

You Score, You Win

The Consequences of Giving Credit Where Credit is Due

by Michael Turner, Alyssa Lee, Robin Varghese and Patrick Walker

JULY 2008



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Executive Summary and Key Findings

The value of including utility and telecom payment information in consumer credit files was shown in “*Give Credit Where Credit is Due*”. That report demonstrated that such non-traditional payment information can be predictive of future delinquency by individuals in general. And through the pervasive reporting of such non-financial payment data to consumer reporting agencies, tens of millions of American with little or no credit history can establish payment histories providing them with access to mainstream affordable credit.

Importantly, a “credit” history can then be established without first going into debt. And as was shown in “*Give Credit Where Credit Is Due*,” the benefits of gaining access to mainstream credit disproportionately accrue to those groups that are currently disproportionately excluded from it, namely ethnic minorities and members of lower income households.

While the reaction to these particular win-win findings (better calibrated lending opportunities and broader financial access) have been largely positive, a number of questions have been raised about the broader and longer-term consequences of fully reporting utility and telecom payments to customer reporting agencies.

This report examines some longer-term effects of the use non-traditional data for lending and does so, where possible and appropriate, with quantitative analysis. Specifically, the new quantitative analysis examines longer-term impacts, the key findings from this analysis are:

- » No evidence in our data of deteriorations of credit score over time for those with non-financial payment data in their credit files and little or no traditional payment data; and,
- » No evidence in our data that those who open new accounts after having only non-financial accounts become over-extended and witness declines in credit scores.
- » No empirical or theoretical evidence to support notion that chronic late payers would be harmed by fully reporting energy utility and other payment data to credit bureaus.
- » All evidence suggests that reporting payment data serves both as a consumer protection and a system wide protection.

“ The overriding social issue is that weak consumer credit reports and low scores play a growing role in the ability of families to get ahead, influencing prices for loans, insurance, mortgages and even renting apartments. So, any progress made on this front ultimately may help some deserving underserved borrowers grow their personal wealth, as well as benefit lenders seeking to capture more emerging-markets business¹.”

Dr. Matthew Fellowes,
Brookings Institution



Our evidence shows average credit scores rising over the year long observation period. We also witness scores rising for those who had only non-traditional trade lines in the beginning of the observation period but who opened lines of credit shortly thereafter. These findings are generally robust across the ethnic, income, and age segments examined.

¹ Steve Bergsman “The thin-file problem: the lack of sufficient credit information to produce a traditional credit score is preventing some borrowers from becoming homeowners. New advancements with alternative scoring technology hold great promise for a whole new population of borrowers.” *Mortgage Banking*, 1 March 2007. Downloaded from http://goliath.ecnext.com/coms2/gi_0199-6438636/The-thin-file-problem-the.html.



Introduction

Today, an estimated 54 million Americans are excluded from the mainstream credit system. This financial exclusion occurs not because of bad credit history, but rather because of a lack of credit information.

Tens of millions of Americans have no credit files or no payment histories in their credit files, and consequently have no credit score, and tens of millions more have too few payment histories in their credit files to be scored with precision.³ The lack of sufficient payment information in credit files can result in reduced access to mainstream credit and forces borrowers toward (toward w/o an “s”) higher priced lenders. Being outside the financial mainstream or paying more, even slightly more, for credit due to a lack of payment information can be very costly. For example, for a \$200,000 mortgage (close to the median house value), a consumer would pay nearly \$100,000 more over the life of a 30-year fixed rate mortgage if he or she had an 8% interest rate (hardly a predatory rate for a 30-year fixed mortgage) versus a 6% interest rate.⁴

A straightforward solution for the millions that are credit worthy “good risks” but lack the necessary payment evidence to show this is to simply add more information to their credit files.

² Information Policy Institute, *Giving Underserved Consumers Better Access to the Credit System*. (New York: Information Policy Institute, July 2005) p. 7. Available at <http://www.infopolicy.org/pdf/nontrad.pdf>

³ Ibid. Pg. 7

⁴ Also, Matt Fellowes, Mia Mabanta. “*Banking on Wealth: America’s New Retail Banking Infrastructure and Its Wealth-Building Potential*”. The Brookings Institution. 2008, found that an individual shifting to a low cost checking account from check cashing services could save \$40,000 over their career. The Center for Responsible Lending estimates that \$4.2 billion is paid by borrowers each year in excessive payday lending fees. See Financial Quicksand for more information: http://www.responsiblelending.org/pdfs/rr012-Financial_Quicksand-1106.pdf”

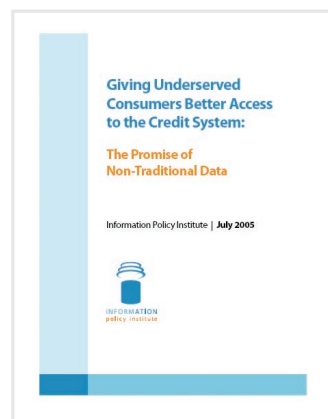
More information is found in many of the most common everyday payments made by consumers, such as electricity, gas, water, telephone, cable, and internet bills, as well as rent, but these are not fully reported to consumer reporting agencies. For these goods or services, the positive information of the on-time payments are rarely reported, but the serious delinquencies and defaults *are* usually reported, either directly or indirectly via collections agencies.

Consequently, the responsible customers paying on time are usually not rewarded for the timeliness of their payments in their credit files. For these responsible customers that do not have other payment histories, this lack of information at consumer reporting agencies can represent tremendous lost opportunity to access more affordable credit. For those with no traditional credit information, it permits the establishment of payment histories without going in to debt. For those with little traditional credit information, it permits their risk profiles to be better estimated.

