

**THE PROMISE OF NON-FINANCIAL DATA: HOW USING ENERGY UTILITY AND TELECOMS PAYMENT DATA CAN HELP MILLIONS BUILD ASSETS**

**1.0 Introduction:**

**1.1 *Outside the credit mainstream: Lack of data hurts thin-file Americans***

Despite the vast accomplishments of the American financial system, it has been estimated that approximately 35 million to 54 million Americans remain outside the credit mainstream. For a variety of reasons, mainstream lenders have too little information on them to evaluate risk and thereby extend credit. These are the so-called “thin-file” and “no-file” Americans. As a result, those in most need of credit often turn to check cashing services, predatory lenders, and payday loan providers with effective interest rates as high as 500 percent.

The lack of reliable credit places them at a great disadvantage in building assets (such as homes, small businesses, or loans for education) and thereby improving their lives. Stark evidence of this has emerged recently in the sub-prime home mortgage market. The value of outstanding sub-prime mortgage loans has doubled over the last six years, with a sizeable number of these underwritten as interest-only or low down-payment adjustable rate loans. With rising interest rates, many sub-prime mortgage borrowers will soon face dramatic spikes in their debt service burden. This has led some to speculate—including Fannie Mae’s Chief Economist—that the next 18 to 24 months will bring a record rash of foreclosures.<sup>1</sup>

It is possible that the severity of the looming crisis in the sub-prime mortgage market could have been lessened had lenders been able to access standardized, verifiable, non-financial data to assess credit risk, credit worthiness, and credit capacity. With such data, some borrowers likely would have qualified for a prime loan (non-prime or near-prime), and others may have received offers for affordable fixed-rate loans. Still others may have been disqualified, owing to a more complete picture of a borrower’s credit risk.

**1.2 *The Credit Catch-22: Promoting non-financial data as a policy solution***

Mainstream lenders usually rely on credit history data found in credit files of the three major credit bureaus to determine whether and at what price credit should be extended. For millions of Americans who have not utilized mainstream credit, this can present a catch-22—you must have credit in order to get credit. One, perhaps unpalatable, solution for consumers who may foresee a future need for credit to finance a car or a house is to slowly go into debt so as to build-up a good payment history.

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<sup>1</sup> Presentation of David Berson, Chief Economist at Fannie Mae at Fair Isaac Corporation’s InterACT 2007. San Francisco, 17 May 2007.

We believe a better solution may be to simply broaden the types of payment information reported to credit bureaus. Today, little utility and telecom payment data gets fully reported. Our research indicates that the full reporting (positive and negative payment data) of this payment information to consumer reporting agencies (CRAs or credit bureaus) could help lift millions of Americans into the financial mainstream.

The largest net beneficiaries of including positive energy utility and telecom payment data in consumer credit files are lower income Americans, members of ethnic minority communities, immigrants, younger, and elderly Americans. Therefore:

- Legislation or regulation that would effectively foreclose the reporting of payment data by non-financial institutions to CRAs is ill-conceived and not advisable.
- Further, to permit reporting but exclude that data from credit scoring denies consumers the benefits of their positive payment history. Negative payment data will continue to be reported through existing channels.
- Finally, our empirical analysis indicates that “opt-in and “opt-out” legislation that sets a choice on data reporting has the same negative effect as strictly disallowing reporting. Further, such legislation would also have the effect of excluding the vast majority of thin-file and no-file Americans from the wealth-building benefits.

Despite the measurable benefits to tens of millions of thin-file and no-file Americans—benefits that directly contribute to asset building, wealth creation, and poverty alleviation—lawmakers in a handful of states seek to prevent energy utility and/or telecom customer payment data from being reported to CRAs. With the intent of representing the interests of lower-income and working family households, such legislation will cause undue harm to the very groups the law is intended to protect.

