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How Fintech Companies Can Mitigate the Racial Wealth Gap*

Testimony submitted to
The Task Force on Financial Technology

"Emerging Fintech Consumer Products: Buy Now Pay Later, Earned Wage Access, and Related Products"

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Good morning, Chairwoman Waters and members of the Task Force on Financial Technology. I am Kristen Broady, and I am a fellow in the Brookings Metropolitan Policy Program.

Thank you for the opportunity to appear before you to discuss consumer lending products offered by technology-focused fintech companies.

Introduction

The coronavirus pandemic has created an economic crisis and worsened the racial wealth gap in the United States. African American and Native American people are contracting and dying from the virus at higher rates than white Americans. In August 2021 COVID-19 cases per 100,000 people were 8,915 for Native Americans and 6,524 for African Americans compared to 5,482 for white Americans (Health Equity Tracker). According to the Centers for Disease Control and Prevention (CDC), COVID-19 related deaths per 100,000 people as of August 2021 were 220 for Native Americans, 175 for African Americans and 147 for white Americans. On the economic front, job losses have been concentrated among minorities, women, and low-wage workers. But the discussion started long before the impacts of COVID-19 were realized. The socioeconomic position of Black people and other minorities in America cannot be fully contextualized without considering the marginalization of their racialized social identities as minorities who have historically combatted subjugation and oppression with respect to income, employment, homeownership, education, and political representation.

Data and research show that Black people have on average higher unemployment rates, lower earnings, lower rates of homeownership, and pay more for credit and banking services – all factors that result from a history of structural racism in the U.S. These factors contribute to vast disparities in financial health, and wealth creation and accumulation between their households and white households. The ability of Black households to spend, save, borrow and plan – within the context of structural racism – can be used to explore the nuances of disparities in financial health and wealth creation. Moreover, financial knowledge or financial literacy is one of the determinants of an individual's or group's financial behavior with regard to accumulation or loss of wealth. The deficiency in widely available products that meet the needs of various households is another major factor.

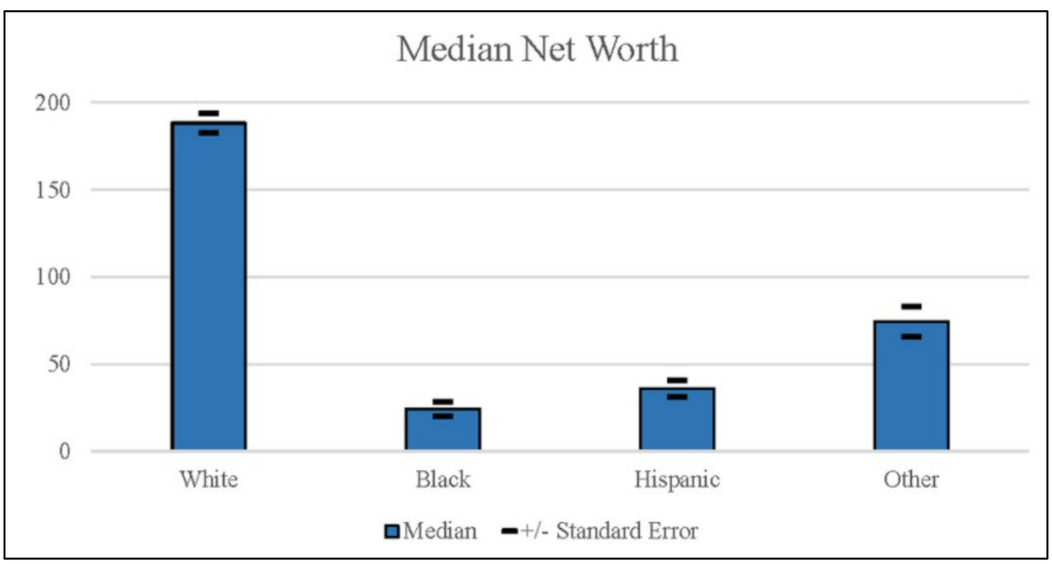
Generally, financial institutions provide financial tools, such as credit cards, personal loans, 401(k) loans, and personal lines of credit. Fundamentally, financial institutions rely on traditional metrics, particularly credit scores, in decisions over the provision of liquidity to individuals – but these measurements may be subject to racial bias, thereby contributing to wealth inequality.

