

# Credit Score and the Disadvantages for Young Adults

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## ABSTRACT

This paper examines the societal issues that young adults face with traditional credit scoring systems. This includes the problem of credit invisibility and the use of outdated metrics that assess one's financial standing. It analyzes how newer potential earners are disadvantaged by traditional models through the exclusion of non-traditional indicators such as rent, utilities, and even modern digital payments. This covers both the US and South Korea, highlighting the increased credit exposure risks and plummeting credit scores of Korean as well as American youth. This research proposes a solution in three steps: the use of alternative financial data, increasing the transparency of AI systems in credit evaluation, and holistic financial literacy. This will reform the credit system into one that actively encourages the inclusion of young adults, mitigates societal risk, and grants unrestricted access to economic opportunities.

## 1. INTRODUCTION

In modern life, access to credit is a foundational aspect of having financial stability, which directly affects one's well-being. Credit, its importance significantly increasing in the late 19th century with the rise of long-term mortgages and installment loans, now heavily influences an individual's ability to secure loans, rent housing, and even gain employment. While the importance of credit and credit scores is immense, however, the demographic group of young adults are facing a disadvantage from traditional credit scoring systems of getting significant barriers in their start of financial life. Most of them are even unaware of the importance of credit and further the disadvantages they face. Since credit scoring models rely heavily on past borrowing behaviors, such as credit card usage and loan repayment, individuals without prior

financial activities, who have just started their separate financial life out of the influence or help of their parents, are often excluded from fair credit evaluation, leading to credit invisibility and limited financial opportunities.

Further beyond the issue of exclusion, current and traditional credit scoring systems often utilize outdated methodologies as well as a narrow range of data sources. Conventional models only account for the use of traditional credit products, while omitting alternative financial behaviors that may reflect one's financial responsibility, such as rent payments, utility bills, digital transactions, and more. This omission results in an incomplete picture of creditworthiness in terms of those of most young adults, who just started their financial life, and therefore disproportionately disadvantages such demographic group. Additionally, further complications are sprouting from the rise and utilization of AI-driven credit evaluation models. While the utilization of AI is an effort to improve the traditional methods of evaluation and may further improve predictive accuracy, many of these systems function as "black-box models". That is, they lack transparency in how credit scores are determined. This current situation on using AI alarms fairness, reliability, and algorithmic biases that may disadvantage young consumers additionally.

In order to address these issues, this paper proposes a modernized method to credit scoring that includes integrating alternative financial data and enhancing AI transparency, all while prioritizing financial education as well. The incorporation of additional financial behaviors of rent, utility, and digital payment histories in credit assessment, specifically for the demographic group of young adults, would positively impact financial institutions and further enable them to make a more comprehensive system that has fair evaluation. Ensuring that AI-based credit evaluation models

provide clear, explainable decisions would improve trust as well as reduce bias. Structured financial education initiatives and beginner-friendly credit-building tools would be able to help young adults gain the necessary experience to manage credit responsibly.

Proposing such three main components would be helpful in arguing that the reform of credit evaluation would foster the creation of a fairer and more accessible credit system for young adults. If the reform is made, these changes would subsequently bring greater financial inclusion and economic mobility as well.

## **2. Analysis of Current Problem: The Challenges of Credit Invisibility**

As priorly mentioned, traditional credit scoring systems exclude young adults by design as they primarily rely on historical credit activity. Many young adults entering the financial system face the state of credit invisibility, which means the lack of sufficient credit history for a score to be generated. This is a big factor that unfavors young adults who did not have prior loans or credit cards, which includes the vast majority of this demographic group, to be nearly unable to have a fair assessment in the start of their financial responsibilities. Unlike the misconception that young adults start with excessively low credit scores, the reality is that they often have no credit score at all, as traditional credit models require prior borrowing activity to establish a credit profile. The problem is that the start of the journey is excessively hard, not the whole process. And such individuals without a score are seen as high-risk borrowers that have difficulties to access financial products. This issue of credit invisibility extends beyond loans; many landlords conduct credit checks before renting properties, and some U.S. employers even review credit reports as part of background screenings [1].