## **2.0 The Value of Energy Utility and Telecom Payments**

In previous work, PERC examined which sorts of *non-traditional* or *alternative* payment information might offer the most promise of being able to efficiently and accurately be reported to bureaus, cover a large number of consumers, including those outside the financial mainstream, and be useful to creditors in making predictions regarding repayment. Among the conclusions was that utility and telecommunications payment information had the greatest potential to assist the largest number of thin-file and no-file consumers in a relatively short period of time. The coverage of such payment information is nearly universal. The industries involved are relatively concentrated and have advanced billing systems, so there would be economies of scale and scope in reporting payment information to the bureaus. And the services involved are somewhat “credit-like”, as opposed to “cash-like”, in that they involve the consumption of a service prior to payment. As such, the payment information may be more easily considered predictive by potential creditors.

Secondly, being “credit-like” means the service providers may also have an incentive to report payment data to a bureau, in so far as that would provide incentives for their customers to pay their bills in a timely fashion. And finally, from the perspective of the utility or telecom customer, we would imagine that the prospect of having their payments fully reported to bureaus should be welcomed. This is because, at present, although most utility or telecom payments are not fully reported to credit bureaus, accounts that are seriously delinquent *are* usually reported, either by the service provider itself or by a collections company. *So, fully reporting utility and telecom payment information effectively means bringing online the more positive payment information, the on-time and moderately late payments.* This should enable utility and telecom customers to be acknowledged and rewarded for making timely payments and not simply be punished, as is predominantly the case now, for making late payments.

### **3.0 Methodology**

Using actual credit files, telecom and utility payment information, commercially used credit scores, and actual payment outcomes over a year, we examine the impact fully reporting telecom and utility payment information would have on credit scores, access to credit, and loan performance. We see how many consumers would be able to be scored with the addition of the alternative data, how the alternative data impacts those already able to be scored and whether and to what degree the alternative data assists in predicting who are good risks and who are bad risks. Further, each of the individual credit files was appended with socio-demographic data from Acxiom allowing us to break results down by race, gender, age, income, and other such segments.

We use around 8 million credit files from TransUnion which do contain at least one fully reported utility or telecom payment along with over one million that do not, as a control.

### **4.0 Impact of adding Utility and/or Telecom Payments to Credit Files**

At the time we began our study, the TransUnion database contained around 8 million credit files that had a telecom or energy utility payment fully reported for at least a year. This represented around 4 percent of the credit files in the TransUnion database. Although these consumers are concentrated in a handful of states, due to just a handful of telecom and utility providers fully reporting, we find no reason to believe this population is atypical of the larger telecom and utility customer population<sup>2</sup>.

In **Table 1** below, we see that 9.6% of the consumers with reported utility payments and 14% of consumers with reported telecom payments have no “traditional” payments reported in their credit files. As many credit score models can produce a score with only

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<sup>2</sup> See the full report for basic socio-demographic comparisons of the population with fully reported alternative payment information with a nationally representative sample of consumers with no alternative data reported.

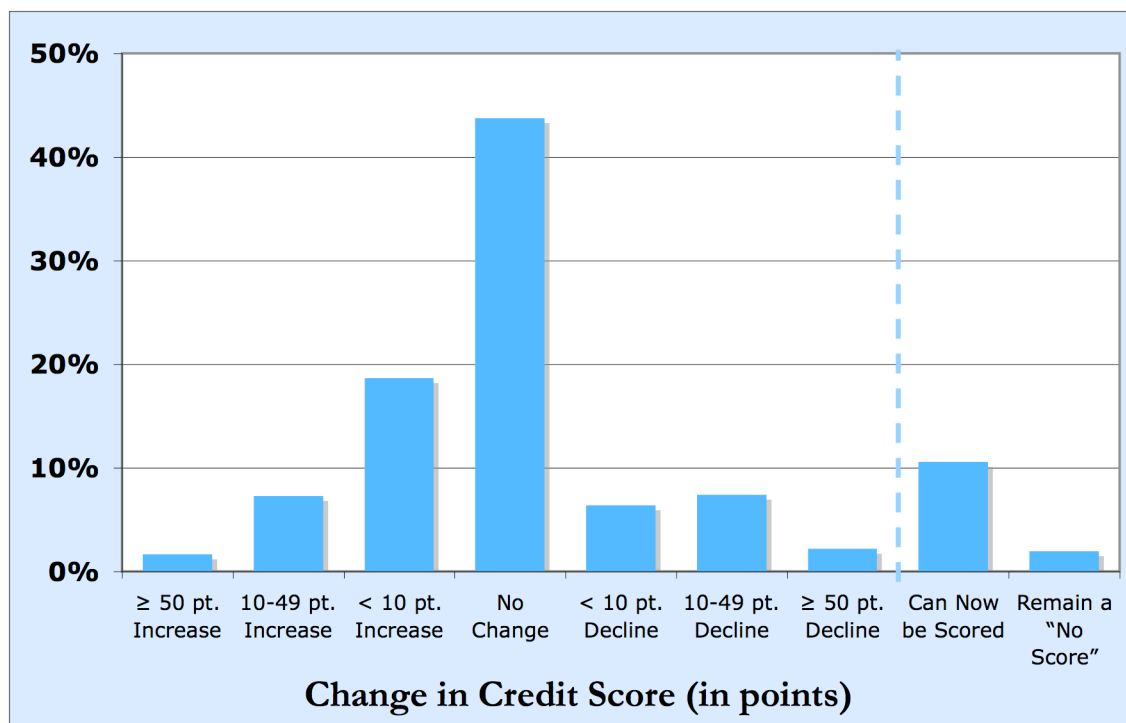
one tradeline, including those used in this study, these individuals move from being unscorable to being scorable because their energy or telecom payment data is reported. Thus, the use of non-financial data all but eliminates the condition of being unscorable.