The Racial Wealth Gap

The racial distribution of wealth is a comparison of the wealth of members of different racial groups and demonstrates significant economic inequality in the United States. In 1990, white people accounted for 75.64 percent of the United States population and in the first quarter of that year white households held $18.88 trillion (90.1 percent) in household wealth, compared to $0.83 trillion (4 percent) held by Black households where Black people accounted for 11.75 of the population and $0.44 trillion for Hispanic households (2.1 percent) with Hispanic or Latino people making up 8.99 percent of the population (Federal Reserve and U.S. Census Bureau). Thirty years later, in the second quarter of 2020, white households held $94.04 trillion (83.9 percent) in household wealth while according to 2019 U.S. Census data white people accounted for 60.1 percent of the U.S. population. Though the percentage of white people in the U.S. population decreased by 15.5 percent, the share of wealth held by white households only decreased by 6.2 percent. Comparatively Black people accounted for 13.4 percent of the U.S. population in 2019 and Black households held $4.64 trillion (4.1 percent) in household wealth in the second quarter of 2020. The Hispanic or Latino population increased to 18.5 percent in 2019 and Hispanic or Latino households held $2.69 trillion (2.4 percent) in household wealth (Federal Reserve and U.S. Census Bureau).

In 2016 the median net worth (in 2019 dollars) of the typical white non-Hispanic household was $181,900, nearly ten times greater than that of the typical Black household's wealth, $18,200 (Board of Governor of the Federal Reserve System). Four years later, in September 2020, new data was released in the 2019 Survey of Consumer Finances (SCF), which showed a continuation of the long-standing and substantial wealth disparity between Black and white households. The data showed a slight decrease in the disparity in family wealth for white and Black families. In 2019, the median net worth of a typical white household, $188,200, was 7.8 times greater than that of a typical Black household, $24,100 (Board of Governors of the Federal Reserve System). Figure 1 shows median net worth by race in 2019. Between 2016 and 2019 white household wealth increased by 3 percent, while Black household wealth increased by 33 percent. Hispanic or Latino households experienced the greatest percentage increase in household wealth between 2016 and 2019, 65 percent, from $21,900 to $36,200.

Figure 1. Median Net Worth by Race: 2019



Source: Board of Governors of the Federal Reserve System

While the numbers discussed in the previous paragraph illustrate a small redistribution of wealth between white, Black and Hispanic or Latino households, they also illustrate the historical racial wealth gap that exists in the United States. And though the racial wealth gap has decreased since 2016, only one percent (or fewer) of the wealthiest families in the U.S. were Black or Hispanic in

2019 (Bricker, et. al, 2020). According to the Survey of Consumer Finances, nearly 75 percent of the families in the wealthiest 1 percent own privately held businesses and private business assets make up more than one-third of their balance sheets, illustrating the importance of private business ownership to wealth accumulation (Bricker, et. al, 2020). In addition to private business ownership that leads to a positive return on investment, net worth or wealth is a function of inheritance, past levels of disposable income, and the propensity to save (Lamas and McNeil, 1988). In addition to its obvious negative impact on Black and Hispanic individuals and communities, the racial wealth gap also constrains the U.S. economy as a whole and it is estimated that it will dampen consumption and investment by between $1 and 1.5 trillion between 2019 and 2028, 4 to 6 percent of the projected GDP in 2028 (Noel, et al., 2019).

Fintech Companies Can Mitigate the Racial Wealth Gap

Financial technology (fintech) companies can mitigate racial financial health and wealth gaps that hamper Black and Hispanic families' financial security through product offerings and policies they put in place. Through technology and automation, they can reduce costs and prices, speed up delivery and increase convenience for underserved populations (Saunders, 2019). Over the past 20 years, fintech companies have provided new ways to capture data, reach broader audiences, and expand access to credit (Strochak, 2017). These companies also have the potential to think differently about policies and programming that can amplify opportunities for Black and minority communities. These private sector innovations can be paired with public policy interventions as well to address some of the systemic issues that have contributed to the financial health and wealth gaps.