In South Korea, this issue of credit invisibility is particularly more severe. That is, the credit scores of young adults in Korea are actually declining over time. According to the report from the Bank of Korea, the credit ratings of individuals in their 20s have been consistently falling since 2008, which was the opposite from those of older generations, which have been increasing [2]. Further on, the number of young adults in their 20s classified as credit risks are rapidly increasing. With credit

invisibility being one of the major reasons that attribute to this trend, some other causes include high youth unemployment, rising tuition costs, and increasing reliance on private loans, all of which make it harder for young Koreans to build strong credit profiles early on [3]. The delinquency rate for mortgage loans held by people in their 20s was 0.39% across 19 major banks as of September 2023. Additionally, outstanding debt among borrowers in their 20s at South Korea's top three online banks—Kakao Bank, K-Bank, and Toss Bank—grew 3.7 times in one year and reached ₩58.7 billion KRW, or approximately \$44.3 million USD. [3][4]. This shows that unlike the situation in the U.S. where starting credit scores have been gradually increasing though some hardships, South Korea's younger population is currently facing worsening financial conditions that impact their creditworthiness.

The fundamental problem is that young adults struggle to generate a score in the first place, not that they start with excessively low credit scores. This leads to restricted financial opportunities, and further to other consequent disadvantages in the future. Without access to better credit-building tools as well as alternative credit evaluation methods, young adults in both the U.S. and South Korea will continue to face barriers to financial stability.

## **3. Overcoming Barriers**

As credit invisibility is a substantial barrier to start credit assessments, overcoming credit invisibility is a major challenge for most young adults. Primarily, this is due to structural barriers within the financial system, a lack of beginner-friendly credit-building tools, and widespread financial illiteracy. One of the most significant components of this barrier is the reliance on traditional credit evaluation methods, even for assessing those who don't have prior history. As a result, individuals who have never used credit products are often denied access to financial opportunities. In the U.S., approximately 45 million Americans are either credit-invisible or unscorable. This subsequently makes it difficult for them to qualify for loans or secure favorable interest rates [5]. The situation being similar in South Korea where credit scores have been declining among young adults, this issue is exacerbated by rising youth debt and stricter lending standards [4].

Beyond the problem of flawed scoring models, young adults also struggle to find accessible and low-risk credit-building tools. Due to the absence of credit, many first-time borrowers are pushed toward using subprime credit cards with high fees, followed by predatory lending terms as well. In 2021, 39% of Gen Z had subprime credit scores [6]. Furthermore, the Federal Reserve data of 2023 showed that subprime credit card delinquencies had been increasing, reaching 5.34% in Q3 2023 [7]. These statistics show that a fair portion of young adults rely on subprime credit products and further the financial risks young borrowers face. If there are no safer alternatives young borrowers are able to use, more of them would continue to fall into financial traps while trying to establish good credit scores.

The lack of financial education among young adults also builds up to this issue. Many young adults lack a basic understanding of how credit scores work, which therefore leads to poor financial decisions. They make high credit utilizations as well as undermine the negative effects of frequent missed payments. Financial literacy rates are alarmingly low in the U.S., with half of U.S. adults lacking fundamental financial knowledge [8]. In South Korea, financial literacy is not a mandatory part of the school curriculum [4]. As they become adults unprepared, they subsequently tend to make poor debt management and cause rising default rates among young borrowers.

The three components—outdated credit evaluation models, predatory lending practices, and insufficient financial education—that combine into a huge barrier for young adults creates a system where they are already disadvantaged even before they ever begin. To address these obstacles that they face, therefore, this paper shows that three things are necessary to ensure young consumers can establish financial independence; structural changes in credit scoring, better access to credit-building products, and improved financial literacy initiatives.

