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Financial Inclusion: Past, Present, and Hopes for the Future

Remarks by

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at

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Thank you, Art, and let me say how excited I am to be a part of the Federal Reserve Board's inaugural conference on financial inclusion and innovation.[1] Financial inclusion is central to the Federal Reserve's mission of promoting a strong and stable financial system and a healthy economy that works for everyone. This event brings together academics, practitioners, and thought leaders to discuss how financial products and practices are evolving to better meet the needs of individuals and businesses historically underserved by the financial system.

I have spent much of my career in the public sector and academia working on topics related to financial inclusion. I've found that projects that bring together public, private, academic, and nonprofit perspectives are often the most productive, since we all approach the issue differently and can learn from each other's perspectives. Forums like these provide good opportunities to form connections and spark collaboration.

Looking over the past few decades, significant progress has been made in improving financial inclusion, including progress on many of the issues that will be discussed at this conference. And yet we still have further to go. Continued support for responsible innovation in this space is needed and can benefit from engagement across industry, academia, and regulators. This morning, I will touch on how approaches to financial inclusion have evolved, where things stand today, and how we can continue progress toward a more inclusive financial system.

Advancing the Goals of Financial Inclusion

The goal of financial inclusion is to improve access to affordable financial services that meet the needs of individuals and businesses. Banking the unbanked is part

[1] The views here are my own and do not necessarily reflect those of my colleagues on the Federal Reserve Board or the Federal Open Market Committee.

of that, but we also need to make sure that both bank and nonbank products and services are designed to meet the financial service needs of low- and moderate-income households. And we need strong consumer protections to guard against abuse.

Banks are playing a pivotal role in innovating to serve low- and moderate-income households, sometimes in partnership with financial technology companies, or fintechs. For example, we have seen a growing number of banks offering small-dollar loans, expanding use of alternative data to underwrite and price their credit products, and investing in tools to help better understand consumers' financial health. When adopted in a responsible and well-managed manner—with systems, processes, and policies in place to monitor and manage related risks—these innovations can broaden access to fair, affordable, and transparent bank-provided credit. This in turn can create financial resilience among small businesses and help individuals and families become homeowners, build wealth, and become financially empowered.

The Importance of Durable Inclusion

Innovations in banking services are important to improving financial inclusion. But to have a durable impact on society, innovations must be adopted responsibly. Banks must have controls to manage risks and prevent violations of law, and their approach must keep pace with the growth of new products and services. Complexity can exacerbate risks and requires banks to pay particular attention to ensure that laws are followed and customers protected. To the extent banks are working with fintech partners, banks have a responsibility to manage the risks associated with the third parties they partner with to serve their customers.

We have, unfortunately, seen examples of failures of banks to effectively manage the risks of partnerships with other companies that support services to their end customers, and these failures have resulted in customer harm. In communities where people are living on tight budgets or with limited access to financial services, disruptions of this kind can be catastrophic. These examples are a reminder that providing innovative financial services comes with responsibilities to ensure that risks are appropriately controlled. Durably supporting financial inclusion means ensuring that necessary controls grow in step.

Use of Alternative Data

We do see great promise to improve financial access when innovation is done with the appropriate risk controls in place. One such promising avenue is the use of alternative data in credit decisions involving small-dollar loans. Historically, access to the financial system was limited for many households and small businesses that lacked key financial credentials. For example, traditional credit models favor an applicant that already has a sufficient credit history and a file from a credit reporting bureau to qualify for lending. This leads to a catch-22 where lower-income applicants with scant credit history but ample ability to repay are denied access to credit because they do not have a credit history.[2] As a result, many lower-income households, both banked and unbanked,

[2] The Consumer Financial Protection Bureau reports that, as of 2016, 26 million Americans (11 percent of adults) do not have a credit record at one of the three national credit reporting agencies. See Kenneth P. Brevoort and Michelle Kambara, *CFPB Data Point: Becoming Credit Visible* (Washington: Consumer Financial Protection Bureau, June 2017), https://files.consumerfinance.gov/f/documents/BecomingCreditVisible_Data_Point_Final.pdf.

end up using a range of formal and informal services outside the banking system that too often keep households in a cycle of debt.[3]

Actions by the Federal Reserve have supported the opportunities, as well as identified potential risks, associated with innovations in bank products and practices marketed to those who have limited access to the financial system. In 2019, the Federal Reserve's alternative data statement highlighted the benefits and risks when banks and nonbank firms leverage alternative data in credit underwriting, particularly for borrowers that have been locked out of conventional borrowing.[4] This guidance underscored the potential benefit of using data that has a clear connection to creditworthiness, such as information on inflows and outflows from a bank customer's deposit account. With the share of households with bank accounts much larger than the share with credit scores and especially with prime or near-prime credit scores, this information has the potential to allow underwriting of a much larger pool of potential reliable borrowers. In addition, in 2020, the Federal Reserve issued principles for responsible small-dollar lending, typically uncollateralized loans of less than $2,000 that often leverage alternative data while being underwritten.[5] This guidance has encouraged the spread of these types of loans to households and small businesses that otherwise have had limited access to credit.[6] In

