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HELPING CONSUMERS OBTAIN THE CREDIT THEY DESERVE

HEARING

BEFORE THE

SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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HELPING CONSUMERS OBTAIN THE CREDIT THEY DESERVE

Thursday, May 12, 2005

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to call, at 10:03 a.m., in Room 2128, Rayburn House Office Building, Hon. Spencer Bachus [chairman of the subcommittee] presiding.

Present: Representatives Bachus, Castle, Ryun, Hensarling, Brown-Waite, Pearce, Neugebauer, McHenry, Sanders, Maloney, Watt, Sherman, Gutierrez, Moore of Kansas, Waters, Carson, Ford, Baca, Green, Moore of Wisconsin, and Clay.

Chairman BACHUS. [Presiding.] The Subcommittee on Financial Institutions and Consumer Credit will come to order.

Today we are holding a hearing entitled, "Helping Consumers Obtain the Credit They Deserve."

As we learned during our recent debates on the Fair Credit Reporting Act, a consumer's credit history can play an important role in his or her ability to obtain credit, as well as the price of the credit offered.

However, we also learned that many consumers who pay their bills on time may not have sufficient information in their credit reports demonstrating their credit worthiness. This is due to the fact that not all companies provide payment history information to credit bureaus.

Today's hearing will provide us a forum in which we can explore the type of information that may be valuable in the credit underwriting process, but that are underreported to credit bureaus. We may also identify any structural barriers that may hinder the reporting of such information.

Generally, we want to learn more about how we can improve consumers' credit options, especially for those consumers who are low or moderate income.

This committee has demonstrated time and time again a dedication to ensuring that all American consumers maintain a level of access to financial services and products that is unrivaled anywhere in the world. Today's hearing further demonstrates this commitment.

I want to particularly thank Chairman Castle for requesting this hearing, and I commend him for his leadership in this area.

Consumers in the United States have more ready access to low-cost credit than consumers anywhere else in the world. This is due in large part to public policies that support the pooling and sharing of consumer credit data.

The availability to lenders of complete and accurate data on past consumer borrowing behavior is considered essential to an efficient credit market.

Despite the enormous growth in the U.S. credit market, many consumers still experience difficulty obtaining adequate consumer credit because they have little or no credit history.

I understand it is estimated that as many as 55 million Americans do not have sufficient credit history for a lender to accurately determine their true risk of default.

Many of these consumers may be making timely payments on various monthly or contractual obligations. However, these payments are often going unreported to the credit reporting agencies.

For example, many landlords do not report information to credit bureaus, so a renter's credit history will not necessarily reflect the fact that the consumer is paying regularly. The same can be said for some utility companies, cable companies, and telecommunications companies.

If a consumer does not have significant amounts of information in his credit report, that consumer is said to have a "thin file," making it difficult for creditors to assess his credit worthiness.

Consumers in low-and moderate-income households may be more likely to have thin files because they do not have mortgages or other forms of traditional credit that show up in credit reports. Therefore, a low-income renter may find himself in a vicious cycle of not having adequate low-cost credit available because he or she has not had access to credit in the past.

We need to explore whether the information that could be provided by landlords, utilities, phone companies, cable companies and others to credit bureaus can be valuable in the underwriting process. For example, would a creditor be more likely to grant a mortgage to a consumer if the creditor knew that the consumer faithfully and diligently paid his or her phone bill each month?

I also look forward to learning more about why certain types of companies do not report information to credit bureaus. Is it too expensive? Are there other barriers? Are there other motivations? Is there too much liability involved?

It is my hope today's hearing will allow us to explore ways in which the use of alternative data not currently reported to credit bureaus may benefit millions of Americans that either do not currently have a credit score or little information in their credit file.

Let me again thank Mr. Castle for his leadership on this issue. He is strongly committed and I admire his dedication to ensuring that the underserved have access to the low-cost credit they need and deserve.

The Chair now recognizes the ranking member of the subcommittee, Mr. Sanders, for any opening statement that he wishes to make.

[The prepared statement of Hon. Spencer Bachus can be found on page 47 in the appendix.]

Mr. SANDERS. Thank you, Mr. Chairman, and thanks for holding this important hearing.

The title of our hearing is "Helping Consumers Obtain the Credit They Deserve." I think the hearing title is very appropriate and important, but I would add a caveat.

And that is, while we should be helping consumers obtain the affordable credit they deserve, the truth of the matter is that in too many instances these days, more and more consumers, whether they are college students without jobs, seniors on fixed incomes, low-and middle-income families, are gaining access to credit, but from predatory lenders, payday lenders, rent-to-own companies, used-car salesmen, subprime lenders, retailers, and credit card companies that they cannot afford.

They are being ripped off.

I think this committee has the obligation to deal with this reality that millions and millions of consumers—and I do not know the more gentle word to use, but the reality is they are being ripped off by sky-high fees and outrageous interest rates. I think people all over this country understand that.

Let's just take a look at credit cards. Each and every year, credit card companies put 5 billion applications in the mail to consumers.

Mr. Chairman, do you know that 5 billion—I tell that to people and they cannot believe it. That is an astronomical number. But 5 billion credit card applications go out.

I have often stated I think my family receives about half of them, but that is apparently not the case. Your family may get the other half. I do not know, but there are a lot of them.

Consumers are now over $2 trillion in debt, while for 5 consecutive years in a row credit card companies made record-breaking profits, and their CEOs in some cases earned hundreds of millions of dollars in compensation.

I think, Mr. Chairman, this is an issue we should be focusing on.

Credit card companies alone collected over $21 billion in fees last year, compared to only $7.3 billion in 1994. So the whole issue of fees and the kinds of very high fees that they are charging is something this committee, in my view, should look at.

Revenue from late and penalty fees has jumped from $1.7 billion in 1996 to an amazing $11.7 billion today. Over the past 8 years, late fees have risen from $10 to as high as $39, and experts are predicting that late fees could balloon to as high as $50 this year. Today, if consumers are even 1 hour late on credit card bills, they will get slapped with as much as a $39 late fee and a penalty interest rate as high as 29 percent.

Predatory lending abuses cost consumers over $9 billion a year.

Mr. Chairman, as you may know, I am not a great fan of Newt Gingrich, but here is what his former aide and bankruptcy expert Robert R. Weed had to say about this subject in a front-page story that appeared in the Los Angeles Times.

He said, "Most of the credit card companies that end up in bankruptcy proceedings have already made a profit from the companies that issued them. That is because people are paying so many fees that they have already paid more than was originally borrowed."

Mr. Chairman, as 1.6 million Americans filed for bankruptcy last year, many paid more in credit card fees than they originally borrowed in the first place. I think this has got to stop.

To address these concerns, I have introduced H.R. 1619, the Loan Shark Prevention Act, to protect consumers against predatory lending.

Specifically, this legislation would, one, cap interest rates at 8 percent above what the IRS charges income tax deadbeats. Currently, the cap would be about 14 percent, the same level that the Senate approved by a 74-to-19 vote in an amendment offered by then-Senator Al D'Amato in 1991. So we would like to do what Mr. D'Amato pushed for in 1991.

Number two, it would cap bank and credit card fees at $15.

Number three, ban the credit card interest rate bait and switch. As you know, Mr. Chairman, credit card companies are doubling or tripling interest rates on consumers even though they always paid their credit bills on time. I think all over America, people regard that as just extremely unfair. People paid their credit card bills on time. The companies should not be allowed to double or triple interest rates.

Loan-sharking is an odious practice, whether it is performed by street corner thugs or the CEOs of large banks. Charging economically vulnerable Americans outrageous interest rates and fees is simply not acceptable. Amid all the recent political discussion over values, this certainly does not constitute moral behavior.

So, Mr. Chairman, let us keep in mind when we are talking about helping consumers obtain the credit they deserve, that it must be affordable credit.

I thank the Chair for holding this hearing, and I look forward to working with him.

Chairman BACHUS. Thank you, Congressman Sanders.

Obviously, some of those numbers are disturbing. It is certainly not good news for American consumers.

Mr. Castle?

Mr. CASTLE. Thank you very much, Chairman Bachus, for holding this hearing. I appreciate it.

Also thanks to Ranking Member Sanders, Newt Gingrich's new best friend, for being here today and his statements on this. He has always been interested in these subjects.

I would also like to thank Chairman Oxley and Chairman Bachus for working with me on bringing this issue before the committee. Obviously, I believe it is an important one that warrants further discussion.

Today, more people have access to credit than ever before. However, there are indications that some Americans—the young, minorities, and recent immigrants in particular—are not truly engaged in this competitive marketplace because they have little or no existing credit history for which lenders can assess risk and offer credit.

As our witness Dr. Turner states in his recently released report, "Giving Underserved Consumers Better Access to the Credit System," there are an estimated 35 million to 50 million American borrowers who do not have credit scores, bank accounts, or whose files have too little information to be used in allocating credit.

I feel there is information, such as rent and utility payments, that is not currently reported to the credit reporting agencies that could be helpful to consumers.

For example, if an individual pays their rent on time each month, there is no transmission of this information to the credit reporting agencies. Conversely, individuals with mortgages do receive credit for paying their obligation on time, and this further adds to their credit score and history.

Mr. Chairman, that raises a question. If people regularly meet their contractual obligations for a variety of services, why should that responsible behavior not be taken into account and used to the advantage of the consumer?

Now it could be that the different payments I mentioned may not prove to be predictive of future behavior, and there may be State regulations related to certain utility providers that limits sharing of some of this information. I hope that our witnesses today will help us better understand the predictiveness and value of the data.

I am pleased that a number of the panelists will discuss innovative products that the marketplace has developed to better serve the needs of all of our constituents, especially those with thin or no credit history, so they can have access to the best and most competitive offers of credit possible.

I would just like to say, one of the goals here is to try to channel consumers into mainstream lending practices, if you will. I tremble sometimes to think of some of the borrowing practices that do go on, be it the use of the credit cards because they cannot get other credit, as Mr. Sanders has mentioned, or obviously some lenders who are out there trying to gouge when the regular lenders, if you will, could perhaps fill the same obligation to these individuals at rates which would be more appropriate.

Let me just say this, because I think it is important, and that is that this hearing, as far as I am concerned, is not pursuant to legislation either introduced or to be introduced, so much as it is hopefully an evolving way of looking at consumers.

Maybe at some point down the road some form of legislation will be needed. Maybe it will be needed at the State level. But the bottom line is that we are trying to shed a light on practices which a number of our witnesses here have started to watch and hopefully be able to serve a part of our population that is less served now.

So I do very much, Mr. Chairman, appreciate the hearing, and I appreciate our witnesses being here.

I yield back.

[The prepared statement of Hon. Michael N. Castle can be found on page 51 in the appendix.]

Chairman BACHUS. Thank you, Chairman Castle.

At this time, I would like to introduce our witnesses.

We have Ms. Lisa Nelson, who is vice president of business operations at Fair Isaac Corporation; Mr. Mark Catone, senior vice president, First American CREDCO; Ms. Gwen Thomas, senior vice president, Consumer Real Estate Branch, Bank of America; and Ms. Margot Saunders, attorney, National Consumer Law Center.

You have testified before our committee previously, and we welcome you back.

And Dr. Michael Turner, president and senior scholar at the Information Policy Institute.

Thank you, Dr. Turner.

At this time, we will have our opening statements.

Ms. Nelson, if you would go first. Thank you.

STATEMENT OF LISA NELSON, VICE PRESIDENT, BUSINESS OPERATIONS, FAIR ISAAC CORPORATION

Ms. NELSON. Mr. Chairman and members of the committee, my name is Lisa Nelson. As you have just heard, I am vice president of business operations for Fair Isaac Credit Services, which is a wholly-owned subsidiary of Fair Isaac Corporation.

Thank you for the opportunity to testify before you today about Fair Isaac's leadership in the utilization of alternative credit data, specifically as it pertains to the launch of our new product, the expansion score.

My comments highlight Fair Isaac's written statement submitted to this committee earlier.

Fair Isaac has been providing statistically based credit risk evaluation systems, commonly known as credit scores, since 1960.

Today there are many different kinds of credit scores used by thousands of credit grantors. The most well-known are the broad-based credit scores that rely on data provided by the three national credit reporting agencies.

We were asked to come before you today to describe how alternative credit data is being used within the lending community to provide access to consumers seeking credit to fulfill their dreams, which might include purchasing a home, obtaining a car loan, or simply getting a credit card.

My remarks this morning focus on three areas. I will describe the important role of alternative credit data, the expansion score itself, and how they benefit the consumer.

So, first, the role of alternative credit data.

Credit risk scores are typically a three-digit number that rank order consumers according to their credit risk. These and other credit scores use traditional consumer credit data consisting of positive information, such as the consumer has made all payments on an existing account, and negative information, which might include the fact that the consumer has failed to repay a loan.

The expansion score leverages alternative credit data rather than relying on the traditional data. It is similar to the classic scores in that it uses both positive and negative data and relies on technology upon which other FICO scores have been built.

Fair Isaac is committed to finding and using the best nontraditional credit available from third-party data providers. To provide its service, we resell data we obtain from a number of consumer reporting agencies that collect that data from the furnishers.

An example of the data that we use within the score includes deposit account records, check-writing behaviors, telephone payments, and purchase plan performance.

You may ask, why have we chosen to resell this data rather than create and maintain our own database? This strategy ensures that the expansion score will use the best and most predictive alternative credit data available.

Also, the expansion score has been designed to utilize new sources of credit data as they become available. This approach allows us to continue exploring business relationships with reputable consumer reporting agencies that aggregate this alternative credit data.

Next, I would like to describe how the data is used within the FICO expansion score.

Fair Isaac developed the expansion score using the same statistical approach used to develop the classic FICO score. In developing the expansion score, Fair Isaac analyzed anonymous alternative credit report data to statistically determine what factors are most predictive of future credit performance.

Credit grantors who cannot obtain a traditional credit risk score for the consumer can now, for many people, obtain the expansion score. The same 300 to 850 score range is used by both the classic FICO and the expansion scores. Consumers with higher scores are predicted to be more likely to repay creditors as agreed.

Early results show that lenders are able to score and underwrite a high proportion of the credit underserved market. Fair Isaac has analyzed data from several lenders in mortgage financing, automotive lending, and bank cards, and has observed scorability rates as high as 80 percent. This means that the expansion score was available for eight out of ten applicants for whom a traditional risk score was not available.

So finally, what does this mean for consumers?

As mentioned earlier, we are estimating there are roughly 50 million credit underserved adults. This group is not only large, it is diverse. No one should assume that this group represents a subprime lending market.

Expansion scores help create access to credit for those consumers that choose to seek it, while enabling lenders to make informed decisions. They also make credit more affordable by helping to automate the lending process.

In conclusion, using alternative credit data in scoring improves access to credit for Americans who may have been turned away in the past and provides lenders with the necessary risk management tools to make good decisions.

Thank you.

[The prepared statement of Lisa Nelson can be found on page 61 in the appendix.]

Mr. CASTLE. [Presiding.] If I would truly be the Chair, the first thing we would do is change the size of the print on the placards in front of you because I cannot read them from here particularly well.

But the next witness is Mr. Catone, who has already been introduced. He is recognized for 5 minutes.

STATEMENT OF MARK CATONE, SENIOR VICE PRESIDENT, FIRST AMERICAN CREDCO

Mr. CATONE. Thank you, chairman and distinguished members of the Financial Services Committee. My name is Mark F. Catone, senior vice president with the First American Corporation.

Thank you for inviting us to testify today on the topic of helping consumers obtain the credit they deserve.

The changing demographics of the population in the United States are reshaping the demand for housing, automobiles, and other goods and services. As a result, these changes are having a significant impact on the credit markets.

According to many sources, including prior testimony to this committee, immigration has accounted for more than one-third of household growth since the 1990s.

For the most part, the credit system in the United States has done a good job and continues to improve. No where else in the world today can you buy a car in under an hour or qualify for a home purchase online in the time it takes to fill out an application and click a button.

One of the remaining barriers confronting immigrants, low-and moderate-income borrowers, and other consumers entering our credit system is the problematic issue of little or no credit information.

There is no one answer or quick fix to this issue because of the existing built-up infrastructure of what we know as the credit reporting system, credit scoring, and what is referred to as nontraditional credit.

There are, however, several areas we are active in that we believe should be examined and improved upon that will lead to more comprehensive solutions in the long run.

There are four points.

Make quality data available. The December 2004 report by FTC to Congress under section 318 and 319 of FACTA identifies data such as bill payment histories at utilities, telecommunication carriers, as well as rental payment histories, to be rich sources of data indicative of credit behavior.

The limited reporting and the economics of collection of this data are problematic. Our company is very active in compiling and delivering what are referred to as nontraditional credit reports, which mortgage originators and investors accept and have a fairly well-defined standard.

We collect this data on demand, working with the lender and the consumer. We apply what we believe to be best practices in due diligence and verification of the creditor information, resulting in the reduction of risk for the lender and ultimately to the investor. This is an on-demand service capability, and it is part of the solution today in the mortgage reporting industry.

We also believe making additional utility, telecom, and related payment data available at credit bureaus or otherwise in an automated way will reduce the number of no-file and thin file reports.

The second point—packaging of services in order to make the transaction economical.

Again, the FTC report cited earlier also notes that the data identified is more expensive to collect and to add to the system and closes by noting that this makes ready solutions an economic challenge. In order to address this, the industry should look for ways to mitigate the expense of sourcing additional data.

Our company offsets the higher expenses of compiling and verifying information for mortgage transactions, for example, by wrapping it into a fixed-cost comprehensive settlement package, ef-

fectively mitigating the higher one-off cost of credit alone. This concept may make more sense for other loan types.

Third point—we need to provide more education and guidance to the consumer.

We saw early on that a full-service consumer help line is key to providing both education and issue resolution to consumers. When our customers access credit for the extension of a loan, we provide education to the consumer if issues arise or education is needed relative to the credit report provided. This is an expensive function to provide, but we believe it is necessary and other players should follow this lead.

Finally—encourage the standardization of credit reporting for consumers who do not have credit reports, but can demonstrate financial competency.

Most loans employing nontraditional data today are considered manual loans, which must be handled outside of technology, resulting in higher costs to the lender and the consumer. Standardization of nontraditional credit reporting, both in method and technology, will lead to overall lower costs as industry players build this into their systems and infrastructure. Ultimately, everyone benefits.

That concludes my verbal testimony. I would like to thank the Chairman and the committee and welcome any questions.

[The prepared statement of Mark Catone can be found on page 55 in the appendix.]

Mr. CASTLE. Thank you, Mr. Catone.

Ms. Thomas is recognized for 5 minutes.

STATEMENT OF GWEN THOMAS, SENIOR VICE PRESIDENT, CONSUMER REAL ESTATE, BANK OF AMERICA

Ms. THOMAS. Good morning, chairman, Congressmen, and committee members. It is a pleasure to be here to talk on this topic.

I am Gwen Thomas with Bank of America Consumer Real Estate, where my responsibility is to increase homeownership among low-income individuals of all colors and minority individuals across the United States.

It is an honor to be here today to talk on this topic that is so critical for us to be able to make continued progress.

My testimony will focus heavily on a lot of focus groups. We call it voice of the customers that we have done with individuals who have limited credit. I accepted the subcommittee's invitation because I believe there are many opportunities and benefits that we can bring both to the customer and to the lenders and, thus, to the communities.

Bank of America is the largest consumer bank in the United States, with more than 33 million customers, and that is about one-third of the households across the country. With that size, we have an obligation to make sure we meet the needs of the consumers we serve and, thus, utilizing nontraditional credit helps us toward achieving that goal.

We have all seen the statistics on projected growth in the minority population, according to the U.S. Census Bureau. The Hispanic segment of growth will be a 188 percent increase by 2050; Asian, 213 percent by 2050; and African-American, 71 percent by 2050. So those are significant increases.

Unfortunately, a lot of these individuals will not have traditional credit or have thin files, which causes potential barriers to achieving homeownership. Of those segments, the majority of the first-time homebuyers in the future will come from the various ethnic segments.

Based on the focus groups we did, the interesting thing we heard from customers and potential customers was what was most important to them was getting a yes, getting it quickly, having a quick decision, be it yes or no, no surprises, privacy, and making sure that we understand that as part of the culture, cash is very much a part of the culture, especially with some of the part-time employed individuals who get paid in cash.

While the traditional customer segments have some of the same desires about things that were important, the utilization of cash was the most unique piece for the segments that have the most significant growth.

The bank has developed a lot of processes to meet the needs of the individuals with nontraditional credit. However, while we have those processes, they are highly manual, and they have the potential to sacrifice data integrity. Because of data validity issues, we only use the processes in a very limited way, and the processes are not currently automated for what we are using.

Failing to use nontraditional credit can cause us to decline customers who have good credit and could qualify for a home. That is what our end goal is, is to get people into homes. Once we get them into homes, that is one of their best assets that helps them build wealth.

One of the examples of a very successful program we have had is a program called Neighborhood Champions. That is a program we started 5 years ago focused on teachers. Now that program is extended it to firefighters, policemen, health care workers, and others that work in related fields.

That program uses nontraditional credit, as well as undocumented income, meaning income where a person is paid by cash, to help them qualify for the loan. This has been a creative way to help homeowners. But, again, the nontraditional credit is a piece that, if automated with the data validity, can really help improve that process much more.

For consumers with traditional credit histories, lenders have automated processes and scoring models. Those scoring models can provide objective, consistent, and quick decisions.

And credit information generated through those models have a direct interface to the credit reporting bureaus. Once you have that information in the bureaus, it can provide a depth and length of customers' credit experience. It lets you know who is searching for credit, and it also helps you understand how the person utilizes and repays their credit.

While these models are very good and they are automated, the drawback to the scoring models is that they are dependent upon information reported to the credit bureaus. For individuals that are either new immigrants or that use credit infrequently or that may just be coming out of college, they do not have the traditional credit to get reported to the bureaus, even though they may have been

living with their parents or an aunt or uncle and paying rent for 12 months. That really could demonstrate good credit behavior.

We need to find an easier way for reporting alternative payment histories. While current manual processes that we and others use in limited circumstances, and in some cases is accepted by the secondary market in a very limited way, it really does not work as efficiently as we would like for it to.

One advantage of an automated process is the ability to treat all applicants equally. Bank of America is testing but not currently using any of the new automated systems that have nontraditional credit because we want to continue to work with potential partners as they improve the predictability of the information.

Our goal is for this process to become more automated in a way that meets our criteria consistently and with integrity, which will broaden the opportunities for use.

In conclusion, what I would like to say is providing alternative sources of data to current mortgage lending processes could greatly benefit multicultural and low-income customers. It would increase the number of people who can get into a home, reduce declinations, and help us to increase homeownership in the community.

I am very pleased we have started this dialogue, and I look forward to continuous conversations.

Thank you.

[The prepared statement of Gwen Thomas can be found on page 87 in the appendix.]

Mr. CASTLE. Thank you, Ms. Thomas.

Ms. Saunders is recognized.

STATEMENT OF MARGOT SAUNDERS, ATTORNEY, NATIONAL CONSUMER LAW CENTER

Ms. SAUNDERS. Thank you, Mr. Chairman. I am happy to be here today.

I represent the low-income clients of the National Consumer Law Center, as well as the Consumer Federation of America, the National Association of Consumer Advocates, and the U.S. Public Interest Research Groups today.

We believe that the reporting of alternative credit data holds the potential to help consumers considerably.

However, because of the way the credit data and scores are currently being used in the marketplace, if these systems are built incorrectly or inappropriately used, the dangers to consumers could be devastating.

We analyzed these new data systems through the prism of how they are currently being used.

In addition to access to credit, credit scores and credit reports are being used to price credit. Some of the risk-based pricing that results from this use of credit scores today has supposedly justified very, very high-cost credit which is often unaffordable and leads to credit failure, default, and foreclosure.

The credit scores currently are being used for eligibility and price for insurance in some States. They are also being used for employment, the initial decision relating to obtaining employment, as well as job retention.

In some areas of the country, utility companies are looking at credit scores to determine eligibility for access to utility service. And there has been consideration of, and so far rejection of, the use of credit information to price utility service, which certainly must be kept on the radar screen.

Because of that wide variety of uses of credit scores and credit data, we are very concerned that these new systems be developed based on fundamentally sound principles so that the information that goes into the new credit scores is truly relevant to the question of whether or not the consumer will have a likelihood to repay the credit for which the score being used.

I am going to come back to that and talk about that mostly, but we also have concerns obviously that the information be accurate. We are very concerned that as these new credit data sources arise or grow, they only be allowed to be used for credit purposes until they have been thoroughly tested.

Finally, there is considerable concern already on credit scores that they have a discriminatory impact and that they are built based on discriminatory history. We want to ensure, or we would hope to ensure, that the new credit scoring systems do not exacerbate this problem.

It is essential that new scoring systems use payment histories which have characteristics substantially similar to the credit for which the systems are used. Specifically, one needs to look at the motivating factors behind both types of credit.

The problem is that for many low-income people, for example, utility payments and some forms of credit such as payday loans and rent-to-own transactions have very different inherent features which send significantly different price and motivating signals to the consumer regarding whether to pay or not.

We completely agree—I want to get this on the table—that a monthly rent obligation is an excellent source of information to use to base an evaluation of a consumer's willingness and likelihood to repay similar credit, especially a home mortgage obligation.

The rent payment is an exchange for essentially the same product: a home to live in. The payment is generally at the same intervals: monthly. The consequences of not paying are similar: loss of the home and a forced move. Similarly, the requirement of a regular months payment for a wireless telephone bill is certainly relevant to requirements for other monthly obligations.

But a utility bill for heat, gas, or water consumers is not appropriate. That is because many of the programs devised to help protect low-income households from shut-off of essential utility service in the cold winter months do not punish for late payments. In fact, many Federal and State programs designed to assist low-income consumers with high utility bills are only triggered once the consumer is delinquent.

Similarly, payday loan characteristics are very different than those for traditional loans. The consumer repaying a payday loan has a very different set of criteria to face.

Number one, it is a huge lump-sum payment. Number two, failure to make that payment might result in criminal prosecution. Number three, making the payment may result in not having essential funds for food or rent or some other necessity. Four, payday

loans, unlike other loans, have lenders who actually encourage consumers to not repay the full loan immediately, and they offer discounts and coupons for consumers who do not repay fully. They like the rollover; rollovers are how they make their money.

I am out of time, but I am happy to answer any questions. Thank you.

[The prepared statement of Margot Saunders can be found on page 72 in the appendix.]

Mr. CASTLE. Thank you, Ms. Saunders.

Dr. Turner?

STATEMENT OF MICHAEL TURNER, PRESIDENT AND SENIOR SCHOLAR, INFORMATION POLICY INSTITUTE

Mr. TURNER. Good morning, Mr. Chairman, honorable members of the subcommittee. I am grateful for this opportunity to testify before you today.

I would like to commend Chairman Bachus, Chairman Oxley, and Chairman Castle for their leadership on this complex and crucial issue of consumer credit.

Two years ago, I appeared before this subcommittee to discuss the benefits that Americans enjoy as a result of our national credit reporting system. That system is, by most accounts, the envy of the world. It is one of the engines behind the remarkable rates of homeownership in the United States. It is also of enormous help to those Americans who wish to start their own business.

The success of our system of credit reporting is inarguable. But despite that success, many Americans, conservatively estimated at 35 million, remain outside of that system.

The reasons for this are not altogether clear. Despite the complexity of this issue, we have identified one of the reasons for their difficulties, namely the lack of credit information about these 35 million Americans at the three national credit bureaus.

Credit bureau information is, as we all know, one of the key means by which lenders make decisions on loans. And of course, paradoxically, without credit to begin with, it is difficult for such consumers to establish that they are credit worthy. It is like trying to get your first job when all the jobs posted require 3-to 5-years' experience.

We are here today because we believe alternative data offers a possible way to help consumers overcome the consumer credit hurdle. Categories of alternative data include energy and water utility payments, landline and wireless phone bills, auto liability insurance payments, rental payments, especially apartments, and certain types of retail payments.

We recently completed the first part of a two-stage study examining the inclusion of alternative data in consumer credit reports. Several of our preliminary findings should interest members of this committee.

Our first key finding is that utility and telecom data are likely to be the most immediately useful and practical alternative data for reaching people with little or no information in their credit files.

By "useful," I mean that virtually all Americans purchase services from utilities, including most of the population with which we

are concerned here. In our analysis, we refer to this metric as "coverage."

By "practical," I mean that these industry sectors are populated by a relatively small number of very large firms, meaning that there are very few data furnishers to reach. In our analysis, we refer to this metric as "concentration."

Finally, there are benefits for these companies where they do begin reporting. We have seen strong evidence suggesting that reporting customer data to credit bureaus, combined with customer awareness programs, substantially reduces delinquencies and defaults.

Our second key finding is that nontraditional data is unlikely to negatively affect the credit scores of most Americans. Serious negative information is already reported by utilities, telecommunications firms, and other sources of nontraditional data, typically indirectly through collection agencies. What is not generally reported is positive information or timely payments. Reporting positive data improves credit scores and builds credit history.

Given this, the public policy question then becomes, what can we do to promote the sharing of this information?

Our study also examines factors that hinder the reporting of alternative data. In our forthcoming research, we identify two economic barriers and two regulatory barriers that may deter the reporting of this information.

The four barriers are, first, in many States, regulatory uncertainty acts as a soft barrier on the provision of nontraditional information. This is especially true for utility providers that are often unsure of the permissibility of reporting. As a result, without clarification from State legislators or regulators, the fear of potential legal liability and public relations fallout acts to block the sharing of customer data with credit bureaus.

Second, in our survey, at least two States have laws that prevent utilities from reporting certain types of consumer payments.

Third, some prospective furnishers are reluctant to report this data fearing that it will enable competitors to steal their customers.

Fourth and finally, some firms may have complex and incompatible legacy IT systems in place that would make the cost of reporting greater than any perceived benefits.

These last two are obviously problems we should leave to the market, but public officials can address the first two barriers we identified: again, regulatory uncertainty and legal hindrances.

In some ways, regulatory uncertainty could be dispelled with little more than a public commitment to the idea of alternative data sharing. Public service firms should be encouraged to at least look at whether or not reporting alternative data might be a good idea for them.

We have framed what we believe are the key practical questions concerning the reporting of alternative data. In the months ahead, we intend to work with members of the credit reporting industry, financial institutions, utilities, and consumer education organizations to measure whether and how much the inclusion of alternative data in consumer credit reports could help more Americans

realize their dreams, dreams like homeownership, buying a new car, or starting their own business.

We look forward to providing our findings to members of this subcommittee in the near future.

Again, I thank the members of this committee and the chairman in particular for this opportunity and welcome your questions and feedback.

[The prepared statement of Michael Turner can be found on page 92 in the appendix.]

Mr. CASTLE. Thank you, Dr. Turner.

Thank you, all. This is a very interesting panel, and you have a lot to say.

We do not have enough time in our questions to be able to possibly cover all of the things that we should cover, but I will start by yielding to myself for 5 minutes.

Let me ask just one basic question. I said this in my opening statement, and ever since I said it, which my staff helped prepare, I have sort of questioned it.

That is, I said that 35 million to 50 million Americans are without credit scores. If my recollection is correct, we have, what, about 280 million people in the United States of America, a lot of which are children. Thirty-five million to 50 million sounds high to me.

Does anyone here—and if you do not know, do not try to answer—but does anyone here have any idea what the number really is? In any of your businesses, have you ever tried to identify that whole number of those who do not have credit scores at this point?

Ms. NELSON. We have, and our ranges are similar to yours. I mentioned 50 million. The general thought process that got us to that number was that of the total population, it is estimated that there are about 215 million adults aged 18 or over living in the United States.

Mr. CASTLE. I am sorry, how many?

Ms. NELSON. About 215 million.

Mr. CASTLE. Right.

Ms. NELSON. So I am just walking you through our logic. This comes from a number of different sources that we have pretty much culminated together.

And then from there, we are also estimating that there are about 165 million of those consumers that have enough data within the bureaus to generate a score.

So our estimation is that of the remaining 50 million or so, about 30 million do have data at one of the three national repositories, but not enough to generate a score, and another 20 million probably have no data at all.

Mr. CASTLE. So we are dealing with pretty big numbers here.

Ms. NELSON. Yes.

Mr. CASTLE. This is not just a problem of 1 million people or several hundred thousand or something like that, but a big number.

This is a question I could ask any of you, so I will just try to limit it and I will ask Mr. Catone perhaps and Dr. Turner to comment on this.

I indicated in my opening statement that this hearing was not preparatory to introduce legislation, and you mentioned it a little

bit, Dr. Turner, not that we should do it, but you mentioned a little bit in what you stated.

My question is, do you feel that at a State or Federal level that we should be considering some form of legislation, statutory legislation or regulation to deal with these issues?

Obviously, from all five of you, it is an evolving issue. In fact, there are some differences that are very interesting here in terms of what you view as significant data in terms of alternative credit information.

My question is, should we be regulating this? We have been doing a lot of regulating around here lately. I am a little reluctant to over-regulate. I would be interested in your viewpoints on that.

Mr. CATONE. It is an issue of economics. It is much more expensive to do manual compilation of data or verifications of the data, do the proper fraud checks and things to prevent information that may not be quite right from entering the system. Lenders and investors are concerned about that aspect of it. So it is much more expensive to serve that community.

What needs to occur at some point in time—and based on the changing demographics of the United States, it may be 2 years, 5 years, 10 years—but something would need to be done to adjust the economic incentives to serve the market better. We are starting to see that, and the reason we are sitting here today is because it is becoming an issue. So there is a whole set of economics that come into play. That is the reality of the situation.

Mr. CASTLE. Dr. Turner, do you have a quick answer to that?

Mr. TURNER. I would not endorse regulatory activity at this juncture. The barriers that we identified in terms of policy primarily are indirect.

We have spoken with utility companies that are reporting and met with their public service commission in their State and let them know that they were going to report and were told outright that they should not report. They went ahead and reported anyway because there were no statutory prohibitions on the book. They were doing this as a matter of courtesy.

We have also spoken with regulators actually in your State, Mr. Chairman, and there was a case where a utility was reporting data and was told not to report the data by the public utility commission and discontinued the practice despite the fact that no laws were on the book.

In California, we had conversations with regulators there and they, in fact, suggested that there were requests from utility companies in California to report the data and asked the regulator, "Do we have permission to do this?" The regulator said, "Sure, go ahead." The utility company said, "Can we have this in writing?" The regulators were unwilling to put this in writing until they got direction from the legislature.

So it is really a matter, I think, of some sort of guidance from the State legislatures at this juncture. Only two States have varied prohibitions on the books for the onward transfer of this data, and it is not with this issue in mind.

Mr. CASTLE. Thank you. I appreciate that. Obviously, this is an evolving issue, so we will continue to look at this.

I am just interested, if I could ask a little bit of a different question of Ms. Saunders, of you, and perhaps Dr. Turner—I thought I saw disagreement here, because, Ms. Saunders, you were pretty adamant that utilities were not necessarily very predictive, primarily in terms of a mortgage. But in terms of lending perhaps, I think all of you agreed that rent is in that circumstance. Part of it is that the programs that exist that do not even have any implications until you go into default, to a degree.

Dr. Turner, you talked about the utilities and telecommunications as the most promising and practical source of nontraditional information. I would say there is a bit of a conflict there in terms of what you both have said, not to pit you against each other. There is probably some truth in what both of you have said.

Maybe we should start with you, Dr. Turner. Can you defend why you said that? I think I understood Ms. Saunders's position, and perhaps she can try to respond to that.

I am not looking for trouble here. I am just looking for the best answers on what might be predictive or not.

Mr. TURNER. Ultimately, I think we disagree actually not only on utilities and telecoms data, but also on rent data as well.

In our analysis, we identified industry sectors that have a high level of concentration, meaning just a few data furnishers or prospective data furnishers, and a high coverage, meaning that many of the lower-to moderate-income Americans, the unbanked, the thin or unscorable filed Americans, would have these services.

Rental payments are highly fragmented. It does not really reach a lot of the affected population.

We do think, for example, if there is some sense of a need for public policy, many of those in affordable housing or public housing actually would benefit potentially from having their payment history reported. That is an area where State public housing authorities could act.

But ultimately, in any of these data types, we are not prepared to make judgments as to whether or not one data set is currently more predictive than another. That is an empirical matter. That is what we are setting out to do in our quantitative analysis in the next component. We are just not prepared to suggest qualitatively that certain types of data are better or worse without the benefit of actual empirical analysis, regression analysis.

We are aware of some groups that are actually putting this to the test in the trenches and meeting with consumers, asking them to volunteer to have their data reported, and measuring over time whether or not it makes an impact on their score and their access to credit and the terms of credit.

Mr. CASTLE. What do you think, Ms. Saunders? Is it empirical data, or can we put a qualitative mark on each of these things as to what is better and what is not?

Ms. SAUNDERS. I think Dr. Turner is correct that we need to do a lot more analysis.

I want to explain that while we are concerned with the furnishers who are providing the data, we are also very concerned with the users. So part of our concern with using utility payments as a means of gaining information about the consumer is guided by the fact that we really do not want to see utility bills in the future

based on risk, as some non-regulated utility providers have already proposed doing and have been rejected.

Specifically in Texas, there was a bill that would have allowed—or there was consideration of that exact question. Let me clarify that. Let me emphasize that what they were proposing to do was to charge higher rates for electric and gas for low-income consumers who had worse credit.

That is exactly what we are most afraid of because electric and gas and other utilities are essentials, and you should not be able to do that. So part of our concern with the furnishing of utility information is guided by the fear on the back end.

I do agree with what Dr. Turner said, that when some utility bills are seriously delinquent, they are already reported to the credit reporting agencies, so that it would not hurt in those situations. But I would challenge him on the point that all delinquent utility bills are regularly reported because I think that is just not the case across the country.

Mr. CASTLE. Thank you, Ms. Saunders.

My time is up, and Ms. Moore is recognized for 5 minutes at this time.

Ms. MOORE OF WISCONSIN. Thank you so much, Mr. Chairman.

I apologize to the panel for not hearing the testimony of these distinguished panelists.

I have listened with interest over the discussion of the use of rent and utilities as a means of getting these folks with thin records an opportunity to receive credit, particularly mortgages.

Ms. Thomas, I came in during your testimony.

I guess my question is, why can't we develop some sort of instrument where people who do not have any credit history are presumed to be bankable, innocent until proven guilty?

