Evaluating the Impact of an Automated Low-Cost Credit Building Program on Graduate Students' Financial Capabilities and Access to Credit

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PROJECT CONCEPT NOTE

Introduction

Credit builder loans (CBL) are an opportunity for people with limited or poor credit to build a positive credit history through an accommodating payment structure. Traditional CBLs mitigate risks for lenders by requiring borrowers to complete monthly installment payments before they receive the loan. While this structure may encourage borrowers to save, it propagates unrealistic demands on low income borrowers liquidity. Conversely, the Georgetown University Alumni & Student Federal Credit Union (GUASFCU) offers alumni, current students, and their immediate families access to a risk-free Credit Building Program at little to no expense. After borrowers pay a one-time fee, the credit union deposits the loan in a restricted account and make monthly loan payments on their behalf. The program thus represents the first credit-building loan product to guarantee borrowers a track record of consistent loan payments. This research project will evaluate the impact of the GUASFCU Credit Building Program on participants' access to credit and financial well-being. In so doing, it will acknowledge potential inequities among minorities and low-income populations and identify opportunities and challenges to improving the intervention's external validity.

Motivation

People's credit history can play a pivotal role in their approval for rental housing, car loans, or even important promotions. Nonetheless, low-risk credit-building opportunities are difficult to access given that retail banks have a perverse incentive to deemphasize credit-building opportunities among borrowers qualifying for higher interest rate loans. CBLs offered by other federal credit unions may pose significant short-term financial burdens that exclude borrowers with limited disposable income. These programs typically function as savings accounts by requiring individuals to make payments toward the loan prior to receiving the funds.

Individuals who cannot consistently afford and manage monthly payments fail to establish a favorable credit history and improve their credit scores. GUASFCU addressed issues related to the cost and burden of making on-time payments by offering a significantly subsidized low to no-cost service that freezes the loaned funds in a separate account and automatically draws from the account each month to make timely loan payments in the borrowers' name.

Background

There have been few studies on whether credit builder loans meaningfully improve recipients' financial capabilities. Building on research conducted so far, this project unravels the importance of automation and liquidity in designing an effective credit-builder product. In a systematic review of 24 financial capacity interventions, Birkenmaier, and colleagues noted "the need to develop a more definitive evidence base for financial capability interventions." Nonetheless, using an "intent-to-treat" design, Burke, et al. (2022) studied over 1500 credit union members to evaluate whether a stand-alone CBL improved low-income adults' financial standing. Borrowers made a preemptive payment toward the loan, the loaning institution immediately deposited the amount paid toward the principal into the borrowers' savings account. Participants' payment history at baseline significantly predicted whether their credit scores improved. Among those without existing debt, CBL borrowers were 24% more likely to have a credit score that increased by an average of 8 points. Conversely, scores for CBL takers with existing loans declined by an average of 5 points. Scaling observed effects up by a factor of 5 to account for the differential take rate between the study's two arms yielded an implied difference of 65 points in post-treatment effects between the two groups. The authors suggest that this difference may be partly attributed to the increased rate of payment delinquency among CBL takers with existing loans.

People without an account at a Federal Credit Union or Community Bank may use a handful of other strategies to build or improve their credit. Experian's Credit Boost is a broadly targeted credit building service that adds preexisting monthly payment obligations such as rent and utilities to a user's credit report. A secured credit card may also be a viable solution for people looking to diversify their credit report or maintain liquidity down the line (Martin, 2020). Unlike traditional CBLs where consumers receive the sum of their monthly payments at the end of the program, credit card owners typically pay a deposit equivalent to the total credit card limit as collateral to protect the credit lender in instances of default (Santucci, 2016). People who keep their accounts open experience an improvement of around 25 points in their credit score on average over the course of two years (Santucci, 2016). Secured credit cards offer more flexibility than traditional CBLs by proving purchasing power to low-income borrowers when they urgently need it. While secured credit cards can insure against the negative effects of low liquidity under the appropriate circumstances, they may have a relatively negative long-term impact on liquidity for some borrowers. Most secured credit card holders maintain a revolving balance that continues to grow if they routinely pay less than they utilize every month (Santucci, 2019). This behavior would increase their monthly payment obligation over time, reducing any insurance against low liquidity offered by the line of credit. Borrowers also sacrifice liquidity during the period ranging from 6 months to multiple years that it would take for them to graduate from a secured to an unsecured account holder. To receive their deposit back sooner, cardholders would need to close their account, likely incurring an additional hit to their credit score (Santucci, 2016).