- **Create inclusive financial services products for people who are credit invisibles or low credit individuals. For example:**

  Cash Flow

  - **Smooth and stabilize cash flow by collaborating with enterprise.** Financially vulnerable populations experience greater income and expense volatility. Offering accounts that do not have overdraft fees, minimum balance requirements, and account maintenance fees can help reduce the negative impacts of this volatility (Walsh, 2020).
    - One example is the Build Card. Through its Build Card, a $500 unsecured credit card, FS Card (acquired in 2018), Inc., founded in 2014 by Marla Blow, an African American woman, looks beyond past credit history to provide customers with a buffer to pay for necessities when their income is unexpectedly lower or when expenses rise without warning (Gerhardt, 2017). FS Card is designed to move small-dollar loan customers into more affordable products and provide honest mainstream financial products to the mass market, allowing under-served borrowers to meet their everyday liquidity needs (The Moguldom Nation).
  - **Provide interest-free buy now, pay later capabilities so that consumers can comfortably make purchases and spread out payments as they get paid.** Klarna's buy now, pay later option allows customers to split the cost of their purchase into 4 smaller payments, without paying any interest or impacting their credit score. This

allows consumers the ability to try items before they pay for them and only pay for items that they keep.

Saving and Investing

- **Help Americans build emergency savings.** According to an AARP 2020 national survey of U.S. adults aged 30 and older, 3 in 5 African Americans experienced an unexpected financial challenge in the past year. A study by EPI found that in 2016 half of families had no retirement savings at all and that disparities existed by race. Two-thirds (68 percent) of white non-Hispanic families had retirement savings, compared to 41 percent for Black families and 35 percent for Hispanic families. To increase the saving ability of Black and Hispanic families, fintech companies can offer high-yield savings accounts, automated savings features, and robo and micro investing tools to increase savings opportunities (Walsh, 2020).

Credit

- **Use alternative data and machine learning to extend affordable credit to a larger population of consumers** (Walsh, 2020). While traditional credit-scoring mechanisms are backward looking, new data and algorithms provide the opportunity for fintech companies to use better indicators to determine creditworthiness (Strochak, 2017). People generally need credit and access to other financial services to buy homes and cars, finance businesses, and send their children to college, in addition to non-credit contexts including hiring processes for some jobs (Robinson and Yu, 2014). Credit scores can significantly impact consumers' financial lives as lenders rely extensively on them in decision making for mortgages, auto loans and credit cards (Consumer Financial Protection Bureau). Financial institutions are exposed to the risk of adverse selection. To mitigate this risk, FICO credit scores are used to assess the financial health of potential customers and borrowers. Providing an alternative application method that includes cash flow data, or an interview to assess creditworthiness would provide access to credit services for populations that may not qualify through traditional credit scoring. Additionally, fintech companies should participate in algorithmic bias assessments in order to identify and solve for potential inherent biases in their machine learning capabilities that may be part of any credit underwriting assessments.

- **Provide fast, fair, and flexible small business lending products that do not require a personal credit score for underwriting.** The same alternative data and machine learning solutions mentioned above in the context of consumer credit, can also be applied to small business lending. Eliminating the use of FICO scores and reducing collateral requirements will enable greater access to these underserved communities of entrepreneurs.

    - PayPal Working Capital, established in 2014, offers fixed-rate loans to small business owners based on the small business' sales to assess creditworthiness. This method allows for a transparent and flexible fixed cost loan that can be repaid through a percentage of the small business' future sales. Past research, conducted by PayPal has shown that PPWC loans are over-indexing to low-and-moderate income communities as well as areas with greater minority population.

- **Focus on access to capital through a racial equity lens. In addition to being deliberate in how small business credit products meet the needs of Black-owned small businesses, capitalize on opportunities to work with government stakeholders and provide a fintech perspective so that as laws and regulations are updated they reflect the changing landscape of financial services. For example:**
    - Engage in the Bureau's Section 1071 Rulemaking process
    - Participate in the Bureau's Special Purpose Credit Program (SPCP)
    - Engage with OCC Project Reach
    - Engage with FDIC tech sprints
- **Offer products that bridge the gap between cash and traditional financial services that empower people to participate in the digital economy. For example:**
    - Customers can use the PayPal app or the PayPal Cash Card to load money or withdraw cash from your PayPal account at Walmart.
- **Hire more people of color and institute employee financial wellness initiatives like providing equity to all employees and raising wages.** Income disparity falls squarely at the intersection between racial wealth inequality and financial health. Fintech companies should institute hiring policies that require interviewing a diverse pool of applicants for any open position. They should also implement employee financial wellness initiatives whereby employees at all levels earn a living wage (target 20% of net disposable income), and are provided with company equity as part of base compensation.
- **Meet people where they are in their communities, working more intentionally with local leaders, MDIs (Minority Depository Institutions) and CDFIs (Community Financial Depository Institutions).**
    - MoCaFi is a great example. Founded by Wole Coaxum, an African American, Oxford-educated Wall Street executive in 2014, Mobility Capital Finance Inc. (MoCaFi) is a digital banking platform that has enrolled more than 25,000 users, raised more than $6 million in seed funding, collaborated with Fortune 100 companies, and established a presence in major U.S. cities. MoCaFi's objective is to empower Black households and businesses by:
        - Collaborating with community organizations, local officials, and area businesses in targeted cities;
        - Addressing unbanked and underbanked communities of color by providing affordable banking and credit counseling services;
        - Increasing African American homeownership by 100 percent in designated cities; and
        - Working with cities to implement a plan for African American business hubs (MoCaFi).