There are many people who deliberately do not have credit because they heave learned what we have learned years later: You should not have too many credit cards in your pocketbook. The generation before me, my uncles and aunts paid all their bills, bought things on layaway, except for owning their own home.

I am wondering, number one, why it is a problem that people have thin credit?

Secondly, I also am concerned about using utilities as a factor in determining credit because energy costs—I am from Wisconsin, and energy costs have far outpaced people's ability to pay, even people who are not regarded as low income.

In addition to which, people have due dates that are completely arbitrary. It is not like every bill is due the first of the month. The billing date may be the 14th of the month. If you pay on the 15th, then you are in trouble.

I guess I would like for Ms. Thomas, Ms. Saunders, to sort of respond to these concerns that I have, and anyone else who would like to jump in.

Thank you.

Ms. THOMAS. I think your first point about why is it considered a thin file and the whole thin file piece is a standard definition based on individuals having less than three credit lines. That is why we accept that information manually today. If a person does not have enough credit, we ask for rent, utilities, telecom, insur-

ance, anything that can show us payment history. Because typically you will find that there is good payment history there, it is just not automated.

Then for the utility piece specifically, back to your and Ms. Saunders's point, if we see indications where those payments have not been paid on time, when you are doing this manually, you can ask further questions to seek the understanding of what happened. In most cases, the customer can explain that it was due to some extreme circumstance, that we can then move forward with the loan.

Ms. MOORE OF WISCONSIN. That is a very good point.

I remember once I was subjected to a utility shut-off and I had paid all through the moratorium and still had a $2,000 bill come spring. When they asked further questions, they discovered that I had a 30-year-old furnace that had originally been a coal furnace converted to an oil furnace, and I had converted it to a gas furnace. It was very inefficient, and that was the reason that I just could not keep pace with the utility bills.

Ms. Saunders?

Ms. SAUNDERS. I would like to pose the juxtaposition between utility bills and standard credit.

Most credit offered to middle-income consumers is underwritten. There is an evaluation made by the lender about the consumer's ability, not just willingness but ability based on income, to repay that loan.

Utility bills and payday loans are not underwritten. In fact, they are quite the reverse. Utility bills can very often be very large, much larger for lower-income people than they are for higher-income people because they live in houses which are not weatherized and because they have many people in their family.

So we are using information that is really not relevant, and that is our concern.

Ms. MOORE OF WISCONSIN. I also want to ask one final question, Ms. Saunders. You mentioned pricing credit used to justify high interest rates. I have seen this continuously where creditors just are in glee to see a little glitch on your credit report. So I have come to think that somehow the Fair Isaac scores are not fair.

I have heard many reports, experienced it personally, where there is almost this little game where people just really are in glee about bad credit.

Can just anybody respond to that before my time expires?

Thank you, Mr. Chairman.

Ms. SAUNDERS. If I might very quickly, I would like to point you to that part of my testimony where I discuss in some detail the discriminatory questions that have been raised about credit scores already.

There have been lawsuits, and there have been a lot of studies, and a lot of people believe that current credit scores do have discriminatory impact. And we are concerned that as these new alternative sources of credit scoring develop, that we not exacerbate that problem.

Ms. NELSON. I just need to point out one comment to what was just said. That is that, as we develop scores, we are very cognizant of what is allowed and not allowed as factors that drive the score.

So that is an important piece of understanding that I would like to make sure this entire subcommittee understands.

Secondly, when you talk about the fairness of the scores, the score has been proven time and time again to be a solid predictor of risk. I think part of what you are describing is some lenders' decisions and policies around how to react to that score when dealing with the consumers themselves.

So I just want to be careful not to leave the impression with this committee that the scores do not work. The scores absolutely are predictive of consumer behavior going forward.

But policies that surround that score is an issue that I think every lender deals with in a very, very strategic and personalized way. So it is difficult to describe any practice as being industry-wide. We know that there are some lenders that are more aggressive than others in how they deal with consumers in that account review mode.

Mr. CASTLE. Thank you, Ms. Moore. We appreciate it.

Chairman Bachus is recognized for 5 minutes.

Mr. BACHUS. I thank the chairman.

I guess before I ask a question, I would make a statement. I am not sure that this Congress or this committee should ever require companies or individuals to share information about payments. That is being pretty intrusive if you ordered utility companies to share that with credit bureaus.

You know, 90 percent of the landlords in this country are individuals, so it is a very decentralized thing. That would take a monstrous bureaucracy and enforcement system if you required all of them to report that. I mean, that would be a pretty overreaching law.

I am also concerned about privacy. That is a very important issue in this country, is people's privacy. For the Government to start saying that you have to give out information on your customers or on your tenants would be, to me, almost a revolutionary thought because that gets in the public domain. So I would make that comment.

I would ask that with 90 percent of the rental units in the hands of individual landlords, is it even practical to require such a reporting system? Let me ask that question first. Just any feedback from the panel on that?

Ms. NELSON. I would provide a couple of thoughts.

I have a history not with Fair Isaac but in prior employment with a consumer reporting agency that is obviously not one of the three national bureaus. The services we provided were to financial institutions to help manage risk on the debit side of their house.

That is an example where back when that company was founded in the early 1970s, it was not a highly concentrated banking industry as it is today. There were thousands and thousands of banks across the country.

The inception of that particular business model occurred because banks were getting hurt by consumers that were either being abusive or fraudulent with their checking accounts. So there was a reason for the industry to cooperate together, share information and help themselves manage risk.

I raise this as an example because Mark already mentioned that the economic model behind this issue is a significant aspect in that there are significant costs both to the furnishers that provide the data, as well as the aggregators.

And there has got to be some sort of incentive. In some industries the incentive is to be able to better manage the risk within my industry if I share with my competitors information, both positive and negative.

So in the case of the rental industry, if there was enough incentive to that group of small business owners to be able to start sharing that data, that is the incentive that gives them the reason to start to share the data and, therefore, would be available for use to help consumers beyond finding that new housing, but also to eventually obtain a mortgage.

So the economic model is a big issue. Tied to that is the whole regulatory aspect.

If you look at the work that any of us are doing today, all alternative credit data is governed by the FCRA and FACTA. So we have the same consumer protection mechanisms in place as we do with the national bureaus.

So whether you are a large national bureau or a very small boutique consumer reporting agency, your obligations as an aggregator and the obligations of your furnishers are identical in that you have to be certain the data is accurate.

Mr. BACHUS. I guess my question was more, aren't there some real practical hurdles to even—I almost hesitate to ask the question because I would not be in favor of requiring America's landlords to report.

Ms. NELSON. The costs would be insurmountable, I believe.

Mr. BACHUS. That was really it.

Let me go on to utility payments for a minute.

Number one, I would say I am not sure what the value would be because people are going to pay their utilities, or the option is to get the service disconnected at times, I would think. But secondly, with utilities they estimate payments.

My mother, for instance, with $1,200 Social Security, she will have a bill that comes in one month and it is $15 for water, then the next month it is $115. They vary quite a bit. The gas bill—I have seen them; they will go from $100 to $250. What we do is we supplement that and my mother pays them. But her utility bills can really go up and down. I actually charted that out, and they go up as much as 40 percent and 50 percent.

So I would think some people do that by paying one month a certain amount each month. And I think most, like Alabama Power, I think their policy—probably somebody pays $50 on a $50 bill, and the next month they get a $150 bill and they pay $75 and catch up. I am not sure anybody thinks there is anything wrong with that.

Mr. TURNER. If I could just respond to the utility question.

Again, I think whether or not any individual data sets are predictive in terms of one's credit risk, credit capacity, or credit worthiness, there are ultimately empirical questions.

In terms of utilities, I agree with Margot Saunders; all of these data sets have different characteristics. They are likely to have dif-

ferent predictive value for different lenders, for example. What may matter in a home mortgage loan immensely may not matter so much for general purpose revolving credit.

However, in our analysis, we make a distinction between types of alternative data that are more credit-like, meaning that you receive a service before you make a payment, like a credit card. You can use a credit card before you have to make the payment, or that are more cash-like, like a debit card. We think that that is a meaningful distinction.

And when you look at a thin file or someone who is unbanked and you have no ability to accurately predict the probability of default, if you can populate that file then with credit-like components, utility data, wireless phone data— again, they have different characteristics—it may be possible to make a better assessment of that individual's credit worthiness. That is what this is really about.

Ms. THOMAS. What I would like to add to that—and you made an interesting comment about privacy because that is a concern—but one of the challenges sometimes for the customer when you are trying to get that mortgage loan approved—and that is the hat that I am wearing is if they do not have receipts, because who keeps 12 months of utility and rent receipts, it is tough for the customer sometimes to get the information, and sometimes we try to help them do that.

Mr. BACHUS. I would say this. I would agree with you. I think if someone low or middle income, particularly, that needs to establish credit, I think that if they sign something and say, I would like the utility company to supply my payments, or a landlord, I can certainly see that. That does away with most of my privacy concerns.

Ms. THOMAS. Okay.

Mr. BACHUS. I think that a tenant probably has the right to ask for that, and I am sure landlords would not mind supplying that. I would hope not.

Ms. THOMAS. Some of them do not mind; some do.

Mr. BACHUS. Yes. That is a very good point. I had not thought of that.

I yield back. I do not have any time left.

Mr. CASTLE. Thank you, sir.

Congressman Baca is recognized for 5 minutes.

Mr. BACA. Thank you very much, Mr. Chairman, and thank you for having this hearing.

Let me ask this question of Mark Catone.

In your testimony, you discussed the changing demographics that impact credit markets. You state that immigrants have accounted for more than one third of the household growth since 1990. Immigrants are included in a list of rising numbers of consumers, and I state, "A rising number of consumers who are planning to make major purchases either earlier in their lives or soon or after becoming U.S. citizens."

I am very much concerned that Real ID and the laws to establish national ID cards for employment purchases will affect immigrant consumers in the U.S. It is true that the use of nontraditional credit reporting, such as utility statements for immigrants, can provide them with greater credit availability. However, I am more con-

cerned that the Real ID will prevent some banks from doing business with immigrants. It may push them further into the category of unbanked.

Can you comment on the Real ID bill as a new barrier for immigrants seeking to build a credit history? This is question number one.

And two, what do you believe can be done to prevent this, if anything?

Mr. CATONE. Let me position it in terms of our experience and our experience of compiling nontraditional data in response to mortgage originators' and investors' loans.

We have seen alternative identification presented to use for those consumers in compiling that information—for example, consumers that may not have a Social Security number or who may have an individual identification number or an alternative mechanism.

There is not anything that I am aware of—and I am probably not the best person to speak on the regulatory subject of the identity issue, but in our experience, we do not differentiate between whether an individual has a different type of identity or verification of that nature.

We are responding to our originator or a mortgage investor's request to compile a nontraditional credit report for the purpose of extending a loan. So it is more general based than broad based. We are not telling the difference between one or the other.

We do verify the identity, the address of the applicant. We do verify the data that is sent to us and that we collect and compile. That is transmitted back to the mortgage lender or the investor.

So I do not have the depth, I think, of granularity you are looking for in terms of the identity issue.

Mr. BACA. So it could create a problem, though, because right now most of them can use matriculas for identity purposes and banking purposes, but if Real ID was put into place, the difficulty then in terms of the banking, as well, would also impact our societies because individuals use either banking or credit through banking, not only in obtaining credit and credit rating, but they also use the banking to pay a lot of their payments.

In making payments from the banking or checking accounts, they end up becoming taxpayers on sales tax, so that sales tax then could conceivably be lost within each and every one of our communities based on what may be implemented and how it is interpreted, with Real ID, the law that just passed last week. I just wanted to find out if it would have any impact on our banking system based on Real ID.

Let me ask you another question. This one goes to Michael Turner.

Latinos are more likely to have no credit history—22 percent compared to 4 percent of whites and 3 percent of African-Americans. Some suggest that part of Latino culture is to remain debt-free. What cultural or economic reasons are there that create the discrepancy? This is question number one.

And how can we increase and improve education to Latinos and other minorities, especially regarding the new use of nontraditional credit risk indicators to encourage a healthy credit history so they are able to enjoy the same credit availability as their neighbors?

That is difficult when it comes out with the credit rating being higher for a Latino versus a non-Latino.

Michael?

Mr. TURNER. Thank you for the question. There are two questions, actually.

I cannot pretend for a moment to fully understand or explain the discrepancies. I have seen analysis that suggests that, for instance, with the Latino community in particular, there is an issue of part-time residency.

I lived in Washington Heights with the largest Dominican population outside of the Dominican Republic. Many people in my neighborhood would leave for 3 or 4 months at a time and go back to D.R. They would not pay utility bills for 3 or 4 months, and then when they could come back everything would be paid.

So in a traditional credit model, that is a pretty serious negative, a serious delinquency, but it may not accurately reflect, for instance, their credit risk or credit worthiness.

I am aware of some efforts to try and better understand certain populations and these discrepancies in credit scores and how they are explained behaviorally. We do not analyze that in our study. It is certainly an interesting topic, and it is a very rich subject, and it is worth a lot of analysis, but I cannot really speak directly to that.

What I can speak to, and I think you make a very important point here, the group that we are talking about, the unbanked, recent immigrants, thin-file Americans, they are not likely to have a high degree of financial literacy. What is the significance of a consumer credit report? What is the meaning of my credit score? Why does it matter in day-to-day life?

We are dialoging through our own work with programs that are actually out in the field working with low- to moderate-income Americans, different immigrant populations, and testing. They are small efforts at this point, and they are vastly underfunded. But they are testing whether or not they can hold a focus group or educational seminars, get consumers from these populations to volunteer to have this data shared, and to track over time whether it matters materially to their score, to access to credit, to the terms of that credit.

I think that is a tremendously important effort. I think certainly, at least I am hopeful that one of the outcomes of this hearing is an increased awareness of the importance of those efforts.

Mr. CASTLE. Thank you, Mr. Baca.

Mr. BACA. I know that my time has expired, but I hope we do more educational awareness training because we do not want them to prey on these kinds of individuals, because their credit, being minorities, is a lot higher than anyone else. If there is that kind of educational training, at least they will be aware to look at their credit rating, change whatever needs to be done in that area, so this way they do not continue to prey as, hey, I am going to make X amount of dollars because their credit rating is so high, so ,therefore, I am going to charge X amount of dollars.

Thank you very much.

Mr. CASTLE. Thank you, sir.

Ms. THOMAS. Chairman Castle, may I add one brief comment to what he was saying?

Mr. CASTLE. If you can be very brief.

Ms. THOMAS. One organization, the National Association of Hispanic Real Estate Professionals, is doing a lot around educating the Latino community on that particular issue.

Thank you.

Mr. CASTLE. Thank you. You were brief.

Mr. Pearce is recognized for 5 minutes.

Mr. PEARCE. Thank you.

I have a series of questions, and I am going to ask for the shorter answer rather than the expansive answer. Five minutes elapses really quickly, and if you are drifting off, I will probably pull you back, but do not take it personally.

I do not want to talk about the unethical people who exist on both fringes: unethical lenders who would exploit or unethical consumers who would take advantage of it. I am trying to wrestle with the concept somewhere out in the middle of how we deal with people who have not always been on the upside of the economic spectrum.

Ms. Nelson points out that their improved techniques are allowing actually credit to be given more widely. Instead of a categorical exclusion, we are actually getting down into some of the participants maybe that previously could not have gotten credit because we have better information.

Ms. Saunders is somewhat uncomfortable, on page two, with people pricing credit based on your ability or your previous history of paying. And yet I find Ms. Thomas, I suspect you all, if you find someone who is not a very good credit risk, but you are going to try to work them into your program, and I see that happening.

Our district is very poor, and Mr. Baca has pointed out a lot of people in the Hispanic economy are actually on the cash economy.

Do you all find that your costs associated with some of those clients are higher than the costs associated with someone who just sends a payment in every month?

Ms. THOMAS. What we see, and I do not have the exact cost numbers, but it does take longer in terms of cycle time, which can translate into costs. So it takes more effort working with the consumer.

Mr. PEARCE. So if you have a higher cost, if you do not charge a greater price, and you have a higher cost, then you are actually charging someone else for that person's cost.

Ms. THOMAS. We are charging that individual, but we are not charging them a higher rate.

Mr. PEARCE. I am just saying that if it is a higher cost and you charge the same thing you are charging someone else with a lower cost, then actually you are either accepting less margin, and if that margin becomes negative, you then charge someone else for fees that would go over here.

Ms. THOMAS. No, that is not the case. It does impact our productivity, so you are correct there.

Mr. PEARCE. That is all I needed to know.

Ms. Saunders, you would feel very uncomfortable with any price increase no matter what the credit risk?

Ms. SAUNDERS. No, sir. I think you misunderstand me. I was trying to put a lot of ideas into a few short words.

We do not disagree with the idea behind or the justifications of risk-based pricing. We certainly see many instances where low-income consumers have benefited from them.

What we disagree with is the very typical practice among some creditors of using risk-based pricing——

Mr. PEARCE. Sure, yes, those are the ones I said we are not going to talk about. Yes, there are unethical people. But you are giving clarification, and that is what I am asking for, that you really do not object to the price. It is the unethical treatment of price increases.

Ms. SAUNDERS. Well, there is a recent study that came out in the paper just a few weeks ago where it showed that those consumers of credit cards that were paying the late fees and the default interest rates were actually subsidizing the middle-income consumers who were not paying anything. So in terms of subsidies, I think it is going that way.

Mr. PEARCE. I appreciate that.

On your program, Ms. Thomas, in the underserved market, what kind of success rate are you having on the repayment of your loans?

Ms. THOMAS. We are having a very good success rate. We monitor that pretty closely. That is how we were able to get the practice of utilizing nontraditional credit approved in the first place.

Mr. PEARCE. And typically people in this credit category that you are reaching down trying to now extend services to, they usually are not going to be the people looking for the $100,000 to $200,000 loans. So what size loans do you find them targeting? What is the smallest loan you give?

Ms. THOMAS. I am sorry, what was the last one?

Mr. PEARCE. What is the smallest loan you all give?

Ms. THOMAS. Loans can vary anywhere from $70,000 up—I think about different markets, where $100,000 could be a low-income home, a low-income mortgage. And for individuals that are on the extreme end of the credit risk, we require counseling, education, because we have——

Mr. PEARCE. No, I am just asking for what size loan.

Ms. THOMAS. Anywhere, $70,000 up to, in California it could be $200,000-plus.

Mr. PEARCE. And that is my point, that one of the greater tasks for us, I think, is some of the smaller banking institutions. You all do a good job of outreach and reaching in, but really in our district we find that the low loans of $30,000 really not many people want to offer down in there. It kind of addresses Ms. Saunders's concern that there are not many participants willing to go down into that range.

So we really have the testimony here that would allow us to give a lot more people access to credit if we can figure out how to measure the parameters and we can find lenders who are willing to get out and take that step and charge a reasonable rate of interest and give access and take the risk.

I appreciate the fact that Bank of America is doing that. Somewhere we have to find the measurement tools that will then allow

us to really thread the needle a little bit more finely than these categorical exclusions.

So myself, I appreciate all of the efforts on both sides of trying to solve it because it is a thing that affects my district a lot. We are low income. We are majority minority, and people just work hard and stay on cash economies.

So I salute you for what you are doing. We will see if we can facilitate it. And thank you all for your good testimony.

Mr. CASTLE. Thank you, Mr. Pearce.

Ms. Carson is recognized for 5 minutes.

Ms. CARSON. Thank you very much, Mr. Chairman.

And thank all of you, certainly, for being here.

My question is one of not to be combative, but simply to understand the process better.

For example, I have a neighbor. Well, let me start over. There are consumers who are good payers. There are consumers who are slow payers. And there are consumers that do not pay at all. I understand that, and I am not favoring the no-pay-at-all when they can pay, please.

In situations like in my district where the gas bills have skyrocketed—in my own case, this is not hypothetical, I have lived in the same house for 35 years. My winter gas bill has gone from $100 a month to $700 a month now. It is just outrageous. We have neighbors in the same situation, who are low-income, who have had to borrow payday loans, put utilities on credit cards, to keep their utilities on. Sometimes it works and sometimes it does not, but the more they borrow, the more the cost of the utilities becomes.

In your scoring process, do you by any chance take into consideration people who have been good payers and then suddenly something happens and they go down the drain financially and do not pay the utilities on time and a lot of them are disconnected?

Do you use a unique scoring system that would take all of that into consideration if you know about it? And how can you know about it if somebody does not tell you about the circumstances?

Ms. THOMAS. In terms of a scoring system, that example would not be dealt with in an automated way, but in a manual way we can ask the question. Because if you see a person's history has been good and all of a sudden something happens, we usually will ask for an explanation, and if the explanation is one that makes sense, then we can use that information to continue underwriting the loan. But it is not automated; it is manually done.

Ms. CARSON. So it is always manually done when the red flag comes up. Who ultimately determines if your credit scores are statistically sound? Is there some independent external oversight of your credit scoring methods?

Ms. NELSON. Are you asking as a lender or as an industry?

Ms. CARSON. Industry.

Ms. NELSON. Fair Isaac continually works to validate the predictiveness of their score. Every lender that uses the score will then manage the score and their loss rates so that they are looking at their own portfolio to be certain and confident that the cutoff ranges that they are using are appropriate for the business that they are trying to attract.

So it is a very personalized process for each lender in terms of monitoring performance of the scores that they have used.

Ms. CARSON. I have another question. I see that payday loan lenders can be used to determine FICO expansion scores. I know anybody that goes regularly to a payday lender is in financial trouble anyway. If you go borrow $100, and when you pay it back it is going to cost you $120 or $130, you automatically have a problem anyway.

So how then do payday loans become a part of the equation when you know straight up? I have constituents, because I tried to close payday loans down, and they were outraged at me. "How dare you. That is what I depend on." Well, hell, I didn't know. I just thought you were getting ripped off unfairly or unnecessarily. So payday loans are very popular with some people.

Now my district, don't confuse what it is. It is not African American. It is not welfare oriented. We just happen to have some constituents who fall through the cracks. I have to qualify that because people look at me and presume that I am from an African-American district, and that is not true, even though I have been elected to Congress five times.

So it is not to rely heavily on somebody that is of color, somebody that is on welfare, any of that. I get annoyed because people automatically make those assumptions when they look at me.

But how then do military families rely ordinarily on payday loans because the Government, I am not going to use the word because I do not know if there any kids in the audience, but they are not runaway brides. They are trying to protect the sanctity of this country, the freedom of the country. Military people rely on payday loans all the time. I think it is something like 23 percent of them that are on active duty in the military.

So then how do you differentiate those kinds of situations, payday loan lenders, in your scoring process?

Ms. NELSON. Specifically to the expansion score, we have looked at the value or the predictiveness of payday lending behavior, loan behaviors for consumers. So we have analyzed it, but today it is not part of the expansion score.

Ms. CARSON. You do not use it?

Ms. NELSON. No.

Ms. CARSON. You do not use them. I take your word for it.

Ms. NELSON. You have my word for it. We do not use payday lending information.

Ms. CARSON. I am going to yield back the balance of my time.

Mr. CASTLE. Thank you, Ms. Carson. Thank you very much.

Mr. Hensarling is recognized for 5 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman. Thank you for your leadership on this issue. I certainly think it is a worthy topic, whether or not nontraditional data can be used in these credit scores to provide credit to perhaps historically underserved populations. It is certainly a topic worthy of our discussion.

Dr. Turner, in your testimony, you have touched upon it, but I would like for you to elaborate. I think, if I understand you properly, you have concluded that the reporting of nontraditional data is very unlikely to negatively impact credit scores for most Americans. I think you essentially see this as an upside because you have

stated that, by and large, most negative credit information is already reported into the system, and frankly it is the thin file, to use industry parlance, that is the major challenge.

Can you just go into a little bit more detail about what facts and research your conclusion is based upon?

Mr. TURNER. I would be happy to.

In our forthcoming study—and, again, it is a qualitative analysis that sets up the subsequent quantitative analysis—we interviewed a number of prospective data furnishers, lenders, modelers, credit bureaus, et cetera, and really got a firm sense of the landscape of what is and is not reported.

I am in agreement with my colleague here, Margot Saunders, that all utility companies do not report all negative data. I never ever implied that or inferred that. There are some utility companies that are reporting both positive and negative data directly to credit bureaus currently. It is a minority, but there are some that are doing it.

What I focused on was the indirect reporting from this universe of alternative data providers, the telephone companies, your landline, your wireless, utility companies. When accounts go into serious delinquency or default, they go to collection. The collection agencies report payment and nonpayment, the entire set of information, to the credit bureaus. So those sets of negative data from this range of alternative data furnishers are already reported.

So if in a hypothetical situation, all utility companies, all wireless provides, et cetera, were to begin reporting positive and negative, the net impact would be unlikely to be very negative for those that we have identified as thin file or unscorable or the unbanked.

What they would benefit from would be the overwhelming amount of positive payment history that would be appended to their files and may, and again this is an empirical question, may enable them to enter into the mainstream credit system.

Mr. HENSARLING. In your testimony, didn't you also mention that the lack of access to credit may help explain why there are lower levels of entrepreneurial activity among the poorer segments of the population? Is that correct? Did you reach that conclusion?

Going back to the question of the payday lending, I found the comment of my colleague to be interesting because indeed I have found a number of my own constituents who find payday lending to be a far superior alternative to paying fees, late fees on credit cards, and bounced check fees, and reconnection fees, and the rest.

Ms. Saunders, I believe in your testimony, if I am quoting you correctly, "the essential characteristics of payday loan transactions are so different than more traditional forms of credit that the payment or nonpayment of these liabilities is simply not relevant to whether a consumer will pay a credit card bill or traditional car loan." I am reading from your testimony.

If you would accept the proposition that the thin file is a challenge for any underserved populations, why would you deny me—or maybe you would not, but if I am in the business of extending credit and I have one individual who has no credit history whatsoever and I have another individual who I see over the course of 2 years has taken out seven payday loans and has repaid each and every one on time, it seems to me—and you might disagree, but we

could have a logical disagreement—I might consider that to be predictive behavior of one's credit worthiness.

Are you advocating a policy that would deny me that right as one who is in the business of extending credit?

Ms. SAUNDERS. I am simply advocating a policy of ensuring that the information that the creditor receives relating to your ability to make the repayment is relevant.

I would posit the theory that whether a particular consumer repays payday loans or not is probably not relevant. I leave it to my colleagues around the table to prove me wrong. If it is in fact entirely predictive that a payday loan consumer will repay or will not repay based on traditional credit, based on how they have used payday loans, then I may be wrong.

My analysis and our kind of uniform analysis among the consumer groups is that it would not be predictive, but I may be wrong. I have been wrong before; I hate to admit it.

Mr. HENSARLING. But regardless of the relevance or irrelevance, would you advocate the policy denying me that right?

Ms. SAUNDERS. I would advocate the policy simply of ensuring relevance. That is the policy I want.

Mr. HENSARLING. I seem to be out of time. Thank you.

Mr. CASTLE. Thank you, Mr. Hensarling.

Mr. Ford is recognized for 5 minutes.

Mr. FORD. Just to follow up on a lot of questioning from my friend, any sense, real quick, of the profile of those who take out payday loans?

Because I think the point my colleague made is interesting. I think most people who do, there is a perception that they have to be black and poor. And I think your point was that that is not the case, but the reality is, I do not think that the profile that my colleague has painted is necessarily an accurate one. Most people who go get payday loans are people who cannot get help from traditional sources.

Although maybe the payday loan industry hopes it evolves to that point that you have envisioned, Congressman, I do not think that is the case at the moment. Maybe Ms. Nelson and others can dispute us. I saw her nodding when you raised your question. As wonderful a description as it is, I think it is more fictitious than it is realistic.

I would ask the question, Ms. Nelson, you talked about how your scores are a solid predictor. I have a bias against what you all do. I want to start out before we get going. You say that as much as it is a solid predictor, you all do not have much control over what lenders do.

Do you think you have any responsibility as to what lenders do, since you all developed that score?

Ms. NELSON. We have a responsibility to help them understand what the score is predicting.

Mr. FORD. Right. But we know that there are abuses, and you do not think that you have any responsibility to address it?

I think the question that my colleague asked about, you take into account. Mr. Thomas was kind enough to say that it is done on an individual basis if it is a good point that a consumer may have about why they were late making a payment.

But you all do not take any kind of systematic approach to this in terms of accounting for differences in prices and the fact that someone may hit a hard time.

I am of the opinion that you all could do a better job than you do. It is easy to put the score out there and say, "We have nothing to do with it now." You know what it is used for. You know how it is used.

We voted on bankruptcy reform here in the Congress a while ago, and I voted for it because I did not think the credit card companies or others should be responsible fully for this. I think all of you all are responsible in some ways, and we have to start at the root and work our way across.

But you do not think you have any responsibility to adjust when you know lenders are using it in ways that it should not be used or using it in ways that hurt consumers?

Ms. NELSON. We have an obligation, first and foremost, to make sure that lender has permissible purpose to use the score.

In terms of our ability to systematically adjust the score based on qualitative information about the consumer, it is virtually impossible. That is why the score is used as part of a decision process by any lender. I do not think that we should make the assumption that the score is the one and only aspect of the decision.

Mr. FORD. How often do you think it is the one and only aspect?

Ms. NELSON. It is the first aspect for the automated process.

Now most of the customers that we work with, and Ms. Thomas is a terrific example, have manual underwriting processes so that if a consumer kicks out of that automated process for whatever reason, if the score is too low, or if there are other risk elements that makes that lender uncomfortable, that then moves into a manual underwriting process, both from a lender perspective, as well as if you talked to the GSEs.

So our role in the process is really to help automate as much of the decisioning as we can, to streamline the process, bring out cost. Then once you have consumers that go outside of that automated process, we are absolutely supportive of manual intervention.

Mr. FORD. But you do not apply any pressure for them to do any of that. You just provide the score. However they choose to respond to it, if you have good actors like Ms. Thomas or bad actors, or medium-level actors, you all do not really put any pressure on anybody. You just release the score.

Ms. NELSON. I would say that is correct simply because I do not know what pressure we have on our customers to be able to influence their individual business practices.

Mr. FORD. No, I did not ask if you could develop a kind of pressure point. I was just curious. You all do not do anything other than just provide the scores.

Ms. NELSON. Correct.

Mr. FORD. You are aware that sometimes the scores are used in ways that there are some good actors who are using it, as you cite Ms. Thomas's practices, and there are people who use it in a bad way.

So you are aware that there is a variance in how the scores can be used and how some people will use the score not as the only factor but as part of a set of considerations.

Ms. NELSON. I cannot say that I am aware of any specific examples like that, no.

Mr. FORD. You just said Ms. Thomas uses it for certain purposes.

Ms. NELSON. All I am saying is I would not characterize the fact that there is a score as a bad way. So we applaud efforts for lenders that want to go above and beyond the utilization of a score in their decisioning process.

Mr. FORD. Right. So presumably that means it is good if you are applauding it. Right?

Ms. NELSON. And presumably, we believe that most lenders do that very thing.

Mr. FORD. But there are some that do not, and you all have to be aware of that too, right? You know some are not doing it, so presumably you would not applaud them. My only point is, I think you are more aware of things than you say you are.

I hope this committee, as we look at nontraditional factors, we talk about payday loans. I say to my colleagues, we are one of the biggest payday loan users in the world; the United States is. Our payday loan folks are called Japan and China. And thank God they keep loaning us money to finance the things everybody here puts cards out for us to do.

This is not a partisan thing at all, but of all the people in the country to be getting on people about debt, we at the Federal level, the United States Congress, trying to tell people how to manage their money better when we run $400 billion deficits year-in and year-out and a $7.5 trillion national debt is a remarkable thing.

But God is in the blessing business, and maybe we will figure out a way to get out of this mess.

I hope that we take very seriously what has been said today. I do hope that we can find better ways to gauge people's credit, basing it on how much people pay or if people are able to pay their light bills or their phone bills and stuff.

I mean, we would not do this to rich people in this country. And to say to poor people that we are going to develop the system that you all are putting together, I think you can do better, and not you, but just the whole industry can do a lot better than what you all have presented us today.

I am one person on this committee who will fight tooth and nail, Mr. Chairman, to ensure, I do not care what they look like. If they are working people, and they are trying to support their families, and factors outside of their control are causing costs to go up, they should not be saddled with a weak effort like we have heard here today. We should come up with a better way to determine these things. Whether you live in Delaware or Texas or Tennessee, and whether you are Democrat or Republican, there has to be a better way to do this.

Ms. Nelson, I did not mean to jump on you, but I think if you all applaud certain practices, you ought to figure out a way to encourage those practices. It is the only fair way to do it. We do it here in the Congress, and you all should be expected to do it in the private sector as well.

Mr. CASTLE. Thank you, Mr. Ford.

Mr. McHenry is recognized for 5 minutes.

Mr. MCHENRY. Thank you, Mr. Chairman

This is mainly directed at Ms. Nelson, but I would love to have the whole panel chime in if you feel so led.

It is interesting to me that we are debating sort of a regulatory scheme for the marketplace of credit. It seems to me that especially your company, Ms. Nelson, you are in a position where you are trying to have, I would say, a market advantage, that maybe your system of scoring is more accurate for institutions to use, that you are a better predictor of someone's credit worthiness.

Is that your business, would you say?

Ms. NELSON. Obviously, the Fair Isaac business has been built around the development of credit scores.

What I came here specifically to talk about was the creation of a sister service called expansion score, which takes in the best alternative credit data available in the marketplace today for the purposes of helping to score those consumers that previously could not get a traditional score.

So when we talk about regulatory framework, we sit perfectly inside the regulatory framework that exists today to ensure accuracy and completeness of data and, therefore, solid scores that can be developed from that data to predict the likelihood of credit risk for any individual consumer.

Mr. MCHENRY. But there are many institutions that are doing exactly what you are doing. There is a choice that businesses can make to use your exact business rather than another's.

Ms. NELSON. Correct. We are one option of many. And you have heard today Ms. Thomas talking about the processes they go through to evaluate whether or not they can extend a mortgage to a consumer. Mr. Catone has explained the same thing.

So what the unique element of the service that we bring is that we are trying to help the industry automate all of this, so Mr. Catone is able to generate one-by-one consumer reports or nontraditional credit reports for any consumer that is applying for a mortgage.

What we are trying to do is supplement that with an automated process that is going out and, at a macro level, finding data providers that have that positive information that we can pull together and generate a score. I think the clear difference here is that we are very supportive of all the other efforts. You could almost look at this expansion score as a first step.

So if we are able to find information about checking accounts or payment plans where there is a lot of positive information, we are able to generate a score that is high enough for that lender to feel comfortable. It is a first step. It can either be used as a big piece of the decision or an indicator for the decision to move on and invest in the creation of a full-blown nontraditional credit report.

Mr. MCHENRY. But it is the marketplace there which you are responding to. Is that correct?

Ms. NELSON. Absolutely, absolutely.

Mr. MCHENRY. Is there a regulatory framework that is holding you back in providing more accurate scores and a more accurate prediction of credit worthiness that perhaps Bank of America, let's say, needs, that they would like to have this additional information—

Ms. NELSON. Right.

Mr. MCHENRY. —So they could extend credit?

Ms. NELSON. If you look at a classic or a traditional credit score, typically I believe the average is maybe 13 credit lines feed into that score. Within the expansion score, we have a much lower number of alternative credit data sources or data points.

And so, as we gain more and more alternative credit data to be made available to all of us in the industry, it is going to enhance our ability to get that score to be refined further and further for the consumers.

So when you ask, is there a barrier, right now our barrier is trying to find those alternative credit sources to continue building and building the value of the score and the report that we are able to provide, which would then allow much more automation and efficiency in the process than having to go through the manual systems today on each and every one.

It does not displace the need for the manual reviews, but it allows a lot more of those consumers to pass through the system without having to go through the cost of the manual reviews.

Mr. MCHENRY. Dr. Turner, it looks as though I was going to you next.

Can you describe the marketplace forces that are driving the direction that we are trying to go in here, with actually providing more information to extend credit?

I think there is a great failure in Congress to understand that there is a marketplace, and the marketplace will drive innovation. The marketplace will drive a great advance in extending credit in many different things.

We had a hearing just not too long ago about data security, and I think there is a marketplace for companies such as Bank of America. Bank of America has this wonderful commercial that describes the accuracy of their check processing and their innovation there and the accuracy by which the process the checks.

I just think we need to look at what the marketplace is driving toward, and is there a barrier that government is imposing through regulatory schemes or laws or whatnot that are actually holding back this process of innovation.

Mr. TURNER. There are several questions there.

Our study touches on some barriers that impede these flows. We talk about two economic barriers and two regulatory barriers. We surveyed about 25 State regulatory commissions, and we are only aware of regulatory barriers that forbid the onward transfer of telephone, wireless, wireline, electric, water, utility data in two States. So it is about 8 percent.

We have no reason to expect the balance in the remaining 25 States that that number would be markedly higher. Those prohibitions were not expressly for preventing credit reporting. They had different purposes.

So I do not see a substantial regulatory barrier in the States or federally. What is more important that in preventing this is the regulatory uncertainty. Utility companies want to report the data.

One of the market forces driving them is cash flow. They have high delinquency and default rates. Reporting payment history is a disciplining mechanism. It improves cash flow. So they have a powerful market incentive that is driving the demand for this data.

But they cannot report the data, the utility companies, because their regulators will not give them written permission to do so, even though there is nothing statutory that prohibits them from sharing the data.

So yes, there are barriers, but they are more indirect and soft barriers than direct.

Other market forces, and I think that my panelists got to this as well, there is a lot of this information that is gathered already. If you look at the mortgage insurance industry, mortgage insurers gather vast amounts of alternative data for use in underwriting decisions about mortgage loans. They collect data we have not even discussed here. They collect the presence of children, truancy issues. They manually verify all of this data.

If there were a company or several companies that were able to systematically gather this data and then provide it to those who want it for their decisioning processes, that is an unmet need. It would be a tremendous efficiency for the mortgage insurers, for instance.

So there are market forces compelling the collection of this data on a variety of different levels and a variety of different directions.

Mr. MCHENRY. Thank you.

Mr. CASTLE. Thank you, all.

Thank you, Mr. McHenry.

Ms. Maloney is recognized for 5 minutes.

Mrs. MALONEY. Thank you.

And I thank all the panelists for being here today and for your testimony.

One fact that many consumers are not aware of is having more than one credit card or two or three credit cards lowers your credit rating. This is particularly a challenge with young people or many people.