Findings from Previous Research

Exploration of Alternative Data

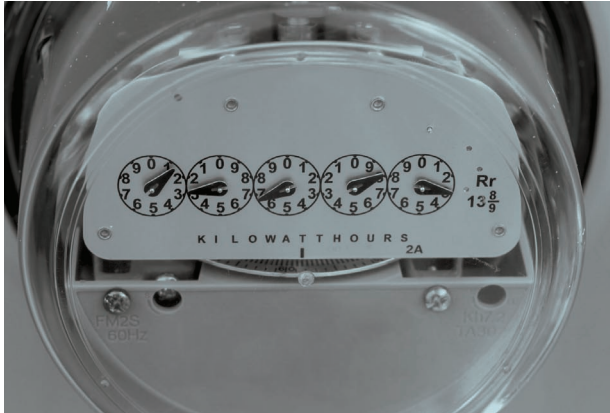
PERC initially explored types of additional payment data that could be added to consumer credit files in *Giving Underserved Consumers Better Access to the Credit System*⁵.



<http://www.infopolicy.org/pdf/nontrad.pdf>

This report concluded that the full reporting of energy utility and telecom payments held the best near-term promise to aid an enormous number of financially underserved consumers, and that, while there are some technical, economic, legal, and regulatory barriers to be overcome, none should be substantial. The benefit of including these payments in consumer credit files is the near universal coverage of the underlying services. Such reporting, then, should make it much easier for most of the current thin- and no-file population to have at least one, probably two, and maybe more payment histories in their credit files.

⁵ Information Policy Institute, *Giving Underserved Consumers Better Access to the Credit System*. Available at <http://www.infopolicy.org/pdf/nontrad.pdf>



Short-Term Impacts of Including Full-File Energy Utility and Telecom Payment Information in Consumer Credit Files

Following the release of the initial report on alternative data, PERC embarked on the second phase of the initiative⁶.

This phase focused on quantifying the initial, short-term, or static, benefits to consumers and lenders from the full reporting of telecom and energy utility payments. We were able to do so because a small share of consumers do have utility and telecom payment information fully reported to one consumer reporting agency. Of the major consumer reporting agencies, TransUnion's consumer credit files contained the greatest number of full-file utility and telecom payment histories. In early 2005 when this phase of the initiative began, only around four per-

cent of TransUnion's consumer credit files contained a fully reported telecom or utility payment, though this translates to around eight million files, far more than enough to conduct meaningful impact and segmentation analysis.

The aim of the research at this stage was to investigate, primarily, three issues :

- (1) the impact of non-traditional data on credit scores,
- (2) the impact on the performance of credit scoring models when non-traditional data is used in the model, and
- (3) comparisons of credit access and use among those with and without non-traditional data

For most of the calculations, two estimates were derived, one for the entire sample and one for thin-file consumers only. In addition, results were also broken down across various socio-demographic segments, such as age, household income, and ethnicity.

The following methodology was used to estimate the impact of full-file utility and telecom payment data on credit scores and model performance.

In March 2005, credit scores were generated from a number of commercially used scoring models, including the tri-bureau VantageScore model, for 8 million credit files with the alternative data. The alternative data was then removed from those 8 million credit files and the files were rescored.

For the 8 million consumers, credit scores using alternative data and credit scores without alternative data can be compared with everything else held constant. This is how the impact on scores is determined. Comparing how well each set of scores "predicts" the outcomes for which they were designed

⁶Alternative data refers to all data that has not been traditionally reported to consumer reporting agencies.

to predict, such as, 90+ days late on any obligation, bankruptcy, or 60+ days late on a mortgage, over the following year is how we determine the impact on model performance.

The actual payment outcomes over the following year were obtained by credit file data for the same set of consumers obtained in March 2006. Finally, two samples, of about 4 million files each, containing credit files that had no alternative payment data were pulled in March 2005 and March 2006 to enable comparisons of credit access and use between those with and without alternative data. These files were pulled at random, and are representative of the American consumer population for which no utility or telecom payments are fully reported.

The key findings of the analyses were that:

- (1) the inclusion of utility and telecom payment information increases access to credit for the thin and no file;
- (2) this inclusion improved the ability of lenders to assess risk; and
- (3) these gains in access to credit are disproportionately observed among low-income groups, ethnic and racial minorities, the young and the old.

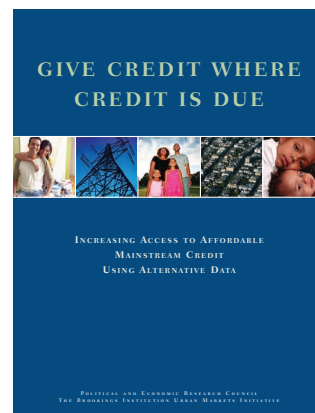
While our findings were extensive regarding what the inclusion of this data means for loan performance, the consequences for thick-file borrowers, and the impact on scoring models, the key findings for consumers are:

- » The risk profile of the thin-file/unscorable population—after energy utility and telecommunications data sets are included in their credit files—is similar to that of the general population (as measured by the pattern of credit scores).
- » The inclusion of energy utility data in all consumer credit reports increases the share of those accepted for credit (acceptance rate) by 10 percent, and including telecommunications data increases the acceptance rate by 9 percent, for a 3 percent target default rate. That is a lender hoping for a loan non-performance level of not more than 3% can accept an additional 10% of the applicant pool when utility data is included, because the data helps lenders better distinguish between a good risk and a bad one.
- » Members of ethnic communities and other disadvantaged social groups experienced gains in the level of acceptance greater than the overall rate for the population. Latinos saw a 22 percent increase in acceptance rates, and African Americans witnessed a 21 percent increase, in comparison to 8 percent for non-Latino Caucasians. Similarly, those who earn \$20,000 or less annually increased their acceptance rate by 21 percent, and those who earning between \$20,000 and \$29,999 increased theirs by 15 percent.