#### **4. Proposing Solution**

In order to address the barriers of credit invisibility and limited credit-building opportunities, this paper argues that financial institutions as well as policymakers should implement a multi-faceted approach. The first

approach is that alternative credit evaluation methods should be incorporated into the assessment process particular for young adults. If so, a more overarching assessment of creditworthiness would be provided. Non-traditional financial behaviors such as rent payments, utility bills, and digital transaction history would be able to serve as strong alternate indicators of financial responsibility for those without prior credit history. Previous studies have shown that including rental payment history in the credit assessment model would result in up to 77% improved credit scores of previously unscorable individuals [9]. Similar methods of such are already adopted and being used in countries like the UK and Australia, so that lenders are allowed to seek broader financial behaviors when evaluating credit applications [10].

Another proposal is that financial institutions should develop more accessible while low-risk credit-building products targeted at young adults. Supportive programs like secured credit cards or credit-builder loans would help first-time borrowers establish credit as well as the necessary knowledge on using credit effectively and safely, without the high risks related with traditional credit cards. Currently, a positive tendency is being observed from some U.S. banks, as they have begun experimenting with subscription-based credit models [11]. By using such products, young consumers are able to gradually build credit through monthly payments linked to streaming services or mobile plans. For further improvement on alleviating the hardships young adults face, more accessible, low-risk credit-building products should be developed for young adults.

Third, financial education should be prioritized so that consumers understand how credit works and how big its effect may be in their financial life before they begin borrowing. Mandated credit education programs either in high school or college would be helpful to equip young people with the knowledge to navigate credit responsibly. Gamified financial learning platforms, such as AI-driven budgeting apps, are seen to be effective in helping young adults track their financial behavior and receive personalized credit-building recommendations.

Combining all aspects, this paper suggests developing a new targeted credit assessment model for young adults, which incorporates alternative data

sources and an improved AI-driven predictive analytics. The assessment model's incorporation of alternative data sources for financial indication, such as rental payments, utility bills, and recurring financial commitments, would lead to the creation of a more holistic and inclusive assessment of creditworthiness [12]. Further, utilizing AI in an improved way than current assessment methods would be essential, in terms of being reliable and accurate. Research suggests that machine learning models can incorporate non-traditional financial behaviors, for example savings habits, transaction trends, and even employment stability, to make a more effective prediction of the borrower's ability to repay loans [13]. However, current existing models, while striving to incorporate this, mostly suffer from explainability issues and function as "black-box systems" that lack clarity [14]. As such problematic issues lead to concerns about fairness and reliability, the new hybrid AI-credit model should focus on using interpretable machine learning techniques so that it can certify credit decisions remain transparent for consumers. In addition, adopting a dynamic credit scoring system to the new model would result in an enhancement on credit accessibility for young borrowers. That is, it should implement a sequence of assessing systems that adjusts based on real-time financial behavior rather than static historical data. Research on system dynamics models demonstrated that predicting future financial stability using real-time factors could significantly reduce credit risk all while allowing financial institutions to offer more personalized credit opportunities [15]. Incorporating such aspects in a new credit assessment model would positively contribute to expanding financial inclusion while maintaining risk accountability for lenders.

## 5. Conclusion

The problem in the credit scoring of young adults is that they face credit invisibility in their start of the financial life, as well as they lack sufficient access to effective credit-building tools. Traditional assessment models rely too heavily on past borrowing which most young adults have no experience of. The subsequent failure in accounting for non-traditional financial behaviors results in giving the demographic group a disadvantage. With the problem of the credit assessment progress itself, the scarcity of beginner-friendly credit products and

limited financial education leaves young consumers at a disadvantage in addition.

In order to create a more inclusive system for young adults, who would grow up to lead the economy, reforms should be made in the system itself as well as related fields. Alternative data sources must be integrated into credit scoring to allow responsible financial behaviors beyond loan repayment to contribute to creditworthiness. Low-risk credit-building products tailored to first-time borrowers should be offered and structured credit education initiatives should be prioritized before the young adult's step into society. By implementation of these reforms, young adults would be offered equitable financial opportunities. Ultimately, it would foster greater long-term financial stability and reduce economic disparities, so that an equal opportunity is given to everyone.

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