They walk into stores. I represent New York. It is a large retail base. The Fair Credit Reporting Act was tremendously important to the city that I represent and to our economy for institutions to be able to have a Federal standard so they could make decisions and allow credit.

But a side of it, and I would like to ask Bank of America, Ms. Thomas, consumers are not aware of this. Many promotions are always there. You can go into a store in my city or probably anywhere in this country and they will say, take out a credit card and we will give you 20 percent off; we will give you $100 if you spend $300 and take our credit card; we will give you $50—I mean, all of these promotions to entice consumers to have credit cards. In many cases, they may use the credit card just once, yet it remains on their credit file and lowers their credit rating.

As a source of credit cards, what is your comment on it? Should we notify consumers that having more credit cards lowers their credit rating? By the time they try to buy a car or an apartment or whatever, their credit rating is ruined because they have 10 or 20 or 30 credit cards.

Ms. THOMAS. One of the ways that we try to address that is through consumer education. We do a lot of financial literacy at the school and college level.

In talking to a college student who says they have 12 credit cards for emergencies, and you ask, what is the emergency? And it is to buy a dress to go to a party. That shows us lack of the education.

So that is one way, not only college students, but other adults who also have the same issue. It is just continuous education is the best way, but it is still not enough. There is still more that needs to be done in that space.

Mrs. MALONEY. Do you think we should require better disclosure of this adverse consequence on credit cards so that people could be notified when they are applying?

You do not even have to apply for a credit card in New York. They are practically hawking them on you. You get them in the mail. They mail them to you. In literally every store, you can go into a gum shop store, and they have their own credit card.

So do you think if we required better disclosure: "Congratulations, you have this credit card, but please be aware that if you have more than three credit cards, your credit rating will be lowered."

Ms. THOMAS. I do not know that it should be a requirement. I think it needs to be an awareness that is continuously done so people know that that is a problem, because you are right. Most people do not know.

Mrs. MALONEY. I would like to ask the credit agencies—and we all have challenges in our work. Ms. Nelson and Mr. Catone, could you clarify for me what is the procedure in the credit agencies? And why is it a decision to lower credit if someone has 10 cards? If a consumer has 10 cards and they have totally paid off the debt so they have no debt, why do you lower the credit card rating?

This was an issue in the Fair Credit Reporting Act. We became aware that you could have had a credit card for 10 years, maybe used it once, paid off the debt, but still your rating would be lowered if you had more, I believe, than three cards.

Could you clarify what the standard is?

To me, I think when you are looking at credit, you want to know what the person's payment schedule is and what the debt is. So if a person had 100 cards and they paid off all their debt, why are you lowering the credit rating on them?

I was told the standard was three cards, and then you lower the credit standing, but maybe you could clarify our understanding of it.

Mr. CATONE. Maybe Ms. Nelson can clarify one part of that.

There are two pieces here. One is the alternative data or the nontraditional data. Many underwriting standards allow compilation of payment pattern history, one being credit cards or utility data, rent data, whatever. These underwriting standards in the mortgage industry at least have been very, very different than the traditional. You see that Fair Isaac has come out with a different score for that application.

I think what you are referring to is the existing type of scoring mechanisms that have been in the marketplace and are in wide use today, if I am not mistaken. And that is a more general issue. So there are two here.

Mrs. MALONEY. Okay. I would like to understand how the credit agencies create their credit scoring as it applies to the number of credit cards that you have. Could you answer that?

I was told by a credit agency when one of my constituents called, that if anyone had over three credit cards, their credit scoring was lowered. Is that true?

Ms. NELSON. I cannot say specifically if it is true or false, but I can tell you that more important than the number of cards possessed by a consumer is what degree of debt have they consumed on those cards. So if I have three cards and they are all maxed out, it is a very different scenario than having three that are not in use. Right?

Mrs. MALONEY. The example that I am using is every credit card is paid off completely at the end of the month. There are 10 credit cards that the consumer has not even used in 10 years. They used them in college. Ten years later, they are not using them. They are still on their credit report, and just the mere fact that they have the credit cards lowers their score, even though it has been paid off completely. Consistently for 10 years, there has been no debt on those credit cards. I was told that it lowers the credit scoring.

Can you clarify that? If you cannot do that today, would you get back to us in writing?

Because I have heard it three or four times from constituents who are stunned when they finally go to get a credit score that they have a low score, although they have no debt, make a lot of money, always pay their debt, always pay the credit card off at the end of the month, only use one of them. Yet just the mere fact that from their college days or whatever or because there was a promotion that gave them 20 percent off or whatever, they have a terrible credit score.

I think that that is a problem, and people should be aware of it, and they are stunned to find out about it, and I was stunned to find out about it.

Ms. NELSON. And that is exactly what I will do. I will go back and get specific information around that question of number of cards. I cannot tell you specifically today how it would, if at all, affect a score, but I will gladly research that and get back to you.

Mr. CASTLE. Thank you.

Thank you, Ms. Maloney.

Mrs. MALONEY. Okay.

Mr. CASTLE. Mr. Clay is recognized for 5 minutes.

Mr. CLAY. Thank you, Mr. Chairman.

And I thank the panel for participating today.

Getting access to credit at reasonable rates is one of the more difficult tasks faced by minorities, women, moderate-and low-income workers, and immigrants. Credit agencies cite that there is insufficient credit history using traditional data in a majority of the cases.

Do we have conclusive evidence that employing the use of non-traditional credit information is effective in dealing with minorities' problems of limited access to credit? And how effective is the use of these? And what do we compare the results to?

Anybody can tackle it.

Ms. THOMAS. What we see at Bank of America is that there are individuals that we would have otherwise declined because they did not have enough credit that we can say yes to because we are trying to figure out, within reason, because you do not want to put somebody in a home they cannot keep, because it is not about getting a loan, it is about keeping it.

But if we did not utilize some of the nontraditional data, we would have to say no. And if a person has demonstrated good payment behavior, then that is a way of getting them into that home.

Mr. CLAY. Well, how reliable is the use of nontraditional data in determining payment behavior patterns or any other credit-related behavior? What suggestions do you have to address this problem?

Ms. THOMAS. In terms of reliability?

Mr. CLAY. Yes.

Ms. THOMAS. Because the process is so variable from customer to customer and type of alternative credit you would use, we have seen some data that shows good behavior, especially around rental data, but other types of data, there is still more analysis to be done, and we only do it on such a limited basis because there is such variability in it.

Mr. CLAY. Well, how about young people just starting their jobs, careers? How do you gauge whether they are worthy of a home loan or worthy of a credit card? Do you take in extenuating circumstances, other factors to determine that?

Ms. THOMAS. For a young person just starting out—because I had several people on my staff under 30, which was good learning for me—they may have been paying rent to a parent, and they could demonstrate it, or they were paying rent on an apartment. So that is an example of one. They may have one credit card. Some have a bunch, and we worked on those.

So that is data we can use, but they typically will be a thin file because they do not have enough, but it is the same thing. They can demonstrate payment history.

Mr. CLAY. Ms. Thomas, let me ask you, some young people that come right out of college are heavily indebted with student loans. Do you ever give consideration to them as far as purchasing a home and then rolling that student loan into the mortgage?

Ms. THOMAS. We give consideration to that, but if we see where there is a severe struggle with doing that, along with other debt, oftentimes what we will do is refer that young person to some credit counseling. They do not have to take it, but we want to get them in better shape now so that they can continue to progress not only with that mortgage, but other things as well.

So sometimes we can say yes. Sometimes we have to refer them and hope they will come back after we have educated them.

Mr. CLAY. I see, after they have accumulated some time and credit history.

Ms. THOMAS. And understand what they can do to improve their situation.

Mr. CLAY. Thank you for your response.

Mr. Catone, how do you view the use of such nontraditional credit score such as the FICO expansion score and the instant-merge credit reports? How do each of them reach their targeted consumer

groups? Are the programs having a major impact on helping consumers get better access to credit?

Mr. CATONE. What I want to point out is that the financial services industry is very automated today. There is a heavy investment in technology, process, and things to make it very economical and fast to underwrite a consumer for any financial instrument.

In cases where there is obviously not enough data and things of this nature, it falls into a special category. As the other panelists have noted, it goes into a manual process. It takes longer. It is more difficult. The consumer does not understand these things.

So there are a variety of underwriting criteria depending on the program, Bank of America's program or what have you, that override and can adjust for different types of situations, credit counseling being one of those; other types of payment history data being those types as well.

So I think you have to look at the underwriting standards that are in the industry today, specifically counseling. There are many studies out that have proven that pre-home purchase counseling contributes to the integrity of being able to repay that loan and budget and things of this nature.

Mr. CLAY. Thank you for that response.

Thank you, Mr. Chairman.

Mr. CASTLE. Thank you, Mr. Clay. We appreciate your being here and appreciate your questioning.

We are going to bring this to a close. We appreciate all the panelists being here and for answering our questions.

It is possible that some of the members may have additional questions for the panel which they will submit in writing to you in the course of the next 30 days. I do not know how likely that is; nobody has seemed to opine that way today, but that could possibly happen.

So with that, I declare this hearing adjourned.

And thank you again for being here.

[Whereupon, at 12:06 p.m., the subcommittee was adjourned.]

A P P E N D I X

May 12, 2005

Opening Statement

Chairman Michael G. Oxley

Financial Services Committee

Subcommittee on Financial Institutions and Consumer Credit
Helping Consumers Obtain the Credit They Deserve
May 12, 2005

Thank you, Chairman Bachus, for convening this hearing on promoting greater access to credit through the collection and reporting of data that has not traditionally been captured by our nation's credit reporting system. Today's hearing continues the important work of this Subcommittee on consumer credit issues, which reached its high-water mark with enactment last Congress of the Fair and Accurate Credit Transactions Act, historic consumer-protection legislation that gives every American the right to a free annual credit report and significantly advances the fight against identity theft.

I would also like to commend the gentleman from Delaware, Mr. Castle, for calling the Committee's attention to the issue that is the subject of today's hearing, and for the fine work he did in helping us craft the FACT Act.

As was conclusively demonstrated during the exhaustive hearings on the Fair Credit Reporting Act that Chairman Bachus presided over during the 108th Congress, America boasts the most sophisticated and efficient credit markets in the world. By giving potential creditors access to detailed, continuously updated information about consumers' payment histories and outstanding financial obligations, our national credit reporting system has vastly expanded the availability of credit to all segments of American society.

Statistics now show that almost 70 percent of Americans own their own homes; 73 percent own at least one general purpose credit card; and nearly 66 percent have auto loans or leases. Loans that used to take hours or days to approve are now being processed within minutes, thereby increasing efficiency in the marketplace.

Yet even with the explosion in credit availability that we have witnessed over the past two decades, obstacles remain for certain underserved groups seeking to gain access to the financial mainstream. Our Committee has devoted significant attention in recent years to one aspect of the problem — the millions of Americans who lack bank accounts. Particularly for low and moderate-income individuals, opening a checking or savings account can be an important first step in establishing a credit history, which can unlock doors to other financial opportunities.

A study by the Federal Reserve found that maintaining a bank account is an important factor – more significant than household wealth, income, or education level – in predicting whether an individual has a mortgage or auto loan. Moreover, the more entrenched in the traditional financial system a consumer becomes, the less likely he or she is to fall prey to abusive credit terms or other financial scams.

For many young adults, minorities, and recent immigrants to our country, the largest obstacle to gaining an economic foothold is their lack of a track record in the responsible use of credit. Consumers who don't already have credit cards, mortgages, or other significant credit obligations may find it difficult to demonstrate their creditworthiness to prospective lenders, resulting in credit either being denied altogether or offered at substantially higher rates.

Yet many of these same consumers who lack credit histories **have** demonstrated an ability to meet periodic financial obligations — such as monthly rent, electric, gas, cable, telephone, rent-to-own, or day care payments — that are not typically captured in the data reported to the three major credit bureaus.

Today's hearing will highlight several innovative private-sector initiatives to collect this kind of non-traditional data and use it to generate credit histories on some of the estimated 55 million American consumers who do not currently have a standard credit score. Armed with such a score, these consumers will stand a far better chance of qualifying for mortgages and other forms of consumer credit that can provide a ticket to a better way of life.

Let me once again thank Chairman Bachus and Congressman Castle for their work on this issue, and for their continued commitment to improving access to credit for all Americans. I look forward to the testimony of our witnesses.

Opening Statement
Chairman Spencer Bachus

Subcommittee on Financial Institutions and Consumer Credit

"Helping Consumers Obtain the Credit They Deserve"
Thursday May 12, 2005

Good morning. The subcommittee will come to order. Today we will hold a hearing entitled "Helping Consumers Obtain the Credit They Deserve". As we learned during our recent debates on the Fair Credit Reporting Act, a consumer's credit history can play an important role in his or her ability to obtain credit, as well as in the price of the credit offered. However, we also learned that many consumers who pay their bills on time may not have sufficient information in their credit reports demonstrating their creditworthiness. This is due to the fact that not all companies provide payment history information to credit bureaus.

Today's hearing will provide us a forum in which we can explore the types of information that may be valuable in the credit underwriting process but that are underreported to credit bureaus. We may also identify any structural barriers that may hinder the reporting of such information. Generally, we want to learn more about how we can improve consumers'

credit options, especially for those consumers who are of low or moderate incomes. This Committee has demonstrated time and time again a dedication to ensuring that all American consumers maintain a level of access to financial services and products that is unrivalled anywhere in the world. Today's hearing further demonstrates this commitment. I thank Mr. Castle for requesting this hearing and I commend him on his leadership in this area.

Consumers in the United States have more ready access to low-cost credit than consumers anywhere else in the world. This is due in large part to public policies that support the pooling and sharing of consumer credit data. The availability to lenders of complete and accurate data on past consumer borrowing behavior is considered essential to an efficient credit market. Despite the enormous growth in the U.S. credit market, many consumers still experience difficulty obtaining adequate consumer credit because they have little or no credit history. I understand that it is estimated that as many as 55 million Americans do not have a sufficient credit history for a lender to accurately assess their true risk of default. Many of these same consumers may be making timely payments on various monthly or contractual obligations. However, these payments are often going

unreported to the credit reporting agencies. For example, many landlords do not report information to credit bureaus, so a renter's credit report will not necessarily reflect the fact that the consumer is paying regularly and on time. The same can be said for some utilities companies, cable companies, and telecommunications companies.

If a consumer does not have significant amounts of information in his or her credit report, that consumer is said to have a "thin file," making it more difficult for creditors to assess the consumer's creditworthiness. Consumers in low- and moderate-income households may be more likely to have "thin files" because they do not have mortgages or other forms of traditional credit that show up on their credit report. Therefore, a low-income renter may find himself in a vicious cycle of not having adequate access to low-cost credit because the person has not had access to such credit in the past.

We need to explore whether the information that could be provided by landlords, utilities, phone companies, cable companies, and others to credit bureaus could be valuable in the underwriting process. For example, would a creditor be more likely to grant a mortgage to a consumer if the creditor

knew that the consumer faithfully and diligently paid his or her phone bill every month? Are some types of information more valuable than others? I look forward to hearing today's witnesses' thoughts on this topic. I also look forward to learning more about why certain types of companies do not report information to credit bureaus. Is it too expensive? Are there other barriers? Is there too much liability involved? We also need to explore whether such information can be reported in a reliably accurate manner. It is my hope that today's hearing will allow us to explore ways in which the use of alternative data, not currently reported to the major credit bureaus, may benefit the millions of Americans that either do not currently have a credit score or have little information in their credit file.

Let me again thank Mr. Castle for his leadership on this issue. He is strongly committed to this matter and I admire his dedication to ensuring that the underserved have access to the low cost credit they need and deserve.

The chair now recognizes the Ranking Member of the Subcommittee, Mr. Sanders, for any opening statement that he would like to make.

Statement of Congressman Michael N. Castle

Financial Institutions Subcommittee Hearing on
"Helping Consumers Obtain the Credit They Deserve"

May 12, 2005

Thank you Chairman Bachus and Ranking Member Sanders for holding this hearing before the Financial Institutions Subcommittee today. I would like to specially thank both Chairman Oxley and Chairman Bachus for working with me on bringing this issue before the Committee, I believe it is an important one that warrants further discussion.

Today, more people have access to credit than ever before, however, there are indications that some Americans -- the young, minorities and recent immigrants in particular -- are not truly engaged in this competitive marketplace because they have little or no existing credit history for which lenders can assess risk and offer credit. As our witness Dr. Turner states in his recently released report, "Giving Underserved Consumers Better Access to the Credit System," there are an estimated 35 to 50 million American borrowers who don't have credit scores, bank accounts, or whose files have too little information to be used in allocating credit.

I feel there is information, such as rent and utility payments, that is not currently reported to the credit reporting agencies that could be helpful to consumers. For example, if an individual pays their rent on time each month there is no transmission of this information to the credit reporting agencies -- conversely, individuals with mortgages do receive credit for paying their obligation on time and this further adds to their credit score and history.

Mr. Chairman, that begs this question: If people regularly meet their contractual obligations for a variety of services, why should that responsible behavior not be taken into account and used to advantage the consumer? Now, it could be that the different payments I mentioned may not prove to be predictive of future behavior and there may be state regulations related to certain utility providers that limit sharing of some of this information.

But, I hope that our witnesses today will help us better understand the predictiveness and value of the data. I am pleased a number of the panelists will discuss innovative products the marketplace has developed to better serve the needs of all of our constituents, specifically those with thin or no credit history, so they can have access to the best and most competitive offers of credit possible.

Thank you again Chairman Bachus for holding this hearing today and I look forward to hearing from our panelists.

Opening Statement

Congressman Paul E. Gillmor (R-OH)

Subcommittee on Financial Institutions and Consumer Credit

May 12, 2005

Hearing entitled: *"Helping Consumers Obtain the Credit They Deserve."*

I want to thank the Chairman for calling this hearing today. Throughout the last decade, our citizens have increasingly participated in our capital markets and in our housing markets. Stockownership and homeownership are at all-time highs as Americans have become comfortable with the options that are available to them. The FACT Act, one of this Committee's greatest accomplishments from the 108th Congress, works to ensure that the American people have the tools to protect this expanding credit history and have access to a free annual credit report.

For a large portion of our country, however, access to our deep credit markets may be unavailable as they have failed to gain a sufficient credit history. This population, typically consisting of young Americans, minorities and recent immigrants, have not had the opportunity to establish a strong credit history and a good credit score. Often times, their lack of a strong credit history is not indicative of credit risk, but instead is due to a lack of eligible credit building venues.

There have been discussions recently about ways in which a timely payment history for rent, utility bills, telephone, rent-to-own, day care and other such transactions can be included in an individuals credit history. With millions of Americans participating in these activities each day, there may be a way to capture this payment history and build credit.

I look forward to hearing our distinguished panel discuss alternative sources of credit reporting and thank the Chairman for calling this important hearing.

May 12, 2005

Statement of Congressman Steven C. LaTourette
Hearing entitled, "Helping Consumers Obtain the Credit They Deserve"

Chairman Bachus, I appreciate you holding this hearing, and would like to thank my colleague, Congressman Castle, for bringing this issue to the Committee's attention. There is no doubt that our nation's credit granting system is – and should rightfully be – the envy of the world. More Americans own a home, finance a car, and are able to purchase goods on credit thanks to this system. That said, the perils and pitfalls associated with such readily available credit have been well documented before this Committee, as has the evaluation process through credit reporting by which that credit is extended.

Our work on reauthorization of the Fair Credit Reporting Act in the last Congress made great strides in solidifying our national credit granting system, and also combating identity theft. However, it did not alter the voluntary nature of the credit reporting system. As might be expected in a free market society such as ours, certain segments of the population remain underserved, or subject to credit terms you and I might find ridiculous. One area where this is very evident is in the extension of credit to America's farmers.

While the availability of credit to average American consumers has skyrocketed over the last few decades, Federal Reserve data indicates that non real-estate loans to American farmers has steadily and drastically diminished since 1980[1]. The combination of price pressures across the industry and a volatile export market has forced farmers to make expensive technological investment to trim costs and remain competitive. The resulting razor-thin margins mean that many farmers must turn to their local lender in order to stay afloat. Mr. Chairman, the unfortunate reality is that the availability of farm credit is disappearing.

A large portion of my District in Northeast Ohio is agricultural. Even ten years ago, I would drive through eastern Lake County and Ashtabula County, passing dozens of hay and wheat fields, and many cattle and hog farms. Today that's not the case. I believe that in part, this is due to the

[1] Source: Federal Reserve Board, Agricultural Finance Databook, April 2005.

consolidation of rural banks. The days of establishing close, personal relationships with your local bank owner are, by and large, a thing of the past.

In regions such as Northeast Ohio, where the agriculture industry has been seriously affected by the pressures I mentioned earlier, it seems there is a direct relationship between these struggles and a decline in the availability of credit. The nature of our global economy may lead some to interpret this as an inevitability. Some might even see it as evolutionary. However, there is a public cost that is being overlooked. By way of example, in milk production alone, the U.S. became a net deficit nation – i.e. domestic production failed to meet commercial and public demand – at the same time agriculture lending dropped to less than two percent of total lending.

There was a time when everyone's television set was made in America. There was also a time when American financial institutions were happy and proud to support American farmers, through even the darkest of economic times and market adjustments. We know what happened to televisions, and a similar phenomenon is happening with the disappearance of farm credit. The security of American food supplies is no small issue, and it is something American financial institutions should keep in mind as they decide to support or abandon our family farmers.

Thank you, Mr. Chairman.

Testimony

Before

Subcommittee on Financial Institutions and Consumer Credit

Of the

COMMITTEE ON FINANCIAL SERVICES

Regarding

"Helping Consumers Obtain the Credit they deserve"

Thursday, May 12, 2005

Submitted by: Mark F. Catone
The First American Corporation
1 First American Way
Santa Ana, California 92707
(619) 938-7595
(619) 938-7029 (fax)
Email: mcatone@firstam.com

Chairman Bachus and distinguished members of the Financial Services Committee, my name is Mark F. Catone, Senior Vice President with The First American Corporation. Thank you for inviting us to testify today on the topic of "Helping Consumers Obtain the Credit they deserve".

The changing demographics of the population in the United States are reshaping the demand for housing, automobiles and other goods and services. As a result, these changes are having a significant impact to the credit markets. According to many sources, including prior testimony to this committee has shown that immigration has accounted for more than a third of household growth since the 1990s[1]. Also, in general, we are seeing many more consumers, immigrants or otherwise, striving to make major purchases, such as the purchase of a home, earlier in life or very soon after their establishment in the United States.

One of the barriers confronting immigrants, low-and moderate-income borrowers and other consumers entering our credit system in the United States is the problematic issue of little or no credit file information.

Consumers who are part of the system, who are established and who have a credit report flow through our financial institutions relatively smoothly and in an automated way. No where else in the world today does the credit system allow a consumer to buy a car in under an hour or qualify for a home purchase on-line in the time it takes to fill out an application and click a button.

However, consumers who have not been part of the system, who do not have established credit, who have not, because of cultural norms, immigrants or otherwise, or disadvantaged consumers – are not well served by the industry today.

In some ways, it has become a "condition", a stigma. When a consumer applies for credit and does not have a credit report, or has too little data in their credit report, the automated underwriting technology the industry has invested in within the last 20 years is either impaired or not useful. The lender must expend more time and resources working and evaluating these applicants versus applicants who move through automated systems.

From a consumer's perspective, it becomes difficult to explain why their application for credit takes longer than their neighbors across the street or that of their co-worker. They become confused about this, and accuse the lender, the industry and others of discrimination because they believe they are not being treated the same as everyone else.

For example, and I will use the mortgage lending industry as my reference point, consumers who have little or no credit report information at the national credit bureaus

[1] Harvard Joint Center for Housing Studies, 2004, and other sources.

are referred to as needing a "non-traditional" credit report. This term is well known and understood in the mortgage industry[2].

The mortgage industry has had a well defined method of establishing a Non-Traditional credit history when a consumer has little or no creditor reported information residing at the national credit bureaus. These methods were established to address the no-file and thin-file issue and have been with us since HUD, FHA and other agencies began guaranteeing home loans. Through the years the industry has adopted these general standards, with some variation, including Fannie Mae and Freddie Mac at the federal level and agencies like Mass Housing at the state level, and subsequently, the majority of mortgage lenders in the market today.

Credit bureau data, being very standardized and efficient for the most part, facilitated and made possible credit scoring, a process of summarizing risk and creditworthiness in a three digit score and factor codes. By having little or no credit file information, no credit score can be calculated.

Consumers whose files contain insufficient information to calculate a credit score are not considered in systems that rely on automated underwriting, resulting in a "manual underwriting" processes, which is more expensive and time consuming. Not only are mortgage lenders more likely to process automated loans first, leaving the manual loans until later, these consumers are placed into higher risk categories and matched to different loan programs.

This further encourages the outcries of discrimination by consumers, simply because they have not participated in our financial system for either enough time or in the same way as established consumers.

There are also other consequences when no credit file is available, which includes the automatic assignment of the consumer to a higher risk category, even though the consumer may be able to demonstrate creditworthiness by producing his or own records showing mom-traditional creditor references.

In summary, and as far as recommendations, there is no one answer or quick fix to this issue because of the existing built up infrastructure around what we know as the credit reporting system, credit scoring and non-traditional credit. There are however, several areas that can be addressed that may lead to more comprehensive solution in the long run:

1. Making More Data Available

   The December 2004 Report by the FTC to Congress under sections 318 and 319 of the Fair and Accurate Credit Transactions Act identifies data in the form of bill payment histories at utilities and telecommunications carriers to be a

[2] Fannie Mae Sellers Guide; Section X, 804: Using Nontraditional Credit History to Assess Credit Risk (06/30/02)

rich source of data indicative of credit behavior. Utilities and carriers however, only provide limited reporting to the credit bureaus.

There is no doubt that the addition of a substantial amount of utility payment data to the national credit reporting system would result in lowering the number of no-files and thin-files. Consumers, who pay rent, in most cases, also pay utility, phone and cable bills.

Utilities may incur additional expense in becoming compliant as data furnishers under the FCRA, including the expense of disputes. We would recommend examining whether utilities, as a data furnisher, while needing to provide the data in a structured and standard way, should be burdened with the same disputes requirements defined under FCRA.

Landlords, utilities, phone carriers are entities who provide services to consumers for payment, not a creditor who has extended a loan to the consumer such as a bank, Credit Card Company or a mortgage lender, at least not in the same way and to the same degree. We may need to modify existing rules regarding disputes based on this fact.

For example, and assuming the quality of a utilities record keeping process, if a consumers payment history is in error, or a balance suspect, should that not be a standard customer service call to the utility and not a dispute to the credit bureau? The consumer already must obtain proof of a difference from the creditor currently. This scenario creates two calls and/or letters the consumer must invest in, rather than one.

We will also need to address the issue of additional expense of the credit bureau in adding and maintaining that data on the credit file. Most credit bureaus look at additional data of this type differently, and may treat it as a different product, not integrating or not packaging it with the current credit file in order to recoup the maintenance or capitalize on the new data. If this occurs, reports may not include the data, credit scores may not be reflective of this data, and possibly more and different reports and scores will need to be integrated at high expense across the industry.

2. Create a Uniform Standard of Credit Reporting for Consumers who do not have Credit Reports but can Demonstrate Financial Competency

Standardization will lead to lower overall costs as industry players build the standard into their systems and infrastructure. Provide third-party oversight to ensure these standards are not geared toward specific commercial interests, but allow competition.

Allow this standard to include more diverse sources of data than is available today; very similar to what we are discussing here today in relation to

rent and utility data. For example, most credit reports and credit scoring models fail to adequately take into account important positives or compensating factors, such as the use of pre-purchase and post-purchase housing counseling which many experts believe can affect projected risk, and are in fact required for many agency loan programs.

Allow verified alternative non-reported payment history data such as buy-here-pay-here sources, cash payments and the like as well as, in the case of immigrants, financial and payment history data from other countries.

3. Build the Non-Traditional Standards into The Technology.

As stated before, the non-traditional credit report standards, at least within the mortgage industry, are very well defined. Most organizations who employ automated underwriting technology have not built these options into these platforms due to the relatively low number of loans of this type.

We should find ways to encourage or require that these standards, as the case may be by loan type, similar as it is today for full-file loans, to be built into the various technology platforms. Even the general data interchange standard established and maintained by the Mortgage Banking Association does not include a standardized way to handle non traditional credit type information.

Until then, these types of loans will continue to be kicked out to a manual process and result in the same issues and frustrations as mentioned before.

4. Make More Data Available - Data Must be Predictive

As it is said, the devil is in the details. A host of companies are promulgating various data and related solutions to this and related challenges. We need to be diligent in matching appropriate data and solutions to the problem at hand. For example, a mortgage lending credit underwriting exercise is different than that of underwriting an automobile loan.

As I mentioned before, there is a well-defined Non-Traditional Credit reporting standard in the mortgage lending industry. This standard exists because it is predictive of risk associated with a mortgage lending transaction. For example, the most important element included within this standard is a requirement for a verified twelve-month rental housing payment history. Both rental payments and utility payments attached to the same residence have been widely accepted to be predictive of mortgage payment risk - if a consumer can dependably pay rent, it is likely that he or she can pay a mortgage as a substitute for the rental payment.

This is not necessarily the case when it comes to an automobile loan. It is entirely likely that what works well for mortgage, may not be applicable or

economical for an automobile loan. An automobile loan is usually in addition to a rental housing payment, not a replacement to one therefore, not necessarily predictive of loan success to the degree as a mortgage loan. Other factors would need to be considered. In many cases, automobile loan risk, because of the size of the transaction, is simply managed by the requirement for a co-signer to the loan.

5. Bundled Services in Order to Make the Transaction Economical

Again, the December 2004 Report by the FTC to Congress under sections 318 and 319 of the Fair and Accurate Credit Transactions Act identifies additional sources of data that may be appropriate. The report also notes that most data identified is more expensive to collect and add to the system and closes by noting that this makes ready solutions an economic challenge.

In order to address this, the industry should look for ways to mitigate the expense of sourcing additional data. For example, my company, First American, offsets the higher expense of compiling and verifying Non-Traditional Credit information for a mortgage transaction, by wrapping it in a fixed-cost comprehensive settlement service package, effectively mitigating the higher one-off cost of credit alone.

This concept may make sense for other loan types.

That concludes my verbal testimony and again, I would like to thank the Chairman and the Committee for the opportunity to present to you here today. I would be pleased to answer any questions you may have.

A WRITTEN STATEMENT OF FAIR ISAAC CORPORATION

ON HELPING CONSUMERS OBTAIN THE CREDIT THEY DESERVE

BEFORE THE UNITED STATES HOUSE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

WASHINGTON, D.C.

MAY 12, 2005

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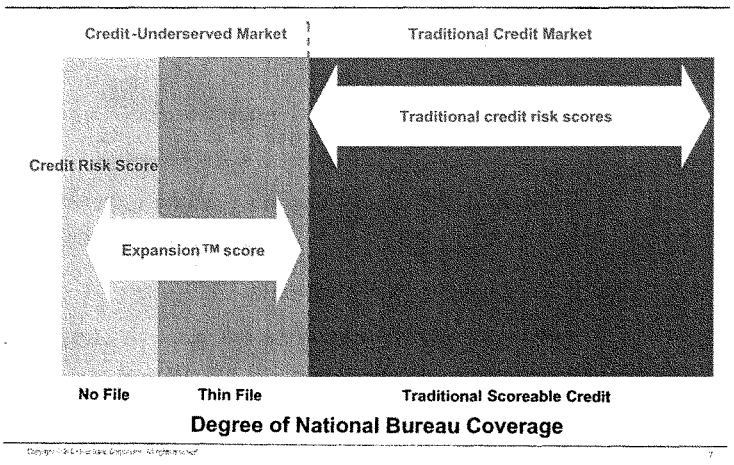
Introduction. Mr. Chairman and members of the committee, my name is Lisa Nelson. I am the Vice President of Business Operations for Fair Isaac Credit Services, Inc. a subsidiary of Fair Isaac Corporation. Thank you for the opportunity to testify before you today about Fair Isaac's leadership in the utilization of alternative credit data, specifically with respect to the launch of Fair Isaac's new Expansion™ Score.

Fair Isaac Corporation. Fair Isaac Corporation is the preeminent provider of creative analytics that unlock value for people, businesses and industries. Founded in 1956, Fair Isaac helps thousands of companies in over sixty countries reduce fraud and credit losses, lower operating expenses, and make more credit available to more people. Fair Isaac pioneered the development of statistically-based credit risk evaluation systems, commonly called "credit scoring systems," and is the world's leading developer of those systems. Thousands of credit grantors use broad based credit risk scores commonly known as "FICO® scores" generated by Fair Isaac-developed scoring systems implemented at the national credit reporting agencies. Fair Isaac has also developed custom scoring systems for hundreds of the nation's leading banks, credit card issuers, finance companies, retailers, insurance companies, and telecommunication providers.

There Are Different Kinds of Credit Risk Scores. The most well known credit risk scores are the broad based credit risk scores developed by Fair Isaac known as classic FICO scores and widely distributed to lenders by the three national credit reporting agencies under the brand names: Beacon from Equifax; FICO® Risk Score Classic, from Trans Union; and, the Experian/Fair Isaac Risk Model from Experian. A FICO credit risk score is a three-digit number that rank-orders consumers according to their credit risk using traditional consumer credit data stored by the three national consumer reporting agencies. This data consists of both positive information, e.g. the consumer has made all payments due on a trade line for ten years, and negative information, e.g. the consumer failed to repay a loan. Other credit risk scores also rely on data from the three national credit reporting agencies, such as credit risk scores developed by each of the three national credit reporting agencies, other third party developers and models

developed for specific industries, such as the mortgage, automobile and telecommunications industries.

Fair Isaac Credit Services, Inc. has recently released the Expansion score which utilizes alternative credit data rather than relying on the traditional data used by other scores. The Expansion score was developed specifically for the segment of the consumer population that historically has not been eligible for credit because they do not have enough traditional credit data to generate a credit risk score. The Expansion score is similar to other credit risk scores in that it utilizes both positive and negative credit history and relies on the technology on which other Fair Isaac credit risk scores are based. It is much different, however, in that it utilizes alternative credit data collected by credit bureaus other than the three national consumer reporting agencies. The diagram below compares the role played by the Expansion score and by traditional credit risk scores, and the role that data plays in each of them.



With Credit Scoring, More People Get Credit, They Get It Faster, And It's More Affordable. Credit risk scores mean more people have access to credit. More people can get credit regardless of their credit history because credit risk scores allow lenders to safely assess and account for the risk of consumers who have no existing relationship with the lender, who have never entered the lender's branches, and who may have been turned away in the past by other lenders. Lenders use scores not only to evaluate applications, but also to manage the credit needs of existing customers by extending additional credit or helping consumers avoid overextending themselves.

Credit risk scores mean people get credit faster. Credit risk scores are used to provide "Instant credit" at a retailer, an auto dealer, over the phone, or on the Internet. Even mortgage loans that used to take weeks can now be done in minutes. All of this has occurred while lenders have not only preserved but strengthened their visibility and control over their risk exposure.

Credit risk scores mean people pay less for their credit. Scores make credit more affordable by reducing the cost of evaluating applications, reducing loan losses, reducing the cost of managing credit portfolios, reducing marketing costs with prescreening, and cutting the cost of capital with securitization. This efficient flow of credit and capital has a large part to play in the continued robustness of the American economy. By enabling lenders to extend credit quickly while managing their risk, credit reports and credit risk scores have made credit more accessible, at lower rates, to more people.

Until the recent introduction of the Expansion score, many consumers found it hard to enjoy the benefits created by credit risk scores because the credit history used by traditional credit risk scores was insufficient to generate a score. The Expansion score brings the benefits of credit scoring to many in the underserved population by utilizing alternative sources of credit data along with the same technology used by traditional Fair Isaac credit risk scores to generate the Expansion score. As more lenders learn the benefits of the Expansion score and a credit risk

score is available for more consumers by virtue of additional sources of alternative credit data, more Americans will be able to get the inexpensive credit they need to buy homes or consumer goods.

A Significant Portion Of Americans Cannot Be Scored Using Traditional Scores.

It is commonly estimated that as many as one-fourth of all credit-eligible consumers in the US either lack traditional credit reports entirely or have traditional credit reports with too little information (known as "thin files") for making a good prediction of credit risk. Perhaps as many as 50 million consumers (roughly 25% of adults living in the U.S.) do not have enough credit data within the national repositories to generate a traditional credit risk score. This group is not only large, it is diverse. No one should assume that this group represents a sub prime lending market. This is a non-homogenous group, including:

- Immigrants
- College students and other young adults
- Recently divorced or widowed people
- Americans that historically have not utilized traditional credit due to cultural influences, the era in which they were raised, or other factors.

While not all of these individuals will seek credit, Expansion scores create access to credit for them, while enabling lenders to make a more informed decision if and when Americans in this population do seek credit.

The availability of a credit risk score to previously unscoreable consumers means:

1. Even more people have access to credit. Lenders are better able to assess risk and tailor credit for each consumer's needs.
2. More Americans are able to get credit faster. Credit risk scores are used to provide "Instant credit" at a retailer, an auto dealer, over the phone, or on the Internet. The Expansion score's use of alternative credit data sources can open

the door to the convenience of instant credit to more people, while lenders maintain visibility and control over their risk exposure.

3. Borrowers pay less for their credit. Credit risk scores make credit more affordable by reducing the cost of evaluating applications, reducing loan losses, reducing the cost of managing credit portfolios, reducing marketing costs with prescreening, and cutting the cost of capital with securitization. As the Expansion score market develops, consumers for which credit risk score were previously unavailable should see less costly credit. Moreover, it is logical to expect that as the efficiencies and lower risks associated with scoring reach a larger portion of the borrowing population by virtue of the use of alternative credit data, lender's overall costs will drop and all Americans will enjoy credit that costs even less than it does today.

The Expansion Score Utilizes Alternative Credit Data And Fair Isaac Scoring Technology To Create Credit Risk Scores For Americans In The Traditionally Credit Underserved Market.

A FICO credit risk score is a 3-digit number that tells lenders how likely it is a borrower will repay as agreed. The Expansion score is a credit risk score based upon non-traditional consumer credit data (in other words, data from sources other than the traditional credit files of the major national credit reporting agencies). The purpose of the Expansion score is to predict the credit risk of consumers for whom a traditional credit risk score is unavailable. Like traditional credit risk scores, the Expansion score provides a snapshot of credit risk at a particular point in time. Credit grantors who cannot obtain a traditional credit bureau risk score for a consumer due to insufficient history for that consumer in traditional databases can now, for many of those consumers, obtain an Expansion score from Fair Isaac Credit Services, Inc.