» Most striking was the finding that when alternative data is included, 10 percent of the analysis sample (more than 800,000 consumers) moves from being unscorable to scoreable. That is, 10 percent of the population that is not otherwise scoreable becomes so and thus is better able to access mainstream credit. This gain results from the fact that two-thirds of thin-file segment become scoreable when alternative data are included in their credit files. In our one-year observation period, 16 percent of thin-file borrowers with nontraditional data in their files opened a new credit account compared with only 4.6 percent of thin-file borrowers without it. In short, the inclusion of alternative data increases the availability and use of credit.

Additional Questions on the Consequences of Including Non-traditional Payment

The findings of *Give Credit Where Credit is Due* have been received well by policy makers, lenders, community groups, and even the industries called upon to share data. While the results of the study are broad, we did narrow the focus of it to the first, most basic questions needing exploration. Initial impacts on scores, score performance, credit access, and segmentation analysis were among these. However, the simulations and analysis we conducted, as well as the underlying data, are extensive and offer further insights into how consumers access and use credit when non-traditional information is reported to consumer reporting agencies. We detail some of these additional insights in this report.



<http://www.infopolicy.org/pdf/alt-data.pdf>

The first lesson from this analysis explores whether there are harms from fully reporting energy utility and telephone payment data to credit bureaus and consumer reporting agencies. There is a perception that those with chronic late payments, and who

currently have no credit score, would be better served by having no score than by having a low (subprime) score.

Here, it is necessary to elucidate the concept of ‘harm’ in this market. Since the value of the proposed changes depend greatly on relative harm (in terms of potential credit access) to those with no score vs. the same population having a low (subprime) score owing to chronic late payments on utility bills—it is important to clarify what we mean by ‘harm’. A true harm is what is known as a Type 1 or Type 2 error.

A *Type 1 error* is the misidentification of someone who is a high credit risk as being credit worthy. In this case, the risky borrower would be extended credit on favorable terms. This is a real harm in that it leads to overextension by the borrowers, harms the lender, and harms other borrowers (who need to pay a higher price for credit). A *Type 2 error* is the misidentification of someone who is credit worthy as being highly risky. Again this harms the borrower but also the system as a whole. In this case, a credit worthy person is either rejected or is offered a lower amount of credit at a higher price than their risk profile merits.

Commonly, regulators and activists focus on the possibility that including non-financial payment data can increase what seems like a Type 2 error—that a pattern of late non-financial payments would pre-

clude some individuals from either accessing credit, or getting favorable terms. It should be noted here that identifying someone as a high credit risk based on information that suggests that they are in fact a high credit risk and do not merit an extension of credit *is not a harm*. In fact, it is arguably a powerful protection against overextension and bankruptcy.

By this account, those who are consistently unable to pay energy utility and telephone bills probably shouldn’t be taking on additional debt via non-collateralized loans. If their income is not such as to enable them to pay other regular commitments, credit at that juncture will prove the necessary ingredient in a recipe for personal financial disaster, as segments of the ‘subprime’ mortgage market have shown⁷. In addition to utility and telephone obligations, the borrower now has credit debt that must be paid monthly and which accrues interest and penalty fees for late or non-payment. *In this sense, having a low score does not harm a prospective borrower, but actually can serve as a consumer protection by limiting creditors from extending debt to individuals who are fundamentally unable to handle it at that point in time.*

The ability to differentiate between “goods” and “bads” from a credit risk perspective is fundamental to the safety and soundness of our national credit system. This, in turn, is a public interest that must be protected. The real harm is not simply identifying people as high risk, rather it is *misidentifying* people as either high or low risk. The inclusion of non-

⁸ There may be some perverse incentives that need to be addressed, such as some states requiring late payments by the consumer, or sometimes a disconnection notice in order to prove need and receive energy assistance. Although the scope to which this is the case is unclear. From the data furnisher side, utility firms are said not to have incentives to maintain accuracy, and thus scores may worsen owing to data quality issues. See Margot Saunders’s testimony before the House Subcommittee on Financial Institutions and Consumer Credit on May 12, 2005, “Helping Consumers Obtain the Credit They Deserve.”

⁹ This is of course trivially the case will all debt other than that taken out for investment. Debt is taken out for current consumption in exchange for future consumption.

financial payment data, both ideally and in practice, lowers rates of misidentification and thereby lessens harms. And, importantly, it does so across income and ethnic groups.

The second lesson stems from an examination of what happens to the scores of the credit underserved population over the observation period. That is, would the reporting of utility and telecom payment data improve or worsen their scores over time, especially for the thin-file and no-file populations about whom this study is fundamentally concerned?⁸

While the approach used in *Give Credit Where Credit is Due*, which uses comparisons of counterfactual exclusion of alternative data at a specific point in time, produces improvements in credit scores, it may be the case that credit scores would decline over time when non-financial data is reported. Simply, the static approach in our earlier report may generate inadequate and perhaps misleading indicators of impact on score over time and thus credit access over time. To be sure, other findings in *Give Credit Where Credit is Due* clearly show increases in access to credit, but these are not explicitly tied to scores. A detailed examination of this question follows below, and comprises part of the core quantitative analysis in this report.