**Table 1: Impact of reporting utility and telecom payments on consumer credit files**

Total Number of Payment Histories	Consumers with Utility Payments Reported		Consumers with Telecom Payments Reported	
	Including Utility Payments	Excluding Utility Payments	Including Telecom Payments	Excluding Telecom Payments
<b>Thin File, &lt;3</b>	<b>11.8%</b>	<b>17.0%</b>	<b>18.4%</b>	<b>23.0%</b>
<b>0</b>	-	9.6%	-	14.0%
<b>1</b>	7.7%	4.0%	13.4%	4.9%
<b>2</b>	4.1%	3.4%	5.0%	4.1%
<b>Thick File, ≥3</b>	<b>88.2%</b>	<b>83.0%</b>	<b>81.6%</b>	<b>77.0%</b>
<b>Sample Size</b>	7,519,020	7,519,020	590,795	590,795

As depicted in **Figure 1**, only around 4% of the general population see changes in their scores greater than 50 points, with about an equal share seeing rises as falls. Notably, nearly 45% see no change in their scores at all. The biggest practical impact appears to be the nearly 10 percent who go from being unscorable to scorable.

**Figure 1: Impact of Reporting Utility Payments on VantageScore**



While the impact of including the non-financial data seems to wash out when viewing the broader population, the story is dramatically different when viewing the thin-file and no-file population. Since much derogatory energy utility and telecoms payment data is already reported to CRAs directly or indirectly (through collections agencies), the inclusion of fully-reported payment data—that is, positive and negative payment data—tends to have a net positive impact on the score distribution for thin-file and no-file Americans.

**Table 2** below shows that by including energy utility payment data, nearly three-quarters of the thin-file/no-file population witness an improved score (or, are able to be scored at all), while just 13% see their scores decline and just over 4.3% remain unscorable.

**Table 2**  
**Impact of Utilities and Telecom Trades on VantageScore**  
**Consumers with Less than 3 Traditional Trades**

	Consumers with Utility Trades		Consumers with Telecom Trades	
	Including Utilities (#1)	Excluding Utilities (#2)	Including Telecoms (#3)	Excluding Telecoms (#4)
<b>Percent Affected</b>				
≥ 10 pt. Increase in Score	16.9%	NA	9.1%	NA
< 10 pt. Increase in Score	2.6%	NA	1.8%	NA
No Change	2.9%	NA	4.1%	NA
< 10 pt. Decline in Score	2.8%	NA	3.3%	NA
≥ 10 pt. Decline in Score	10.2%	NA	13.5%	NA
Can Now be Scored	60.3%	NA	67.7%	NA
Remain a No Score	4.3%	NA	0.5%	NA
All Consumers	100.0%	NA	100.0%	NA

Source: March 31, 2005 Credit Files for Analysis sample

In general, the relative importance of a single tradeline (a payment or transaction history) increases as the number of tradelines in an individual’s credit file decreases. In our representative validation sample, looking at those who had payments reported, the median number of traditional payments histories in their files is about 10. So, for most individuals, the addition of another payment history or two from a utility or telecom service provider will have little or no impact.