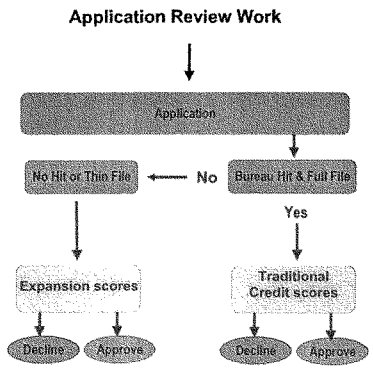
The FICO® Expansion 300-850™ credit risk scores are in the same range used by the classic FICO credit risk scores. As with traditional credit risk scores, consumers with higher scores are

more likely to repay creditors as agreed. Also similar to the traditional credit risk scores, the Expansion Score rank-orders consumers by the likelihood that they will become severely delinquent (90 days or more past-due) on a credit account in the 12 months following scoring. Also like traditional credit risk scores, Expansion scores can change over time, as subsequent credit risk predictions reflect changes in underlying behaviors.

Fair Isaac developed the Expansion score model using the statistical approach used to develop the classic FICO score. In developing the Expansion score, Fair Isaac analyzed anonymous alternative credit data to statistically determine what factors are most predictive of future credit performance. Factors that do not have predictive value and factors that by law cannot be used in the credit decision are excluded from consideration. The Expansion score meets all requirements of Regulation B of the Equal Credit Opportunity Act. The Expansion score models are built based on a combination of empirically derived and expert-based capabilities, producing a strong ability to rank-order consumers based on future risk. As with any generally available broad-based credit risk score, the lender is obligated to track usage over time to validate the score's performance on their loans and demonstrate that the score rank-orders risk on the lender's unique book of business.

Please see the diagram below to understand how the Expansion score fits within the lender's decision making process.

Work flow considerations



Once the lender has been approved for access to the Expansion score, a variety of channels are available to that lender for getting Expansion score reports on applicants including web entry, a system-to-system interface and batch delivery.

Early Results Conclude The New Expansion Score Enables Lenders To Score And Underwrite A High Proportion Of The Growing, Credit-Underserved Market.

To test the effectiveness of the Expansion score, Fair Isaac analyzed data from multiple lenders in mortgage financing, automotive lending and bank cards. Across the various vertical applications, early results showed a scorability rate as high as 80%, meaning that of applications that resulted in no-hits or thin files when traditional credit risk scores were requested, eight out of every ten received an Expansion score.

Fair Isaac Is Committed To Finding And Using The Best Available Non-Traditional Credit Data Within The Expansion Score.

One distinction between Expansion scores and traditional credit risk scores is the source and nature of the credit data used to generate the credit risk score. The Expansion score analyzes non-traditional credit data from third party data providers. Examples of such data include deposit account records, check writing behaviors, telephone and purchase payment plan performance. Fair Isaac Credit Services, Inc. obtains and resells data from a number of consumer reporting agencies that collect the data from the furnishers. This ensures that the Expansion Score will use the best alternative credit data available (i.e. the most predictive) and will be immune from any tendency to rely on data simply because it is part of a database controlled by Fair Isaac Credit Services, Inc. Moreover, the Expansion Score is designed to utilize new sources of credit data as the data becomes available and research shows adding it will improve the predictiveness of the score. This approach allows Fair Isaac to be data agnostic, and we continue to explore business relationships with all reputable and compliant consumer reporting agencies that aggregate alternative credit data.

What fuels the Expansion Score now and going forward

- Positive Alternative Credit
- Negative Alternative
- Thin File Credit
- Public Record
- Third Party Verified
- Application Data

The availability of both positive and negative alternative credit data is important to the performance of the Expansion Score. Fair Isaac seeks out both kinds of credit data. By utilizing multiple sources of both positive and negative alternative credit data, the Expansion Score is typically able to find data and score as high as 80% of the applications provided to us by lenders.

The broad, nationwide data coverage and extensive use of technology positions the Expansion score as a leading edge solution for the needs of the lending community.

Existing Regulation Adequately Protects Consumers And Allows For The Use Of Alternative Credit Data To Expand The Availability Of Credit.

The Expansion Score uses credit data. This means Fair Isaac Credit Services, Inc. and all of the companies that provide the data for the Expansion Score operate as consumer reporting agencies, comply with the Fair Credit Reporting Act (as amended by FACTA), and are therefore regulated by the FTC. This means that even though the credit data used is different than that used by traditional credit risk scores, consumers are protected by an existing and proven regulatory scheme. For example, consumers have the right to obtain a copy of the credit report underlying the Expansion Score and can exercise their FCRA rights to correct errors in the data. Furnishers of credit data have an obligation to respond to questions about the accuracy of data furnished just like banks that provide trade line information to the national CRA's must respond to such questions.

Lenders that become subscribers of the Expansion score service are put through a review process to determine that they are a legitimate entity and have permissible purpose to obtain an Expansion score. This process includes but is not limited to utilizing public records to confirm the entity's existence and standing, obtaining information about the organization's past business practices, including whether they are known to be an existing user of credit risk scores, verification of contact person's employment status with the entity, and in some instances on-site visits.

Participating in the system by furnishing data to credit bureaus is voluntary and should remain so because the free market is the most efficient means to find new sources of data. Furnishers of alternative credit data work with a data aggregator that is able to use the data from the furnisher

to deliver an economic benefit to the furnisher within the furnisher's industry. The benefit the furnisher gets from the aggregator acts as the economic incentive needed for the furnisher to undertake the burden of complying with FCRA imposed furnisher obligations. Further regulatory burdens are unnecessary and will decrease participation. The Expansion Score and the providers of the alternative credit data it utilizes operate in compliance with the existing regulatory framework and further regulation is not required.

Everyone Benefits From Alternative Credit Data And The Credit Risk Scores It Supports.

The Credit underserved market is a non homogenous group of people; many of whom need access to credit to fulfill their dreams. Although lenders want to enlarge their market and extend credit to such consumers, they need a tool to manage their risk and costs. Fair Isaac Credit Services, Inc. combines both positive and negative alternative credit data with the strength of Fair Isaac analytics to generate the Expansion score that is easily assimilated into lender processes and decision making. The Expansion Score offers consumers access to financial services by enabling lenders to safely expand their markets within the context of an existing regulatory scheme that has proven to be safe and effective for consumers, lenders and the economy.

Testimony
regarding
"Helping Consumers Obtain the Credit They Deserve"

Subcommittee on Financial Institutions and Consumer Credit
May 12, 2005

by
Margot Saunders
National Consumer Law Center
on behalf of its
Low Income Clients
and
Consumer Federation of America
National Association of Consumer Advocates
U.S. Public Interest Research Group

Margot Saunders
Managing Attorney
National Consumer Law Center
1001 Connecticut Ave, NW
Washington, D.C. 20036
(202) 452-6252
margot@nclcdc.org
www.consumerlaw.org

Testimony
regarding
"Helping Consumers Obtain the Credit They Deserve"

Subcommittee on Financial Institutions and Consumer Credit
May 12, 2005

Mr. Chairman, Mr. Sanders, thank you for asking me to testify today. My testimony, provided on behalf of the low income clients of the **National Consumer Law Center,**[1] as well as the **Consumer Federation of America,**[2] **the National Association of Consumer Advocates**[3] and the **U.S. Public Interest Research Group**[4] addresses the issue of how to expand the items of information used to determine eligibility and price for credit for new entrants into the credit marketplace.

We commend the Committee for considering the important issues related to the use of alternative credit data on consumers with no credit histories or with inadequate credit information in their credit files. You have asked me to address the question of whether the reporting of alternative credit data could expand credit opportunities. The answer to this question is unquestionably "Yes" – the reporting of alternative credit data holds the potential to help consumers considerably. If the new data and scoring systems are built and used appropriately, the potential benefits to consumers are significant. However, because of the way that credit data and scores are being used in the marketplace, if these systems are built incorrectly, or used

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[1] The **National Consumer Law Center, Inc.** (NCLC) is a non-profit organization specializing in low-income consumer issues, with an emphasis on consumer credit and access to affordable utilities issues. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. As a result of our daily contact with these advocates, we have seen numerous examples of invasions of privacy, embarrassment, loss of credit opportunity, employment and other harms that have hurt individual consumers as the result of violations of the Fair Credit Reporting Act. It is from this vantage point – many years of dealing with the abusive transactions thrust upon the less sophisticated and less powerful in our communities – that we supply these comments. NCLC publishes a series of sixteen practice treatises and annual supplements on consumer laws, including *Fair Credit Reporting* (5th ed. 2002 and Cumulative Supplement 2004) and *Access to Utility Service* (3rd ed. 2004) as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers and a quarterly energy and utility newsletter.

[2] The **Consumer Federation of America** is a nonprofit association of over 280 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through advocacy and education.

[3] The **National Association of Consumer Advocates** is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

[4] The **U.S. Public Interest Research Group** is the national lobbying office for state PIRGs, which are non-profit, non-partisan consumer advocacy groups with half a million citizen members around the country.

inappropriately, the danger to these consumers could be devastating. This danger is compounded by the fact that many Americans do not have any understanding of how credit scores are developed and used.[5] The goal of this testimony today is to outline some of the issues surrounding the creation and use of the new data gathering, to add the voice of consumers to the development and potential regulation of these new credit data systems.

The prism through which we analyze alternative data systems is the fact that credit data and scores are used to analyze much more than a consumer's worthiness for credit. Today, it is typical for credit scores to be used to affect –

- The **cost of the credit**. In the increasingly risk based method of setting rates and terms for credit, a credit score can often mean the difference between an affordable loan or one that is predatory – and destined to fail.
- **Eligibility for and price for insurance**. Credit based information is used to generate *insurance scores*.
- Both initial **employment and job retention**. In some situations, workers are simply deemed ineligible for employment if they do not have adequate credit scores. In others, credit information and scores are checked on an ongoing basis by employers, and workers can be fired for negative information on their credit report, or even low credit scores.

In addition, in some areas of the nation, policy makers have contemplated allowing credit data to be used to determine initial **eligibility for and the price charged for essential utility service**.

Given the current and potential uses of credit data to affect the fundamental economic issues in a household, it is critical that the *new* data collection not exacerbate the situation. There is already a serious polarization of credit opportunities between those with high credit scores and those with low or not credit scores – higher income and more sophisticated consumers routinely are able to access the better sources of credit and obtain lower cost credit options. Subprime credit, which is more expensive (sometimes only by a few percentage points in the cost of credit, yet too often by multiples of the cost), should always be seen as a temporary stop on the road to more affordable and more suitable credit. The new credit data systems under consideration in today's hearing should be developed based on the goal of establishing *low cost* and *affordable* credit opportunities. These new systems must be built with the *consumers' interest as paramount.* For this to occur, the new systems must expand access to affordable credit, while not harming consumers in other areas, such as access to and retention of employment, insurance and utility service.

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[5]Consumer Federation of America and Fair Isaac Corporation, *Many Americans Misunderstand Credit Scores According to New National Survey*, March 15, 2005; Consumer Federation of America, *Consumers Lack Essential Knowledge, And Strongly Support New Protections, On Credit Reporting and Credit Scores,* July 28, 2003.

The balance of this testimony will explore the important cautions that we recommend be considered in the development of these new credit information systems. To ensure that consumers are truly protected in the development of the new credit data systems, the following issues must be addressed:

1. **Ensure that the Information is Relevant to Determining Likelihood of Payment.** The information relied upon in the new credit data system must be truly relevant to the assessment of a consumer's willingness and ability to repay. As many consumers who have thin credit files are also low income, their decisions on which bills to pay are often driven by different factors than those with higher incomes. These factors must be considered when evaluating whether to include a particular source of information in the new credit data base.
2. **Ensure that the Information is Accurate.** A primary problem with using some sources of alternative credit data is that the recipients of the consumers' payments may not have ready access to information about consumers' payment patterns on a reliable, consistent basis.
3. **Ensure that the New Credit Data is Used for Appropriate Purposes Only.** Creditors have openly touted the new credit systems as sources for new customers. However, public policy is only served if –
   a. The new systems are used by both prime as well as subprime creditors;
   b. The new systems result in *lower* cost credit products for consumers; and
   c. Non-credit uses of the information (such as for new employment or job retention, access or price for utility service, or access or price for insurance) are *strictly limited* until the accuracy and reliability of the scoring systems have been adequately tested and assured.

4. **Ensure that the New Credit Systems are Not Discriminatory.** Credit scores have long been considered to have a disproportionate impact on minorities. Compliance with the letter and the spirit of the Equal Credit Opportunity Act in the development and use of these systems is essential to avoid exacerbating an already problematic situation with the traditional credit scoring model.

Additionally, the evolution of these systems provides an opportunity to advance good public policy through credit scoring by providing more weight to some payments than others. Currently at least one of the credit systems has a model for considering payments to some providers as more important than others.[6] Under this model, for example, the timely payment of a child support payment will provide more positive points to the credit score than the timely payment of a parking ticket.

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[6]For a detailed analysis of this and related issues, *see* Karen Gross, *Commentary: Give Credit Where Credit Is Due – The Use of Credit Scoring*, Consumer Finance Law, (Winter 2004); *For Student Loan Borrowers, Good Credit Where It's Due*, http://chronicle.com Section: The Chronicle Review, Volume 51, Issue 15, Page B16.

1. Ensure that the Information is Relevant to Determining Liklihood of Timely Payment

There is a serious problem with many of the proposed new items to be evaluated in the new credit scoring system when it is used for low income households. In a low income household, decisions on whether to make payments on time are often based on much more complex criteria than simply the consumer's willingness to pay a particular bill. In various articles discussing the benefits of new credit information data bases and scoring methods, many types of alternative sources of regular payment information are lumped together as being potentially relevant to the determination of a consumer's likelihood of regular credit payments. Examples routinely included are rent, utility payments, wireless payments, remittances to one's home country, repayments of loans from payday lenders, payments to rent to own dealers, and the like.

It is essential that these new scoring systems use payment histories which have characteristics substantially similar to the credit for which the systems will be used. Specifically, the motivating factors for both types of payments (the one being used to measure a consumer's likelihood of repayment and the one for which the measure is being evaluated) must be similar. The problem is that for many low income people, utility payments and some forms of credit, such as payday loans and rent to own transactions, have inherent features which are significantly different than traditional monthly credit payments.

We completely agree that the payment of a *monthly rent obligation* is an excellent source of information on which to base an evaluation of a consumer's willingness to repay other credit, especially a home mortgage obligation. The rent payment is in exchange for essentially the same product – a home to live in. The payment is generally at the same intervals – monthly. The consequences of not paying are similar – *loss* of the home and a forced move.

Similarly, the regular payment of a wireless telephone bill is certainly relevant to a consideration of whether the consumer is a good candidate for another type of information exchange service – such as local or long distance telephone, or perhaps even internet access.

Current Utility Protections for the Poor Facilitate Negative Payment Histories. Utility payment information – especially for fuels such as gas, electricity or oil that are used to heat homes during the cold months – is entirely inappropriate to use as the basis for any other credit considerations. This is because factors the low income families use to decide whether to pay for utility service are very different than for other credit.

Many of the programs devised to protect low income households from shut off of essential utility service do not punish for late payments. Indeed, in some of these programs, additional benefits are triggered only after payment delinquencies. As a result, the utility payment histories for low income households will quite often have little relevance to the issue of whether the consumer would make timely payments if they were able.

As the result of the huge spread between low income consumers' ability to pay utility bills and the size of these bills, especially during the high cost months of winter, a number of statutory and regulatory protections have been developed to assist these neediest customers through the winter months. Since utility services are a necessity, required in most American climates to keep warm and stay alive, a household's utility bill depends primarily on the type of home, type of heat, and number of people in the household. The expenditure is non-discretionary, and the ability of the customer to pay the utility bill on a timely basis is not a factor. The bills are charged for the service, and consumers do their best to pay, regardless of ability.

This lack of nexus between the bills and ability to pay is exactly the reason that there are special rules for paying utility bills – which attempt to protect both the consumers and the utility providers from the failure of the utility system to consider ability to pay in the establishing the charges for service. As a result, many of the programs developed to assist low income households with utility bills give priority to households in crisis. Oftentimes payment assistance is only triggered by utility payment delinquencies:

- Requirements for Emergency Heating Assistance May Result in a Poor Payment History: The Low Income Home Energy Assistance Program, LIHEAP, the federal assistance program to help the most vulnerable households afford their heating and cooling bills requires states to set aside a reasonable amount of their LIHEAP block grants for crisis assistance.[7] For the majority of states in FY 2005, *LIHEAP crisis benefits require a disconnection notice or actual disconnection.*[8] The crisis benefits are either supplemental energy assistance payments or expedited LIHEAP assistance payments, depending on the state and the nature of the crisis.
- Winter Moratoria/Extreme Temperature Shut-Off Protections: Because loss of heating in the winter can be lethal for the elderly, the young and the sick, many of the cold weather states have imposed shut-off moratoria for energy utilities. While the utilities cannot disconnect households in these states, the households are still responsible for paying their bills. Recent arrearage and disconnection data from those states that collect this information indicate that more households are falling behind on their utility bills and are eventually disconnected at the end of the moratoria.[9] Numerous advocates report

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[7]42 U.S.C.sect. 8623(c).

[8]NCAT LIHEAP Clearinghouse, "Crisis Definition – FY 2005." The LIHEAP statute defines energy crisis as "weather-related and supply shortage emergencies and other household energy-related emergencies." (42 U.S.C. sect. 8622(3)).

[9]As of December 15, 2004 in Pennsylvania, 4,496 households remained without electric service and 10,509 who heat with natural gas were without service. Correspondence with Mitch Miller, PA PUC staff Dec.3, 2004. In Rhode Island, there were nearly 3,000 service terminations in September, more than any other September on record, and 20% more than in September 2003. Meanwhile, there were only 1,800 service restorations, down 9% from last September. The gap between shutoffs and restorations in September '04 was 1,171, higher than any other September on record and 131% higher than the gap in September 2003. The total gap for 2004, a proxy for unrestored accounts

increased disconnections every spring at the end of the shut off periods. Energy bills have been increasing at the same time federal energy assistance has decreased.[10] There is a growing energy affordability gap and a substantial number of low-income households who must sacrifice other basic necessities in order to pay the utility bills.[11]

The factors that motivate consumers to make timely or non-timely utility payments are different than those to determine timely payments underwritten credit. Low income utility consumers are sent signals which allow them to *not* pay without negative consequences. To allow other negative consequences to result – by using utility bills in a new credit score to establish eligibility for low cost credit, is not helpful and undermines the relevance of the data for the new scoring systems.

Payments to Payday Lenders and Other Abusive Creditors Is *Not* Relevant to Other Credit Decisions. The essential characteristics of payday loan transactions (as well as some other very high cost lenders such as rent to own dealers and title pawn lenders) are so different than more traditional forms of credit, that the payment – or non-payment – of these liabilities is simply not relevant to whether a consumer will pay a credit card bill or a traditional car loan. For example, when a consumer decides whether to make a repayment of payday loan, the factors in that decision include 1) a relatively large sum of money due in one lump sum (the entire principal of the payday loan is generally repayable within a two week period); 2) the consumer may believe that the failure to make the payment could have dire consequences as many payday lenders will threaten criminal prosecution for the failure to honor a check; 3) yet the payment of the loan in one lump sum may result in the consumer having no funds to pay for essentials, such as food or rent. In fact, it is important to note that payday loan consumers are *encouraged* by the lenders *not* to repay payday loans but instead to roll them over, time and again.[12]

These characteristics of payday loans are very different from standard forms of credit. Traditional credit generally has a series of regular payments, which are determined to be affordable by the creditor through underwriting. Traditional credit generally has some grace period in which the consumer can make payments. The non-payment of traditional credit does not trigger the fear of criminal sanctions.

Rent to own transactions (RTO) are similarly starkly different from traditional credit. Although in rent to own transactions, the payments are generally regular, and sometimes

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from January 2004 – September 2004 was 7,520, higher than any other September on record. Analysis of John Howat, NCLC Oct. 15, 2004.

[10] Olivia Wein, "The Continued Surge in Residential Energy Costs Outpace the Spending Power of LIHEAP," NCLC Energy & Utility Update, Fall 2004.

[11] See e.g., NEADA, *National Energy Assistance* (April 2004).

[12] Creola Johnson, Payday Loans: Shrewd Business or Predatory Lending?, 87 Minn. L. Rev. 1 (Nov. 2002). Indeed, some payday lenders give their customers coupons to encourage non-payment.

affordable (however, merchants in these transactions do not do any underwriting either), the transactions are designed to fail. Despite the fact the most RTO customers enter into the transaction with the intent to purchase the items, the huge majority of these transactions do not result in ownership.[13] Indeed the merchants' incentives are to ensure that the consumers pay for as long as possible on the contract yet not complete the contract to achieve ownership – because that ensures the continued payment stream.

The bottom line here is that some alternative forms of credit may be relevant for consideration on a credit report – because the incentives and potential consequences are similar. However, other forms of credit, like utility bills, payday loans and rent to own transactions are so inherently different from traditional credit, that including information about the payment – or non-payment – of these loans is irrelevant and not predictive of the consumer's willingness to make regular payments on extensions of credit that has been underwritten to determine affordability.

2. Ensure that the Information is Accurate.

The whole system of credit reports and credit scores relies on the accuracy of the information provided by the furnisher. Furnishers of information in the traditional credit reporting system have *some* incentive to provide accurate information because they rely on that very information in making their own credit decisions. However, even in the traditional credit system, the incentives for accuracy are seriously deficient, and as a result, credit reports are full of inaccuracies.[14]

However, there are virtually no incentives for the reporting – much less the *accurate and complete* reporting – of data related to non-traditional sources. Most non-traditional sources of credit do not use the credit reporting system, so they do not have the selfish incentive to promote the reliability upon which they are dependent. Moreover, as is more fully discussed below, it would be bad public policy to promote the development of an alternative credit reporting system for the purpose of providing more information to these high cost creditors. As the system remains voluntary with the creditors, there is no requirement for reporting – and no penalty for not reporting – credit information.

The distinction between accuracy and completeness remains. Unlike the requirement of

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[13]Federal Trade Commission, Bureau of Economics Staff Report, Survey of Rent-to-Own Customers, Executive Summary.

[14]Consumer Federation of America and National Credit Reporting Association, *Credit Score Accuracy and Implications for Consumers* at 24 (Dec. 17, 2002), available at http://www.consumerfed.org/121702CFA_NCRA_Credit_Score_Report_Final.pdf; U.S. Public Interest Research Group, *Mistakes Do Happen: Credit Report Errors Mean Consumers Lose* (1998), available at http://uspirg.org/uspirg.asp?id2=5970&id3=USPIRG&; Consumer Reports, *Credit Reports: How Do Potential Lenders See You?*,at 52-53 (July 2000).

reasonable procedures to assure maximum possible accuracy that the FCRA places on consumer reporting agencies, the FCRA does not directly specify a standard of accuracy for those who furnish information to consumer reporting agencies. Furnishers are required to report accurate information, but there is no specific requirement that the information be complete.[15] As a result, furnishers could fail to report relevant information that would radically change the credit analysis of a consumer's report, so long as the information that it did report was technically accurate. This situation is only slightly ameliorated by the recent changes in made to the FCRA by the FACT Act.[16]

The FCRA also provides only limited remedies for consumers against furnishers who provide inaccuarate and incomplete information. Under the current law, the consumer must dispute the inaccurate or incomplete information, await the results of an investigation by the credit reporting agencies and the furnishers and hope that the investigation results in such information being removed or modified.[17]

The flaws in the current credit reporting system will only be compounded if appropriate safeguards are not in place to ensure the information furnished by traditional and nontraditional sources of credit transactions are reported accurately and completely.

3. Ensure that the New Credit Data is Used for Appropriate Purposes Only.

In evaluating the issues surrounding the new credit data and scoring systems, it is necessary to keep in mind that the driving force behind their development is *not* to provide consumers with less expensive credit. Instead, the inducement for these new systems is a new source of customers, along with a reduction of risk for those customers, for the credit industry.[18] An incidental benefit *may be* the opening of new, lower cost, credit opportunities for consumers. However, as that benefit is not the goal, that benefit cannot be assured, and policy makers[19] should closely supervise the development of these systems to evaluate and address at least the following three concerns:

a. The new systems must be useful to – and thus used by – the least cost creditors, as well as those who traditionally market to consumers considered to be higher credit risks. If only

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[15] 15 U.S.C. § 1681s-2(a).

[16] Pub. L. No. 108-159 (Dec. 4, 2003), amending the Fair Credit Reporting Act, 15 U.S.C. § 1681 *et. seq*

[17] 15 U.S.C. § 1681s-2(b).

[18] *See*, W.A. Lee, *New Tools to Find Nontraditional Customers*, American Banker, August 6, 2004, at 5: "With the consumer credit market continuing to get healthier, card issuers are looking to stretch their risk parameters to find new prospects, according to the companies helping them."

[19] Presumably the policy maker for whom it makes the most sense to intervene and evaluate the development of these new data systems is the Federal Trade Commission.

subprime creditors use the new credit evaluations, then it is virtually certain that these consumers will continue to be segregated into higher cost credit. As the basic premise behind the development of these new evaluation systems is that the current system of credit scoring does not adequately assess the risk of lending to consumers with thin or no credit files, an assumption inherent in this development is that some proportion of these consumers have very low risk.

If risk based pricing is to be fair to the universe of consumers, those consumers who are actually riskier borrowers should be charged higher prices for their credit than those consumers who are truly lower risk. A fairer and more thorough evaluation of consumers who have been considered risky borrowers simply because not enough information was known about them will necessarily result in the identification of some of them as very good candidates for low risk – and thus "low cost" – credit. The lowest cost credit is generally provided by "prime lenders." The new systems must be useful to and accepted by these prime lenders, to enhance the potential for the lowest cost credit to be offered to this new pool of potential customers.

b. The credit products offered to the newly identified group of low risk consumers must in fact have lower costs than the credit products currently available to them. The news articles about the new credit scoring products have generally indicated that the credit industry sees these new scores as facilitating new credit to new customers, rather than lower cost credit.[20] These consumers are typically borrowing from the highest cost creditors – payday lenders, rent to own dealers, etc.(indeed those creditors are the proposed sources of the information to be used in the new scoring system). It will not be difficult for the mainstream traditional credit industry to offer lower cost, fairer, terms of credit to this class of consumers. However, in exchange for the gathering of information about these consumers – and the inherent loss of privacy – there should be an implicit promise that lower cost credit will be made available for some substantial percentage of this group of consumers.

If the credit industry continues to use the assumptions inherent in risk based pricing to justify charging higher interest rates and fees for extensions of credit which are considered risky, then equivalent savings in credit costs must be provided to consumers who are less risky.

c. Non-credit uses of the information (such as for new employment or job retention, access or price for utility service, or access or price for insurance) must be *strictly limited* until the accuracy and reliability of the scoring systems have been adequately assured. One of the most contentious issues currently in the world of credit scoring is the use of credit reports and credit scores for non-credit purposes, such as for insurance and employment hiring and retention purposes.

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[20] *See, e.g.* Broderick Perkins, *Non Traditional Credit Borrowers Score Again*, Realty Times, April 26, 2005: "Fair Isaac's FICO 'Expansion' credit risk score is likewise designed specifically to help lenders extend credit to consumers in what is largely considered a 'under served' market of 'cash-basis' borrowers."

A particularly controversial issue is the use of credit scores by automobile and home insurers to determine whether to insure a consumer and at what price. The credit scores used by insurers, or "insurance scores," are specially developed for insurers and not the same as generic credit scores, but they nonetheless are based solely on credit history. Consumers can obtain one version of their insurance scores from ChoicePoint for $12.95.[21] The practice has become widespread, with one survey showing that ninety-two percent of auto insurers surveyed use insurance scores.[22] As a result, a consumer with a poor credit history may be charged forty to seventy-five percent more in premiums for automobile insurance.[23]

The practice of using insurance scores has been criticized as fundamentally unfair and is particularly burdensome to low-income consumers least able to afford high insurance rates. In addition, the use of insurance scores probably disproportionately burdens racial minorities, given that they have lower credit scores as a group. Several states have passed legislation regulating the practice,[24] and legislation has been proposed in many other states.[25] Insurance companies defend their actions by noting the high correlation between credit scores and loss experience.[26] A number of class actions have been filed challenging the practice.[27] Insurance regulators in both Texas and California have taken enforcement actions against insurance companies over this practice.[28]

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[21] See ChoicePoint's consumer website at www.choicetrust.com.

[22]Brian Grow & Pallavi Gogoi, Insurance: A New Way to Squeeze the Weak?, Business Week, Jan. 28, 2002, at 92 (citing study by Conning & Co.).

[23]Pamela Yip, One Number, Many Uses, Dallas Morning News, Apr. 8, 2002, at 1D.

[24]A summary of some of the state insurance laws governing use of credit information is included in National Consumer Law Center, Fair Credit Reporting, Appx. B.3 (5th ed. 2002 and Supp.).

[25] Pamela Yip, One Number, Many Uses, Dallas Morning News, Apr. 8, 2002, at 1D.

[26] *Id.*

[27]DeHoyos v. Allstate Corp, 345 F.3d 290 (5th Cir. 2003) (holding that a challenge to credit scoring under the FHA and federal Civil Rights Acts was not preempted by the McCarran-Ferguson Act), cert. denied, 124 S.Ct. 2074, 158 L. Ed. 2d 621 (2004); Owens v. Nationwide Mutual Ins. Co., 2003 WL 22364319 (N.D. Tex. Oct. 1, 2003) (class action alleging that use of credit scores for homeowners insurance violates section 3604 of the FHA and the federal Civil Rights Acts); Nat'l Fair Hous. Alliance v. Prudential Insurance Co., 208 F. Supp. 2d 46 (D.D.C. 2002) (class action alleging that the use of credit scores to determine eligibility for homeowners insurance has a disparate impact on minorities in violation of the FHA); Wells v. Shelter Gen. Ins. Co., 217 F. Supp. 2d 744 (S.D. Miss. 2002) (class action challenging use of credit scores under Mississippi insurance law). Cf. Ashby v. Farmers Group, Inc., 261 F. Supp.2d 1213 (D. Or. 2003) (dismissal of claim under Fair Credit Reporting Act against insurance management services company that used credit scores in ratesetting).

[28]Press Release, Tex. Dept. of Ins., State of Tex., Farmers Insurance Reach Agreement (Nov. 30, 2003) (resulting in a $100 million settlement, including $30 million in refunds for improper use of credit scores. Settlement does not prohibit use of credit scoring in insurance, and requires only disclosures acceptable to the Attorney General); R.J. Lehman, Allstate Settles California Insurance-Scoring Dispute for $3 Million, Bestwire,

A study conducted by the Missouri Department of Insurance found a stunning correlation between insurance scores and race as well as income, age, marital status, and educational attainment.[29] Using credit score data aggregated at the ZIP code level collected from the highest volume insurers in Missouri, the study found the following:[30]

- Insurance scores were significantly worse for residents of high-minority zip codes. The average consumer in an "all minority" neighborhood had a credit score that fell into the 18.4th percentile, while the average consumer in a "no minority" neighborhood had a credit score that fell into the 57.3th percentile--a difference of 38.9 percentile points.
- Insurance scores were significantly worse for residents of low-income zip codes. The average consumer in the poorest neighborhood had a credit score 12.8 percentile points lower than residents in the wealthiest communities.
- The correlation between race (high-minority neighborhoods) and credit scores remained even after eliminating other variables, such as income, education, marital status, and unemployment. Residency in a minority concentration neighborhood proved to be the single most reliable predictor of credit scores.
- The gap in credit scores was also expressed on a more individualized basis. The average gap between the percentage of minorities with poor scores and non-minorities with poor scores was 28.9 points. The gap between lower-income and higher-income households was 29.2 percentage point.

The author and researcher of the Missouri study concluded that "the evidence appears to be credible, substantial, and compelling that credit scores have a significant disproportionate impact on minorities and on the poor."[31]

A study conducted by the Texas Department of Insurance resulted in similar findings.[32] Instead of using geographic neighborhood as a proxy for race, the Texas study was able to determine the actual race of policyholders by using motor vehicle records for approximately 2 million consumers. The Texas study found dramatic disparities by race, finding that African American and Hispanic consumers constituted over 60% of the consumers having the worst

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March 5, 2004 (Allstate allegedly violated California law prohibiting use of credit information in underwriting or ratesetting for auto insurance; settlement prohibits use of credit scores and imposes a $3 million fine.)

[29]Brent Kabler, Mo. Dept. of Ins., Insurance-Based Credit Scores: Impact on Minority and Low Income Populations in Missouri (Jan. 2004).

[30]*Id.*

[31]*Id.*

[32]Texas Department of Insurance, Report to the 79th Legislature - Use of Credit Information by Insurers in Texas, December 30, 2004.

credit scores, but less than 10% of the consumers having the best scores.[33] Thus, African Americans and Hispanics were over-represented in the worse credit score categories and under-represented in the better credit score categories. The Texas study concluded there was a consistent pattern of differences in credit scores among the different racial and ethnic groups, with whites and Asians faring better than African Americans and Hispanics.

Given the considerable issues with the use of traditional credit scores in insurance, it is imperative that these problems not be compounded by the use of these new credit scoring models for insurance – or for employment – purposes until their accuracy, relevance, and predicative value for these purposes have been thoroughly proven.

4. Ensure that the New Credit Systems are Not Discriminatory.

As long as there have been credit scores, there have been concerns that scoring systems contain biases which disproportionately impact protected groups.[34] These concerns are heightened by numerous studies showing that, as a group, certain racial and ethnic groups have lower credit scores than whites. As the new credit scoring systems are developed, every effort should be made to ensure that the potential discriminatory problems inherent in their older, more traditional counterparts, are not replicated in these programs. For one thing, the federal government should conduct an ongoing review of all credit scores for legitimacy, accuracy and disparate impact. Astonishingly, this kind of review does not currently occur.

A 1996 Freddie Mac study found that African-Americans are three times as likely to have FICO scores below 620 as whites. The same study showed that Hispanics are twice as likely as whites to have FICO scores under 620.[35] Fair Isaac's own analysis showed that consumers living in minority neighborhoods had lower overall credit scores.[36]

A Federal Reserve Board study of over 300,000 credit history files found that fewer than 40% of consumers who lived in high minority neighborhoods had credit scores over 701, while nearly 70% of consumers who lived in mostly white neighborhoods had scores over 701.[37] A

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[33] *Id.*

[34] Fed. Reserve Bank of Boston, *Perspectives on Credit Scoring and Fair Lending: A Five-Part Article Series (*pt. 1), Communities & Banking, Spring 2000, at 2.

[35] See Freddie Mac, Automated Underwriting: Making Mortgage Lending Simpler and Fairer for America's Families (Sept. 1996), available at www.freddiemac.com/corporate/reports/moseley/mosehome.htm.

[36] Fair, Isaac & Co., The Effectiveness of Scoring on Low-to-Moderate Income and High-Minority Area Populations 22, Fig. 9 (Aug. 1997).

[37] Robert B. Avery, Paul S. Calem, and Glenn B. Canner, Credit Report Accuracy and Access to Credit, Federal Reserve Bulletin (Summer 2004).

more comprehensive report on credit scoring and disparate impact will be conducted by the FRB, FTC, and HUD pursuant to the 2003 amendments to the Fair Credit Reporting Act.[38]

A study by researchers at the University of North Carolina of borrowers who received community reinvestment mortgages showed that one-third of African Americans in this pool had credit scores under 620, as compared to only 15 percent of whites. Furthermore, this same study found that another one-third of African-Americans had credit scores between 621 and 660 (as compared to 20 percent of whites), which means that two-thirds of African-Americans in this pool had what is considered marginal or poor credit.[39]

If even a single factor in a credit scoring model correlates to race or other prohibited bases, the results of the model may be discriminatory.[40] The Official Staff Commentary to the Equal Credit Opportunity Act, put out by the staff of the Federal Reserve Board, seems to concur, noting that an "empirically derived, demonstrably and statistically sound" credit scoring system may be flawed and thus subject to review and challenge under the ECOA.[41] These concerns are intensified by the "black box" nature of credit scoring systems.[42]

As these new credit repositories and credit score models are being designed to address holes in the system that clearly implicate racial minorities significantly, special care must be

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[38] Fair and Accurate Credit Transactions Act of 2003, Pub. L. No. 108-159, § 215 (2003); *See also,* Mark A. Fisher, Minorities Score Lower in "Colorblind" Ratings, Columbus Dispatch, Apr. 14, 1999, at 5A. The same survey found that African-Americans who do have credit cards miss their minimum payments more than twice as often as whites do.

[39]Roberto G. Quercia, Michael A. Stegman, Walter R. Davis & Eric Stein, Performance of Community Reinvestment Loans: Implications for Secondary Market Purchases, in Low Income Homeownership: Examining the Unexamined Goal (Nicolas P. Retsinas & Eric S. Belsky eds., 2002), at 363: Table 12-7 (statistics derived from an analysis of 5,549 community reinvestment loans). The credit score cut-offs for what is considered to poor, marginal, and good credit are derived from Freddie Mac's categories used in its Loan Prospector system. Freddie Mac advises lenders that applicants with FICO scores below 620 indicates high risk, between 620 and 660 indicates an uncertain credit profile, and above 660 means they are likely to have acceptable credit reputations. See Freddie Mac, Automated Underwriting: Making Mortgage Lending Simpler and Fairer for America's Families, available at www.freddiemac.com/corporate/reports/moseley/mosehome.htm (Sept. 1996).

[40]*See* Office of the Comptroller of the Currency, Credit Scoring Models (OCC Bull. 97-24, May 20, 1997) (warning against the use of "models that may include characteristics that may have a disparate impact on a prohibited basis or raise other Equal Credit Opportunity Act (Regulation B) or Fair Housing Act concerns"); Press Release, Office of the Comptroller of the Currency, OCC Alerts Banks to Potential Benefits and Risks of Credit Scoring Models (No. 97-46, May 20, 1997), available at www.occ.treas.gov (advising national banks "to avoid illegal disparate treatment by insuring that adequate controls exist during the pre-scoring, scoring, and post-scoring states of the credit application process").