Lending circles are a credit-building intervention targeted toward immigrants with limited credit histories (Reyes et al., 2013a). Mission Asset Fund's implementation of this credit intervention formalizes the small personal loans that are common in many close-knit, lower-income communities (Reyes et al., 2013a). In 2011, Mission Asset Fund piloted a program in five Bay Area communities in partnership with charities that had a presence in these communities and Citi (Reyes et al., 2013b). The intervention was associated with a nearly 600-point improvement in credit scores among program participants who had no credit history and a 168-point improvement in credit scores for low-income participants. The effect was smaller for people with higher incomes and an established credit history. There are several websites that offer peer-to-peer lending services that function similarly to MAF's lending circles, but they tend to be targeted toward people who own or intend to start a business.

Intervention

The Georgetown University Alumni and Student Federal Credit Union started the Credit Building Program in 2012. The structure of the loan has remained the same since its inception. In 2020, GUASFCU partnered with Georgetown University (GU) to subsidize the cost of the lowest-tiered loan for current GU students. The program offers $1000, $2000, and $3000 loan options for all members. Most members who sign-up for the loan are undergraduate students, who typically go from having no credit score to a score in the high 600s – low 700s at the end of the program. A GUASFCU representative conceded that the loans are unlikely to have a large effect on people with significant debt or outstanding payments. To that end, they do not significantly undermine loaners' ability to discern borrowers' creditworthiness.

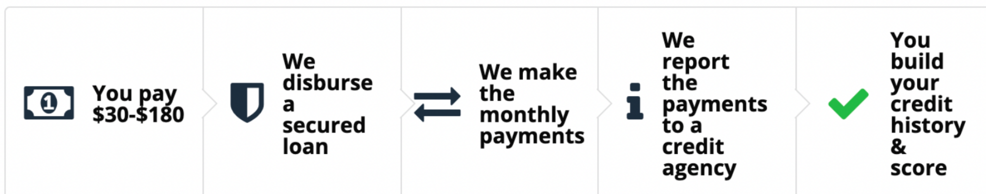
Table 1. *GUASFCU Credit Building Loan Offerings and Sign-Up Fee*

Type	18 Months	24 Months	36 Months
Basic $1,000 Loan	$30	$40	$60
Preferred $2,000 Loan	$60	$80	$120
Plus $3,000 Loan	$90	$120	$180

Conceptual Framework

The borrower (or Georgetown University) pays the sum of the loan's interest when they sign up to receive the loan. The banking institution then freezes the loan in a separate account and uses the funds to pay off the loan over a period of 18-36 months. In short, borrowers are guaranteed a history of on-time payments and a higher credit score (all else equal) without having to monitor the loan account or manage monthly payments. A higher credit score provides program participants with increased access to more diverse and affordable credit products, putting them in a better position to purchase property, invest in business ventures, and remain financially resilient in times of emergency.

Figure 1. *GUASFCU Credit Building Program Loan*



Implications for outcomes of interest

Whether participants' credit scores rise and remain in good standing has implications for the effectiveness and sustainability of the program -- that is, whether the program achieves the desired outcomes and whether those outcomes are likely to persist. Other outcomes of interest that point to the program's effectiveness include participants' borrowing limits, interest rates, and approved credit options. Furthermore, overall credit use and the use of credit product features (e.g., reward points) signals the program's impact, or whether the intervention makes a meaningful difference in participants' lives. Null results along these parameters only could indicate that the outcomes of the program are not relevant to participants' consumption, or that those effects are delayed. It could also indicate the need to address an important confounding or mediating factor, such as race or financial literacy.