For the thin-file and no-file population, by contrast, the impact of integrating non-financial tradelines into a consumer credit file can be dramatic as **Table 3** shows. For instance, when utility payment data is excluded, just under 16% of the thin-file population have scores above 620, the typical cut-off point for a prime borrower. In addition, nearly 65% of the sample remains unscorable. By contrast, when utility data is

included, the prime population swells to nearly 51%, while the unscorable segment diminishes to just 4.3% of the sample.

**Table 3**  
**Impact of Utilities and Telecom Trades on VantageScore**  
**Consumers with Less than 3 Traditional Trades**

Credit Score	Consumers with Utility Trades		Consumers with Telecom Trades	
	Including Utilities (#1)	Excluding Utilities (#2)	Including Telecoms (#3)	Excluding Telecoms (#4)
851+	3.3%	0.7%	1.6%	0.4%
801-850	4.1%	3.4%	2.4%	1.7%
741-800	14.7%	3.9%	9.6%	2.2%
681-740	16.3%	4.3%	5.3%	2.3%
621-680	12.5%	4.6%	7.3%	3.3%
561-620	19.9%	7.6%	20.3%	7.7%
501-560	24.9%	10.8%	52.9%	14.2%
No Score	4.3%	64.6%	0.5%	68.2%
All Consumers	100.0%	100.0%	100.0%	100.0%
Sample Size	1,280,553	1,280,553	137,256	137,256

Source: March 31, 2005 Credit Files for Analysis sample

Since more information enables scoring models to better distinguish good risks from bad risks, we expect the thickening of the credit files of those thin-file individuals with only one or two traditional payment histories reported to result in such individuals having improved access to mainstream credit.

#### **4.1 Who are the thin-file and no-file individuals?**

Looking at our “utility” and “telecom” samples we see that the groups likely to be most impacted by the addition of utility and telecom payment data are ethnic minorities, younger individuals, older individuals, and those with lower incomes. Where the overall proportion of thin-file holders in the utility (telecom) sample is 17% (23%), among African-Americans it is 28% (48%), Hispanics it is 32% (40%), 18-25 year olds it is 24% (36%), those over 65 it is 18% (18%), and for those with incomes under \$30,000 it is 27%. (34%).

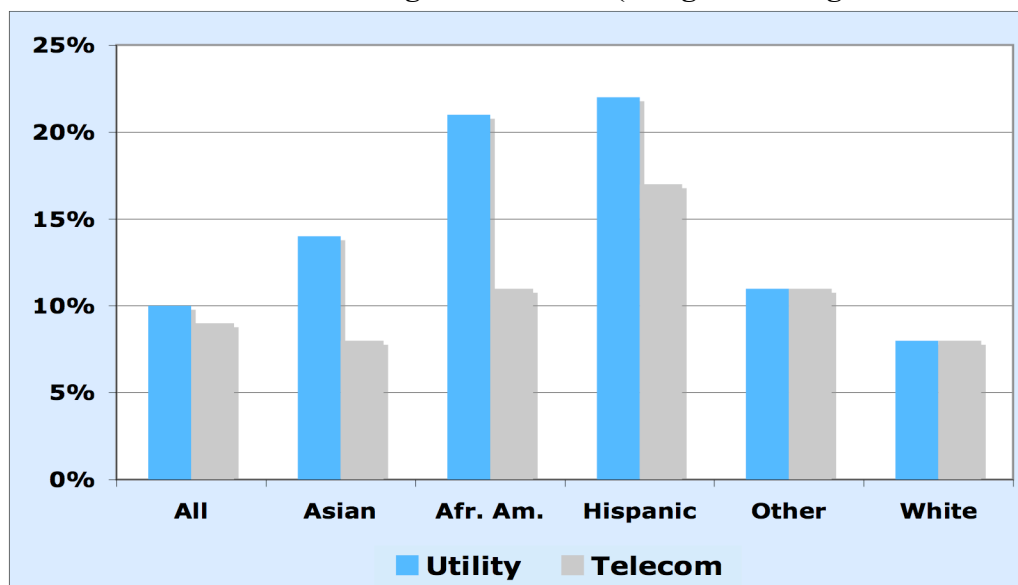
**4.2 Non-financial data improves risk assessment and expands access to credit.**