The third and final question addressed in this report is whether the reporting of alternative data will not simply lead to greater credit access, but also lead to excessive credit access or “over-indebtedness.” The idea behind this concern is that in using alternative, non-financial, data to bring people in to the financial mainstream, we may be bringing people in who are not ready. We may be bringing in consumers with little or no experience with credit and then setting them up for a fall as they show up on lenders’ radar screens and are sent credit offers from

perhaps “predatory” lenders. This is a longer-term issue which we did not initially address in detail in *Give Credit Where Credit is Due*, but which we will investigate a little deeper here.

Over-indebtedness occurs when the debt service burden exceeds someone’s capacity to pay, or at the least places great financial strain on their household. Someone may be subjectively excessively indebted even as they make their payments, but because of debt an observer or even the subject feels that other activities (savings, or current, as opposed to past, consumption) are foregone⁹. The measurement of over-indebtedness by inability to sustain a debt load as indicated by lateness of payment and defaults is in many ways a more objective and more conventional. Further, the credit score itself is a good measure of over-indebtedness as it captures use of available credit and lateness of payments.

In what follows we quantitatively examine these issues—how does reporting payment data impact scores over time and does reporting payment data lead to over-extension—both in the aggregate and for socio-economic subgroups. We have heard some speculation that some financially disadvantaged or minority groups might be more harmed than helped with the full-file reporting of utility or telecom payment to consumer reporting agencies. This question was mainly addressed in “*Give Credit Where Credit Is Due*,” which found that access to mainstream credit should rise disproportionately for members of low-income households and ethnic minorities with the greater full-file reporting of utility and telecom payment information. Even so, socio-demographic analysis is included in this report to address those concerns.



Additional Findings In On-Going Analyses

The Inclusion of Utility Payment Information Does Not Worsen Scores Over Time

In the original study we found that the inclusion of utility and telecom payment information does not worsen scores.

The following chart shows frequencies of score changes that result from the inclusion of utility payment data. That is, the chart compares score differences when utility data is added, all else being equal.



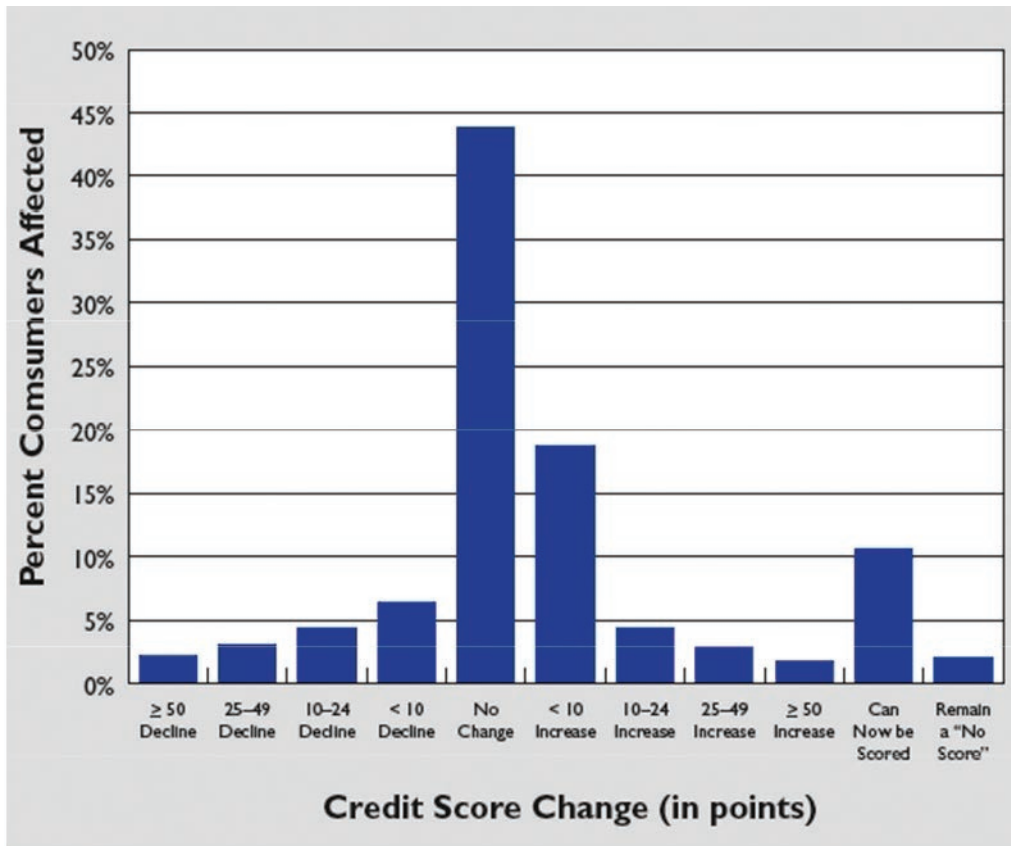


Chart 1: Change in Credit Score with the Addition of Utility Payment Data (VantageScores in March 2005, Source: "Give Credit Where Credit Is Due")