Relevance

The intervention's novel credit-building strategy represents a low-risk alternative for people without access to a cosigner or consistent income. Although the program is scalable to other institutions, an oversaturated market would reduce the effectiveness of credit scores in predicting creditworthiness. Still, promising results could provide evidence for streamlining additional end-user processes to promote saving and investing.

Methodology

Research and Sampling Design

Researchers use email, posters, and word-of-mouth to recruit current Georgetown University graduate students to participate in the study. The recruitment materials do not disclose the purpose of the study but rather instruct students with a U.S. bank account to complete a Financial Capabilities Survey that determines whether students are enrolled in the study and compensated via Venmo or CashApp after completing all the necessary requirements. The first part of the survey includes questions that assess students' prior knowledge of GUASFCU's Credit Builder Program. It also includes questions that gauge students' financial capacity and access to credit. After completing Part 1 of the survey, students who indicated prior knowledge of the CBL program or high access to credit are notified that they do not qualify for the study. The remaining students are notified that they have been enrolled in the study and given additional information including instructions to complete Part 2. The survey randomly assigns participants to treatment or control and provides the former with a separate form to sign up for the loan. To increase the potential impact of receiving the loan on participants' credit scores, the treatment group receives a $2000 loan with a 24-month repayment period subsidized by the study and Georgetown University (instead of the $1000 loan with an 18-month repayment period covered by the University).

Data Collection

Researchers access or solicit copies of participants' FICO® scores and credit reports based on Experian credit data[1] every three months for the duration of the study. These include participants' payment histories, credit limits, outstanding debt, age of accounts, recent credit inquiries, and any delinquencies such as bankruptcies.

Participants provide additional quantitative and qualitative financial information by completing the Financial Capabilities Survey at the beginning and end of the study. The survey (issued through SurveyCTO) asks participants to report demographic and financial information such as their race and personal income and gathers qualitative insights such as participants' financial habits and goals. A preliminary outline of the survey is provided below.

Survey Questions Outline

- **Screening:** Awareness of the CBL program (students with prior knowledge of the program will be excluded from the sample)
- **Demographic:** Age, gender, race, occupation, relationship status, etc.

[1] FICO® scores and credit reports are accessible online for free every 30 days with an Experian Creditworks℠ Basic: Free account without it constituting a hard inquiry.

- **Quantitative:** Income, consumption, savings, rent/mortgage, wealth, banks, etc.
- **Personal perception:** Socioeconomic status, financial stability, fiscal responsibility, financial literacy, and current access to credit
- **Money Habits:** Budgeting, borrowing, investing, saving, spending, and managing credit
- **Financial Goals:** Goals, strategies, and perceived barriers to building and accessing credit (including experiences with other credit-building financial products)
- **Credit Score Impact:** Financial capabilities (consumption choices, financial independence, purchasing power, etc.)
- **Secondary Impact:** Related outcomes (mood, work-life balance, housing and career choices, personal goals, leisure, etc.)

Limitations

The research design aims to address important limitations of the study. The study samples graduate students who, unlike undergraduate students, are largely unaware of the CBL Program. Since graduate students tend to already have a credit score, the study is unlikely to capture the effect of the program on people without a credit score. Moreover, Georgetown University graduate students are not representative of the people in historically disadvantaged communities who would benefit most from this type of loan structure.

Although participants are compensated for completing the enrollment requirements, the study may still incur a low sign-up rate or high rate of attrition. Participants who do not finish the survey or loan form will be reminded to complete them through text nudges and ineligible students who volunteer to assist with the study. Similar methods are used to solicit credit reports from students who opt not to provide their Experian login information. Researchers aim to encourage participants to provide their login information by explaining in the survey that researchers cannot access their credit card information, pin, security questions, or social security number with their Experian login information.

Hypotheses

Hypothesis 1: The treatment group will experience a significantly larger increase in their average credit score and

Hypothesis 2: The treatment group will report a larger increase in their financial capability and access to credit.

Hypothesis 3: The loan will have a larger, positive impact on students with thinner credit profiles.

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