We find that use of utility and telecom payment data improves the performance of credit scoring models. This is an important finding. Since such information is not widely reported and as a result scoring models are not specifically optimized for such payment information, there could be a concern that the use of this alternative data would do more harm than good. We, however, find little reason for such concern. For instance, when looking at only those individuals that were scoreable with and without the alternative data we still see on average a modest improvement the score models' performances as measured by a commonly used gauge (the KS statistic), Type 1 and Type 2 error rates, default rates for given acceptance rates, and acceptance rates for a given default rate. If we include the unscorable but for the alternative data population, and assume they rank at the bottom of the risk ranking, look at only the thin-file population, or both, we see much larger improvements in the measures of model performance.

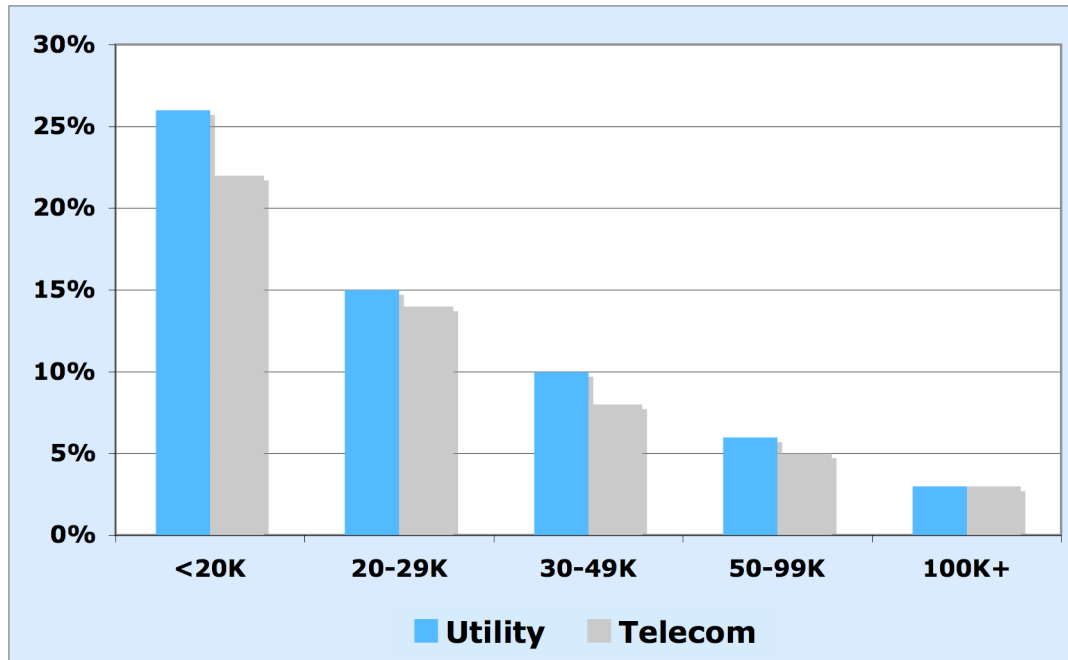
**4.3 Impact on Access to Credit**

The ultimate measure of the impact of the alternative data is summed up best by examining its potential effect on access to mainstream credit. We find that assuming a 3 percent default rate, a lender would have the ability to lend to approximately 10 percent more borrowers using the utility or telecom data. This is brought about by two factors. First, new entrants who are only scoreable with the alternative data are brought into the system. And secondly, the use of the alternative data allows for a better risk sorting of those who were scoreable without the alternative data, particularly among those with only one or two payment histories. In other words, this increase in access is driven by an increase in access among the thin-file population. Decomposing this 10 percent increase in access, ethnic minorities, younger individuals, older individuals, and those with lower incomes gain the most. **Figures 2 and 3** show the breakdown by ethnicity and income.