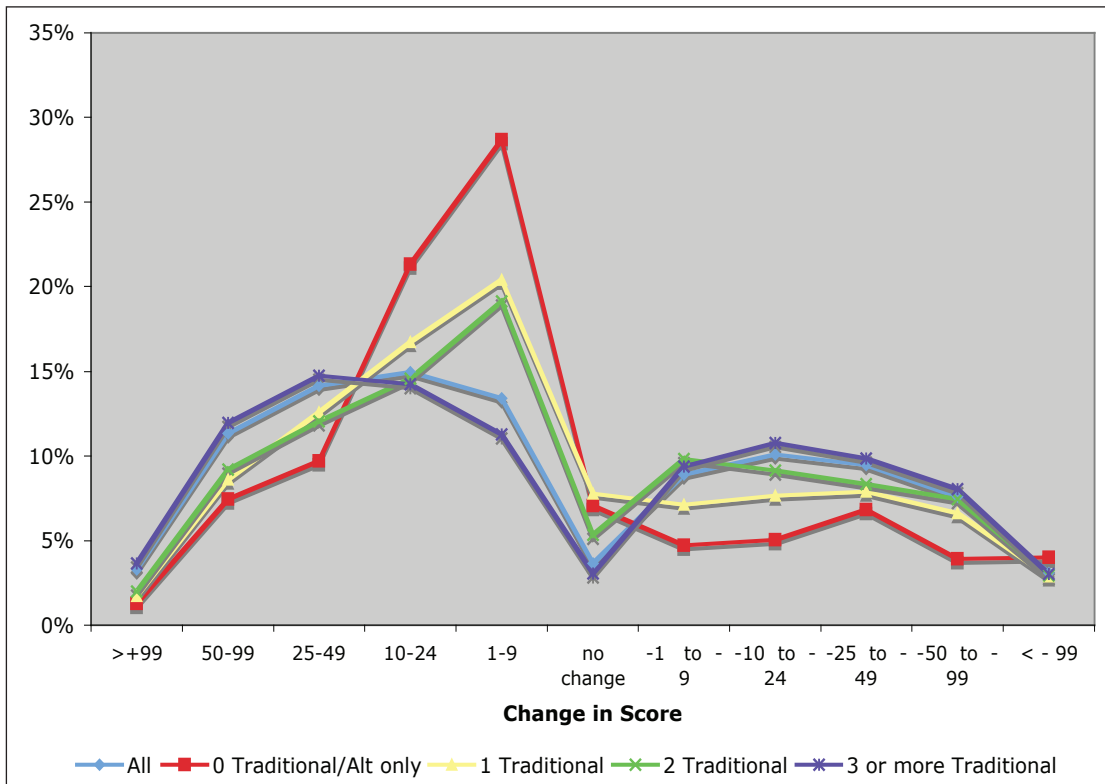
Nearly 45 percent of consumers witness no change in their credit score (VantageScore) with the addition of the utility payment data. More consumers witness increases in scores than decreases, and very few see changes larger than 10 points. Considering the VantageScore ranges from 501 to 990, the changes are very minor in the general population. The largest material impact shown in this chart is the approximately 10 percent of consumers that become scoreable with the addition of the utility data. (It should be pointed out that serious delinquencies are already reported as they go to collections.)

The above is a comparison of static states rather than what happens to consumers over time as utility data is reported. However, the files do allow us to see what happens with the scores over time when utility payment data is reported. We found that the picture is even *more* sanguine if we examine changes in scores over a year period for consumers whose reports include utility payment information. The chart below breaks changes in score over the yearlong observation period by the number of *traditional* trade lines existing in credit files at the beginning of the period. (Recall, that thin-file consumers are disproportionately

low-income and minority consumers.) This chart shows that scores increased for consumers by a larger degree than they decreased over the period. In fact, the closest to a symmetrical distribution across increases and decreases is found among the thick-file. In fact, for those with only alternative data, more than twice as many consumers see their scores rise as see them fall.

While the thin-file are disproportionately low-income and minorities, a more direct measure of the impacts is needed in order to assess whether utility data reporting is useful, or it results in negative consequences that are disproportionately felt by minority and/or low-income consumers. In the original study, we saw that the inclusion of utility and telecom data disproportionately *raised the scores* of low-income and minority consumers.

Chart 2: Changes in Score for Consumers with Alternative Data Over a 1-year Period, by Number of Trade Lines (from March 2005 to March 2006)



(Source: Authors' calculations using TransUnion credit files)



Chart 3 and Chart 4 below show the changes in acceptance rates (or the share of consumers that are accepted for a loan under the criteria set by the scoring system) for a 3% delinquency target (that is, for a goal of having no more than 3 percent of borrowers ever being 90 days or more late in payment) with the inclusion of utility and telecoms payment information by income and ethnicity/race respectively. As can be seen, acceptance rates increase as a result of the inclusion of the information. This shift is a necessary result of improvement in predictive power, and of the inclusion of consumers who would not be scorable and thereby left outside the system.