[41]Official Staff Commentary, 12 C.F.R. § 202.2(p)-4

[42] *See* National Consumer Law Center, Fair Credit Reporting, §14.5.1 (5th ed. 2002 and Supp.).

taken to avoid the racial disparities and discriminatory impacts that have appeared to plague the traditional sources of credit scores.

Conclusion

The Committee's consideration of these important issues related to the use of alternative credit data on consumers with no credit histories or with inadequate credit information in their credit files. We hope that the Committee will make strong, pro-consumer recommendations relating to these new credit repositories and scoring systems which will ensure that the the new data and scoring systems are built and used appropriately, as the potential benefits to consumers are significant. Caution should be used, however, because if these systems are built and used incorrectly the danger to consumers could be devastating.

Testimony Submitted

To

United States House of Representatives

House Financial Services Committee
Subcommittee on Financial Institutions and Consumer Credit

Thursday, May 12, 2005

By

Gwendolyn Garnett Thomas
Senior Vice President, Neighborhood Lending Executive
Bank of America
Consumer Real Estate

INTRODUCTION

Chairman Bachus, Congressman Sanders, members of the Committee, good morning; my name is Gwen Thomas. I am Bank of America's Consumer Real Estate Neighborhood Lending Executive responsible for developing strategies and leading a team that creates processes, products and programs that result in increased homeownership for all citizens with emphasis on multicultural and low-to-moderate income consumers.

It is an honor to appear before you today to discuss the impact and options on use of non-traditional sources of credit information by lenders in making credit decisions. I should say at the outset that my testimony will draw heavily on voice of customer research we have conducted at Bank of America among customers we refer to as "limited credit consumers", defined in our research as consumers with less than three traditional credit reporting agency trade lines over any timeframe.

I have accepted the Subcommittee's invitation to participate in this panel to discuss non-traditional sources of credit information because I strongly believe that there are many opportunities and benefits for both consumers and lenders.

TESTIMONY

Bank of America is the largest consumer bank in the United States with more than 33 million customers, serving one-third of U.S. households. With that broad reach comes an obligation we take to heart to ensure we are meeting the needs of a broad range of consumers in all the communities we serve. We feel that use of non-traditional sources of credit information can be a viable way to further that goal.

We have all seen the statistics about the projected growth of multicultural or minority populations in the U.S. According to the U.S. Census Bureau, the Hispanic population is expected to grow 188 percent by 2050. They also predict growth in the Asian population

by 213 percent and 71 percent in the African-American population by 2050. These segments are also projected to be the fastest growing segment of first-time homebuyers and some within these segments will not have traditionally established credit histories. We find this challenge to be a potential deterrent for lower-income consumers.

Multicultural consumers indicate they want quick decisions, no surprises, privacy and the understanding that culturally they may operate with cash – much the same demands that we see from individuals with traditional established credit histories.

At Bank of America, we have developed processes to address the needs of individuals without traditional credit reporting agency history. However, these processes are highly manual and have the potential to sacrifice the integrity of the data. It is because of this data validity issue that at this time these processes cannot be automated.

Failing to use non-traditional sources of credit information can result in the declination of consumers who are otherwise well positioned to purchase a home. In addition to helping these consumers realize their dream of homeownership, obtaining a mortgage loan establishes the traditional credit history they need, which combined with a home as an asset, can greatly improve their financial position.

One example of where this has proven to be successful is our Neighborhood Champions mortgage program. This program was launched five years ago to help teachers buy homes in the communities they serve. Last year, we expanded the program to include police, firefighters and health care workers. Non-traditional sources of credit information, as well as supplemental income from activities such as tutoring or off-duty security work, can be used to qualify. This creative effort benefits not only homebuyers and Bank of America, but also the communities where these professionals live and work.

For consumers with traditional credit histories, mortgage lenders have developed automated processes and scoring models that provide objective, consistent and quick decisions to applicants. Credit information is generated through direct interfaces to the

major credit reporting agencies such as Equifax, Experian and TransUnion. Each provides information regarding the depth and length of the consumer's experience with credit, the search for credit, as well as how credit is utilized and paid.

These scoring models have an obvious drawback in that they are dependent upon information contained at the credit reporting agencies. These agencies often do not have information for new immigrants, those who use credit infrequently or younger individuals who have yet to establish a traditional credit history. Nevertheless, it is very likely that these same individuals may have been paying rent to a landlord or utility bills for a period of 12 months or longer.

We need to find an easier way to allow for the reporting of alternative payment histories. While the current manual process that we and others use are in limited circumstance accepted by the secondary markets, it does not work efficiently and its utilization is very limited. One of the advantages of an automated process is the ability to treat all applicants equally. Bank of America is not currently pursuing that approach because the validity and predictability of an automated system is still being tested.

Our goal is for this process to become more automated in a way that meets our criteria for consistency and integrity, which will broaden the opportunities for its use. However, we understand that landlords, utility companies and cellular telephone companies, to name a few industries, may be reluctant to report consumer payment data to the consumer reporting agencies because they must then construct and maintain these reporting systems, as well as provide a process whereby a consumer can dispute the information provided. Creative solutions that provide these companies with an incentive to report their experience with customers will directly benefit the consumers that we are trying to reach.

While the GSEs have continued to analyze the opportunities in this space, including work with Bank of America, another area of improvement lies in the current underwriting guidelines they set for mortgage lenders. Broader guidelines coupled with more readily

available non-traditional credit data would significantly enhance lender approvals. GSE underwriting requirements drive mortgage lender behavior because most lenders depend on their relationship with the GSE to provide the ongoing liquidity to make loans to individuals with non-traditional credit. Thoughtful revision to these guidelines could open the door to homeownership to more individuals without traditional credit.

CONCLUSION

Providing alternative sources of data such as rental and utility information to the current mortgage lending process could greatly benefit a broad range of multicultural and low- to moderate-income consumers. It would increase the number of deserving individuals that have good credit and reduce the frustration of declination due to not having sufficient traditional credit documentation. This clearly helps us meet our goals in serving our communities, knowing that increased homeownership helps to strengthen families and communities, which benefits all of us. But in the highly regulated environment we operate in, we have to find the right balance between compliance and expanded access.

I am very pleased that we have started this dialogue. I strongly believe that working together we can find ways to make alternative credit data available and make this a win-win situation for all.

Thank you again Mr. Chairman and members of the Committee for hearing my testimony today. At this time I would be happy to answer any questions you may have.

Statement by

Michael A. Turner, Ph.D.
President and Senior Scholar
The Information Policy Institute

Before the

U.S. House of Representatives
Committee on Financial Services,
Subcommittee on Financial Institutions and Consumer Credit

Concerning

"Helping Consumers Obtain the Credit they Deserve."

12 May 2005
2128 Rayburn House Office Building

INTRODUCTION

Good morning Mr. Chairman and honorable members of the Subcommittee. I am grateful for the opportunity to testify before you today. I commend Chairman Bachus and Chairman Oxley, and Congressman Castle for their leadership on the complex yet crucial issue of the national credit reporting system.

My name is Michael Turner and I am President and Senior Scholar of the Information Policy Institute. The Institute is a non-profit, non-partisan research organization based in New York City – and is the only institution of its kind dedicated exclusively to issues involving the regulation of information, both domestically and globally.

Since its inception, the Institute has maintained an active focus on issues relating to consumer credit reporting, and has taken its research findings to various federal, state, and international legislative and regulatory bodies on issues ranging from the need for a uniform national law governing consumer credit reporting, to the security of trans-border flows of personal financial information. In addition to the analysis of the importance of the national credit reporting system in the U.S.—the results of which I reported to this Subcommittee two years ago.

When Congress last examined policy issues around our national credit reporting system, they acted swiftly to preserve uniform national standards for consumer credit reporting by passing the Fair and Accurate Credit Transactions Act, or "FACT Act" as it has become known. In addition to making federal preemptions in important areas permanent and also implementing measures to protect Americans from identity thieves, Congress mandated a number of studies, including one by the Federal Trade Commission on whether transactional data not currently included in consumer credit reports could help Americans outside the credit system obtain credit.[1]

The FTC's report to Congress on this topic concludes that there are several types of transactions that could be useful in evaluating a consumer's creditworthiness, and that there are currently barriers to reporting these payments. The Institute also recently completed research designed to assess the value of including non-traditional data in consumer credit reports. We believe our report is useful because it provides an analytical framework for gauging which data sets are most likely to help bring the underserved into the credit system. We also point to courses of actions for industry, regulators and lawmakers to encourage the provision of non-traditional data.

I shall now briefly describe a number of the issues related to non-traditional data, and some of our study's key findings.

[1] Section 318 of the FACT Act required that the FTC examine "whether there are any common financial transactions not generally reported to the CRAs that would provide useful information in determining a consumer's credit rating."

ISSUES TO BE CONSIDERED

Before discussing our findings, some facts about credit reporting and non-traditional information should be kept in mind.

Credit Bureau Data

Access to credit depends on the assessment of the risk level associated with a particular loan. Credit scoring has become the principal means by which credit risk, and thereby price, is assessed. Scoring is an empirical and pragmatic endeavor. Vast amounts of consumer payment information from a statistically valid sample are scoured for patterns, and the patterns are linked to probabilities with the various features of consumers. The latter set of factors can include elements such as residential tenure[2] and overall indebtedness. And from these factors, loans are priced and access is determined, and a decision is made which reflects the risk associated with lending to an individual.

In addition to identifying information such as name, age, and address, traditional sources of data include information on any line of credit: how long the consumer has had the line of credit; credit limit or loan amount; balance; if the account is a joint account; monthly payment; and, payment pattern. Also contained in credit reports are tax liens, bankruptcies, state and county court judgments, and, in some states, delinquencies on child support. Furthermore, credit reports also contain information on inquiries, a list of those who have obtained a consumer's credit report. Inquiries are kept for two years. Positive information is kept for seven years. Most derogatory information is maintained for seven years with some exceptions including bankruptcies and tax liens, which are kept for 10 years.

Credit Bureau Coverage, the Consequences of Exclusion, and Entry into the Credit Market

If there is little or no information on a consumer along these dimensions, then the consumer often cannot be scored, or otherwise assessed. These consumers are often described "thin-file" and have a difficult time accessing credit. And of course, paradoxically, without credit to begin with, it is difficult for such consumers to establish that they are creditworthy.

In most cases there are mechanisms by which thin-file consumers or those who lack credit history altogether may enter the credit market fairly painlessly. For example, parent-child joint accounts for bankcards help many of the young enter the system. Others, by contrast, do not transition so easily into the system or at all. Uncovering the full set of causes why some do and others do not awaits research. Whatever the causes, the consequences can be significant for living standards, opportunities, and asset formation. The last deserves a special mention.

For most American households, the bulk of savings takes the form of homeownership. Rent is turned into equity through ownership and goes to a large extent into savings in the form of real estate assets. The irony is that because of this feature of savings in the U.S., most Americans

[2] One CRA we interviewed found that residential tenure was a useful predictor of likelihood of repay.

need to have access to credit in order to build up substantial savings. This is especially true for poorer households, as the Survey of Consumer Finances regularly shows. For the whole of the American population, home equity accounted for 42% of all assets of those who owned their homes. This share increases as we go down the income ladder. For the bottom 20% on the income ladder (for the homeowner population) home equity accounts for 80% of their assets.

A second and equally pressing dilemma that stems from no files and unscorable files is the lack of access to revolving credit. The issue of revolving credit is thornier, as it raises fears of rising debt burdens. The other face of revolving credit is its use in small business activity. Many small businesses use credit cards—personal credit cards—to finance much of their activity especially in moments where there are bottlenecks in cash flow. (The Federal Reserve's survey of small businesses found this to be increasingly true in the 1990s; the share of small businesses using personal credit cards increased nearly 10% from 41% in 1993 to 45% in 1998.)[3] This is particularly true for the smaller and younger of the small businesses.

Lack of access to credit may help explain lower levels of entrepreneurial activity among poorer segments of the population. Lack of information about credit risk, in turn, helps to partly explain the lack of credit for these consumers. It's clear that low levels of capital act as a hurdle to acquiring credit, as lack of access to credit also acts as a hurdle to building assets. From the perspective of addressing the problem of helping consumers build assets, the proximate issue is how to help them enter the credit system.

The structure described above creates a "catch-22" for many with thin or no files, though low income levels may explain the exclusion of many from the credit reporting system. Briefly, without a credit history, consumers cannot be scored, and without a credit score, they cannot access credit necessary to build a credit history. Building up a credit history initially is not especially difficult for most consumers, but for some consumers, particularly those lacking an understanding of the credit system or with few financial resources, it can be a significant obstacle.

[3] "Financial Services Used by Small Businesses: Evidence from the 1998 Survey of Small Business Finances." *Bulletin*. April 2001. www.federalreserve.gov/pubs/oss/oss3/ssbf98/april2001bulletin.pdf, p. 192

THE PROMISE OF NON-TRADITIONAL DATA

What is Alternative Data?

Data on transactions that are currently excluded from traditional consumer credit reports comprises what is referred to as "non-traditional" or "alternative" data. Though this information is potentially predictive of an individual's credit risk, it rarely reaches the credit reporting agencies.[4]

Categories of "Alternative Data" include:

- Energy payments (water, electric, gas);
- Telecommunications (landline, cellular, internet, cable television);
- Auto liability insurance;
- Homeowner's insurance
- Rental payments;
- Child care payments;
- Payday loans;
- Healthcare payments;
- And, certain types of retail payments (e.g. furniture rental data).

What Can Be Done to Break the Thin-file Catch-22?

The majority of those with unscorable thin-files or without files at all do in fact engage in activities that can be thought of as "credit-like"--that is, they receive goods or services in advance of making a payment. They also make payments that precede services, but whose expected regularity may provide a basis for evaluating responsibility (for example, auto insurance). The regularity and amount of these payments is often one indicator of how risky the prospect of lending to a prospective borrower happens to be. In other words, the vast majority of lower-income Americans reveals their sense of responsibility in whether or not they pay their rent and utility bills on time.

The successful use of alternative data may help move "thin-file" and "no-file" consumers into spheres where traditional data furnishers would also have information on them. In short, it promises a means to help some of the underserved escape the "catch-22" described above and enter into the mainstream credit market.

Using Alternative Data in Consumer Credit Risk Models

While it is very difficult to assess the predictive value of non-traditional data without collecting the information, constructing models, and assessing its performance, it is possible to make some

[4] Interviews with the national consumer reporting agencies (CRAs) confirms that information on auto insurance, rents, positive information on payday loans, and the like are not generally reported. Positive information on utility payments exists in some regions, but it is not a nationwide practice. Interviews with insurance and utility industry associations confirm that reporting to the CRAs is infrequent in much of the country.

reasoned speculations as to which types of data offer the most promise of reaching the underserved.

Here it is important to note that a history of positive information is what allows modelers to fully assess a consumer's likelihood of repayment. That is, it is not the reporting of negatives so much as the presence of negatives and positives that enables models to score information. In many sectors that do not currently report regularly, some negatives such as defaults are reported to credit bureaus.

The problem for those outside of the credit system is less the access to negative information on them than the absence of positive information on credit files. Concerns that reporting by utilities may lead to negative consequences overlooks the fact that most serious negatives are either already reported directly to the bureaus, or via collection agencies.

What most candidates for viable types of non-traditional data share is the character of obligation—there is an agreement of payment for a service of some kind. The relationship may be regular, and is ideally regular, though notably payday loans are not regular for the most part. In some instances, payment is received prior to the receipt of services, such as rent, in which payment is for the month following, but the failure to receive payment does not automatically terminate the receipt of service. In other instances, such as utilities and telecommunications, payday loans, payment is received after services are offered. And in others still, payment must be made before services are extended, such as insurance or tuition. In all instances, information about these relations is likely to offer some insights into an individual's ability and willingness to repay a loan and a general sense of their credit risk.

OUR RESEARCH

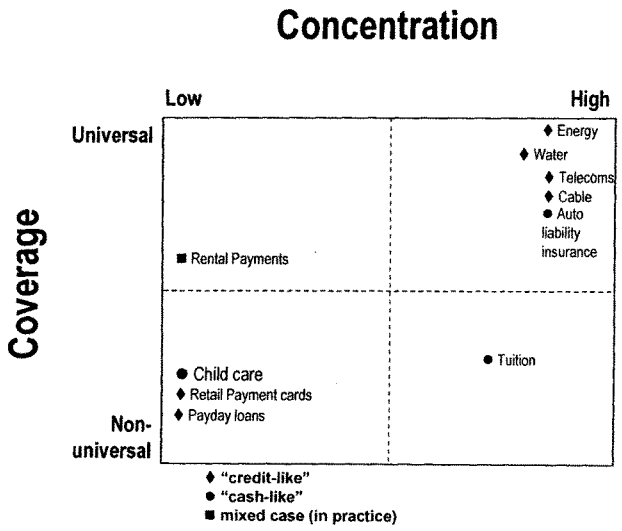
The Information Policy Institute recently completed the first stage of an analysis examining the potential costs and benefits of including alternative data in consumer credit reports. The study provides and analytical framework for assessing the potential usefulness of including various non-traditional data for different populations with an emphasis on low to moderate income Americans. The report also includes an examination of existing technological, regulatory, and economic barriers that may impede alternative data flows. This paper will be forthcoming shortly. We describe the research program used in the first phase of our analysis below.

Methodology

Our examination of the potential sources of non-traditional information relied on interviews that were structured by an analytic typology. The typology took into consideration three factors or dimension: (i) the number of consumers that purchased services from the sector (or **coverage** in the figure below); (ii) the ratio of consumers to the providers of the service (or **concentration** in the figure below); and (iii) the extent to which a service was cash-like and the degree to which it was credit-like. Coverage provides an indication of how likely a source of information is to reach the underserved. Concentration offers an idea of the costs or effort that would be necessary to reach

potential data furnishers, as well as the costs of furnishing for each consumer. Whether a service is cash-like or credit-like gives some indication as to the incentives that a source of non-traditional data has for furnishing data.

The following figure illustrates the configurations. We structured our interviews accordingly. We did not interview anyone in the sectors that occupy the lower right quadrant. No sector in that quadrant has, to our knowledge, either examined furnishing data or has had an interested party such as a credit bureau attempt to organize it to furnish.



In addition to potential providers in these sectors and/or those who have organized the provision of information by this sector, we also discussed the issue with some end users, prospective lenders who are seeking information on underserved segments, and the credit bureaus.

Findings

We expect that most parties will be affected positively by the reporting of non-traditional data.

> Consumers: For the estimated 35 to 50 million American borrowers who don't have credit scores, bank accounts, or whose files have too little information to be used in allocating credit, the use of alternative data about individuals could potentially enable them to access credit from mainstream lenders. The use of non-traditional data may also have an impact on borrowers who are already part of the credit reporting system, optimizing risk

assessment and reducing inefficient cross-subsidies from responsible borrowers to higher risk borrowers.

Creditors would also benefit from an increased ability to assess risk, which results in a reduction in bad loans, an increased ability to price loans to match risk, and higher performance rates for their entire portfolio of loans.

Furnishers of non-traditional data would also benefit from the disciplining effect of reporting, including fewer delinquent payments and reduced charge-offs.

There are impediments to this type of information sharing. Two economic barriers and two regulatory barriers may deter many prospective data furnishers from reporting.

1. Would-be data furnishers that are unfamiliar with the reporting systems and some of the practices that mitigate poaching don't want to share customer data for fear that sharing will enable competitors to steal their customers.

2. Some firms may have complex and incompatible legacy IT systems in place that would make the cost of reporting greater than any perceived benefits.

3. At least two states have statutory prohibitions on the onward transfer of customer data by regulated utility companies. In those states, no customer data from telephone companies, electric, gas, or water companies can be shared with credit reporting agencies as a matter of law.

4. In many states, regulatory uncertainty acts as a soft barrier on the provision of non-traditional information. This is especially true for utility providers which are often unsure of the permissibility of reporting. As a result, without clarification from state legislators or regulators, the fear of potential legal liability and public relations fall-out acts to block the sharing of customer data with credit bureaus.

Some key findings from our forthcoming analysis include:

- *Utility and telecom data is likely to be most useful for thin-file and no-filed Americans.* Data from utility companies, especially telecommunications firms and energy companies cover nearly all Americans including large segments of the underprivileged. Furthermore, these sectors are concentrated and have incentives to furnish data.
- *Non-traditional data is very unlikely to negatively affect the credit scores of most Americans.* Serious negative information is already reported by utilities, telecommunication firms, and many other sources of non-traditional data. What is not reported is positive information, i.e., on time payments. Inclusion of positive information stands to reward most consumers by positively improving their credit scores, or by generating a score where it was previously impossible to do so owing to insufficient information.
- *Prospective data furnishers need regulatory clarity.* Among those firms with customer data with the greatest potential to help enable access to credit to the unbanked and thin-filed, many are public service companies such as utility providers. Such firms confront great

regulatory uncertainty concerning data sharing, and would benefit from affirmative clarification from regulators and legislators.

Sector Specific Considerations

Utilities: As the analysis above suggests, consumer information furnished by utility providers offers the best promise for expanding credit access to the underserved. Utility payments are practically universal, and the sector is heavily concentrated, so relatively few potential data furnishers would have to be convinced of the merits of reporting. Some utility companies, however, have expressed reluctance to begin reporting, and few utility companies report both positive and negative data to the national repositories. In some cases negatives are only received by bureaus indirectly, specifically, those accounts that have been remanded to collections.

The reason why utilities have been reluctant to report may have something to do with the history of the sector and its heavily regulated character. Interviews with utility companies revealed that a hurdle to reporting was the absence of a clear authorization from state regulators that they can report on consumers. As public service companies that are more subject than others to political pressure; their response is understandable.

It should be recalled that the consumer credit reporting system is voluntary. Experimentation, lessons from other firms, affirmative consent from state regulators, and the development of industry practices may be necessary before utilities begin reporting data in meaningful numbers.

Auto liability insurance: As with utility data, auto insurance is also subject to considerable scrutiny and regulation. But here the limitation appears to be more a market based rationale for non-reporting. Insurance carriers can quickly discipline those who are delinquent with their installments. As a result, policyholder knowledge that late payments are being reported may have a marginal disciplining effect, but not likely of the same magnitude as the expected effect in other industries with a weaker disciplining mechanism. Auto liability insurers may further benefit from richer and more robust consumer credit reports, particularly those that include non-traditional data, as they rely heavily on data from consumer credit reports to build their own underwriting scores.

Rental: Our report notes some of the advantages and problems of including rental data in credit reports. The principal issue with rental data is the large number of landlords in the US rental market. The largest landlords still only account for a small fraction of the market. Of course, these limitations may be outweighed by the benefits of having whatever data that is available reported to the bureaus. The responsiveness of the market to an opportunity to improve the quality of its product clearly mitigates the need for government intervention to achieve the same objective.

There may be room for public policy on the issue of rental payment data on the underserved. For example, those who use public housing are more likely to have thin-files or be unbanked than the average American.

Objections

The reporting of non-traditional data is not without its critics. There are three common objections.

First, there are fears that the use of this information will negatively impact consumers, notably in the form of risk based pricing. Some worry that additional negative information will dynamically raise the price of credit on existing credit lines. response. This objection is based on a misunderstanding. Most of these sectors considered here report negatives already. Collection agencies report delinquent accounts, and, likewise, landlord tenant disputes are included in credit reports. That information already makes it into pricing models. What is not currently considered are the positives, which have the effect of lowering price and improving access for consumers, especially the underserved.

Second, others fear that the inclusion of certain data sets—notably data about payday loans—will do more harm than good for low to moderate income Americans. The concern about including payday loan data stems from the high APR on such loans, and the belief that payday lenders contribute to borrowers' financial duress. Normative judgments about the practice aside, should the inclusion of payday loan data prove to be an accurate predictor of default, then those un-banked or thin-filed who make use of such services, and make prompt payments could stand to benefit.

Third, there are those who are opposed to sharing the financial and transactional data that comprise the core of a consumer credit report. Note here that this concern comes at a high price for the underserved. As noted above, access to credit is crucial for households that wish to develop assets, given that households save primarily in the form of houses. This is particularly true of households further down the income ladder. The ostensible protection of the privacy of the underserved thus involves reducing their opportunities to create assets and wealth.

FUTURE RESEARCH

Whether or not any data from the identified universe of potentially useful non-traditional data has any predictive power in consumer credit scoring is purely an empirical matter. Towards this end, The Information Policy Institute is currently developing a project to assess the predictive power of various data sets and measure the potential impact of the reporting of non-traditional data on consumer access to credit. In addition, further research will measure the full range of potential benefits from this information exchange, including benefits to prospective data furnishers, borrowers, and creditors. The project will involve the direct participation of credit bureaus, prospective data furnishers, and creditors. This research is expected to be completed during the second half of 2005.

Community Financial Services Association of America

What are CFSA + PRBC doing?

The members of the Community Financial Services Association of America (CFSA) are recruiting customers to have their payday advance repayments reported to PRBC, Inc. to document their responsibility in meeting financial obligations.

Why is this a good idea?

Most decisions on granting credit, issuing insurance, and offering employment are based on credit reports from the 3 major credit bureaus. To have a credit history, one must have had a credit card, a car loan, a mortgage, a retail installment agreement, etc. To have a good credit history, one must have had no problems with credit.

Millions of Americans, particularly low- to moderate-income consumers, foreign-born nationals, and immigrants, who live paycheck-to-paycheck, have become overextended with credit products. Many lack the qualifications (income, assets, no bank account, etc.) to be considered for these products.

However, these same people may have excellent payment histories for such regular expenses as rent, utilities, cable TV, insurance and payday advances.

Properly compiled, this data could be used as an adjunct to or a substitute for traditional credit bureau reports to facilitate decisions on the fiscal responsibility of applicants for longer-term loans, insurance, employment and the like.

Don't the existing credit bureaus record this data on consumers?

The major credit bureaus record data on medium- to long-term installment and revolving credit. They also accept negative payment information from some large billers.

None of the major credit bureaus record positive data on consumer payment of regular bills.

None of the major credit bureaus accept data from payday advance companies.

The major credit bureaus have said that were they to obtain reliable data that a customer used a payday advance, they would reduce that consumer's credit score for that practice.

What will CFSA members offer to their customers by using the PRBC Service?

CFSA, the trade association representing the largest U.S. payday advance companies, contracted with PRBC to introduce its reporting service to their customers and submit repayment data to PRBC for customers who signed up for the service.

CFSA believes that the advances its members make to their customers act as "bridges" to help customers transition through difficult financial circumstances in their lives.

CFSA believes its pioneering relationship with PRBC will establish an additional "bridge" that helps its customers transition from the use of short-term payday advances, to longer-term credit that provides a more secure financial life and promotes wealth building.

First American to Develop New Credit Scores
BY CRAIG LINDER, The American Banker, October 14, 2003

WASHINGTON -- To encourage homeownership among minorities and the poor, one of the nation's largest title insurance and realty services firms plans to cut low-income consumers' closing costs by 25% and develop an alternative to Fair Isaac Corp. credit scores.

The plan by First American Corp. of Santa Ana, Calif., is a response to years of complaints by consumer groups that financial companies' reliance on credit scores makes it harder and more expensive for minorities and low-income consumers to obtain loans and insurance, and to reports by federal regulators that closing costs are often a barrier to minority homeownership.

Landon Taylor, First American Corp.'s vice president of market development, said that its plan addresses both of those concerns while allowing the company to expand its potential customer base. "We look at it as an investment in the future," Mr. Taylor said. "We've seen all the numbers. If we can put ourselves in a position to serve that minority and low-income market, we will sell more of our products."

First American is slated to unveil its effort at a briefing in Los Angeles today. For the next five years it will donate 1% of its annual pretax income to community homeownership initiatives and will set aside 10% of its net income to use in for-profit capital investments in low-income and minority communities.

But the biggest change, consumer advocates said, could come if First American successfully develops an alternative to FICO scores.

Long the dominant measure of a customer's potential credit risk, the scores have come under fire from consumer groups, because they are based almost exclusively on reports prepared by the three major credit bureaus. Because low-income consumers and recent immigrants do not have the banking relationships and credit agreements that the bureaus monitor, they often have low or incomplete scores and are pushed toward higher-cost home loans as a result, consumer advocates say.

"FICO scoring is useless for immigrants and other first-time homebuyers," said Bob Gnaizda, the general counsel and policy director at the Greenlining Institute, the San Francisco group that helped First American develop the plan. "This will pull more people out of the subprime market." The new system, which First American hopes to have in place by the middle of next year, would fill those gaps by examining a number of documents to determine a customer's credit risk, perhaps including payday-loan histories, bankruptcy filings, rental payments, and criminal records, Mr. Gnaizda said.

According to Mr. Taylor, it is still being developed and tested, but it would draw from consumer databases that First American has acquired over the past three years.

The new scoring system could prove to be a model for other financial services companies to use in evaluating credit applications from low-income consumers. Mr. Gnaizda said his group has approached large banking companies, including Washington Mutual Inc. and HSBC Holdings PLC, about adopting the alternative system.

Birny Birnbaum, the executive director of the Center for Economic Justice, a consumer group in Austin that focuses on credit reporting, said using additional information to determine risk could boost access to credit, but only if consumers are not penalized for using the types of financial services often relied upon in low-income communities, like payday loans.

"The lack of information in your credit history is a negative," Mr. Birnbaum said. "To the extent that additional credit information is included, that could be a plus, but it really depends on how that information is being used."

First American would also create a bundled package of title insurance and closing services for low-income homebuyers that would cut their closing costs by 25%. It hopes that lowering the cost of its services and bundling them will increase sales enough to make up for the discount and build its business beyond its title insurance roots.

Robert P. Napoli, an analyst with U.S. Bancorp Piper Jaffray, who covers First American, said competitors like Fidelity National Financial Inc. and LandAmerica Financial Group will likely develop their own bundled packages.

The Center for
Financial Services Innovation
An initiative of ShoreBank Advisory Services

PAY RENT, BUILD CREDIT
SUCCESS STORY

Challenge:

Fair Isaac Corporation estimates that 50 million Americans do not have the necessary record to obtain a credit score. These consumers may have paid rent and other bills on time for years, but such payments have not been included in traditional credit scoring models. Thus reliable, potentially valuable customer prospects have been effectively barred from the low-interest mortgages and credit available to other consumers. This situation creates obstacles to home ownership and asset development in the fast-growing underbanked market segment, while at the same time preventing financial institutions from accurately assessing risk and expanding their customer base in today's highly competitive environment.

Solution:

To address this problem, Pay Rent, Build Credit (PRBC) was launched in December, 2003. PRBC offers a new model for credit reporting, allowing consumers to demonstrate their creditworthiness using non-traditional measures. PRBC's goal is act as a supplemental credit bureau, translating on-time payments into a credit history that lenders and financial services providers can use to identify first-time home buyers and entrepreneurs who would be good candidates for prime rate loans.

PRBC's business model puts the power into the hands of the consumer by enabling them to sign up for PRBC, rather than hoping that their landlord or other creditor will do so. The service is free to consumers, and lower in cost to lenders and others request reports: $2 to $6, rather than the $20 for a Verification of Rent report. While the data is sold for "permissible purposes," PRBC does not force consumers to buy back their own information. Consumers sign up online and indicate which information they want tracked. The customer then presents physical proof of the relevant payments to PRBC's third party verifiers located across the country, at participating banks, credit unions, accountants, and others. PRBC converts this information into electronic data that can be scored by automated underwriting and risk assessment services.

PRBC offers two products, the basic Bill Payment Scorecard, which determines points based on payment size and timeliness, and the more sophisticated Achievers 100+, which adds criteria such as maintaining a bank or credit union account, having direct payroll deposit, or using an ATM or debit card. Both products are available online in English and Spanish.

Results:

Early results for PRBC are impressive. In just over nine months, without extensive marketing, over 2,000 customers in 47 states as well as the District of Columbia have signed up for the program. The initial enrollment, which is spread across every major region of the country, suggests that this model will have wide appeal and usage.

PRBC expects to have 3.5 million customers by 2007, and 10 million customers by 2009. Citigroup, Fannie Mae and Freddie Mac have all signed on as PRBC's initial data subscribers. As Michael Nathans, PRBC's founder and CEO has said, PRBC "is about enabling individuals who are simply assumed to be high-risk to demonstrate otherwise." For millions of consumers and their landlords, lenders, bankers, and realtors, that demonstration is about to transform their choices, their businesses, and their lives.

MEMORANDUM

TO: COMMITTEE ON FINANCIAL SERVICES

FROM: MARK F. CATONE, SENIOR VICE PRESIDENT, FIRST AMERICAN CREDIT INFORMATION GROUP

SUBJECT: RESPONSE TO QUESTION BY REP. BARNEY FRANK (D-MA) FOR THE FINANCIAL INSTITUTIONS AND CONSUMER CREDIT SUBCOMMITTEE HEARING ON 'HELPING CONSUMERS OBTAIN THE CREDIT THEY DESERVE"

DATE: 6/17/2005

CC:

Question: How are non traditional data verified for accuracy and completeness?

Response: FHA, HUD, VA, US Rural Housing Services all have Non-Traditional Credit report guidelines published as part of their loan purchase or loan guarantee programs. These however, are very general and vague with regard to many details for exact collection and verification, the "how" and the "what" if you will. Fannie Mae and Freddie Mac have the best guidelines however they are both different standards and describe different methodologies as well as leave some decisions on collection and verification to the processors discretion (references below citing sections in each agencies underwriting guidelines). One example from many would be the ability to aggregate two rental payment histories for two different rental properties (say, six months apiece) to achieve a twelve month payment history, which is highly desirable and indicative of creditworthiness related to real estate ownership.

Recognizing that a standardized way of performing the production of a non-traditional credit report would lead to faster turn-around times, improved fraud protection for the lender and investor, lower cost and a credible credit history that any lender could rely on for accuracy and completeness to the standard, we set out to create a best of breed standard that meets or exceeds all existing documented standards.

Attached is First Americans "Data Compilation and Verification Standards for Consumers Requiring Non-Traditional Credit History" document, which is carries the name of our program "ANTHEM" – Assisting Non-Traditional Homebuyers in Emerging Markets. This is an internal document describing First Americans "best of breed" data collection and verification process for Non-Traditional credit reports, where the consumer either has literally no credit file or has a "thin" credit file. In these situations, lenders have a difficult time in evaluating the consumers credit worthiness because of the lack of data, which also results in not being able to calculate a credit score.

In addition, we are working to include international credit information, Individual Tax Identification Number identification and verification and other important data and standards relating to the demand for this broad area.

We do not hesitate to disclose in this public forum because of the importance we place on this issue. As more people and more legislators recognize the issues in this area, the more progress we will achieve in addressing the growing issue and benefits of standardization in this area.

The document describes the answer to your question is detail. Please do not hesitate to contact us for any additional information, explanation or concerns you may have.

References:

Fannie Mae Sellers Guide: X, 804: Using Nontraditional Credit History to Assess Credit Risk (06/30/02)

Freddie Mac Servicers Guide: 37.11
Verification of payment history (2/7/03); Documenting other payment references

FHA Single Family
4155.1 REV-5: Mortgage Credit Analysis for Mortgage Insurance, One- to Four-Family Properties
CHAPTER 2: MORTGAGE CREDIT ANALYSIS (10/03)
CHAPTER 2, SECTION 1: CREDIT HISTORY (10/03)
2-3: ANALYZING THE BORROWER'S CREDIT (10/03)

Rural Housing Service
Administrative Notices
RD AN No. 4068 (1980-D): Single Family Housing Guaranteed Loan Program (SFHGLP) Applicant Credit History Verification (04/01/05)

VA
Lender's Handbook, Current Issues (9/15/04), CI, 4: Home Mortgage Disclosure Act (HMDA) (9/15/04), CI, 4-f: Credit History (9/15/04)

Anthem Report

Data Compilation and Verification Standards for Consumers Requiring Non-Traditional Credit History

August 3, 2004 – 2.2.3

REGISTERED MARKS

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XPN is a registered mark of Experian Corporation.

References to EFX in this document refer to Equifax Credit Information Services, Incorporated

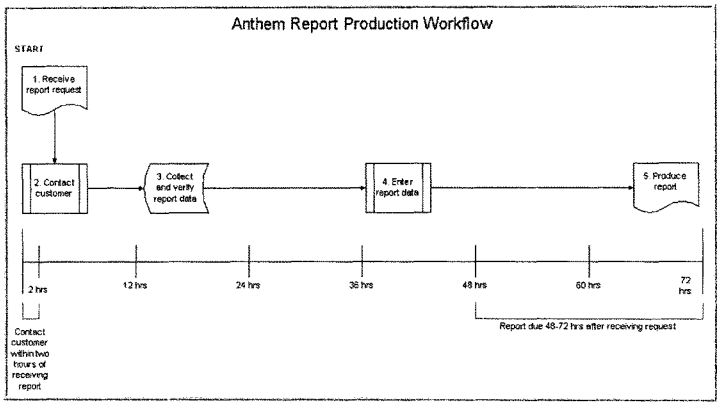
For internal use by Anthem Report Verifiers

The intent of this document is to provide clear guidelines for the process of creating an Anthem Report. Use of the ANTHEM PLATFORM system as it pertains to the Anthem Report is handled in a separate document. This document focuses entirely on providing Anthem Suite of Services to the lender and consumer.

ABOUT THE ANTHEM REPORT PROCESS

This document describes the steps in processing an Anthem Report request and generating an Anthem Report.

Later sections describe these steps in detail. However, this image illustrates a summary of the process.



In sum, the processor receives the report (1) and has 48-72 hours from that point to complete it. Within two hours of receiving the report, the processor contacts the customer (2) to notify him or her of the report request. Then the processor collects and verifies the Anthem Report data (3), enters the data (4), and produces the Anthem Report (5).

See the following sections on each step for its specific components.

For the steps involved in...	See page...
Receiving the Anthem Report request	5
Contact the consumer	5
Collecting and verifying Anthem Report data	6
Entering Anthem Report data	12
Producing the Anthem Report	12

Also, the sections at the end of the guide, "Altering the Anthem Report After Delivery" (page 12) and "Anthem Scoring" (page 12) provide information that supports the Anthem Report process.

ANTHEM REPORT PROCESS

This section describes the steps in each phase of generating an Anthem Report.

Receiving the Anthem Report Request

Important
Start processing time now.

1 Perform required ANTHEM PLATFORM steps to initiate Anthem Report production.

2 If SSN provided, use existing IM report.

3 If SSN provided, but no IM report exists, do the following:

- Contact lender to inform them that you will first order a traditional IM report.
- Order traditional IM report, and then continue with Anthem Report production if necessary.