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[3] For example, see Michael S. Barr, "Financial Services, Savings and Borrowing Among Low- and Moderate-Income Households: Evidence from the Detroit Area Household Financial Services Survey" (3rd Annual Conference on Empirical Legal Studies Papers, March 30, 2008), https://dx.doi.org/10.2139/ssrn.1121195.
[4] See Board of Governors of the Federal Reserve System, "Interagency Statement on the Use of Alternative Data in Credit Underwriting," CA letter 19-11 (December 12, 2019), https://www.federalreserve.gov/supervisionreg/caletters/caltr1911.htm.
[5] See Board of Governors of the Federal Reserve System, "Interagency Lending Principles for Making Responsible Small-Dollar Loans," SR letter 20-14 / CA 20-8 (May 20, 2020), https://www.federalreserve.gov/supervisionreg/srletters/SR2014.htm.
[6] For more details on the impact of small-dollar loan guidance, see Daniel Gorin, Sarah Gosky, and Michael Suher, "Empirical Assessment of SR/CA Small-Dollar Lending Letter Impact," FEDS Notes (Washington: Board of Governors of the Federal Reserve System, July 28, 2023), https://doi.org/10.17016/2380-7172.3329.

addition, given the small but growing number of banks partnering with fintechs for alternative data and small-dollar lending, among other things, the Federal Reserve issued guidance in 2023 and 2024 on how to responsibly manage these third-party relationships.[7] Taken together, these statements are helpful resources to ensure that banks are using the technological innovations from these third parties in safe and responsible ways.

As noted in the alternative data guidance, alternative data can be sourced from a bank's own relationship with its customers. And evidence from research and industry experimentation suggests that information on cash flow from an individual's bank account can help predict credit risk while expanding credit access.[8]

We are already seeing progress in this space. Banks and credit unions of all sizes are starting to use alternative data to offer small-dollar loans to their existing customers with short-term liquidity needs. Given the early promise of these loans, this area seems particularly suitable for banks to innovate and experiment safely and fairly, within the confines of safety and soundness standards and consumer protection laws.

In addition, banks and others have done extensive work over the past few years to measure the impact of bank products on the financial outcomes of customers. Among those metrics are a set of financial health indicators around a customer's cash flow and payment history that capture their ability to meet their own short-term liquidity needs,

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[7] See Board of Governors of the Federal Reserve System, "Interagency Guidance on Third-Party Relationships: Risk Management," SR letter 23-4 (June 7, 2023), https://www.federalreserve.gov/supervisionreg/srletters/SR2304.htm; and Board of Governors of the Federal Reserve System, "Third-Party Risk Management: A Guide for Community Banks," SR letter 24-2 / CA 24-1 (May 7, 2024), https://www.federalreserve.gov/supervisionreg/srletters/SR2402.htm.

[8] For example, see FinRegLab, "The Use of Cash-Flow Data in Underwriting Credit: Empirical Research Findings," https://finreglab.org/wp-content/uploads/2023/12/FinRegLab_2019-07-25_Research-Report_The-Use-of-Cash-Flow-Data-in-Underwriting-Credit_Empirical-Research-Findings.pdf.

build financial capacity, and affordably access financial services over time.[9] Such indicators can help banks better understand the impact of their products and services on their customers, so that they support their customers' longer-term financial resilience. These indicators can also equip customers with the transparency and tools to assess financial service offerings.

Potential of Instant Payments

I'd also like to highlight the potential for real-time payment systems—including FedNow® and private sector systems—to advance financial inclusion. These services will enable banks to offer customers the ability to send and receive money immediately, which can help customers weather income disruption and unexpected expenses. By reducing payment delays and the high costs for consumers associated with those delays, FedNow can over time improve access to the financial system and lower costs.

Increased Access to Consumer Data

I'm also interested to see how increased access to consumer-authorized data will change the landscape for innovation. As the rules, regulations, and practices related to expanded access and sharing of customer-permissioned data flows evolve, consumers may benefit from having a fuller picture of their financial life to better understand ways to improve their financial health. Customer-permissioned data access, alongside innovations in digital identity, also has the potential to allow banks to better assess a borrower's creditworthiness, increase customer access to financial services, offer customized and innovative financial products, and empower individuals to move more freely in the emerging digital financial system. Of course, bank adoption will play a key

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[9] Examples of financial health indicators include a customer earning more than they spend monthly, having access to adequate savings, and maintaining a prime credit score.

role in unlocking the power of such innovation. As with most innovations, regulators will need to ensure appropriate measures are in place to protect consumers and promote financial stability. For example, regulators will need to be diligent so that the entities to which consumers grant access to their data safeguard privacy and data security.