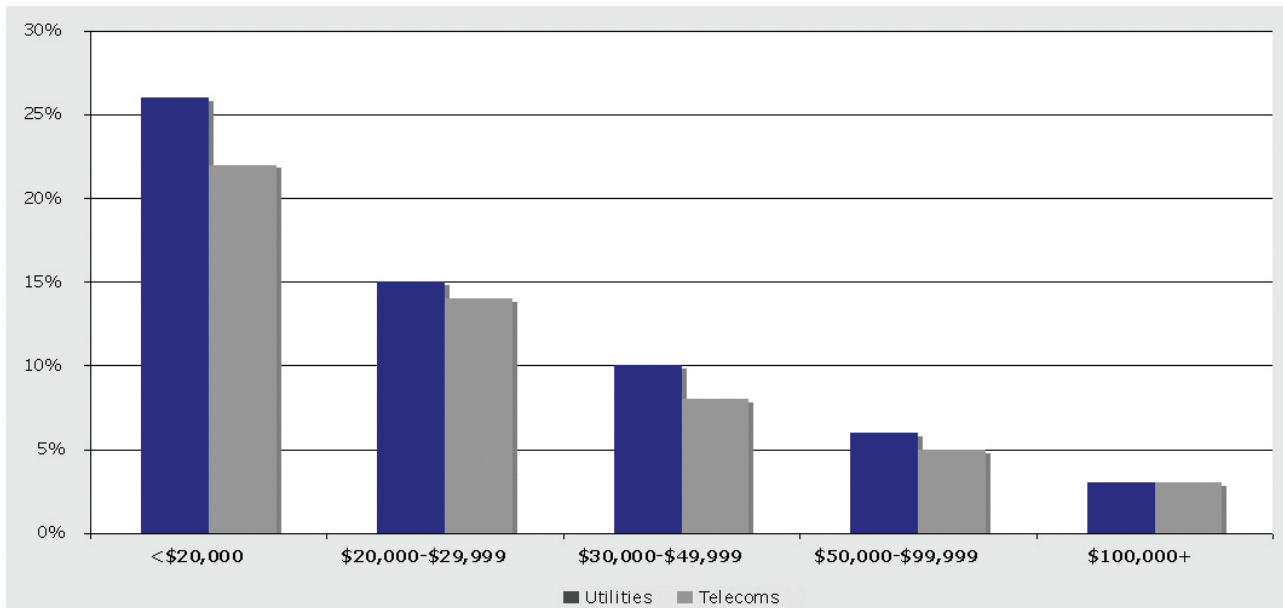


Chart 3: Change in Acceptance Rates by Income at 3% Delinquency Target (Static, March 2005)

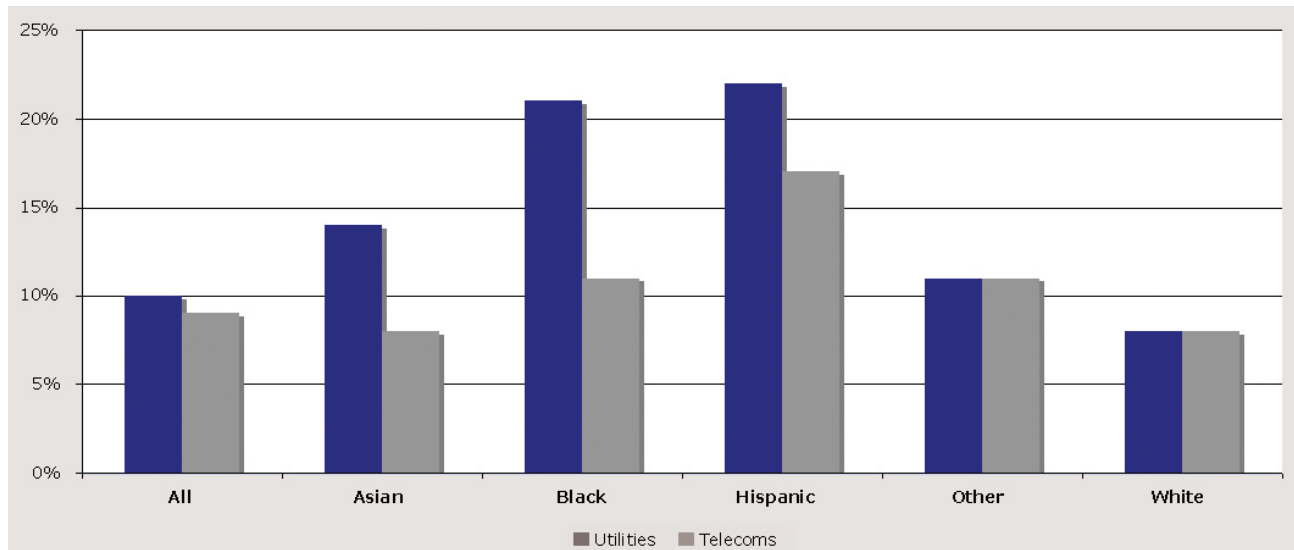


Chart 4: Change in Acceptance Rates by Race/Ethnicity at 3% Delinquency Target

Changes in acceptance rates in the form of increases are most dramatic for those making less than \$20,000 per year and for African-Americans and Hispanics. In each of these cases the inclusion of utility payment data raises acceptance rates by more than 20%.

The charts above measure statics, that is, what happens to a consumer's credit score when information is added in that moment. The charts below, by contrast, looks at what happened to a consumer's score over the one-year reporting period. The impact

of this inclusion on scores over time again challenges the supposition that perversities in the ways that consumers sometimes make utility payments threaten to worsen consumer credit scores. If we examine the actual movement of scores for consumers with a utility trade line over a year period rather than measure scores with and without utility information, we similarly find that those whose scores improved outnumber those whose scores declined. The following charts show the changes over the year by race/ethnicity and by income.

Chart 5: Changes in Score for Consumers with Alternative Data Over a 1-year Period, by Race (March 2005 to March 2006)

(Source: Authors' calculations using TransUnion credit files appended with socio-demographic data from Acxiom)