**Figure 2: Change in Acceptance Rate by Ethnic Group with the Inclusion of the Alternative Data in the VantageScore Model (using a 3% target default rate).**



**Figure 3: Change in Acceptance Rate by Income Group with the Inclusion of the Alternative Data in the VantageScore Model (using a 3% target default rate).**



### 5.0 Policy Implications and Conclusion

Increasing the full reporting of utility and telecom payments to credit bureaus will (1) have little effect most individuals, (2) improve financial access to those who only have a handful of payment histories in their credit files, and (3) allow those with no credit payment history to build a payment history and access the financial mainstream. The benefits of this improved access will disproportionately accrue to ethnic minorities, younger individuals, older individuals, and those with lower incomes.

Removing legislative and regulatory barriers, preventing their enactment, and clearing up legislative and regulatory uncertainties are key in facilitating the widespread full reporting of utility and telecom payment data. Without these impediments, the business case for reporting this data along with its value to lenders should be sufficient incentives to bring this data online, as with other payment data that is voluntarily reported. The voluntary nature of exchanging such information is key to its efficient gathering and optimal use in a dynamic marketplace.

PERC’s original analysis of alternative data found that the absence of laws permitting the reporting of payment data to consumer reporting agencies (CRAs) served as an effective barrier to energy utility and telecom participation in the voluntary system. This was the case, despite the absence in 46 states of statutory prohibitions.



Given the regulatory uncertainty in an environment of hyper-sensitivity to data privacy and data security:

- Legislators are encouraged to pro-actively pass legislation promoting and encouraging the onward transfer of full customer payment data to accredited CRAs.
- Legislators are encouraged to alter any guidelines that require utility customers to fall behind on their bills to a certain extent in order to be eligible to receive assistance.

Such assistance guidelines in the presence of payment reporting would force some customers in need to choose between receiving support or maintaining their good credit.

Recognizing that there may exist extenuating circumstances in a small handful of states that complicate the immediate reporting of energy utility, telecoms, and other non-traditional data to CRAs—for instance, in the wake of hurricane Katrina, energy utility rates in Orleans Parish have spiked as much as four-fold—some accommodations must be made to avoid harming households that could be unduly adversely affected by having their payment data reported in the near term.

The authors of the PERC/Brookings UMI study do not endorse any outcome that would result in avoidable suffering, yet we believe that legislation that would either ban the reporting of customer payment data, or that would preclude payment data from being used in consumer or commercial credit scoring is not the appropriate response.

### ***5.1 Two wrongs don't make a right: The case of Illinois and utility payment data***

There exist abundant voluntary solutions that can be customized on a state-by-state basis to the particular needs of the citizenry given the unique circumstances. For instance, an ill-conceived law in Illinois that froze energy utility rates for a decade, and that led to a massive rate readjustment when the law expired, should not be remedied by a prohibition on the use of utility payment data in consumer credit scoring.

To do so would only temporarily shelter the unintended consequences of readjustment, but at the same time permanently deny many hundreds of thousands of Illinois residents the ability to build a credit history with their positive payment data. In fact, the palpable benefits for minority communities, the elderly, younger Illinois residents, and lower income households derived from improved access to affordable mainstream sources of credit will be reversed should lawmakers in Illinois pass a law prohibiting the use of energy utility payment data in consumer credit scoring. Worse yet, such a bill, if passed, could be emulated by lawmakers in other states, thereby denying even more people the ability to lift themselves out of poverty and improve their life's chances through asset building enabled by access to affordable mainstream credit.

In the case of Illinois, rather than the proposed legislative solution, we would encourage lawmakers to work with energy utility companies and credit bureaus to identify a voluntary work around. Energy utility companies could agree to a flexible payment plan for customers for a fixed or varied period of time, while bureaus could refrain from integrating derogatory energy utility payment information for a predetermined period.

In this manner, those who pay their bills on time still benefit from having their positive payment data reported, and those who are struggling with the sudden spike in energy utility rates are accommodated both with a flexible payment plan and from having their credit score adversely affected. This approach is not without precedent, as lenders in the Gulf Coast and the national credit bureaus agreed to similar steps in response to the spate of natural disasters in the region during 2005.

