the impact of credit standards on financial health

What It's Costing You and Your Potential Accountholders

Financially healthy people make good accountholders.

They pay their bills on time. They take out loans and make deposits. They save more. They use banking tools to track their spending habits, set up 401Ks and IRAs, and use debit and credit cards to spend on goods and travel. People who are financially healthy – who have enough confidence in their finances to spend, save, borrow, and plan in ways that result in financial security for the short- and long-term – are exactly the kind of accountholders community and regional banks and credit unions need to attract and retain.

The trouble is, less than one-third of adults in the United States are financially healthy.[1]

the impact of credit on potential accountholders

The remaining 70% – or 176 million Americans – are categorized as either financially vulnerable or financially coping.

Of those 176 million people, about 108 million have no or low credit scores – which, for better or worse, is a vital component of most people's financial health.[2] After all, credit scores affect people's ability to borrow, which influences their ability to borrow money

for a house, pay for emergency expenses, or buy a car. Credit can be especially important to families who need to smooth out their expenses while living paycheck to paycheck or pay for something like a surprise medical visit.

Without access to prime credit, these Americans are hindered on their financial health journeys – getting caught in a cycle of debt and bad credit.

Financially healthy people make good accountholders.

credit: the starting line

To have a good credit score, people need access to credit. But, in order to get access to credit, they need a credit score. So, right at the starting line of their financial health journeys, millions of Americans are stuck in a catch-22.

To make matters worse, the starting line for credit seems to be pushed further back for minority communities.

Young adults in majority Black and Hispanic communities tend to have lower average credit scores compared with those who reside in majority white communities.[3] A recent CNBC article points out that "the reason Black and Hispanic borrowers start out behind on their credit scores has less to do with individual behavior and more to do with the limited financial resources of their family households"[4] – citing historical lending policies like property covenants that favored white borrowers and prevented Black people from living in majority white areas.

Research from the Urban Institute found 25- to 29-year-olds in Black communities to have a median credit score of 582; the same age range in majority Hispanic communities to have a median score of 644; and those in majority white communities to have a 687. All compared to the subprime threshold of 600.[5]

the cost of subprime credit

the cost to consumers

Between 2010 and 2021, only 21% of 25- to 29-year-olds in majority white communities saw their credit scores go down – but 26.2% in majority Hispanic and 33.9% in Black communities saw significant declines.[6]

These decreases in credit, unscoreable credit, and low credit scores have significant, long-lasting financial consequences. When people with subprime credit scores look for loans, they only qualify for those with the highest interest rates. Compared to borrowers with prime credit scores, borrowers with subprime credit pay nearly $400 more in interest over three months for a $550 loan; and $3,000 over four years more for a $10,000 loan.[7]

This high-cost credit often leads to cycles of debt that further strain the credit scores of those who can afford it the least.

Worse yet, when left unpaid, the bills for these expensive credit options incur late and penalty fees. Collectively, high-cost credit and overdraft fees cost consumers more than $23 billion every year.[8]

the cost to your financial institution

For people with subprime credit, this spiral means a further decline in financial health.

For community and regional financial institutions, it means a loss in wallet and app share, revenue opportunities, and accountholder loyalty.

The lack of access to affordable credit has left the door open for financial fragmentation. There are an average of three fintech apps on consumers' phones to a primary financial institution's one; and as a point of reference, 200 million bank accounts are connected to Plaid alone. Instead of turning to their bank or credit union, people are looking to fintechs and challenger banks for the help, tools, and technology they need – even when it comes to lending. Fintech lending providers and their investors are taking advantage of this trend: in 2021, global fintech funding surged to a record high of $131.5 billion across 4,696 deals, accounting for 21% of all venture capital funding during the year.[9]

When people go the route of Venmo, challenger banks, financial apps, or other nonbank entities, primary financial institutions are leaving loyalty on the table. Accountholders who believe their bank or credit union is helping them improve their financial health are:[10]

- 3x more likely to be satisfied with that financial institution
- 3x more likely to recommend that financial institution to friends and family

High-cost credit often leads to cycles of debt that further strain the credit scores of those who can afford it the least.

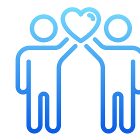
- 2x as likely to continue that relationship
- 5x more likely to purchase additional products and services

the business opportunity

The effects of credit standards and their influence on the ability of people to borrow are far reaching. That's the bad news.

Now, consider the business opportunity. There are more than a million financially vulnerable people you can guide toward financial wellness by helping to improve their credit scores – moving them into the mainstream financial sector so they become accountholders with higher levels of engagement with your financial institution.

By aligning your business strategy with the financial health of potential customers and members, you can expect better financial and social returns – gaining wallet and app share, increasing revenue, and creating loyal accountholders for life.



There are more than a million financially vulnerable people you can guide toward financial wellness by helping to improve their credit scores.

help people take action

To help people improve their credit scores and, in turn, become financially healthy accountholders, consider using the right tools and technology that will make it easy for you to:

- Boost awareness by embedding credit tools into your digital banking platform and offering credit monitoring and identity protection solutions.
- Assist people in interpreting credit reports and determine what actions they need to take next. To do this, look for integrations that offer specific actions an accountholder can take to maximize their score or a credit score simulator that shows how credit scores can be impacted by specific credit actions and behaviors.
- Utilize alternative credit scoring models to expand access to lower-cost financial services.

The truth is, no bank or credit union wants to turn away potential business. That only happens if the risk, which is tied to low credit scores, outweighs the potential profit.

Ensuring consumers' financial health is not only a good way to do business, but it's also a way to increase profitability and revenues.

increase credit scores to improve financial health and your bottom line

Get inspired by one financial institution that helps the financially vulnerable become financially safe.

For more information about Jack Henry, visit jackhenry.com.

sources

1. *Financial Health Pulse® 2022 U.S. Trends Report*, Financial Health Network, accessed December 20, 2022.
2. *Credit Scores: Millions of Americans "Are Stuck in a Catch-22,"* Yahoo! Money, accessed December 20, 2022.
3. *Young Adults' Credit Trajectories Vary Widely by Race and Ethnicity*, Urban Institute, accessed December 20, 2022.
4. *Why Young Adults in Minority Communities Tend to Start Out with Lower Credit Scores*, CNBC: Personal Finance, accessed December 20, 2022.
5. *Young Adults' Credit Trajectories*
6. *Young Adults' Credit Trajectories*
7. *Credit Health During the COVID-19 Pandemic*, Urban Institute, accessed December 21, 2022.
8. *Achieving Financial Wellness: Innovative Companies Empowering Consumers*, Aite, May 2021, 4–5.
9. Monica Johnson. *Fintech Funding Trends*, International Banker, accessed December 27, 2022.
10. *Episode 436*, 11:FS Presents Fintech Insider, accessed December 21, 2022.

jack henry™

© 2023 Jack Henry & Associates, Inc.®