- **Partner with banks that are focused on racial equity.** Whether national or regional banks, do your research to ensure that financial institutions you partner with are meaningful and deliberate in their hiring practices, investments, and products offerings.
- **Engage with BIPOC VCs when looking for financing and with BIPOC asset managers when investing.**

Public Policymakers Can Take Steps to Increase Financial Health

- **Increase Investments in the CDFI Fund and Make Any Relevant Programs that Sunset (like NMTC) permanent.**
- **Create a mandatory financial health curriculum for middle and high schoolers.** As referenced in the introduction of this paper, financial knowledge or financial literacy determine an individual's or group's financial behavior with regard to the accumulation or loss of wealth. Congress has the ability to mandate that our public schooling system equip middle and high schoolers with some form of education so that they know what types of products are available to best meet various needs throughout their adult lives.
- **Enhance broadband deployment.** The potential that fintech provides can only be fully realized when there is 5G internet capabilities spread evenly across the country. Federal and state/local governments should prioritize connectivity, particularly in low-income areas so these communities can unlock the potential of digitization.
- **Raise minimum wage for companies with over 500 employees.** By design, minimum wages boost the pay of workers who are among the lowest-paid in the U.S. labor market. And Black workers have the highest share of those who are paid the minimum wage among all major racial and ethnic groups in the United States. Increasing the minimum wage to $15 an hour, for example, would increase the earnings of 38.1 percent of Black workers, compared to 23.2 percent of White workers. This calculation is based on a combination of workers in states whose minimum wage is determined by the current federal minimum wage of $7.25 per hour, workers in states with a state minimum wage below the federal minimum, and workers in all other states who are currently earning less than $15 per hour (Derenoncourt, Montialoux, and Bahn, 2020).
- **Foster Utilization of the CFPB Special Purpose Credit Program (SPCP).** The Equal Credit Opportunity Act (ECOA) and Regulation B prohibit discrimination on a prohibited basis in any aspect of a credit transaction. The Special Purpose Credit Program (SPCP) provisions of the Equal Credit Opportunity Act (ECOA) and Regulation B, however, provide targeted means by which creditors can meet special social needs and benefit economically disadvantaged groups (Bernard and Ficklin, 2020).
- **Revise and Revive the SBIC program under the SBA to incentivize private sector investments in BIPOC founders.** SBA's Office of Investment and Innovation (OII) leads programs that provide the high-growth small business community with access to two things: financial capital and research and development funds to develop commercially viable innovations. The Small Business Investment Company (SBIC) Program is an investment program that increases access to capital for growth stage businesses. The SBIC program is effective and distinct because the private sector leads with its capital and investment expertise, and then SBIC leverage follows to augment the impact of the private

investment. The government does not pick winners and losers, private investors guide capital to the companies with the best potential (U.S. Small Business Administration, 2018).

- **Revise SBA 7(a) program to enable fintechs to more easily engage with the program.** By modernizing the SBA's lending facilities, private sector participants can come in and help distribute capital to the most underserved areas. Some key aspects of this modernization include, reducing paperwork, improving API architecture to streamline functionality and data access, and update how the lender interacts with the SBA's systems and personnel.
    - The cap on guarantee is at 50% for 7(a) Express program similar to regular 7(a)
        - A higher guarantee will provide better terms (rate and duration)
    - Extending the term of the loan to enable greater cashflow, particularly during this time as SMBs are recovering will be key
        - Innovative companies like PayPal and our competitors have the ability to use innovative underwriting process to serve small businesses. We would love to work with SBA to use technology to expand opportunities.

Conclusion

The ongoing COVID-19 pandemic has disproportionately impacted the Black community in terms of health and economic effects and shined a light on historical racial wealth and financial health gaps in America. Closing these gaps will require that structural, systemic, and historical economic disparities are addressed through significant public policy changes (Moss et al., 2020).