Community Reinvestment Act: Past, Present, and Future

Let me turn now to the importance of the Community Reinvestment Act (CRA) and its role in advancing financial inclusion. As we know well, access to financial services and credit is fundamental to economic security and vital to strong communities. This access is the foundation of homeownership, education, small business development, and other economic activities that improve our lives and neighborhoods. I want to relate these values to the CRA and the Federal Reserve's commitment to encourage access to credit in low- and moderate-income communities.

Congress enacted the CRA in 1977 as one of a set of laws, together with the Home Mortgage Disclosure Act, the Fair Housing Act, and the Equal Credit Opportunity Act, to address redlining, other forms of racial discrimination, and lack of access to credit in low- and moderate-income communities. Fair lending laws set the unequivocal standard that there is no place for such discrimination in the financial system. Federal banking agencies reinforce this standard by taking a bank's fair lending record into account when assigning a CRA rating and evaluating whether banks meet the credit needs in low- and moderate-income communities, consistent with safe and sound lending.

Through the enactment of the CRA, Congress charged the Federal Reserve and other federal bank regulators with the responsibility of assessing the performance of banks in meeting the credit needs of low- and moderate-income communities.

Throughout the CRA's nearly 50 years of supervisory history, the agencies have strived to provide guidance that reflected dynamic changes in the financial landscape and at some points in time revise the regulations to do so.

Last October, the federal bank regulatory agencies issued a final rule to strengthen and modernize the regulations implementing the CRA.[10] Prior to the issuance of the final rule, the regulations had not been significantly updated since 1995. Throughout the rulemaking process, bankers and community groups consistently emphasized the need for greater clarity, consistency, and transparency than was provided under the existing rules and guidance.

In response, much of the detail in the final rule is designed to provide the desired additional clarity. The final rule standardizes the evaluation approach so that it is more consistent across the agencies and more transparent to banks and the public. It does this in a way that builds on how CRA examinations are conducted today.

The final rule includes several provisions intended to advance financial inclusion. For example, it emphasizes the work that minority depository institutions (MDIs) and community development financial institutions do to expand access to credit and opportunity in underserved communities. It also includes a focus on activities that serve Native Land Areas, persistent poverty areas, and other high-need areas.

We take our supervisory responsibilities under the CRA seriously, knowing that it helps to foster real opportunity for consumers and communities. The CRA has served as a critical tool to support financial inclusion across the country since its passage and will remain a vital tool for bankers and community organizations to work together to promote

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[10] Community Reinvestment Act, 89 Fed. Reg. 6,574 (February 1, 2024), https://www.govinfo.gov/content/pkg/FR-2024-02-01/pdf/2023-25797.pdf.

financial inclusion and economic development in low- and moderate-income communities.

The Future of Financial Inclusion

Given the importance of innovation to the goal of financial inclusion, I am grateful that we have been able to gather so many experts on topics related to it.

While we have made considerable progress, we need to continue our efforts to support greater inclusion and a financial system that meets the needs of all Americans. At the Federal Reserve, we will continue to work to improve our understanding of the innovations in financial inclusion, and the intersection of payments innovation and financial inclusion, among others. We also will use our position to monitor innovations that have financial inclusion implications—such as alternative data use and financial health measurement—and keep the public informed on the evolving industry practices that help meet the needs of the financially underserved. For example, we expect to provide additional resources on alternative data use in the coming months. In addition, the Fed's Partnership for Progress program helps MDIs and women's depository institutions (WDIs) navigate their unique business challenges, provides MDIs and WDIs with resources for technical assistance, and conducts research on the unique challenges faced by low- and moderate-income communities.[11] We also actively partner with Native American communities to better understand their financial needs.

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[11] Details about the Partnership for Progress program for MDIs and WDIs can be found in SR letter 21-6 / CA 21-4. See Board of Governors of the Federal Reserve System, "Highlighting the Federal Reserve System's Partnership for Progress Program for Minority Depository Institutions and Women's Depository Institutions," SR letter 21-6 / CA 21-4 (March 5, 2021), https://www.federalreserve.gov/supervisionreg/srletters/SR2106.htm.

In addition to the Federal Reserve's role, the private sector is a key source for financial innovation, and we encourage businesses to responsibly innovate so that new tools that can increase financial inclusiveness are safe for customers and consistent with financial stability.

We would all benefit from additional research in this area. For instance, how do we help ensure that expanding access to fair and affordable credit advances safe and sound lending? Empirically, which innovations are best able to meet customer needs safely and affordably, maintain bank safety and soundness, and promote a healthier economy? And how can we leverage concepts in behavioral economics to improve the effectiveness of credit products? I hope the conversations in today's conference can spark productive dialogue and spur potential research in these areas.

Conclusion

In closing, my hope is that these kinds of efforts, as well as continued innovation in the banking system, can bring us closer to a time when all families and communities in our country have adequate access to credit and financial services on fair, affordable, transparent, and accessible terms.