### ***5.2 Good intentions pave the path: The California opt-in debacle***

While we feel it is clearly the case that legislation that limits the use of alternative data in consumer credit reporting is ill-advised, it is also critical to ensure that legislation that seeks to encourage alternative data is properly designed to have its intended outcome. Recognizing the potential of alternative data to bring millions into the financial mainstream, a bill has been proposed in California to give utility customers an opportunity to choose to “opt-in” and let their utility payment histories be reported.

While this is certainly movement in the right direction, there are at least two major problems with an opt-in scheme, however. First, voluntarily reporting or opting-in by utility customers is already available to Californians via voluntary payment reporting systems, of which to date relatively few have taken advantage. And those who would opt-in would likely be the more financially savvy utility customers, perhaps excluding many who would benefit from the data.

The second problem with an opt-in system is that it would tend to skew the data that is reported to the most positive payment histories. This incomplete, skewed picture would reduce the value of the data to the end-users of it, the lenders, and hence, the ultimate benefits of the data to consumers. This reduced value from the skewing of the reported payment histories also means that opt-out options would reduce the value of the data for all, lenders and borrowers alike.

In previous work, one of the authors explored the viability of opt-in schemes by examining the results from an actual trial conducted by U.S. West (now Qwest Communications). The best method of reaching out to customers resulted in only 29 percent “opting-in” and at a cost of \$20.66 per customer “opting-in”<sup>3</sup>.

Overwhelming empirical evidence over time strongly suggests that putting the onus on the consumer to have their data either reported or not reported yields a socially and economically suboptimal outcome. Either too few will opt-in for the benefits to be widely

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<sup>3</sup> <http://www.netcaucus.info/books/privacy2001/pdf/datarestrictioncoststudy.pdf>

enjoyed—and the data that is reported will be biased rendering its use highly dubious—or those who opt-out will also skew the sample, as the most likely to opt-out would be those who aren't making timely payments.

The current voluntary reporting system of financial data regulated by the Fair Credit Reporting Act provides consumers with choice only as to who may access their credit report, but not with respect to whether or not financial information is reported. That choice is left to the data furnishers. This system has proven highly effective for more than three decades, and is widely accepted by Americans. Replication of this well-tested methodology with respect to so-called alternative or non-financial data, including, but not limited to, energy utility and telecoms data, is encouraged.

### ***5.3 The road ahead: Barrier removal and policy clarification***

In its initial study on this topic (Information Policy Institute, July 2005), PERC presented results from a survey of members of the National Association of Regulated Utility Commissions (NARUC)—the public service commissions that regulate the energy utility and telecommunications industries on the state level. Respondents from four states (CA, NJ, OH, and TX) indicated some form of statutory prohibition on the onward transfer of either energy utility or telecoms payment data to third parties. These laws were generally oriented toward consumer privacy, and did not envision consumer credit reporting when drafted (e.g. in California, the prohibition is on customer proprietary network information or “CPNI,” of which payment data is a subset). We encourage lawmakers in those four states to revisit this issue in light of the findings from the PERC-Brookings UMI joint study highlighting the social and economic benefits from energy utility and telecoms payment reporting to CRAs.

Far more prevalent than actual statutory barriers, however, was the notion of regulatory uncertainty. That is, regulators in a large number of states indicated that they would not grant permission—upon request from an energy utility or telecoms firm—to fully report customer payment data to a credit bureau without written direction from the state legislature. Energy and telecoms firms, unable to secure permission from the regulators—even in the absence of a statutory prohibition—often will not fully report customer payment data. Sadly, the result is that these firms will continue to report negative payment data (delinquencies, defaults) to CRAs. Meanwhile, the vast majority of thin-file and no-file Americans who pay their bills on time and in full will not get any credit for their positive payment histories.

Lawmakers and regulators must remove all barriers to asset building, wealth creation, and poverty alleviation—including the pervasive regulatory uncertainty in the states around the reporting of non-financial data. For these reasons, the optimal way forward is to remove statutory barriers and enact laws that encourage the voluntary reporting of customer payment data by utilities and telecoms to CRAs. If the states cannot or will not act, then we urge Congress to act on behalf of the millions of thin-file Americans.