdic.gov/news/news/press/2014/pr14033.html>.
- 64 See Kate Berry, *Where Have all the CFPB Fair-Lending Cases Gone?*, Am. Banker (Dec. 16, 2019) <https://www.americanbanker.com/news/where-have-all-the-cfpb-fair-lending-cases-gone>.



| STUDENT BORROWER
PROTECTION CENTER

PROTECTBORROWERS.ORG