Contacting the Consumer

Important
Contact the consumer within **two hours** of receiving the report request.

Contact consumer to inform him/her that an Anthem Report has been requested on his/her behalf. Advise consumer that this call is a joint effort and he/she may want to take notes and ask lots of questions.

After reviewing any information already provided by the lender and discussing the Anthem Report process, begin to collect information following these guidelines.

- Rental history, utilities, and other trade options

  Review each of the types of credit that can be used, emphasizing the Tier I data as the most important.

- Individual data values

  Review the data needed for a trade line to be of most value, and then the bare minimum if no alternative exists.

- Verification methods
  - Encourage use of cancelled check copies or bank statements that show payee, date and amount. Explain how to contact the bank to receive copies of checks.
  - Encourage use of copies of payment records/receipts
- Time Service
  - Focus on the speed of the overall loan process and that the credit report is one piece.
  - Review what trades the consumer thinks they can collect and what data/verification method will be possible, then assist in developing a plan with the consumer for what they can do, what FAC can do, and how to accomplish the goal within the 48-72 hour period.
- Continuous Contact

  Throughout Steps 3 and 4, continue to contact consumer to proactively assist in data collection and overcome obstacles that might be encountered.

Collecting and Verifying Anthem Report Data

If the report is a joint Anthem Report, treat all data collection on a per-consumer basis, not per report. Each applicant should attempt to collect the listed information. Joint trades can be counted towards both applicants if both names are on the account. Collect Rental trades plus 3-5 additional trades.

Traditional Report Data

All data from the traditional Instant Merge credit report that would be verified as part of a Residential Mortgage Credit Report (RMCR) should be verified as part of the Anthem Report.

Rental History

General Data Collection Practices

- See Table B for trade lines that qualify under the Rental category.
- Twenty-four to thirty-six (24-36) months Payment History desired. More is always better and certainly allowed.
- If twenty-four (24) months in current rental, sufficient, if not continue to previous rental
- Minimum twelve (12) months to be obtained total, if not possible, pursue up to three (3) Rental trades
- Name of company/person to whom payments are made
- Contact information for payee: Phone and address preferred, but one is acceptable. If a Fax number is available, complete a response fax to verify veracity of fax number before listing in the system.
- Date rental started
- Date rental ended or if still open
- Payment amount
- Payment period (monthly, weekly, etc., not to exceed quarterly)
- Current Status (MOP or closed)

Verification Procedure

1 Use the Payment History verification to determine the overall "Verification Level" of the trade line.

2 Do not record data based purely on the verbal statement of the consumer or lender. One of the verification methods listed in Table A must be obtained for each data piece collected and entered. Level 7 is strictly used for a verification that is approved by at least 2 Anthem Report Verifiers, one of which must be of at least supervisory level, as a special circumstance. Level N is purely for record purposes and should not be used except to address the issue of a trade data mistakenly entered containing data that does not meet an acceptable level of verification.

3 If the payment history is verified by Level 1, 2, or 6, the Anthem Report Verifier must use the cancelled check date or statement/receipt/record date as the date payment was made to determine the MOP of that payment.

Cancelled checks require the additional verification that two cancellations are present, proving that the check was deposited and funds transferred. Once this is complete, the date of the check can be

used in determining what payment it corresponds to and the MOP of that payment.

4 If the payment history is verified by Level 3, 4, or 5, the Anthem Report Verifier must use the dates and status provided as the date payment was made and the MOP status.

Minimum Data Requirements for Rental Trade Line To Be Approved for Display

- An open date, or a beginning pay history date
- A current status or pay history status
- A creditor name
- Creditor contact information
- A payment amount or current amount due if applicable
- A payment period of not greater than quarterly (cannot make payments less often than every three months or four times a year; more often is acceptable)
- Six months of Payment history per trade, unless using for the 12-month minimum needed combined total (consecutive, not counting overlapping months).

Utilities

General Data Collection Practices

- See Table B for a list of trades that qualify as Utilities
- Twenty-four (24) months Payment History desired for each Utility. More is always better and certainly allowed.
- Multiple Utilities desired to reach a total of 3 if Rent present, and 4 if no Rent present
- Minimum of 12 continuous months to be obtained, possibly from multiple utilities if necessary.
- Due to the unique precautions taken by most utility providers to maintain the consumer's privacy, it is highly recommended that more than an Official Creditor Letter of Record be used to collect utility data, especially when considering the payment history.
- Name of company to which payments are made
- Contact information for company: Phone and address preferred, but one is acceptable. If a Fax number is available for transmission,

complete a response fax in order to verify veracity of fax number before listing in the system.

- Date account opened
- Date account closed or if still open
- Highest payment amount
- Current amount due
- Payment period (monthly, weekly, etc., not to exceed quarterly)
- Current Status (MOP or closed)

Verification Steps

1 Payment history verification determines the overall verification level of the trade line.

2 No data can be recorded based purely on the verbal statement of the consumer or lender. One of the verification methods listed in Table A must be obtained for each data piece collected/entered. Level 7 is strictly used for a verification that is approved by at least 2 Anthem Report Verifiers, one of which must be of at least supervisory level, as a special circumstance. Level N is purely for record purposes and should not be used except to address the issue of a trade data mistakenly entered containing data that does not meet an acceptable level of verification.

3 If the payment history is verified by Level 1, 2, or 6, the Anthem Report Verifier must use the cancelled check date or statement/receipt/record date as the date payment was made to determine the MOP of that payment.

Cancelled checks require the additional verification that two cancellations are present, proving that the check was deposited and funds transferred. Once this is complete, the date of the check can be used in determining what payment it corresponds to and the MOP of that payment.

4 If the payment history is verified by Level 3, 4, or 5, the Anthem Report Verifier must use the dates and status provided as the date payment was made and the MOP status.

Minimum Requirements for Utility Trade Line To Be Approved for Display

- Date opened or beginning payment history date
- Current status or pay history status
- A creditor name

- Creditor contact information
- High credit or current balance/amount due
- A payment period of not greater than quarterly (cannot make payments less often than every three months or four times a year; more often is acceptable)
- Six months of Payment history per trade, unless using for the 12-month minimum desired combined total (consecutive, not counting overlapping months).

Other Trades

General Data Collection

- See Table A for a list of Other Trades
- If Rent + 3 other trades have not been collected, continue with other trade options, seeking first Tier 2, then Tier 3 data. If all data obtained from Tier 1 and 2, total not to exceed Rent + 3, or 4 total if no Rent. If any data obtained from Tier 3, total not to exceed Rent + 5, or 6 total if no Rent.
- Twelve (12) months Payment History desired for each trade in Tier 2 & 3. More is always better and certainly allowed.
- Name of company/person to whom payments are made
- Contact information for company: Phone and address preferred, but one is acceptable. If a Fax number is provided/used for transmission, complete a response fax in order to verify veracity of fax number before listing in the system.
- Date account opened
- Date account closed or if still open
- Highest Balance
- Current Balance
- Current amount due
- Payment period (monthly, weekly, etc., not to exceed quarterly)
- Current Status (MOP or closed)

Verification Steps

1 Payment history verification determines the overall "Verification Level" of the trade line.

2 No data can be recorded based purely on the verbal statement of the consumer or lender. One of the verification methods listed in Table A must be obtained for each data piece collected/entered. Level 7 is strictly used for a verification that is approved by at least 2 Anthem Report Verifiers, one of which must be of at least supervisory level, as a special circumstance. Level N is purely for record purposes and should not be used except to address the issue of a trade data mistakenly entered containing data that does not meet an acceptable level of verification.

3 If the payment history is verified by Level 1, 2, or 6, the Anthem Report Verifier must use the cancelled check date or statement/receipt/record date as the date payment was made to determine the MOP of that payment.

   Cancelled checks require the additional verification that two cancellations are present, proving that the check was deposited and funds transferred. Once this is complete, the date of the check can be used in determining what payment it corresponds to and the MOP of that payment.

4 If the payment history is verified by Level 3, 4, or 5, the Anthem Report Verifier must use the dates and status provided as the date payment was made and the MOP status.

Minimum Data Requirements for Other Trade Lines To Be Approved for Display

- Date opened or beginning payment history date
- Current status or pay history status
- A creditor name
- Creditor contact information
- High credit or current balance or current amount due
- A payment period of not greater than quarterly (cannot make payments less often than every three months or four times a year; more often is acceptable)
- At least six (6) payments must be listed in the payment history (note that 6 months of data is assumed to be complimented by additional data to bring the total to 12 months)

Employment Data

- List current employment
- List either a length of employment or start/end dates, as appropriate for ANTHEM PLATFORM

Entering Anthem Report Data

Important
Complete this step between 48 and 72 hours after receiving report.

1 As appropriate, enter data into ANTHEM PLATFORM system; this can be done conjointly with step 3, but only once the information has been verified.

2 No data that has not met some level of verification should be entered.

3 A trade line can be entered and marked for non-display if it does not meet the BARE MINIMUM requirements for display, though it is recommended to focus on the trades that *do* meet the minimum.

Producing the Anthem Report

Important
Complete this step 48 to 72 hours after receiving the report request.

- Provide completed Anthem Report to customer in same method request was received.
- If report not complete at end of 72 hour period, contact lender to inform and provide option of leaving open longer. NOTE: The only acceptable reason for incomplete report is lack of consumer participation when no other method of data collection was possible.
- If report not complete at end of 5 business days, contact lender to offer to send current report, or leave open for up to 30 total calendar days from request.
- Total report time must not exceed 30 calendar days from receipt of request.

ALTERING ANTHEM REPORT AFTER DELIVERY

Use these guidelines to determine when to alter an Anthem Report after delivery.

- If consumer provides additional data after report delivery has been made, contact the lender to advise. If within the 30-day window from receiving the request, ask lender if they would like to update the report or leave as is. Advise that report can be left open for 30 calendar days from START and that up to three Anthem Reports can be delivered based on the subsequent changes. If it is deemed a negligible effect on the quality and/or cost of service, then both the 30

day and 3 report limit can be extended to match those of similar services.

- Within 30 days of receiving the report request, and after initial report delivery has been made, up to three new reports can be provided based on updated information.

ANTHEM SCORING

The Anthem Score will automatically be calculated based on all trade line data that has been verified.

TABLES

This section includes references information in table format. The reference information comprises:

- Verification methods (Table 1)
- Trade line categories (Table 2)
- Data collection summary information (Table 3)
- Frequently asked questions (Table 4)

Table 1: Verification Methods

Level	Verification Method	Description
1	Canceled Checks / Copies of Bank statements	The dates on the check (one date on the front and two dates stamped on back as evidence the check was paid by the maker's bank) and the amount shall be compared with the data provided to verify that the current status, and history of payment are accurate as listed. Copies of bank records indicating an amount paid, payee, and date can be used as well.
2	Printed receipts/records from provider	These receipts/records may take the form of a regular statement provided to the consumer from the service provider showing evidence of payment date and amount.
3	Official Letter of Record from creditor/payee	An Official Letter of Record is provided by the creditor/service provider on formal letterhead/form OR OR signed or otherwise formalized by the appropriate party. type-written/computer-generated dated used to verify only the data contained within the letter itself
4	Verbal verification by FAC Anthem Report Verifier	A certified FAC Anthem Report Verifier in good standing may initiate a phone call with the actual creditor/service provider and verbally ascertain that the data listed is correct.
5	Written statement, but not Official Letter of Record	In some cases the creditor has provided a letter of record that does not meet the requirements to qualify as an Official Creditor Letter of Record. This letter may be used to verify only the data listed within the letter.
6	Handwritten record or receipts from provider	The dates and amounts listed on a handwritten receipt of record shall be used to verify that the current status and history of payment are correct as listed.
7	Other verification method not listed above	In cases where some form of verification was completed to verify the current status and history of payment, but does not meet any of the other verification levels, this category may be identified. NOTE: This level may only be used in special circumstances when the verification used is deemed acceptable by at least two (2) Anthem Report Verifiers, on of whom must be of at least supervisory level.
N	No information available or Unable to Verify	In cases where no verification of the current status and history of payment was possible, this category will be identified. NOTE: Any

Level	Verification Method	Description
		trade line that cannot meet the MINIMUM DATA REQUIREMENTS with one of the above levels of verification for each, shall be marked for non-display.

Table 2:Trade Line Categories

Code	Tier	Category	Subcategory
101	I	Rental/Housing	Residential Rental
102			Business Rental
103			Mortgage
104			Mobile Home Payment
105			Mobile Home Pad
150		Utilities	Electricity
151			Gas/Propane
152			Water
153			Sewer Service
154			Garbage Collection
155			Telephone – land line
156			Telephone – Cellular
157			Telephone – Pager
158			Television
159			Internet
160			HOA dues – *special rules apply
201	II	Insurance	Medical
202			Automobile
203			Life
204			Renter's or Household
205			Other Insurance
301	III	Credit/Store (Installment Loans)	Department Store
302			Furniture Store
303			Appliance Store
304			Specialty Store
320		Installment Loans	Automobile
321			Furniture
322			Major Appliances

Code	Tier	Category	Subcategory
323			Loan from Individual
340		Education/Childcare	Tuition
341			Student Loans
342			Daycare
343			Child Support (not payroll deduction)
360		Medical Payments	Medical Payments
380		Other	Home Owner's Association Dues*[1]
381			Union Dues (not payroll deduction)
382			Church Tithing
383			Parking (regular payments)
384			Self-Storage
385			Payday Loans
386			Other

[1] The HOA dues can qualify in the Utility category if proof is provided that shows non-payment of dues is cause for legal action or eviction based on the rental/lease agreement.

Table 3: Data Collection Summary Table

Step	Item	Details
1	Housing – Tier I	First item for verification is mortgage/rental payment. If no mortgage or rental, other property rental/lease payment is acceptable as listed in Table B (commercial or business rental, mobile home pad rental, etc) Specifically list if utilities are or are not included in rental payment
2	Utilities – Tier I	Second item for verification is utilities. Multiple utilities are acceptable and encouraged. They should be collected in order of importance for maintaining the home: • Electricity • Gas (Natural or Propane) • Water • Sewer service • Garbage Collection • HOA dues (when required in housing contract) • Telephone services (land line first) • Television service (cable or satellite) • Internet service (cable or satellite)
3	Insurance – Tier II	If further trade lines are necessary beyond housing and utilities, insurance payments that are not automatically deducted from a paycheck should be sought third. They should be requested in order that correlates to maintaining the home: • Renter's Insurance or Household Insurance • Medical • Auto • Life • Other
4	Other – Tier III	Only when Tiers I and II have been exhausted and further trade lines are necessary, Tier III data can be sought in the order listed below: • Installment Loan – Auto • Installment Loan – Household appliances / store • Installment Loan – Furniture / store • Installment Loan – Student Loan • Installment Loan – Other store / Specialty • Regular Payments – Tuition • Regular Payments – Childcare • Regular Payments – Child Support • Regular Payments – Medical • Regular Payments – all others

Table 4 Frequent Asked Questions

Q	The consumer makes mortgage payments for another party. Can this be counted under the "Rent" or "Mortgage" category?
A	In this circumstance, the trade can only be listed as a Mortgage if the consumer's name is listed on the loan agreement. This can be verified either through copies of statements showing the consumer's name or by contacting the lender directly. To be listed as Rent, the address for which the payments are being made must match the consumer's residence for that time period. This can be done by comparing statements that show the property address and the consumer's address for that period. Otherwise, the payments can be listed as payment of a personal loan in Tier 3 where the payee can and should be the party to whom the payments were made.
Q	I can't get in touch with the consumer and the clock is ticking!! How does this work with the service time of 48-72 hours?
A	While waiting to reach the consumer, begin the data collection, verification and entry for trade information that was received as part of the initial request. If the consumer cannot be contacted by telephone within 24 hours of receipt of the Anthem Report request, *and* this contact will be necessary to meet the minimum data requirements, contact the lender to let them know that the START time has been affected by the consumer's cooperation. Let them know that you will continue to attempt to contact the consumer periodically throughout the day, each day, at different times, but without the consumer's participation, the delivery time may be impacted. If at the end of 5 business days, the consumer participation has still not allowed a complete report to be prepared, contact the lender and let them know that the Anthem Report can remain open for a total of 30 calendar days or it can be provided as it currently stands if that is sufficient for their needs.
Q	The consumer doesn't have 12 months of payment history. Can the trade line still be used?
A	In almost all cases the trade line cannot be used by the lender if it does not have 12 months of data. However, if there simply is no alternative, it is acceptable to list a trade line with as few as 6 months of data, *and* it should be attempted to provide an additional 6 months in the same category in order to provide a pseudo 12 month record.

The First American Corporation

Date: June 4th, 2005

To: Rodney Pearson

From: Mark F. Catone

Re: 1) Response to request for corrections to transcript
2) Response to questions by Congresswoman Deborah Pryce
3) Response to questions by Congressman Mr. Gutierrez

1. **Response to request for corrections to transcript**

   The transcript is accurate, I have no changes.

2. **Response to questions by Congresswoman Deborah Pryce**

   There will likely need to be some sort of regulation targeted at allowing consumers with thin or no credit report to obtain credit in the same manner and with the same quality as consumers with a credit report. The industry traditionally considers these consumers a higher risk. In fact, lenders that cater to these types of consumers are finding that these consumers have the same or better risk profile than that of consumers with a complete credit report and score. I have attached, with permission, the following article supporting this statement.

   There are strong financial incentives driving the bahavior to treat thin and no file consumers differently. This includes excessively higher interest rates because of a lack or "traditional" credit, where the broker and lender benefit financially, delayed application processing because data must be compiled manually, where there is no incentive to automate for what the industry considers a small number of consumers.

   In addition, these consumers are the target of various forms of fraud because they are categorized differently.

3. **Response to questions by Congressman Mr. Gutierrez**

   Remittance amounts and products should be specifically called out as acceptable to demonstrate the ability to pay bills or other obligations. The issue is that these are not specifically called out as acceptable in the production of non-traditional credit in many cases. Lenders must call out the accpetability of these types of payments as well as investors who purchase these loans.

   As an example, Freddie Mac comes the closest to specifically defining paymnents that are acceptable in their "Single Family Seller/Servicer Guide" section 37.11: Verification of payment history:

   > "Regular payments of a voluntary nature, such as deposits to a savings account, contributions to a payroll savings plan or contributions to a stock purchase plan (but not including payroll deductions for a mandatory retirement program)
   >
   > Though the documentation necessary to establish an acceptable credit reputation may vary, Freddie Mac requires that the Mortgage file documentation clearly demonstrate the Borrower's past willingness to make periodic payments over an extended period."

Whereas, Fannie Mae does not specifically call out these type of payments, but defines specific types in Tiers of non-traditional credit in their "Sellers Guide" in section X, 103.04: Nontraditional Mortgage Credit Report:

> "Tier I credit includes payments for rental housing, payments for utilities (if they are not included in the rental housing payment)—electricity, gas, and water; payments for telephone service; and payments for cable television service. (If the credit reporting agency is able to verify the borrower's payment history for rental housing, it should specify in the report whether the verification was obtained from a professional management company or an individual landlord.)
>
> Tier II credit includes payments for medical insurance coverage (excluding payroll deductions), payments for automobile insurance, payments for life insurance policies (excluding payroll deductions), and payments for household (or renter's) insurance.
>
> Tier III credit includes payments to local stores—department stores, furniture stores, appliance stores, specialty stores, etc.; rental payments related to durable goods (including automobiles); payments for medical bills; payments for school tuition; payments for child care; and payments on a loan obtained from an individual (if the repayment terms are documented in a written agreement and the borrower can provide copies of canceled checks to indicate that the payments are of a continuing nature)."

The issue seems to be in calling this type of payment out specifcially, rather than leaving it for intrepetation or not providing the allowance of this type of payment history type.

This payment type can be accomodated in the current credit score system in two ways:

- If made available and furnished to the national credit bureaus.
- If allowed for use in the underwriting of loans where a "non-traditional" credit report is used.

As far as outreach, the March 2005 GAO report to Congressional Committees as a result of FACTA entitled "Credit Reporting Literacy" reports and reccomends very appropriate educational and outreach under the newly created Financial Literacy and Education Commission (FLEC). It would be very appropriate to develop and include as part of this and other educational programs, the how-to aspects of demonstrating creditworthiness for consumers with no credit reports or scores. The rules and types of documents are very straight forward and if more consumers were aware of the process. Ou company has envisioned a consumer kit of sorts that would allow the consumer to build their own credit report simply and in a very straightforward manner.

Attachements

- ABA article in support of question #2.

12395 First American Way • Poway CA 92064 • Tel: 800-255-0792 • Fax: 888-281-6209
www.firstam.com/credit

Attachement – ABA article in support of question #2 from Deborah Pryce

June, 2005

Banks are Quietly Wooing Undocumented Immigrants

Many illegal aliens are hard-working, tax-paying U.S. citizen wannabes-and banks are banking on their desire to be homeowners, too. And why not? There's no law against it.

By Steve Bergsman

As Washington signals a more lenient immigration policy toward the nation's eight million to 11 million undocumented aliens, U.S. banks like Fifth Third, North Shore Bank and Second Federal Savings & Loan, are quietly courting this group for home mortgages.

"Banks are not an arm of the immigration department," says Kevin Mukri, a spokesperson for the Office of the Comptroller of the Currency, the primary bank regulator. "As long as those getting mortgages meet the requirements of being authorized bank customers, including proper ID, it would be discriminatory not to service them." There is no law against banks issuing mortgages to illegal immigrants, nor against their owning property in the U.S.

An estimated six million to eight million of those undocumented are Latinos, who alone represent a potential $44 billion market in homes, according to the National Association of Hispanic Real Estate Professionals.

The Federal Deposit Insurance Corp. and the Mortgage Guaranty Insurance Corp., a Milwaukee-based mortgage insurer, recently gave their blessing to a product aimed at this group, the ITIN mortgage. An acronym for the Income Tax Identification Number, the ITIN mortgage is marketed to those with the nine-digit Internal Revenue Service number. Working illegal immigrants seek an ITIN number for tax-paying purposes because they aren't eligible for a Social Security number. Both resident and nonresident aliens may have ITIN numbers. Michael Frias, an FDIC spokesman, confirms that banks aren't legally required to verify legal status. "There is no federal banking law that requires banks to verify the immigration status of foreign account holders," he says.

Don Cohen, vp of community lending for North Shore Bank of Brookfield, WI, has been offering ITIN mortgages since September. "This is a whole new market," he says. "Immigrants are hard working, earn income, have down-payment money and want to own a home." If an illegal alien is deported and defaults on his mortgage, the bank would own the home.

Last autumn, the MGIC began working with 35 lenders to offer mortgage insurance for ITIN mortgages, an endorsement that cuts the loans' interest rates, and to date it has insured 196 loans worth more than $25 million. "We recognize the reality of a standing immigrant population,"

says Ryan Daniels, a spokesman for MGIC. He acknowledges that many in this target audience may be undocumented, but underwriting standards only require that applicants have an ITIN number and have paid taxes for at least two years. Not one of its 196 loans has been delinquent, he says.

The growth of ITIN mortgage programs shows how banks have adapted to the economic reality of illegal immigrants, many of whom aren't deported by the Immigration and Naturalization Service unless they commit violent crimes. Although it's illegal to hire them, few employers are prosecuted, and the IRS accepts their tax payments. Moreover, many households with an undocumented immigrant also may include a legal permanent resident or U.S. citizen, frequently a child born here. "Anything that accommodates their illegal presence encourages them to stay and others to come," warns Jack Martin, special projects director for the Federation for American Immigration Reform in Washington, D.C.

For the most part, however, banks are staying out of the political fray, and concentrating on business strategy. Second Federal Savings & Loan, based in the Chicago area, has offered ITIN mortgages for several years, but has renewed its focus in the last 18 months. "With margins narrowing, we got squeezed," says president and CEO Mark Doyle. "We looked at our alternatives. One glaring opportunity was in the ITIN market." It proved to be a solid bet: Today, the bank's $70 million ITIN portfolio is "performing well" with no foreclosures, he says, though he declined to provide profit figures.

Doyle says illegal immigrants have proven to be no bigger risk than legal immigrants or U.S. citizens. North Shore Bank's Cohen concurs, saying, "The risk has been minimal to non-existent."

In November, Cincinnati-based Fifth Third Bancorp introduced an ITIN mortgage in seven markets, drawing twice the number of expected candidates. Says Bill Schumer, vp of product development, "This is a great outlet to help Hispanics establish roots here." Other financial institutions offering the mortgages include Banco Popular in Houston; Self-Help Credit Union in Durham, NC; First Bank of the Americas in Chicago; Texas Bank in Fort Worth, TX; and Mitchell Bank of Milwaukee.

Fair Isaac Credit Services, Inc.
901 Marquette Avenue, Suite 3200
Minneapolis, MN 55402-3232
612 758-5200 *phone*
612 758-6034 *fax*
www.fairisaac.com

July 7, 2005

U.S. House of Representatives
Committee on Financial Services
Mr. Thomas G. Duncan
ATTN: Rodney Pearson
2129 Rayburn House Office Building
Washington, DC 20515
fsctestimony@mail.house.gov

Re: Your June 10, 2005, letter regarding questions of Rep. Barney Frank

Dear Mr. Duncan:

Thank you very much for your letter conveying questions submitted by Representative Barney Frank as a result of the May 12, 2005, hearing titled "Helping Consumers Obtain the Credit They Deserve," held by the Subcommittee on Financial Institutions and Consumer Credit.

To specifically address the 13 questions in your letter:

(1) What is the amount (or absence) of credit information contained in a consumer's file that triggers a categorization of a consumer having a "thin" file?

While there is no standard industry definition of a "thin" consumer credit file, Fair Isaac defines a "thin" file as a consumer file that has some information, but not enough to calculate a FICO® credit score. Using this definition, a thin file would be one that does not have:
1) at least one credit obligation that has been open for six months or longer, and
2) at least one credit obligation with activity reported in the most recent six months.

(2) What percentage of the population who currently have thin files do you think could benefit from the use of nontraditional credit data? What is the basis for your estimate?

We estimate that approximately 15% of the credit-eligible adults in the U.S. have thin file credit reports. We looked at a broad range of U.S. Census, industry and analyst reports to arrive at these estimates. All of these people potentially could benefit from lenders' use of nontraditional credit data and risk scores based on that nontraditional data.

(3) How are nontraditional credit data verified for accuracy and completeness?

The accuracy and completeness of the nontraditional credit data Fair Isaac Credit Services, Inc. resells as part of the FICO Expansion score is maximized by the efforts of the consumer reporting agencies that collect the data and by the efforts of consumers. The consumer reporting agencies that collect the data are motivated to make it as accurate and complete as possible to create a better product for their customers. In addition, Fair Isaac Credit Services, Inc., evaluates potential data sources and selects only those that contribute to the predictiveness of the FICO Expansion score.

Consumers can verify the accuracy and completeness of the data by obtaining a copy of their credit report and, if they find an error, they can exercise their FCRA rights to correct errors in the data. The consumer reporting agencies that supply the credit data and the entities that report the information to those agencies have an obligation to respond to questions and correct errors in the data furnished, just as the national credit reporting agencies and the banks that report trade line information must respond to questions and correct their data.

(4) How many credit scoring models does FICO[1] use? What are the most and least factors considered by these models? What are the sources of the factors used in these models?

Number of FICO credit scoring models.
Fair Isaac develops credit scoring models for use by credit reporting agencies Equifax, Experian and TransUnion, which use our models to calculate credit scores that they sell to lenders and other businesses. We call these models Classic FICO score and NextGen FICO score, referred to collectively in these answers as the FICO score or the FICO score model, but each credit reporting agency gives them a unique brand name as shown here:

Credit Reporting Agency	Classic FICO Score Name	NextGen FICO Score Name
Equifax	BEACON®	Pinnacle℠
Experian	Experian/Fair Isaac Risk Model	Experian/Fair Isaac Advanced Risk Score
TransUnion	FICO® Risk Score, Classic	FICO® Risk Score, NextGen

Fair Isaac also developed the FICO Expansion score for use by its subsidiary, Fair Isaac Credit Services, Inc., to use nontraditional credit data to calculate and provide credit scores to lenders and other businesses.

[1] "FICO" should not be used as an acronym for Fair Isaac Corporation or any other entity. FICO® is a registered trademark of Fair Isaac Corporation, used to refer to its FICO® scores.

Factors in the FICO score model.
Although we will describe for you the factors available for use in the model, the number of factors analyzed for a given consumer depends on the extent to which information that can be considered is available in that consumer's credit report. The FICO score model analyzes information from three sections of the credit report at the consumer reporting agency that calculates the score: 1. Account information; 2. Credit inquiries; and, 3. Public record and collection items. (The FICO score model ignores all information on the report's personal information section.)

The FICO score breaks out this information into the following five main categories which are listed in descending order of importance to the score:

1. Payment history
2. Amounts owed
3. Length of credit history
4. New credit
5. Types of credit in use

These categories are broken down further into the following 22 factors:

Payment History

- Account payment information on specific types of accounts
- Presence of adverse public records (bankruptcy, judgments, suits, liens, wage attachments, etc.), collection items, and/or delinquency (past due items)
- Severity of delinquency (how long past due)
- Amount past due on delinquent accounts or collection items
- Time since (recency of) past due items (delinquency), adverse public records (if any), or collection items (if any)
- Number of past due items on file
- Number of accounts paid as agreed

Amounts Owed

- Amount owing on accounts
- Amount owing on specific types of accounts
- Lack of recent account activity
- Number of accounts with balances
- Proportion of credit lines used (proportion of balances to total credit limits on certain types of revolving accounts)
- Proportion of installment loan amounts still owing (proportion of balance to original loan amount on certain types of installment loans)

Length of Credit History

- Time since accounts opened
- Time since accounts opened, by specific type of account
- Time since account activity

New Credit

- Number of recently opened accounts, and proportion of accounts that are recently opened, by type of account
- Number of recent credit inquiries

- Time since recent account opening(s), by type of account
- Time since credit inquiry(s)
- Re-establishment of positive credit history following past payment problems

Types of Credit Used

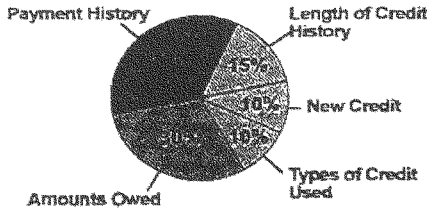
- Number of (presence, prevalence, and recent information on) various types of accounts (credit cards, retail accounts, installment loans, mortgage, consumer finance accounts, etc.)

Sources of the factors used.

Rigorous statistical analysis is used during development of the FICO score models to identify the factors in the useable data available from the consumer reporting agency that have the highest correlation with future payment performance. Hundreds of variables and combinations of variables are analyzed to determine the weight to give each factor, alone and in interaction with other factors.

(5a) In general, what are the ten factors that most affect a credit score? How do these factors interact with one another?

The following chart shows the general weight of each of the five basic categories in a consumer's FICO score.



The FICO score model uses multivariate analysis, which is an analytical technique that considers or solves for multiple (more than one) decision variables at a time. Therefore, which factor will be the most important within any given score depends upon the information available in the credit report for the consumer for which the score is calculated, and how each available factor is assessed by the model in comparison to the other available factors as determined by the multivariate analysis. For example, an overall good credit picture on a credit report can outweigh one or two instances of late credit card payments. As another example, opening many new accounts in a short time will have a greater effect on the score of a person who has been managing credit for only a short time, than the effect on the score of a person whose credit report reflects long-standing accounts in good standing.

(5b) For each of the following factors, please indicate the percentage of FICO credit scoring models that consider them:

1. *number of open-end accounts (e.g., bank and store credit cards, overdraft lines of credit)*
2. *number of closed--end accounts (e.g., auto, mortgage, or installment loans)*
3. *type or purpose of account (bank credit card, store credit card, closed-end auto loan, etc.)*
4. *account balances*
5. *number of accounts*
6. *credit limits on accounts*
7. *ratio of outstanding balance to credit limit*
8. *payment status of accounts (e.g., paid as agreed, 30 days late, etc.)*
9. *age of account*
10. *last activity on account (e.g., open but inactive accounts)*
11. *bankruptcy*
12. *address of applicant*
13. *length of time at current or prior address*
14. *age of applicant*
15. *number of dependents*
16. *occupation*
17. *length of time at current job*
18. *income*
19. *telephone in home*
20. *auto ownership*

The FICO score model considers factors 1 through 11 when that information is present in the consumer's credit report. It does not consider the factors numbered 12 through 20 above. The FICO Expansion score model evaluates non-traditional credit information not found on traditional credit reports, so that model does not consider factors 1 through 11. In some cases the FICO Expansion score model may evaluate loan application data submitted by a lender requesting an applicant's FICO Expansion score, which may include additional elements of the following from the factors listed above.

(6) In credit scoring models, does changing one factor's weighting affect another factor's weighting? For example, could a change in a factor, "the amount owed on accounts," affect the weighting of other factors?

Yes. The importance of any single factor depends on the overall information in the credit report.

(7) What other factors are used in more that 25 percent of FICO credit scoring models?

Please see the answer to Question 4 for the complete list of factors used in the FICO scoring model.

(8) How does the failure of some creditors to report the credit limits available to consumers on their unsecured credit cards factor into a credit score? How can the absence of information on credit limits be offset by other credit information contained in the consumer's file?

Fair Isaac encourages full and complete reporting of all consumer credit information by all lenders. We feel this practice will best serve the interests of consumers as well as the interests of the credit industry. In general, the absence of credit limits has not been shown to dramatically diminish the accuracy and predictiveness of the FICO score model because so many factors are considered by the model. It is true however, that including this information does make the scores marginally more predictive.

When a lender does not report a credit limit, the impact for an individual consumer can be neutral, increase the score, or decrease the score, depending on what other credit information is on the credit report. The missing information could be either a positive or a negative contributing factor to the overall risk evaluation because the FICO scoring model does not look at available bankcard credit (credit limits) in isolation. Generally, the change in a score due to a missing credit limit is small.

(9) How do credit scoring models treat missing information about a factor?

In general, the scoring models assign a neutral value to missing information.

(10) How frequently does Fair Isaac validate each of its credit scoring models?

Fair Isaac redevelops and validates the FICO scoring model every 2-3 years to ensure that the scores' predictive value is maintained over time. The frequency of the redevelopment depends upon the facts and circumstances that occur since the last redevelopment. In addition, lenders validate FICO scores on a regular basis based upon the scores' ability to rank-order the credit risk of their customer population, and they do so under the oversight of regulators who oversee them.

(11) Has Fair Isaac ever performed any evaluation to determine whether credit scoring models have disparate effects on different racial or ethnic groups or on women? Has Fair Isaac ever evaluated its models for their effect on different geographies, i.e., has Fair Isaac ever evaluated its credit scoring models to determine whether there are different average scores for different states, regions, or ZIP codes?

Fair Isaac's development data is depersonalized and it does not contain information that identifies any consumer's gender, race, or any other prohibitive factors as defined in the Equal Credit Opportunity Act. In 1997, Fair Isaac reported on the study of credit scoring designed to determine whether credit scoring had a disproportionate impact on low-to-

moderate income (LMI) individuals and individuals in high-minority areas (HMA)[2]. Because direct race/national origin information was not available, U.S. Census data was used to identify ZIP codes in which a high percentage of minorities reside. The study showed that scoring is very predictive of risk for LMI applicants and applicants in HMA and any disparities in the risk-to-score relationship between the general population and LMI/HMA populations worked in favor of LMI and HMA applicants. The study also showed that credit scoring is a far more predictive screen for both the LMI and HMA applicants than is the judgmental decision making that was relied upon by lenders before they used credit risk scores.

FICO scores do not use any geography-based information (region of country, state, ZIP code, etc). In 1996, Fair Isaac performed a custom study for a client that included the comparison of mean scores by region, based on FICO scores and information provided by the client. If median or average scores differ by geography, the differences are driven by the credit makeup of the consumers in those geographies and not by any feature of the FICO scoring model.

(12a) In addition to developing credit scoring models, has Fair Isaac developed models for credit-based insurance scoring?

Yes.

(12b) What other purposes, if any, has Fair Isaac developed scoring models? If so, what factors are used in more than 25 percent of these scoring models?

In addition to developing the FICO credit risk score (our most commonly used scoring tool) and FICO Expansion score, and credit-based insurance scores, Fair Isaac has developed scoring models that predict outcomes such as payment, profit, response and attrition. Twenty-five percent or more of the credit bureau models we have developed would consider the following factors if present on the credit report: payment history, amounts owed, length of credit history, new credit, and types of credit in use.

(13) Does Fair Isaac require creditors to submit loan information electronically and/or batched with a minimum of accounts? If so, what is the minimum amount of accounts and does this number vary for certain geographies?

No. The consumer reporting agencies manage collection of loan information from lenders for inclusion in their databases.

* * * * *

[2] A copy of the study can be found at Attachment 7 to Fair Isaac's June 4, 2003 Written Statement Before the U.S. House of Representatives Committee on Financial Services, Subcommittee on Financial Institutions and Consumer Credit.

We very much appreciate you contacting Fair Isaac to convey Rep. Frank's questions and we truly hope this information meets his need for additional information. If you have any questions concerning these comments, or if we may otherwise be of assistance in connection with this matter, please do not hesitate to contact me, at (612) 758-5469.

Sincerely,

Lisa Nelson

Lisa Nelson
Vice President Business Operations

Pearson, Rodney

From: Nelson, Lisa M [LisaNelson@fairisaac.com]
Sent: Thursday, July 28, 2005 1:02 PM
To: Pearson, Rodney
Subject: FW: QFR for May 12th FI hearing

Mr. Pearson,
Please provide the following response to Mr. Gutierrez from Fair Isaac to the question he poses in the email below:

Fair Isaac supports lenders' use of all of the information that is legally, economically and efficiently available to make the best and fairest possible decision for each individual with whom they do business. Fair Isaac Credit Services, Inc. created the FICO® Expansion™ Score to leverage alternative credit data. Although research and development using the remittance data would be required to be certain, it is fair to speculate that the Expansion Score could use sources of remittance data if the data proves to be predictive of credit risk and is available in usable form from a consumer reporting agency. Education about the kinds of data used to create credit scores, responsible credit practices and how the credit reporting system works is an effective means of outreach.