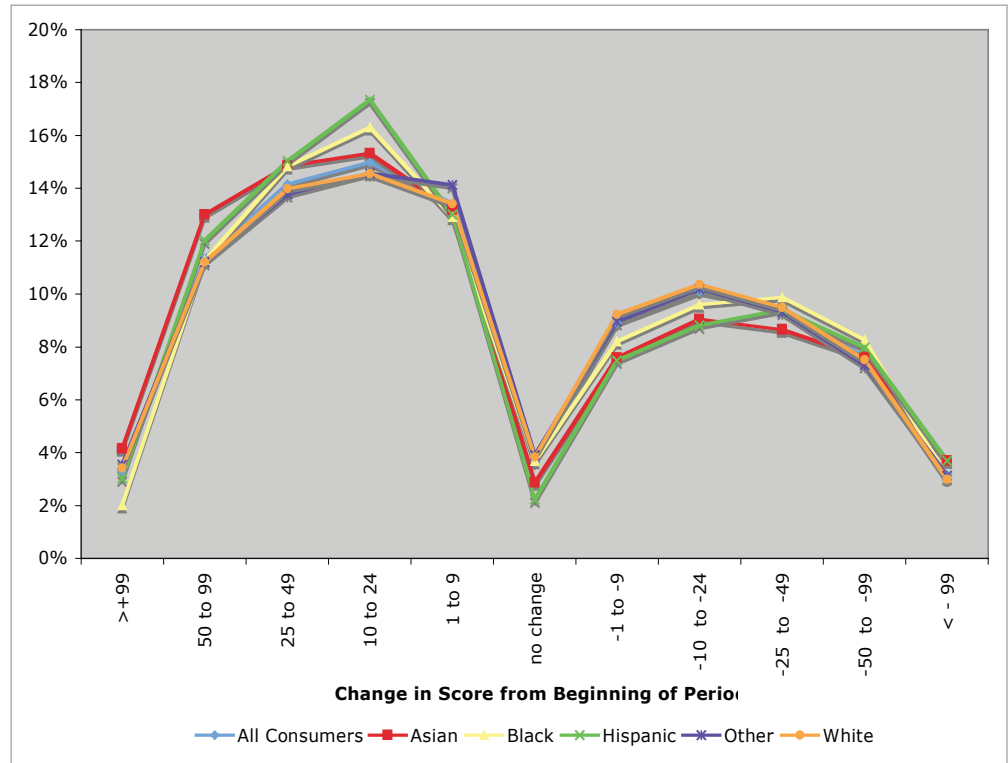
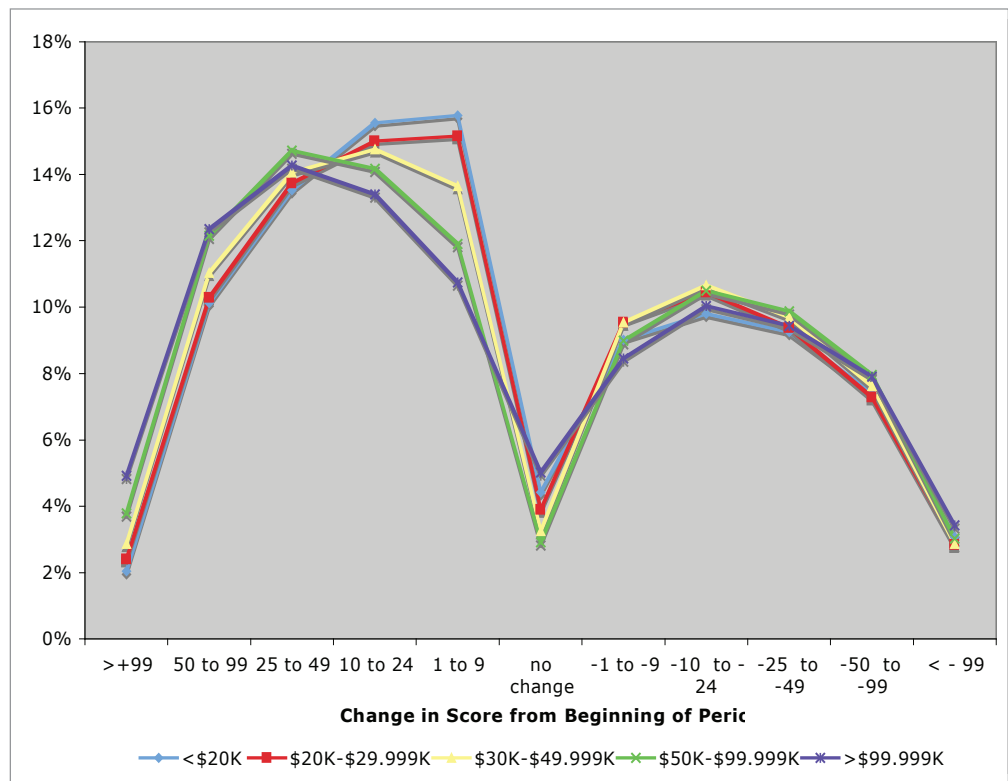


Chart 6: Changes in Score for Consumers with Alternative Data Over a 1-year Period, by Income (March 2005 to March 2006)

(Source: Authors' calculations using TransUnion credit files appended with socio-demographic data from Acxiom)



In sum, the inclusion of alternative data increases their score and thereby access to credit. It does so disproportionately for low-income and minority consumers. Furthermore, it does not appear to *over-extend* credit, that is, to people who cannot afford it, or at prices that cannot be afforded, at least if improvements in score over the observation period are to be taken as indications of better payment histories.

None of this is to say that there may not be problems and hurdles encountered as reporting expands. It may be the case that our very large sample, by virtue of the fact that it has been drawn from populations where utility payment information has been reported for a long time, is comprised of those who've come to understand the ways in which credit reporting and access to credit work and therefore does not capture what happens in populations where utility payments are recently being reported. Given the potential and observable benefits to underserved populations, the answer would most likely lie in support for financial educational initiatives and campaigns, rather than in restrictions to credit access.