Sincerely,
Lisa Nelson

Gwen Thomas
Alternative credit testimony follow-up

Response to questions from Mr. Gutierrez:

What do you think about consideration of remittance payments for credit decisions?
Consideration of remittance payments for credit decisions is something that we have evaluated. At this point, there are four primary challenges with that approach: 1 – consistent reliability of the data as a predictor of payment behavior; 2 – obtaining the data could reasonably raise privacy concerns; 3 – secondary market restrictions; and 4 – knowledge that the funds sent were actually those of the applicant.

Could this be done within the current credit score system?
It is most appropriate for the credit scorecard and risk strategists to comment on what can be done within the current credit score system.

What kind of outreach should be done to bring these often unbanked citizens into the system so that their transactions can provide additional data toward their credit files?
At Bank of America, we have found success in reaching unbanked consumers through alliances with organizations they know and trust, like National Association of Hispanic Real Estate Professionals, National Council of La Raza, National Association of Real Estate Brokers and Asian Real Estate Association of America. These organizations are viewed as a trusted referral source by their constituents.

Earlier this year, Bank of America announced that it will be eliminating the remittance fee for our SafeSend product for consumers with a Bank of America checking account. This move provides an additional incentive for consumers who use remittances to open a checking account. Further, it introduces them to the banking system where they can gain confidence to begin using other products and begin to build a documented credit history.

Likewise, we take a similar approach to reach other consumers including partnering with trusted third party organizations, including churches. In many markets we work with students to help them understand credit and the importance of building good credit.

Response to questions from Mr. Frank:

What percentage of loan applications were evaluated with manual underwriting in 2004? In 2003?

Bank of America's decision engines issued an automated approval on approximately half of our loan applications, with the remaining files referred to an underwriter for evaluation.

In regard to loan applications for consumers who have thin files, what are the bank's guidelines to loan officers for manual underwriting for these applications?
If the applicant has less than 3 traditional credit references (open or closed) on their credit report, Bank of America requires the applicant to provide alternative credit documentation so that the applicant has a total of 4 credit references (the number of traditional trade lines plus the number of alternative credit payment references must total 4). Any alternative credit reference that needs to be documented in a loan file must cover a 12 month period and adequately demonstrate the applicant's ability to successfully manage regularly scheduled financial obligations. Forms of alternative credit references include rental payment history, cable television bill payment, dealer-financed auto loan payments, furniture rental payments, medical bills paid per payment agreement, rent-to-own agreements, telephone bill payment, personal property tax bill payment, day care expense payments, electricity bill payment, gas company bill payment, long term layaways, water bills, and systematic deposits into savings resulting in net gain.

How does the bank monitor the use of manual underwriting to ensure that decisions made on loan applications are not discriminatory against minorities and women applicants?
Bank of America establishes its guidelines to ensure that they are not discriminatory. In addition, quality control reviews are conducted each month on a sample of loans to ensure that our actual practices are aligned with our policies.

Pearson, Rodney

From: Michael Turner [turner@infopolicy.org]
Sent: Friday, January 13, 2006 11:55 AM
To: Pearson, Rodney
Cc: 'Robin Varghese'; 'Dan Balis'
Subject: RE: QFR for May 12th FI hearing. Thanks.
Importance: High
Sensitivity: Confidential

Congressman Gutierrez,

In response to your question concerning the utility of including remittance payments in consumer credit reports, I think it is important to highlight several facts.

First, whether or not remittance payment data has any predictive power, or any value in establishing an individual's credit risk, credit capacity, or credit worthiness is purely an empirical matter. Certainly, if it is established that remittance payment data has predictive power, then there is a compelling business incentive for each of the three national repositories to include such data in consumer credit reports.

We are aware of several industry efforts, among lenders and credit bureaus, to assess the predictive value of remittance payments. To the best of my knowledge, none of these experiments have yielded publicly available results. In addition to these efforts, the Information Policy Institute is about to embark upon a similar endeavor. That is, we are undertaking quantitative research designed to measure the impact of including certain non-traditional data sets in consumer credit reports. Our focus currently includes energy utility data, telecommunications (wireline and wireless), and potentially cable payment information as well.

We selected these data sets as the most promising for Americans with little or no credit history because most low- to moderate income Americans (including the unbanked) subscribe to utility, telephone, and cable services. In addition, these sectors are relatively concentrated, meaning that a relatively small number of data furnishers have payment histories on a relatively large subscriber base. And finally, for purposes of predicting credit risk and credit worthiness, these payments are more credit-like (that is, a service is provided up front, prior to receiving a payment) and not cash-like (where a good or service is provided in exchange for payment at the point of sale). I have attached a copy of our recent study discussing our analytical framework and the reasons why we selected utility, telephone, and cable data as the most promising alternative data sets.

Additionally, the remittance payment industry—outside of Western Union—is relatively fragmented. Thus, even if it were established that such data were predictive of default, then credit bureaus would face an uphill battle in having the data furnished in a voluntary system. Data furnishers need to be convinced that the benefits of reporting outweigh the costs that they must assume to become data furnishers—including those outlined in the Fair Credit Reporting Act and the Fair and Accurate Credit Transactions Act.

Further, the big three national credit repositories have standards for assessing the accuracy and integrity of a furnisher's data. As such, prospective furnishers of remittance payment data would need to demonstrate an ability to consistently and reliably meet those data quality standards before their data could be integrated into a consumer credit report. Meeting these standards with legacy IT systems may impose costs well in excess of any perceived benefits, especially for smaller sized remittance payment companies.

With that said, the Institute has had several conversations with executives from larger remittance payment firms who are interested in reporting their customers' data. They only want to report if the net effect of so doing will yield a benefit for their customers. Such a benefit, then, could be used as a competitive advantage in marketing campaigns. In short, remittance payment industry executives understand the potential business value of reporting payment information to credit bureaus, but want to be certain that a customer benefit is generated before the commit to furnishing data to the credit bureaus. These same executives are also interested in reporting stored value card information as well if doing so would benefit their customers. Again, this is an empirical question—one that industry is presently seeking to answer.

Insofar as remittance payments are common among recent immigrants and members of the low to moderate income cohorts with which our analysis is concerned, there is value to assessing its predictive power. However, because remittance payments are more cash-like, are relatively less universal than utility, telephone and cable payments, and because the industry is relatively fragmented, we believe that this data is less immediately useful than the alternative data sets that we've selected for our analysis.

While we are not immediately examining the value of remittance payment data, we are merging our analytical efforts with those of the Brookings Institution's Urban Markets Initiative, and their pilot program Payment Information Aggregation & Dissemination (PAID), and expect to be working on this issue for the next 18 to 24 months. Almost certainly we will have to visit the issue of remittance payment data, as well as related issues involving other alternative data sets. We would be happy to brief you or your staff on our ongoing findings, and are happy to serve as a resource to your and your staff as you give further consideration to ways to help those currently outside the national credit mainstream.

Sincerely,

Michael A. Turner, Ph.D.
President & Senior Scholar
The Information Policy Institute
306 Fifth Avenue, Penthouse
New York, NY 10001
+1 (212) 629-4557 x 11 NYC Tel.
+1 (919) 960-8081 N.C. Tel.
+1 (212) 656-1732 Fax
+1 (917) 709-6469 Mobile
turner@infopolicy.org
www.infopolicy.org

Giving Underserved Consumers Better Access to the Credit System:

The Promise of Non-Traditional Data

Information Policy Institute | **July 2005**

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Acknowledgments

The Information Policy Institute, an affiliated study center of the Policy and Economic Research Center, would like to extend a special thanks to Experian and Experian-Scorex for their expertise and technical assistance with our research.

Executive Summary

For borrowers, creditors, and data furnishers, the use of non-traditional data in consumer reports is likely to be a "win-win-win" scenario.

- **Borrowers:** Alternative financial data could enable the estimated 35 to 50 million American borrowers who don't have credit accounts, or whose credit histories have too little information to be used in allocating credit, to qualify for credit from mainstream lenders. The use of non-traditional data may also have an impact on consumers who are already part of the credit reporting system. By optimizing risk assessment, costs could be more equitably distributed among borrowers, reducing costs to responsible borrowers.
- **Creditors:** Alternative financial data would increase the ability of creditors to accurately assess lending risk. The results could include a reduction in bad loans, an increased ability to price loans to match risk, and higher performance rates for the entire loan portfolio.
- **Furnishers:** Alternative financial data would result in fewer delinquent payments and reduced charge-offs.

Despite its great promise, there are impediments to this type of information sharing. Both economic and regulatory barriers may deter many prospective data furnishers from reporting.

- Some would-be data furnishers unfamiliar with the reporting systems and the practices that mitigate customer poaching fear that sharing data will enable competitors to steal their customers.
- Some firms may have complex and incompatible legacy IT systems in place that would make the cost of updating their systems in order to report greater than any perceived benefits.
- Some states have statutory prohibitions on the onward transfer of customer data by regulated utility companies. In those states, no customer data from telephone companies, electric, gas, or water companies can be shared with credit reporting agencies as a matter of law.
- Utility providers in many states confront great regulatory uncertainty as to whether they are permitted to report data. Without clarification from state legislators or regulators, the fear of potential legal liability and public relations fallout acts to block sharing of customer data with CRAs.

Our findings in this study show that:

- **Utility and telecom data is likely to be most useful for Americans with little or no credit history:** Data from utility companies, especially telecommunications and energy firms, possess "credit-like" attributes. Therefore, it is potentially most useful in helping bring these Americans into the mainstream credit system.
- **Non-traditional data is very unlikely to negatively affect the credit scores of most Americans:** Serious negative information is already reported by utilities, telecommunications firms, and many other sources of non-traditional data through collection agencies. However, positive information, such as on-time payments, is not reported. Inclusion of positive information stands to reward most consumers by improving credit scores, and it promises to help those left out of the system altogether develop a payment history, thereby easing their access to traditional credit sources.
- **Prospective data furnishers need regulatory certainty:** Public service companies, such as utilities, are among those with the greatest potential to help underserved consumers gain access to credit. Yet, they confront great regulatory uncertainty concerning data sharing and would benefit from affirmative clarification from regulators or legislators of their ability to report data.

Introduction

Credit reporting fundamentals

How it works

In the late 1960s and early 1970s, a wave of consolidation swept the consumer reporting industry in the United States. The national credit reporting system that resulted, comprising the "big three" national bureaus, helped facilitate massive expansion of the credit card market observed in the late 1980s. By the 1990s, three factors, enabled by better risk assessment, contributed to yield a market for consumer credit in the United States, which is, by most standards, the envy of the world.

These factors were:

(i) Increased competition in part facilitated by the use of "prescreen lists";

(ii) Widespread use of credit scores to efficiently analyze lending risk and accurately establish pricing appropriate to the level of risk;

(iii) The growth of secondary markets as a means to refresh capital.

U.S. consumers have benefited immensely from these developments. While it is difficult to quantify the precise contribution of the changes in consumer credit described above, there is little question that they have played a significant role in homeownership growth observed during the past two decades, particularly among the "historically underserved." Between 1983 and 2001, the home ownership rate increased 25% generally and increased 65% among minorities during the same period.[1]

Access to credit brings additional benefits. Consumer credit helps new entrepreneurs launch their businesses. Small business owners often use revolving credit to finance their activities, either as a primary means or as an adjunct to other forms of credit.[2] Increased access to revolving credit, and increased ability to refinance home mortgages, gives families an ability to "smooth over"; periods of financial challenge. And finally, credit cards offer unparalleled convenience in the purchase of consumer goods.

Barriers to market entry for consumers with thin or no credit files

In addition to identifying information such as name, age, and address, traditional sources of data in a consumer report include:

- Information about credit accounts held by the consumer, including how long the consumer has had the line of credit, the credit limit or loan amount, balance, whether the account is a joint account, monthly payment, and payment pattern;

1 Federal Reserve Board, Survey Consumer Finances, 1983 and 2001. www.federalreserve.gov/pubs/oss/oss2/scfindex.html. Also see Hollis Fishelson-Holstine. "Role of Credit Scoring in Increasing Homeownership for Underserved Populations." Joint Center for Housing Studies of Harvard University. February 2004. www.jchs.harvard.edu/publications/finance/babc/babc_04-12.pdf.

2 In 1998, nearly 45% of small businesses (defined as those with fewer than 500 employees) used personal credit cards as a financing source. Marianne Bitler, Marianne Robb, Alicia Robb, and Wolken, John D. "Financial Services Used by Small Business: Evidence from the 1998 Survey of Small Business Finances." Federal Reserve Bulletin, April 2001, p. 192.

- Public records including tax liens, bankruptcies, state and county court judgments, and, in some states, child support payment delinquencies;
- A list of those who have obtained a consumer's credit report.

Access to credit depends on the ability of lenders to assess the risk associated with extending credit to a particular person based on the information in their credit file. This information is scored, then is evaluated by algorithms that measure the risk of lending. Credit scoring has become the principal means of risk assessment and is an important tool in determining appropriate account terms, including price. Scoring is an empirical and pragmatic process through which complex indicators of risk are objectively identified and evaluated to estimate with great accuracy the risk associated with a given loan. Credit scoring methodology is not the subject of this study and so is not discussed here. However, credit scores are the primary tool used by lenders today to evaluate credit risk and are an important aspect of underserved consumers gaining access to the credit marketplace.

A credit score cannot be calculated or lending risk be otherwise assessed if there is little or no information in a consumer's credit file. These consumers are often described as having a "thin-file" and have a difficult time accessing credit. Paradoxically, without credit to begin with, it can be difficult for such consumers to establish that they are creditworthy.

In most cases there are mechanisms by which thin-file consumers or those who lack credit history altogether may enter the credit market fairly easily. For example, parent-child joint accounts for bankcards help many of the young participate in the credit marketplace. Others, by contrast, do not transition so easily into the system. Uncovering the full set of causes as to why some do and others do not make that transition awaits research. Whatever the causes, the consequences can be significant for living standards, purchasing opportunities, and asset formation.

For most Americans, homeownership accounts for the bulk of savings. Rent is turned into equity through ownership and to a large extent becomes savings in the form of real estate assets. The irony is that because homeownership accounts for the bulk of assets, most Americans need to have access to credit in order to build substantial savings. This is especially true for poorer households, as the Survey of Consumer Finances regularly shows. For the whole of the American population, home equity accounted for 42% of all assets of those who owned their homes. This share increases as household income decreases. For the homeowner population in the bottom 20% of income, home equity accounts for 80% of their assets.

A second and equally pressing dilemma that stems from having no file or an unscorable file is the lack of access to revolving credit. The issue of revolving credit is thornier, as it raises fears of rising debt burdens. The other face of revolving credit is its use in small business activity. Many small business owners use personal credit cards to finance much of their activity, especially to manage cash flow bottlenecks. The Federal Reserve's survey of small businesses found this to be increasingly true in the 1990s. The share of small businesses using personal credit cards increased nearly 10% (or 4 percentage points) from 41% in 1993 to 45% in 1998.[3] This is particularly true for the smallest and newest of the small businesses.

3 "Financial Services Used by Small Businesses: Evidence from the 1998 Survey of Small Business Finances." Bulletin. April 2001. www.federalreserve.gov/pubs/oss/oss3/ssbf98/april2001bulletin.pdf, p. 192.

Inability to access credit may help explain lower levels of entrepreneurial activity among poorer segments of the population. Lack of information about credit risk, in turn, helps partly to explain the lack of credit for these consumers. It's clear that low levels of capital act as a hurdle to acquiring credit, just as lack of access to credit acts as a barrier to building assets. Helping consumers build assets then becomes an issue of helping them enter the credit system.

This structure creates serious challenges for many with thin or no files, though low income levels may explain the exclusion of substantial numbers from the credit reporting system. Without a credit history, lending risk cannot be assessed, typically through credit scoring. If their credit risk cannot be assessed, again, usually with a credit score, consumers cannot obtain the credit accounts necessary to build a credit history. Building a credit history initially is not especially difficult for most consumers, but for some, particularly those who lack an understanding of the credit system or who have few financial resources, it can be a significant obstacle.

Those with low incomes and who are left out of the credit system have a difficult time building assets. To a considerable extent this is because they cannot borrow. They have a hard time borrowing because there is far too little information on their credit history to predict risk. Note that this is true of those consumers with "thin-files" who are credit risky as well as those who are creditworthy.

The majority of those with unscorable thin-files or without files at all do in fact engage in activities that can be thought of as "credit-like." While not traditional credit agreements, most consumers have recurring relationships that entail periodic payments. Those relationships may include service provision agreements that require regular payment for the services or goods received. The regularity of these payments is often an indicator of how risky the prospect of lending to the consumer might be. That is, the vast majority of people in the thin-file segment of the population do demonstrate their sense of responsibility through various agreements to pay for regular services. For instance, virtually every consumer makes regular payments for rent, utilities (such as electricity, gas, telecommunications, and cable), and auto insurance. Payday loan installments are another possible example.

Data on these types of transactions, which are currently excluded from traditional consumer credit reports, comprises what is referred to as "non-traditional" or "alternative" data. Though this information is potentially predictive of an individual's credit risk, this information rarely reaches the credit reporting agencies. Moreover, this information may speak to the creditworthiness of consumers with little or no credit history. But were this information catalogued by credit bureaus, and, by extension, evaluated by lenders through credit decision models, these consumers may have less difficulty acquiring credit through conventional means.[4]

It is important to note that a history of positive information is what enables credit score developers, also called modelers, to develop systems that fully assess a consumer's likelihood of repayment. In other words, both negative and positive information is necessary for credit scoring systems to be effective. In many sectors that do not currently report positive information regularly, some negative data, such as defaults, are reported to credit bureaus. Most collection agencies report defaults to credit bureaus, so this information is available in credit files. The problem for those outside of the credit system is less the access to negative information about their

4 Interviews with the national CRAs confirm that information on auto insurance, rents, positive information on payday loans, and the like are not generally reported. Positive information on utility payments exists in some regions, but it is not a nationwide practice. Interviews with insurance and utility industry associations confirm that reporting to the CRAs is infrequent in much of the country.

payment history than the absence of positive information on credit files. Concerns that reporting by utilities may lead to negative consequences overlooks the fact that most serious negatives are either already reported directly to the bureaus or are reported via collection agencies.

The following is an analysis of the information sources that are the focus of attempts to bring underserved consumers into the credit system by reporting non-traditional data and the constraints facing these efforts. The Institute is planning a more thorough and quantitative analysis that will estimate the number of consumers who could enter the credit market and the amount and price of credit that can be extended by reporting non-traditional credit information. That analysis will quantify results by data type. The focus of this study, however, is generally qualitative. The first step of this study includes:

- An identification of the full range of prospective alternative data;
- An analytical framework for assessing the potential usefulness of each of the identified alternative data sets;
- A discussion of which parties may benefit from the use of alternative data in consumer credit reports and the nature of those benefits;
- A discussion of which parties may incur costs from the use of data in consumer credit reports and the nature of those costs.

After a discussion of the use of non-traditional data in consumer credit reporting and its potential benefits, the study examines the economic, technological and regulatory hurdles to doing so by sector and type of information. We examine the current treatment of non-traditional data sources and explore regulatory and practical concerns associated with the use of non-traditional data in consumer credit reports and scoring. Specifically, we look at problems of reliability, verifiability, and predictability (relative to traditional sources) of prospective sources of non-traditional data.

Keep in mind that the successful use of alternative data may not only help extend credit to currently underserved groups, but it may also move them into spheres where traditional data furnishers would also have information about them. In short, it promises a means to help many of the underserved clear current barriers to the credit market.

Should alternative data be integrated into consumer credit reports, the effect of this new data will not be limited to thin-file and unscorable Americans. For those with scorable files, non-traditional data can help to generate a better risk profile. A wider view of a consumer's payment habits, including rent, utilities, cable, etc., potentially could paint a better picture of a consumer's overall risk profile. The use of non-traditional data for thick-file consumers, in creating more accurate risk profiles, can help to reduce cross-subsidies from less risky consumers to riskier ones. That is, it can help make the system fairer by limiting the extent to which responsible consumers pay the cost for less responsible consumers. However, the effect of non-traditional data on the risk profile of "thick-file" consumers may be very small.

Population of thin-files

Estimates of the size of the population with "thin-files" or with no files vary. Yet, even the most conservative estimates place the number in the tens of millions. Fair Isaac Corporation estimates that 54 million Americans lack credit files that can be scored in order to access credit. Of these, 32 million have files that are too thin to score, and 22 million have no files at all. Experian® estimates that nearly 18 million Americans have files too thin to score and that another 17 million have no files at all.[5]

These consumers form the "underserved" market. Surveys find them concentrated among minorities (notably, among African Americans and Latinos), the poor and other low income segments, the elderly, recent widows, and new immigrants (including illegal immigrants).

A demographic breakdown of those without bank accounts serves as a proxy for unscored thin-files and no files. Approximately 9.7% of households in the United States have no bank accounts. Of these, 32.9% are African American. Compare this to the fact that African Americans represent 12.2% of the population.[6] Similarly, Latinos account for 19.6% of those without a bank account but represent 13.7% of the population. By income segment, those without bank accounts are predictably concentrated among poorer households. More than half (50.5%) of these households make less than $10,000 annually, and another 35% earn between $10,000 and $25,000 per year.

Alternative data use for modeling

It is impossible to assess the predictive value of non-traditional data ex-ante — in other words, without actually collecting the information, constructing models, and assessing their performance. However, it is possible to make some reasoned speculations as to which types of data are likely to have the greatest usefulness for credit risk modelers.[7] One of the most important ways to look at alternative data is to assess whether or not that data type is "credit-like." In essence, the question of whether or not a category of data is "credit-like" hinges on a simple question: Were goods provided at the time of payment? If a service or good is provided in advance of the receipt of payment, then we deem it to be "credit-like."

By virtue of this quality, not all regular payments are "credit-like." A second aspect of some of these relationships is that, even if they are not strictly credit-like in the sense described above, there is an agreement to pay for services over time on a regular basis. If in these cases the service provider may terminate services for non-payment immediately, it can be thought of as somewhat more "cash-like," as sanction for non-payment is immediate. Conversely, the more difficult it is for a service provider to terminate the provision of service to a delinquent consumer, the more "credit-like" the relationship. The quality of being "credit-like" is therefore not simply a formal aspect of the payment structure but also results from the practical aspects of sanctions in the event of non-payment at the agreed-upon time.

5 The estimates vary widely because two different proxies are used. FICO uses the proportion of "unbanked" consumers as measured by the Federal Reserve as a proxy for unscorable files. W. A. Lee, "Eyeing the Unbanked: Fair Isaac Starts Bureau of its Own." American Banker, July 8, 2004. Experian bases its estimate on the number of credit-eligible people in the United States and subtracts its estimate of scorable files.

6 Federal Reserve Board, "The Unbanked — Who Are They?" Capital Connections, Vol. 3, No. 2. (Spring 2001) www.federalreserve.gov/dcca/newsletter/2001/spring01/unbank.htm.

7 The CRAs, as well as some lenders, have some preliminary assessments of the predictability of some classes of non-traditional data for some credit instruments. These are still being developed and, moreover, can be expected to vary by credit type. Although, all of those who have run tests with utility information indicate that it is predictive.

We can expect that consumer behavior on credit-like services is likely to be predictive of their behavior on actual credit products. It is also possible that data on regular payments where the transaction is more cash-like may also strongly speak to a consumer's creditworthiness, in so far as these activities may serve as a proxy for a consumer's financial responsibility. Ultimately, whether or not and to what extent a particular category of data is predictive of a borrower's likeliness to repay a loan is an empirical question. But the universe of credit-like data that theoretically could be used to assess one's creditworthiness is larger than one might think.

In this paper we consider a number of broad categories of data that are currently absent from credit reports but might be sufficiently credit-like to have predictive value for lending decisions. The categories of data that some have considered as potential sources of non-traditional data are:

- Energy payments (water, electric, gas)
- Telecommunications (landline, cellular, Internet, cable television)
- Auto liability insurance
- Homeowner's insurance
- Rental payments
- Child care payments
- Payday loans
- Healthcare payments
- Certain types of retail payments (e.g., furniture rental data)

Energy, telecommunications, payday loans, and retail installments are credit-like in the sense described above. Auto liability insurance and child care payments are not. Regular payments that are not *credit-like may be of use to modelers at some point, but credit-like information offers the most promise.* Credit-like services are most promising not necessarily because they are more predictive, but rather because those who offer credit-like services have a greater incentive to report than those who offer cash-like services. In a voluntary reporting system, it is important to take into account the incentives to report. It offers the most promise in so much as those who offer credit-like services have a greater incentive to report than those who offer cash-like services, not that they are necessarily more predictive. And in a voluntary reporting system, it's important to take the incentives to report into account.

While the pros and cons of these data types are considered more rigorously below, it is useful to think about these data types in terms of how they might or might not be credit-like. For example, consider rental payments. While rental payments are typically paid in advance, often on the first of the month, it is rare that eviction proceedings will immediately follow non-payment. But because renters often do fall behind in their rent without immediately being evicted, there is a credit-like quality to rental arrangements. Furthermore, not only is rental data often credit-like, rental payments are analogous to mortgage payments in that the sanction mechanism is almost identical: failure to repay one's mortgage will ultimately culminate in foreclosure, whereas failure to pay one's rent will result in one's eviction.

A stricter, less credit-like logic is at play where the sanction is severe and immediate. For instance, were telephone companies permitted to terminate service for non-payment immediately, it is unlikely that consumers, except those in the most dire financial situations, would fail to make timely payments. As such, it is likely that, in general, services where non-payment results in immediate and severe sanction are decidedly more cash-like than credit-like. As mentioned, in these instances the disciplinary effect of reporting is seemingly small — moreover, service providers do not take a loss — thus the incentive to report is small.

Open questions regarding the credit- or cash-likeness for some types of data remain. For example, people may be far more responsible with payments for daycare, as concerns for children and for getting to work are affected immediately. Experience may show that payday loans are a good predictor of consumer payment behavior. But then again, it may not. There is no systematic evidence as to whether one type of information is more predictive than another. *Ultimately, these are pragmatic and empirical questions that can be answered only in practice.* Modelers have incentives to select those data types that are predictive and reject those that are not, as access to credit, the pricing of credit (and thus profit), and the security of the principal depend on the reliability of the information.

What most candidates for viable types of non-traditional data share is the character of the obligation. There is an agreement of payment for service of some kind. Ideally, the relationship is regular, though notably payday loans are not regular for the most part. In some instances, payment is received prior to the receipt of services, such as rent, in which payment is for the month following, but the failure to receive payment does not automatically terminate the receipt of service. In other instances, such as utilities and telecommunications and payday loans, payment is received *after* services are offered. In all instances, these relations promise to offer some predictive value to an individual's likelihood to repay a loan.

The emergence of information sharing mechanisms

Identifying sources of potential, non-traditional data is not enough to bring the underserved into the credit system. Empirical analysis must establish that alternative data holds predictive power with respect to the likelihood of default. Even if the predictive value of non-traditional data is established, there still are hurdles that must be overcome before the data can be used — economic, regulatory, and technological. Moreover, because the system is voluntary, the incentive to report and collect data must be considered.

We know from experience something of how a robust reporting system can emerge. Not only must non-traditional data have predictive value for lenders and other users of credit reports, there also must be some clear rationale for those who have the data — for example, utility companies or landlords — to invest the time and money necessary to provide that information to credit bureaus. We discuss briefly here how these information sharing mechanisms arose among financial institutions.

In Europe, information sharing mechanisms among banks were created more or less by legislative fiat. By contrast, in the United States the credit reporting system arose in the private sector without government intervention. Lenders are not compelled to furnish consumer data to the three national bureaus. Instead, financial institutions have concluded that voluntarily providing such data to the bureaus is preferable to hoarding the data and shielding the information from their competitors.

Credit bureaus offer financial institutions a comprehensive picture of borrowers, improving the ability to predict the likelihood of repayment. This allows lenders to market and price their loans to reflect the risk of the individual applicant.

By contrast, some of the proposed furnishers of data cited as possible sources of non-traditional data have a much less obvious incentive to furnish to the national credit reporting agencies. One argument, in its simplest form, holds that because rental agencies, utility providers, and other oft-cited potential sources of data do not offer traditional credit products, they are unlikely to see any benefit in providing data to the national credit repositories.

The experience of lenders suggests one incentive for non-traditional data sources to furnish information. Beyond providing a means with which to better evaluate applicants, credit reporting also had an additional benefit to lenders. It creates an incentive for consumers to pay loans on time. While a consumer could still default on loans, the price of doing so is an increase in the cost of future borrowing, at best, or denial of future credit, at worst.

A study of Nicor Gas Corporation's experience with credit reporting showed that the utility reduced its number of delinquent payments by 20% when consumers understood that their payment information was being reported.[8] Once aware that payment history has an impact on future access to credit, consumers have incentive to pay on time. They understand that their payment behavior will affect their access to credit and the price they pay for it.

8 TransUnion, "TransUnion Case Study: How reporting helped Nicor Gas reduce bad debt." (Chicago, Il: TransUnion, 2002).

The Analytic Framework to Assess Alternative Data

Reliability

Credit reporting agencies must be confident that the data they receive from lenders and other sources is reliable for two reasons. First, and by far the more important, any proposed new type of trade line would have to yield usable predictions about "thin-file" or "no-hit" applicants. If the data is not reliable for making sound credit decisions, it is not beneficial to lenders or consumers as part of a credit report. Second, unreliable data increases the rate at which consumers dispute the contents of their credit reports. The dispute process is costly to both bureaus and furnishers who must verify reported data as required by the FCRA. Significant increases in dispute rates would require bureaus to increase their capacity for handling consumer disputes.

In general, the value of any type of data is purely an empirical matter determined by the construction of a model that is subsequently measured against actual loan performance. When considering non-traditional data, there are some additional factors that must be given weight and that we have grouped under the heading of "reliability." Specifically, these factors are accuracy, standardization, and expected regularity.

For "thin-file" and "unscorable" applicants to become eligible for credit, some sort of regular series of positive credit-like behaviors must be catalogued. For those already served by credit, the most important source of this kind of data is regular loan payments. For both groups, the addition of infrequent, inaccurate, or non-standardized data sources will have little or no positive impact on credit access.

Reliability in the sense of accuracy

Payment information must be an accurate account of the applicant's behavior. Has the consumer paid on time? Was the payment in the full amount? If the payment was late, how late was it? Did the consumer in fact default, if he or she defaulted on a payment?

Central to this assessment is the quality of recording payments by the data furnisher. The quality of payment records also eases the reverification process in the event of a dispute. Data furnishers and consumers may have differing accounts of whether a payment was made, in what amount, and on what date relative to when a payment is due.

Reliability in the sense of expected regularity

In order to model the payment activity of consumers, a decision model requires a steady stream of information on a payment line. One CRA suggests that information that is sporadic decreases the usefulness of the trade line in models.[9] One purpose of a model is to assess how timely payments are likely to be. A reliable and regular history of payments is needed in order to make this assessment. If much of the data associated with a trade line is missing, the account itself tells very little about the risk associated with a consumer.

9 Interview with the CRAs.

We should, however, include the caveat that we are discussing ongoing obligations. Financial "events," such as bankruptcies, tax liens, and collection activities, tell lenders quite a bit about the creditworthiness of a borrower. But with respect to using non-traditional data to expand credit access for the traditionally underserved, the dilemma is the lack of a sufficient amount of positive information about timely payments. Regular positive information helps to "thicken" files and thereby expand credit access.

Reliability in the sense of standardization

The third way in which data is deemed reliable is whether it is or can easily be standardized. Standardization and computerization reduce reporting errors. They also enable the use of software that greatly reduces the marginal costs associated with reporting data. Data furnishers enjoy similar efficiency gains from standardization. For instance, in the event of dispute proceedings, where the veracity of disputed items must be verified by the furnisher, standardized data helps speed the process.

Most important, standardization improves the accuracy of data, making it more useful to lenders and other users of credit reports. Standardized formats of reporting include the Consumer Data Industry Association's (CDIA's) Metro2.™ Similarly, standardized reverification formats, such as CDIA's eOscarWeb™, serve to reduce the cost of disputes and make correction of misreported data easier and faster. These technologies also improve the regularity of reporting by automating the transmission of data from furnisher to bureau.

Implementation costs

There are the implementation costs associated with reporting data. Fragmented industry sectors may have greater implementation costs of standardized business segments than non-fragmented sectors. Some sectors may have legacy systems that do not permit automated reporting and reverification. Their reporting costs may be greater than those of comparable firms with newer systems. Others, though concentrated, may have fragmented billing systems. Finally, some sectors may face greater political pressures, as with public companies or public service firms. These issues must be kept in mind when identifying sources of non-traditional data and when considering regulatory changes.

Analytic framework for evaluation

The following criteria were used to evaluate the potential impact of alternative data sources.

The first consideration was the extent to which a category of data furnishers are concentrated. This is best thought of as a sector's consumer to data furnisher ratio or the number of consumers per data furnisher, whether we think of these as a single company or as a billing system. Some sectors (for example, leased parking spaces) involve relatively few consumers for each provider (lessor) of a service. By contrast, electricity providers have a very large number of consumers per furnisher, as electricity providers tend to enjoy regional monopolies.

In general all utilities — electricity, gas, cable, water, telecommunications — are generally characterized by a relatively large number of consumers per data furnisher. One utility company can provide service to millions of households. But from an implementation standpoint, it is the number of consumers per furnisher that offers an idea of the initial setup costs. For example, a provider may have dozens of billing systems and cycles, factors that make reporting more difficult. Large providers can unify their systems but will only do so if the perceived benefits of reporting exceed the perceived implementation costs.

The importance of the ratio is that it gives us some idea of:

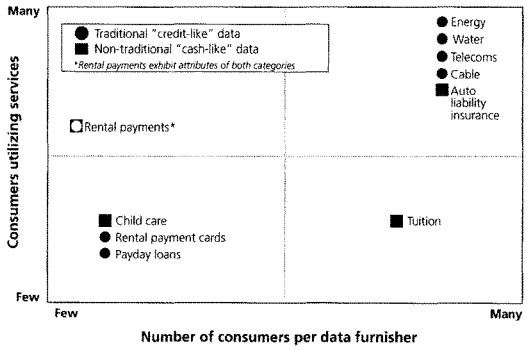
- The costs of reporting on consumers, especially the average cost per consumer;
- The chances of diffusing standardized and computerized reporting formats and systems (such as CDIA's Metro2 format and the eOscarWeb verification system);
- The reliability of information.

For example:

- Large enterprises, which provide services to tens of thousands of consumers, can reap economies of scale in reporting full file. To see why, compare the limitations to reporting that an electric company servicing a city faces with those faced by an individual who rents out a duplex to two families. The former, in all likelihood, already possesses a computerized and unified billing and payment system, whereas the latter is unlikely to use one. The cost of the reporting system and thus the cost of reporting per customer are small, as scale economies obtain greater size. For the latter, these costs may be significant, especially in terms of time and learning.
- Implementing a standardized reporting format in firms that service a large number of consumers is relatively easy. They possess departments that have expertise in billing and information technology. Small-scale service providers, by contrast, are not integrated so effortlessly. This is not to suggest that large providers with fragmented billing systems and different cycles and/or legacy systems will find the transition without cost. Rather, a centralized billing system that serves thousands of consumers enjoys economies of scale in reporting and reverifying data, in the event of disputes, making reporting easier along a key dimension.
- A major problem with smaller, fragmented service providers, such as lessors, is that there is a great chance that the information they provide may be unreliable. In the case of rental payments to small landlords, payments are tracked largely informally, and cancelled checks serve as receipts. The additional problem of unverifiable disputes (a possibility in the absence of a computerized payment system and institutionalized payment processing) also creates disincentives for small-scale providers, given that expected data furnisher liability may be significant.

The second consideration is whether services targeted as potential sources of alternative data are used by large segments of the population regularly — that is, the extent to which the service covers a significant proportion of consumers. Rent and utilities are relationships that the vast majority of thin-file consumers are likely to have. That is, these are relationships that most of these consumers are likely to have on an ongoing basis that provides a regular stream of information, unlike, say, payday loan advances or tuition payments.

The following figure illustrates the value of various alternative data sources along these two key dimensions: number of consumers utilizing services and number of data furnishers.



Note that the data is far more likely to be reliable and easier to furnish with a high number of consumers utilizing services and many consumers per furnisher. As the scope of consumers who engage in the type of activities (and hence are covered by information) moves from few to many, or near universal consumer utilization, the information category becomes more valuable in bringing the underserved into the mainstream credit system.

Using this schema, it becomes clear that payment information from utility companies and telecommunications firms exhibits "credit-like" characteristics and both would be highly reliable and would cover large shares of those with thin-files and no files.

While the majority of those with thin-files pay rent, landlords are highly fragmented. Thus, a reporting system that produces reliable information and elicits the participation of landlords faces significant hurdles. Potential solutions to these hurdles are discussed later in this study.

The most common example of a non-universal type of payment maintained by reliable sources is tuition. Tuition payments cover a smaller share of the population with thin-files. Most of them, like most people in any income range, are not in school at any given time and, moreover, the data will not be perpetual. Students are largely in school only for a few years, and the value of the data will diminish over time. For those in school, the data can assist in accessing credit and moving from non-traditional sources to traditional ones.

Finally, payments like payday loan advances and child care payments are problematic in that they are types of payments made to many small and often informal service providers. Although payday loan services generally have reliable computerized record systems that track payments effectively, and that market is becoming increasingly concentrated, it still is highly fragmented by any conventional measure.

The purpose of the schema above is not to discard some types of information and endorse others. Rather it is to help identify the kinds of problems that must be overcome in order to utilize alternative data in the context of the potential value of the information type.

That said, the framework does allow us to evaluate the relative costs and benefits of different prospective alternative data sets. The analytic typology or framework suggests that data furnished by firms characterized by a large number of consumers per furnisher and that involve are nearly universal services (because most households with thin-files consume them) are good candidates for rapid success.

Data about non-universal services provided by fragmented suppliers, rather than being ignored, should be the focus of resources and further efforts to introduce standardized reporting, or a system of recording payments (perhaps through banks), in order to capitalize on its potential value.

Finally, there is an empirical matter of whether the information itself is predictable and usable. *Predictability*, to reiterate, is an empirical issue and requires that the information itself be tested by various models. *Usability* is a different matter and refers to issues of standardization, regularity, reliability and accuracy.

Some practical concerns

Does the data speak to the underserved?

One key reason for using non-traditional data in a consumer credit scoring model is to help underserved consumers enter the credit system. Therefore, it is important to examine whether or not these types of alternative data capture those with no files or files too thin to score. For instance, health insurance payments may be an excellent predictor of risk, but if there is very little overlap between those who purchase health insurance and the underserved, then the information from this sector is not going to assist them. This is not to say that there are not good reasons to include in reports currently excluded information that covers primarily those with scorable files. As mentioned above, doing so makes the models more predictive and may reduce the cross-subsidy from low-risk consumers to high-risk consumers. But for non-traditional data to help the underserved, it must come from sources that serve these populations.

Data furnisher implementation costs and obligations

There may be sector-specific hurdles and disincentives to reporting. The incentives for data furnishers to report depend on implementation costs and the reliability of information, in order to minimize dispute costs. The costs of implementation of a reporting system include training and the adoption of reporting procedures and mechanisms. As noted, there are standardized formats for both reporting and reverifying information in the event of disputes. These are costs that all potential furnishers have to consider. The average cost of reporting and handling disputes is, as suggested above, smaller for larger companies. Much of the costs are fixed. Those start-up expenses include standardization, training, and the diffusion of techniques and software to report and verify data.

Many costs may be quite peculiar to an industry. Some firms do not know what the level of disputes will be. The practices of some sectors, particularly those seen as public service companies, may be quickly politicized. Energy providers are an example.

Finally, data furnishers are legally compelled under the Fair Credit Reporting Act FACT Act to reverify disputed data promptly in the event of a dispute.[10] The law also imposes certain liabilities on data furnishers. Moreover, FACT Act regulations may ultimately require data furnishers to provide a dispute resolution mechanism directly to consumers. Such a regulation could deter some prospective data furnishers from participating in the voluntary consumer credit reporting system. While these concerns are not all directly related to data reporting, they might give pause to some firms that may expect a higher rate of disputes than firms in the financial sector.

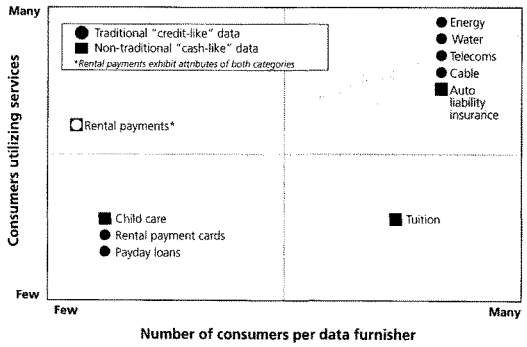
10 15 U.S.C. § 1681.

Analysis

Evaluation of types of data by category

In examining the different sources of alternative data, we interviewed a number of potential data furnishers and some of their trade associations, especially in the utility and insurance sectors. We also interviewed a number of data repositories and CRAs about their efforts to reach the underserved. Finally, we discussed the issue with prospective lenders who are seeking information on underserved segments. The discussion that follows is organized by sectors, which is in turn categorized by their level of concentration and the scope of the consumer population they service. The sectors we examine looked at the issue and/or had initiatives aimed either to provide data or access data on the underserved. In other words, some firms in the sector and/or industry trade associations had examined sharing consumer data, either as part of efforts to bring the underserved into the credit system or for other business reasons. We did not find any companies with a large number of consumers per furnisher but with non-universal scope that had examined reporting payment information. This is most likely because the sector we categorized as such — tuition — is not credit-like. As we noted, whether a trade relationship is credit-like or not affects the incentive to report.

Many consumers and concentrated sectors: Utilities



Utilities

Of the potential sources of non-traditional data, utilities cover the largest number of people. The vast majority of households (more than 90%) have electricity, water, and telephone service. Nearly 68% have cable television.[11] The former three are, for all intents and purposes, essential services in the United States and are regulated as such. These are also the most likely types of unreported payment information to capture the underserved. Unlike rental data, which similarly promises to reach the underserved, these sectors are very concentrated. That is, a handful of potential furnishers serve a large number of consumers.

11 National Cable and Telecommunications Association, Industry Overview. www.ncta.com/Docs/PageContent.cfm?pageID=304. Source: Nielsen Media Research.

In 1997, there were 1,286 electric power transmission, control and distribution firms,[12] 651 natural gas distributors,[13] and 3,428 water supply firms.[14] Moreover, the 50 largest firms accounted for 77.7% of the market for electric power transmission, control and distribution,[15] 86.2% of natural gas distribution,[16] and 72.3% of water supply.[17] Similarly, six firms account for 90% of the local telephone lines provided to consumers. One consequence of this highly concentrated structure is that the diffusion of reporting and verification technologies is easier.

Utilities, of course, are not all alike. Cable television, despite a significant penetration rate, remains a choice and not a necessity. Furthermore, cable rates are less likely to become politicized than electricity rates. But in terms of the differences that are salient to reporting by utilities, some utilities have a ready disciplining mechanism in the ability to cut off service. This is important because one of the principal incentives for utility providers to provide data to the bureaus is to improve their ability to discipline consumers who pay late and, in turn, to improve the timeliness of payments. Where disciplining mechanisms are already in place, reporting data is less attractive.

In general, the most common disciplining measure is to cut off services. But many utility providers cannot terminate or suspend service very easily. Regulations that view these services as essential require that some measure of service be maintained — for example, dial tone and life line services in telecommunications or electricity during the winter months.

In sectors where it is difficult to turn off service, payment histories may better reflect the risk associated with a consumer. This is because consumers will prioritize payments where services may be cut off promptly by a provider, particularly where they deem that service essential.

The telecommunications and energy sectors are worth examining closely. There are other sectors in this category, such as water and cable. However, we focus here on telecommunications and energy because they clearly illustrate regulatory and economic hurdles that may impede reporting of alternative data.

12 U.S. Bureau of the Census, Establishment and Firm Size: 1997 Economic Census, Utilities. (Washington, D.C.: US Department of Commerce) p. 24, www.census.gov/prod/ec97/97t22-sz.pdf.

13 U.S. Bureau of the Census, Establishment and Firm Size: 1997 Economic Census, Utilities. (Washington, D.C.: US Department of Commerce) p. 25, www.census.gov/prod/ec97/97t22-sz.pdf.

14 U.S. Bureau of the Census, Establishment and Firm Size: 1997 Economic Census, Utilities. (Washington, D.C.: US Department of Commerce) p. 27, www.census.gov/prod/ec97/97t22-sz.pdf.

15 U.S. Bureau of the Census, Establishment and Firm Size: 1997 Economic Census, Utilities. (Washington, D.C.: US Department of Commerce) p. 46, www.census.gov/prod/ec97/97t22-sz.pdf.

16 U.S. Bureau of the Census, Establishment and Firm Size: 1997 Economic Census, Utilities. (Washington, D.C.: US Department of Commerce) p. 47, www.census.gov/prod/ec97/97t22-sz.pdf.

17 U.S. Bureau of the Census, Establishment and Firm Size: 1997 Economic Census, Utilities. (Washington, D.C.: US Department of Commerce) p. 48, www.census.gov/prod/ec97/97t22-sz.pdf.

Telecommunications

Telecommunications firms have had historically few restrictions against providing information. In previous decades, when telecommunications was dominated by the AT&T monopoly, service providers could deny dial tone service for non-payment. The disciplining effects of credit reporting negatives were extremely small compared to that of cutting off service. Changes in regulation, resulting from the recognition of the importance of telecommunications in everyday life, made it harder to deny dial tone service for late payments. The result is a renewed interest in reporting positive and negative data to reward consumers who pay on time and sanction those who do not.

Like other utilities, telephone service is characterized by a wide coverage rate and relatively few service providers. This is less true of wireless services, but wireless is also characterized by relatively few providers and increasingly wide coverage rates.

Approximately 93.8% of all households have at least one telephone line.[18] Between 88% and 89% of households that earn between $7,500 and $12,499 have telephones. Furthermore, the industry, while far more competitive than in years past, is characterized by a relatively small number of players. A handful of firms serve the vast majority of households. The 1997 Economic Census showed that 50 telecommunications firms accounted for approximately 90% of the market. This figure does not distinguish between residential and business markets for telecommunications, but the shares appear consistent for the residential sector.

Nearly 1,300 firms have provided telephone services. Their sizes vary from small, rural, local exchange cooperatives that serve fewer than 100 households to very large firms that serve millions. The FCC counted 28 large telephone service providers (those with more than $123 million in revenues) and an additional 26 medium-sized ones. These 54 firms accounted for roughly 90% of local telephone lines provided by the local exchange carriers in 2003.[19] Assuming that 10%–12% of telephone lines are provided for by competitive local exchange carriers, between 83 million and 84.5 million households would be covered by these 54 firms. Each firm could report on hundreds of thousands of households. Wireless, while covering fewer American consumers, also shows wide coverage and relatively few providers.

The fact that there are relatively few providers who serve relatively large numbers of consumers means that diffusing standardized reporting and reverification formats can be comparatively easy and quick.

However, there are concerns telecommunications firms wishing to report payment data would have to consider. These concerns include the possibility that providing such data to the bureaus would enable "poaching" by competitors and whether or not consumers would switch providers because of reluctance to have their payment behavior reported.

One large telecommunications provider we spoke to suggested that the fear of "poaching" good customers is, at most, a minor concern. Whether some consumers would switch providers in response to reporting appears to be more worrisome to providers. Given that programs are at very preliminary pilot stages, there is no evidence for consequences in either direction, and the concerns remain based on speculation.

18 Alexander Belinfante, "Telephone Subscribership in The United States" (Washington, D.C.; FCC, October 2004) p. 6, www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/subs0704.pdf.

19 FCC, "Statistics of Communications Common Carriers." (Washington, DC: FCC, 2004) pp. iii-iv. www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/SOCC/03socc.pdf.

One possibility is that consumers prone to switching as a result of chronic late payment will switch to a non-reporting service provider. If so, telecommunications companies that report payment data will tend to be left with consumers who pay on time. Another possibility is that reporting may attract consumers who are risk averse and wish to receive the additional benefit of improved credit scores for their timely payments.

By contrast, if consumers switch for reasons of privacy or discomfort about reporting payment data, companies run the risk that reporting will lead to a loss of revenue.

The telecommunications sector appears to be encouraging a trend toward reporting. There are pilot programs and experiments underway that will enable potential furnishers to judge the value of furnishing data. Those examining reporting consumer payments are aware of the results of Nicor Gas's experience that reporting can reduce charge offs.

There are regulations that prevent telecommunications firms from reporting in some states. California's Public Utility Commission, for example, forbids telephone or telegraph corporations from disclosing a consumer's credit or financial information to any entity except to a "electrical, gas, heat, telephone, telegraph, or water corporation, or centralized credit check system, for the purpose of determining the creditworthiness of new utility subscribers."[20] However, these restrictions appear to be quite rare (see Appendix). On the other hand, regulatory uncertainty, even in the absence of legal barriers, may give some potential furnishers pause.

Economic hurdles present the largest concerns for the firms that we interviewed. To the extent their billing systems are current and unified, and their billing cycles are not fragmented, implementation costs are likely to be relatively small. Initial costs may be substantial to the extent that billing systems are fragmented, systems are antiquated, and/or billing cycles are multiple. In any case, once the system is set up, the marginal costs of reporting are very small, as are the costs of computerized reverification systems in the event of disputes. However, a significant reduction of payments in arrears as consumers become aware that their payments are being reported may offset these costs. Some local exchange companies have begun pilot projects to test credit reporting, largely driven by the promise of better economic performance and offering consumers additional benefits.

In short, some major telecommunications providers have begun exploring the idea of furnishing customer data to credit reporting agencies. While competitive concerns don't pose a significant barrier to reporting, there are some inter-related regulatory and economic concerns, particularly those relating to data furnisher obligations and consumer dispute settlement processes. Additional data furnisher obligations, such as enabling consumers to dispute data directly with the furnisher, could deter some telecommunications firms from furnishing in a voluntary system.

Public utilities

Public utilities are perhaps the most promising of the prospective sources of alternative data that we examined. The vast majority of households make monthly electricity, gas, oil, and water payments. As noted above, the industry is concentrated. However, public utility companies are, by and large, reluctant to enter into the

20 California Public Utilities Code Section 2891-2894.10.

reporting system, except as purchasers of credit reports. There have been various attempts over the past decade to bring utility service providers into the reporting fold. Because these services are nearly universally consumed, they are highly likely to yield information on underserved consumers. Importantly, various modelers have suggested that the information is very predictive.[21]

The handful of instances in which utilities have reported to the credit bureaus offers some indication of the consequences. Nicor Gas's experience has been a positive one in the form of lower rates of late payments and relatively low costs in implementing a reporting system. Yet, regulatory and economic hurdles remain, and in some instances these hurdles intersect. Moreover, there are public relations concerns.

Regulatory issues in the states prevent the reporting of information to credit reporting agencies. There are three broad types of regulatory hurdles to reporting. First, there may be a straightforward proscription against sharing consumer information without the consumer's explicit consent. Statutes may forbid the sector from sharing information. Stat law may also prevent state-owned firms from sharing information about consumers in a context in which they own utilities. New Jersey laws present such an instance.[22] As with telecommunications, these are largely rare.

Second, regulations may be contradictory or vague, and jurisdictional authority can be confused. For example, Ohio permits certain public and private agencies to share consumer information "in connection" with credit reporting.[23] Some states share regulatory authority with municipalities, creating confusion. Finally, states may also have to clarify regulatory obligations when state laws govern spheres of activity that are not federally preempted.

The regulated nature of public utilities may create yet another disincentive to furnish information. Savings in many states may have to be passed on to the consumer, given that rates and profits are largely regulated. Benefits for energy providers in the form of the reduction of non-payments may not be reaped by the companies themselves in some settings.

The overall problem of regulation lies not so much in the existence of laws that prohibit sharing of data but rather in the absence of laws or clear statements that allow the sharing of data. Because energy providers are heavily regulated firms, regulatory uncertainty makes many of them unsure of reporting. Public utilities are heavily scrutinized by public officials and the public and often need a clear message from legislatures before undertaking reporting trials.

Inquiries conducted by the Institute confirm speculation that the regulatory barriers to utility reporting tend to be *de facto* rather than *de jure*. Our inquiries also confirm that uncertainty about the disposition of regulators is probably the principal "regulatory" barrier to the provision of regular payment data by utility providers. Of 21 states assessed by the Institute, only two states, California and New Jersey, have public utility commission rulings that preclude the reporting of payment data to the bureaus. In the case of California, these restrictions extend

21 Interviews with CRAs and major lenders.

22 Electric (NJSA 48:3-85); gas (NJSA 48:3-85); and cable (NJSA 48:5A-57).

23 Ohio Admin. Code Sections 4901:1-10-12; 4901:1-21-10.

only to telecommunications. In Texas, a bill is pending that would broadly restrict the ability of utilities to report. Communications with regulators in California suggest that energy providers do regularly request the California Public Utility Commission (CPUC) to officially sanction the reporting of consumer data. The CPUC, in turn, would prefer a clear directive from the legislature. In Delaware, where no regulatory barriers exist, regulators several years ago requested that a gas company cease reporting to the bureaus. (See Appendix for a summary chart of Institute inquiries.)

Auto liability insurance

Insurance payments, the timeliness of which is not reported, are another promising source of alternative information. It should be reiterated that these payments are not credit-like, which affects the incentives to furnish this data. The consumption of insurance is widespread. However, it is unlikely that the underserved (thin-filed and no-filed) consume most insurance products. A major exception is auto liability insurance. Nearly every state in the union requires that car owners have auto liability insurance to cover bodily and property damage in the event of an accident.[24] In 2000, approximately 86% of all American households owned at least one car. While the share of households owning cars drops with income, 63.4% of the lowest quintile and 85.4% of the second lowest quintile of households own a car.[25] It should be noted that there are many uninsured drivers.

Auto liability insurance, like utilities, promises to cover a significant number of households that have no-files or very thin-files. Automobiles are needed for daily life in many parts of the country, and again, nearly every state requires car owners to purchase auto liability insurance.

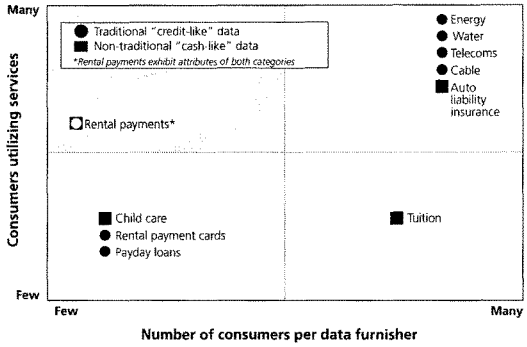
The incentive structure for reporting, at least on the surface, resembles many utilities. Insurance can be suspended or cancelled upon non-receipt of payment. It differs to the extent that payment is received before coverage begins. However, an insurance company that reports to the bureaus will not improve its ability to discipline consumers who are delinquent on their payments, which is a crucial element of the incentive structure to report. But, reporting may serve to attract very responsible consumers who wish additional benefits for paying on time.

Insurance is heavily regulated, especially at the state level. Furthermore, the issue of insurance and reporting is politically charged, given the use of credit reports in insurance underwriting. Finally, there are competitive concerns of poaching for insurance providers, especially considering that credit reports are widely used in the sector and large players dominate.

24 New Hampshire, Tennessee, and Wisconsin are exceptions. They all do assign financial responsibility to motorists in the event of an accident. Tennessee requires proof of financial responsibility, even if pulled over. See the summary of state requirements listed by the Insurance Information Institute, http://www.iii.org/individuals/auto/a/canidrive.

25 U.S. Census Bureau, "Asset Ownership of Households: 2000." Table 2. Asset Ownership Rates for Households, by Selected Characteristics: 2000 www.census.gov/hhes/www/wealth/1998_2000/wlth00-2.html. It is possible that the lower rates of automobile ownership among lower income Americans is at least in part attributable to the relatively high portion of which live in urban areas with readily available substitutes, such as publicly funded mass transportation and taxi services.

Many consumers and unconcentrated sectors: Rental data



Rental relationships, like the purchase of utility and telecommunications services, are widespread. As of 2004, approximately 31.4% of households rented their primary residence. The rate at which households rent, as opposed to own a home, is inversely related to household income. If we use the poverty line as a proxy for the underserved population, 54% of households rent their primary residence.[26] For this reason rental data is likely to cover a large share of thin-file consumers. Homeowners are likely to be covered by the traditional credit reporting system.

Of the approximate 40 million rental units in the United States, 3.2 million are owned by large real estate companies. The remainder is owned by individual investors. Of course, 3.2 million is a sizeable figure. If some non-negligent share of these tenants comprise thin-file consumers, the data can be quite useful. The limits of rental information stem from a host of factors that impact its reliability. First and foremost is that most rental relationships are between a lessee and a lessor, who happens to own one or a small handful of units. These property owners may have little incentive to report in a voluntary system when the average costs of implementing the means to report may be high. We strongly suspect smaller landlords are unlikely to report systematically.

Moreover, even larger landlords may be reluctant to report as the benefits may be small. While renter protection laws often make it difficult to evict a tenant, the threat of eviction is a powerful deterrent to late payments by renters. The additional disciplining effect of credit reporting may be viewed by landlords as negligible in many regions.

26 U.S. Census Bureau, American Housing Survey 2001 Using 2000 Controls Table 2-12. Income Characteristics--Occupied Units www.census.gov/hhes/www/housing/ahs/ahs01_2000wts/tab212.html.

Assuming that only large real estate companies are apt to furnish information, the amount of data provided may still be significant. Were this group as a whole to begin furnishing, we estimate that the information provided would total several million pieces of data a month.[27] By contrast, the 30,000 to 40,000 contributors in the traditional data sector provide nearly 1.5 billion pieces of data monthly.[28] While effort per provider varies by number of consumers, given scale economies, it takes more effort to collect a piece of data from the rental sector than from the traditional sector. None of this is to say that it is not cost effective to do so.

Another proxy for the likelihood that lessors will report is the number of units in a structure. This seems reasonable given the declining marginal costs of reporting and the benefits of doing so. If we then assume that those with more than 10 units in a structure are likely to report, the occupants in 30% (12 million) of all rented housing units can be covered. Admittedly, however, this may be a very optimistic assumption.

There are rent-specific issues that must be taken into consideration when assessing the relative value of the information. First, renters move frequently. Tenure in an apartment is relatively short for a large number of individuals. Approximately one-third of all renters surveyed in March 2000, for example, had moved in the previous year.[29] Information on a tenant's payment history will be sporadic. The consequence of this fact must be left to modelers, but it does raise another issue. A large share of the rental market will remain uncovered, and tenants can be expected to regularly move in and out of apartments that would report rent information. As a result, the data may be inconsistent.

Other issues are not so easy to address with modeling. For example, there are problems of how to address disputes between landlords and tenants, legitimate rent strikes, etc. Many local laws require that rent strikes place the withheld amount in escrow. The escrow accounts in the event of a rent strike could in principle be reported; however, the ease of doing so is not clear.

Furthermore, the credibility of eviction threats varies across regions. Paying rent on time in New York City, when housing laws favor tenants, may be a more accurate indicator of responsibility than rental payments in places where a tenant may be evicted easily. That is, tenants who pay regularly without the risk of such a heavy sanction as eviction may demonstrate a likelihood to pay that may be of more interest to, say, issuers of revolving credit, where the sanction is the denial of future credit. Moreover, the rental sector often considers payments that are more than 5 or 10 days late to be delinquencies. Of course, these are issues for modelers and data repositories. One CRA did indicate that it was creating new fields for rental data, which would cope with the peculiarities of the sector.

There may be a deeper issue potentially confronting the matter of bringing the underserved into the credit system through the use of rental data. The rental corporations and landlords most likely to furnish data are possibly also those who manage rental properties in which the renters already have credit files. Again, this is an empirical question; To what extent are rental units that are more likely to participate in the system inhabited by consumers already in the credit system? If this is the case, then rental data may be of less use than many anticipate, and the hurdles to getting landlords of those renters with thin-files to report may involve

27 U.S. Census Bureau, American Housing Survey 2001 Using 2000 Controls Table 2-1. Additional Indicators of Housing Quality — Occupied Units /www.census.gov/hhes/www/housing/ahs/ahs01_2000wts/tab21.html.

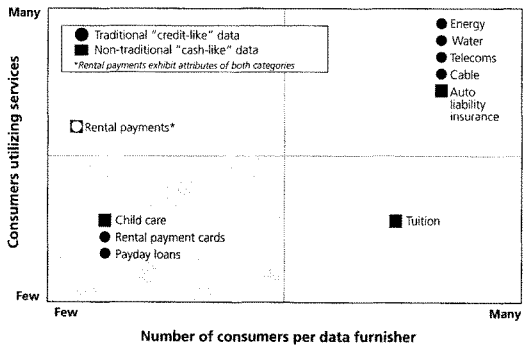
28 Interview with CRA.

29 U.S. Census Bureau, American Housing Survey 2001 Using 2000 Controls Table 2-1. Additional Indicators of Housing Quality — Occupied Units http://www.census.gov/hhes/www/housing/ahs/ahs01_2000wts/tab21.html.

considerable investment and a substantial awareness campaign. To the extent that it is not, rental data promises considerable benefits since it is very likely that it would capture those left out of the system.

Discussions of rental information have left out considerations of public housing. Public housing is more likely to service those with thin or no files, given the overlap with low-income groups. There are approximately 1.3 million families living in public housing in the United States, and these households earn between 50% and 80% of the median income.[30] The units are managed by public housing agencies (HAs). Public assistance covers much of the rent in public housing, but to the extent that tenants do pay a portion of the rent, the information would serve to help build credit files. Reporting on the poor to credit agencies could be controversial. But here the image that credit reports are principally about recording negative information is misleading. Positive data is of greater value to lenders than negative data. And the reporting habits of this sub-sector can more easily be affected by public policy.

Few consumers and unconcentrated sectors: Payday loan advances



Payday loans are short-term loans (2 weeks or so) given to cash-strapped consumers in exchange for a post-dated check or automatic withdrawal from a borrower's bank account. Borrowers are advanced money minus the fees for the advance. Payday loan borrowers must be banked. Whether they are low income or moderate income remains a matter of debate. According to one survey, 23% of payday loan users earn less than $25,000 a year, and 51.5% earn between $25,000 and $50,000 a year.[31] Other surveys suggest that they are significantly lower on the income ladder.

30 U.S. Department of Housing and Urban Development, HUD's Public Housing Program www.hud.gov/renting/phprog.cfm.

31 Gregory Elliehausen and Edward C. Lawrence, "Payday Advance Credit In America." Credit Research Center. Monograph #35, p. 29. http://www.msb.edu/prog/crc/pdf/mono35.pdf. However, see the critique by the Center for Responsible Lending, www.responsiblelending.org/pdfs/Georgetown_Study070102.pdf.

The number of people who use payday loans is small relative to the set of consumers without files or unscorable files. However, payday loans may still capture many of those who are thin-filed. More than 5 million consumers use payday loans services on some regular basis. By one estimate, 91% of the 7.6 million payday loan borrowers utilize the service at least five times a year.[32]

At least one firm may be using payday loan data in a new credit scoring model that uses a number of non-traditional data sets. This indicates that modelers at one firm have ascertained that payday loan data possesses at least some predictive power with respect to estimating the probability of default. In the experience of that firm, payday lenders are heavily computerized and keep detailed records. That experience suggests a large number of consumers per furnisher is not crucial. However, this may result from the peculiarity of the industry itself. Making regular short-term loans requires standardization to track instances of payment.

The larger question goes to the extent to which payday loans and payment histories are reliable measures of credit risk. It could be argued that the sector selects for consumers who are desperate and thus bad risks. The extent to which this information is predictive is an empirical one that will have to be judged by the market.

32 Keith Ernst, John Farris, and Uriah King. "Quantifying the Economic Cost of Predatory Payday Lending." (Center for Responsible Lending, 2004) p. 2 and p. 9. 65.110.82.226/pdfs/CRLpaydaylendingstudy121803.pdf.

Potential and Existing Approaches to Reach the Underserved

There are a number of other approaches to the problem of providing additional data on consumers with thin-files. We consider the standard approach as well as two alternative approaches below:

1. **The standard model:** alternative data furnishers such as rental agencies and utility providers begin providing data to the national CRAs, much in the same fashion as financial institutions did during the 1970s and 1980s.
2. **The aggregation model:** the data collected by a specialty credit reporting agency is aggregated by a third-party reseller for one-time use. This model depends on the presence of niche data aggregators.
3. **The self-reporting model:** consumers report their own alternative data to a specially configured CRA that is structured to receive this data. In this model, independent auditors ensure the quality of the data.

The standard model

The standard model is the notion that alternative data furnishers recognize the value of information sharing and begin to provide positive and negative data on consumers to the three national credit bureaus.

There are many advantages to this particular scenario. First, this would maximize the number of consumers about whom data is available, presuming the practice became widespread. Second, this would negate the disadvantages of the self-reporting approach, whereby the self-selection of participating consumers is likely to favor those consumers who are already credit savvy and are therefore already likely to be part of the traditional credit reporting system.

The three national CRAs have been discussing information sharing with large rental companies, utilities, and telecommunications firms. They also have made it easier to append consumer files with information that is not from traditional sources.

The aggregation model

This model employs the data collected by specialty CRAs that collect data on a variety of niche sub-markets, whether local or service specific. Chief among these sources of data is payday loans but where possible may include checking account overdraft information and retail club membership data. Rather than keeping such data on file indefinitely and incurring the legal obligations of a credit bureau under the FCRA, this data is pooled for one-time use. Lenders who are unable to find sufficient data upon which to base a decision can then utilize the data for that application. The quality of such data may pose a problem for this model. As discussed earlier, payday loans, for example, are often offered at high effective interest rates and so may overstate the rate of default. To the extent there are niche aggregators in other sectors, e.g., rentals, they remain small and serve local markets. As such, they are unlikely to cover any significant share of the underserved. To the extent that information is supplied to them, it is perhaps more economically rational to have the same information supplied to the three national CRAs. As part of a broader file that forms the basis of the vast majority of credit decisions, the inclusion of this information in a three-bureau credit report makes it more likely to be used by credit issuers for less cost and effort.

The self-reporting model

One creative proposal for non-traditional data has been developed by Payment Reporting Builds Credit (PRBC). PRBC collects payment information on rents, utilities, telecommunications services, auto loans, child care payments, and any regular payments that a consumer may make. The system has consumers report their own information as long as it is verified by a third party. Similar approaches have been used for non-traditional mortgage credit reports—but the process is much lengthier. Consumers may also choose to have their service provider or lender report the information to PRBC. Third parties can be banks, credit unions, non-profit credit counselors, tax preparation services, etc. As customers move to online banking, online records, coupled with terms of leases and bills, can serve as verification of bill payments.

The chief issue with this approach is that its "opt-in" nature suggests that many of those who participate are already credit-savvy consumers. As such, they may already have scorable traditional credit histories. It is unclear how much overlap there is between those who enter self-reporting systems and those who have credit files at the CRAs. The problem posed by self-selection bias — in this instance reaching those who are thin-filed or lack credit files — could perhaps be mitigated by credit literacy programs and awareness campaigns for consumers that are underserved.

The bank alternative

One possible method of reaching consumers who have thin or no files is to have a third party issue a "witness report" on the timeliness of payments related to the provision of a service. Banks and deposit institutions generally are attractive candidates. This method is essentially a variant of the self-reporting approach. Consumers would have to authorize reporting.

The advantage of this approach is that depository institutions witness a large number of payments across many types, provided payments are made with checks or online. Rental information, utilities, insurance payments, daycare, or any other recurring payment made in this fashion would be reported through these institutions. Accounts would have to be verified as belonging to a regular trade line. They may also have to be fixed amounts with a regular payment schedule, so that there are not problems of variation in payment. The bank would regularly send information to a CRA. Given that financial institutions already report loan information, setup costs would be low. There may be costs in setting up verification systems, however.

This method would, in principle, reach far more renters than having large rental unit owners report. Similarly, it would reach many other small service providers. Furthermore, financial institutions would have an incentive to report because they are users of consumer payment information. The finance industry's experience with credit reporting has been positive for both the expansion of the market and a reduction in charge-offs.

Financial institutions may balk at such an arrangement if there are issues of disputed costs and data furnisher liability. However, there may be a larger limitation. Like the PRBC model, this model would capture a limited share of the individuals about whom traditional data is not available.

Conclusion: Promise and Limits

Utilities

As the analysis above suggests, consumer information furnished by utility providers offers the best promise for expanding credit access to the underserved. Utility payments are practically universal, and the sector is heavily concentrated, so relatively few potential data furnishers would have to be convinced of the merits of reporting. As such, utility data promises to capture the many Americans who lack bank accounts, are unscorable owing to a lack of credit data, or have thin credit files. The level of concentration in most utility industries suggests this data can be brought on line with less effort and fewer resources than could data from other sectors such as apartment and housing rentals. Some utility companies, however, have expressed reluctance to begin reporting, and few utility companies report both positive and negative data to the national repositories. In some cases negatives are received by bureaus indirectly, only after accounts that have been remanded to collections.

The reason utilities have been reluctant to report may relate to the history of the sector and its heavily regulated character. Because public service companies are more subject than others to political pressure, their response is understandable. Participation in the consumer credit reporting system is voluntary. For that reason, experimentation, lessons from other firms, affirmative consent from state regulators, and the development of industry practices may be necessary before utilities begin reporting data in meaningful numbers.

There are few regulations that explicitly prohibit utilities from sharing data. Interestingly, interviews with utility companies revealed that a major hurdle to reporting was the absence of a clear authorization from state regulators that they can report data to credit reporting agencies. Given the politically sensitive nature of public utilities, an affirmative authorization from regulators is necessary to quell fears of a public and regulatory backlash.

Despite the seemingly high level of interest in achieving some degree of regulatory certainty, the public utility commissions may be reluctant to issue an explicit statement. Further, commissions that want to be responsive to inquiries need a clear message from legislators before issuing any response. An explicit statement, as part of a public effort to reach the underserved, would do much to bring utility data into the reporting system.

On balance, however, utility providers appear a likely candidate for the provision of alternative data, insofar as they have economic incentives to participate in such information sharing mechanisms. In fact, in some cases they already do. Utility providers currently have data aggregated so that it would not be difficult to migrate to a standard reporting format such as Metro2.

For other potential sources of alternative data, it may be more difficult to participate in the credit reporting system without some sort of legislative or economic intervention. For example, child care providers and health care providers clearly have little incentive to provide data because they don't issue forms of credit or provide credit-like services. Similarly, payments to health care providers are subject to widespread disputes between patients and their insurers. Therefore, they have little need for the type of data contained in credit reports.

Auto liability insurance

Like utility companies, auto insurance providers also are subject to considerable scrutiny and regulation. Here the limitation appears to be a market-based rationale for non-reporting. Insurance carriers can quickly discipline those who are delinquent with their installments. As a result, policyholder knowledge that late payments are being reported may have only a marginal disciplining effect. Because auto liability insurers rely heavily on data from consumer credit reports in underwriting policies, they may benefit further from richer and more robust consumer credit reports, particularly those that include non-traditional data.

Rental

We have noted some of the advantages and problems of including rental data in credit reports. Rental data is broadly defined to include housing, apartment, furniture, and consumer durable rentals. To date, most activity around using rental data for credit reporting purposes has focused squarely on housing and apartment rental data. The principal issue with rental data is the large number of landlords in the U.S. rental market. The largest landlords only account for a small fraction of the market. These limitations may be outweighed by the benefits of having available data reported to the bureaus.

Market responsiveness to an opportunity to improve the quality of its product clearly mitigates the need for government intervention. There is, however, room for public policy on rental payment data about the underserved. Those who use public housing are more likely to have thin-files or to be unbanked than the average American. Should rental data prove to be predictive of an individual's risk of default, inclusion of this data into a consumer credit report would help these Americans demonstrate their creditworthiness. If so, Congress or state housing authorities should act to permit this potentially socially and economically beneficial data exchange.

Approaches to using non-traditional data in credit reporting

As just discussed, alternative data sources hold great promise for helping underserved consumers enter the traditional credit market. The challenge is identifying ways in which such data can be incorporated into the credit granting system. A synopsis of potential techniques follows.

Self-reporting: Chances are small that a self-reporting approach will reach consumers who lack files or have files with too few trade lines to score. Our research suggests that the credit savvy, those in some sense furthest away from the underserved, are the most likely to utilize these programs. At the least, substantial investment in awareness programs and financial literacy campaigns would be necessary to reach underserved and unbanked populations.

The aggregation model: Under this model, data collected by a specialty credit reporting agency is aggregated by a third-party reseller for one-time use. This model depends on the presence of niche data aggregators such as those that collect payday loan payment information. These aggregators appear to be rare outside of the payday loan industry.

The traditional credit reporting model: One benefit of the current system is that the informational and organizational costs of authorizing reporting are not borne by the consumer. Consumers do not have to manage reporting their payment histories. Data furnishers report directly to the CRAs. This information is used when

applying for credit. The system has the advantage of overcoming the selection bias that may be operating in a self-reporting model. Those with less than perfect credit histories but still qualified for credit at reasonable prices are included in the system. As a result this approach would capture those who are not particularly credit-savvy and therefore likely to be part of the underserved population.

Objections

This study has documented potential benefits of the reporting of non-traditional data. However, the concept of reporting non-traditional data is not without its detractors. Some of the primary objections articulated by a number of critics are addressed below.

There are fears that the use of this information will negatively impact consumers, notably in the form of risk-based pricing. Some worry that additional negative information will raise the price of credit on existing credit lines, as credit suppliers, especially credit card companies, raise interest rates in response. This objection is based on a misunderstanding. Most of the sectors considered in this study already report negative data but do so indirectly. Collection agencies report delinquent accounts, and, likewise, rental disputes are included in credit reports. As a result, the information already weighs into pricing models. What is not currently considered is positive data. Inclusion of positive information has the effect of lowering price and improving access for consumers, especially the underserved.

Others fear that the inclusion of certain data sets — notably data about payday loans — will do more harm than good for low- to moderate-income Americans. The concern about including payday loan data stems from the extraordinarily high APR on such loans and the belief that payday lenders contribute to borrowers' financial duress. Normative judgments about the practice aside, inclusion of payday loan data could prove to be an accurate predictor of default. If so, underserved consumers who use such services and make prompt payments could stand to benefit. On the other hand, due to the high rates of debt service on these loans, they might actually serve only to diminish the creditworthiness of thin-file consumers who use these products.

Finally, there are privacy advocates who oppose information sharing in general, but more so when it concerns sensitive data, including financial and transactional data that comprises the core of a consumer credit report. This concern comes at a high price for the underserved. Access to credit is crucial for consumers who wish to develop assets, given that Americans save primarily in the form of homeownership. This is particularly true of households at the lowest income levels. Arguably, prohibiting the ability to use non-traditional data sources to protect the privacy of the underserved reduces their opportunities to create assets and wealth.

Future research

Whether or not any information from the identified sources of non-traditional data has any predictive power in consumer credit scoring is purely an empirical matter. Towards this end, The Information Policy Institute is undertaking a project to assess the predictive power of various types of non-traditional data and its potential impact on consumer access to credit. The project will involve the direct participation of credit bureaus, prospective data furnishers, and creditors. This research is expected to be completed during the second half of 2005.

Appendix: State Regulatory Barriers to the Provision of Payment Data to Credit Bureaus by Utility Providers

The following information has been gathered from exchanges with representatives of public utility commissions and from legal research conducted by the Institute. The information presented reflects the best knowledge of the Institute and of those interviewed. We are deeply grateful for the assistance of James Ramsay at the National Association of Regulatory Utility Commissioners for his assistance in this endeavor.

State	Regulatory Barriers
Arkansas	None
California	Wireline and wireless only (CA PUC 2891(a))
Colorado	None (cannot answer on wireless and cable—PUC does not regulate)
Delaware	None
Florida	None
Hawaii	None
Idaho	None
Indiana	None
Iowa	None
Maine	None
Maryland	None
Missouri	None
Montana	None
New Jersey	Yes; opt-in, electric (NJSA 48:3-85), gas (NJSA 48:3-85), cable (NJSA 48:5A-57)
Nevada	None
Ohio	Publicly owned firms
Pennsylvania	None
Texas	Bill pending (H0412in)
Utah	None
Vermont	None
Washington	None
Wisconsin	None

iNFORMATION
policy institute

306 Fifth Avenue, Penthouse
New York, NY 10002 USA
Phone: 212 629 4557
Fax: 212 656 1732
http://www.infopolicy.org

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