Impact of Utility and Telecom Payment Reporting on Credit Access and Use

One of the more compelling findings in *Give Credit Where Credit is Due* is the empirical observation that those who have their utility and telecom payment data reported do in fact gain greater access to credit, all else being equal. The table below shows the differences in access to credit for thin-file consumers (those that should be materially impacted by the addition of alternative payments, here by the availability of \$2,500 more in a line of credit) and compares these to their validation sample equivalents. The differences as noted above are statistically significant.

The figures in table 1 indicate a much higher rate of opening new accounts among consumers with utility and telecom payment data in their credit files. Compared to the group without alternative data, this group is opening more new accounts, accessing more credit and seeing their available credit rise.

Table 1: New Financial Credit Accounts Opened: March 2005-March 2006

	Thin File (<3 Traditional Trades)		
	Consumers with Utility Trades (#1)	Consumers with Telecom Trades (#2)	Validation Sample (#3)
Percent with new Accounts	16.44%	16.42%	4.61%
Avg. # of New Trades Opened	0.27	0.26	0.05
□ Total Outstanding Balance	+ \$1972	+ \$891	- \$402
□ Total Available Credit	+ \$2466	+ \$1094	- \$382
Sample Size	1,036,396	113,240	1,030,357

Thus, over the one-year observation period we see increased credit access and use for the thin-file consumers with alternative data (relative to those without such data) *and* slight improvements in their credit scores. And we should remember that many, more than 850,000 in our sample, would not have had credit scores at all if not for the utility and telecom payment data.

Longer-term Impacts of Alternative Payment Data

When most people think of the longer-term, particularly relating to this issue, they are likely thinking of two or perhaps three years. After that, any direct impacts from gaining credit via alternative payment data would seem rather far removed. And an objection for just looking at one year (as in the results discussed thus far) could easily be that there may be insufficient time for the negative effects to have shown up. For instance, say a person only has alternative data prior to March 2005 and then opens a new account a few months after March 2005. If it takes a few months to start to fall behind, then the potential full negative impact from opening the new account may not show up by March 2006.

To explore the longer-term consequences, what we can do is look at consumers who; (1) only had alternative payment histories prior to March 2003 and; (2) opened up traditional accounts between March 2003 and March 2005. These consumers, then, would have had between one and three years experience with a new traditional account by March 2006.

We can then compare the findings for this group to the one that only had alternative data prior to March 2005 and opened a new account between March 2005 and March 2006, that is consumers with less than one year's experience with a new account.

And, although not as comparable, we can also examine the consumers who had alternative data and only one traditional payment history prior to March 2003. The problem with this, of course, is that we do not know which came first, the traditional or the alternative entries.

Based on these comparisons, we can see how scores change over time to the extent that we believe that there have not been large changes in the types of people we are looking at over time. Follow up research should seek to look at the same group of people, track them for several years, and compare their score over time. We are, however, looking at scores at one period of time and comparing groups with different lengths of history with new accounts. This should produce suggestive results, but, as with most analysis, not conclusive results.

Table 2 shows the change in scores from March 2005 to March 2006. For the sample of individuals who only had utility or telecom payment histories by 2006, we see a rise in the VantageScore of 2.81 points. This is not too surprising, particularly given that the period is one of general economic growth. What we also see is that for those in Group I, those who only had alternative data prior to March 2006 and then opened a new account between then and March 2006 saw a decline of .64 points in their VantageScore. The largest average decline for any of the segments shown is for the African American group and is less than 10 points. These declines are relatively small and it should be remembered that without the alternative data these consumers would have had no score for 2005 and, as was shown before, would have likely been less likely to have opened a new account. Further research is needed to assess longer-term effects, *but the available evidence does not indicate a worsening of consumer situations vis-à-vis debt.*

The next column indicates that those who had alternative data more than two years prior to March 2005 (and then opened a new account between then and March 2005) (Group II) saw somewhat of a reversal of the declines shown in column 1. This could indicate that the small average decline seen initially after opening a new account is reversed in the longer run. This is consistent with the notion of a learning process, an initial decline in scores followed by a recovery. Though the changes are very small compared to the range of the VantageScore and the results may simply be consistent with score stability over time.

One of the problems with only looking at such changes is that, for Group II, say, that there may have been a very large change between 2003 and 2005, with the recovery between 2005 and 2006 only making up for a part of this. For this reason we will want to look at the actual scores of the different groups in 2006.

Table 2: Change in Vantage Score between March 05 and March 06

(Source: Authors' calculations using TransUnion credit files appended with socio-demographic data from Acxiom)

	Alternative Data Only, No New Accounts	Over 3 years of only Alternative Data, No New Accounts	Group I New Account less than a year old	Group II New Account 1-3 years old	Group III Alternative and 1 Traditional account over 3 years old
Average	2.81	2.27	-0.64	5.99	3.25
Ethnicity					
Asian	2.15	2.77	4.15	11.43	6.03
Black	3.41	2.84	-9.56	2.41	2.98
Hispanic	2.58	4.55	-4.09	6.36	5.93
Other	1.81	1.07	2.79	7.87	2.56
White	3.01	1.60	3.15	5.74	2.66
Age					
18-25	0.98	3.24	-5.65	4.53	7.56
26-35	5.43	4.11	1.72	5.23	5.50
36-45	4.28	3.36	2.86	3.52	3.97
46-55	2.55	1.89	2.27	5.31	3.33
56-65	1.71	1.14	4.87	5.64	2.52
>65	-1.71	-2.20	4.96	7.86	-3.23
HH Income (000)					
<20	1.76	0.67	-5.29	4.97	1.91
20-29	1.56	0.58	-1.8	4.70	2.28
30-49	1.94	0.93	1.18	5.21	2.24
50-99	1.52	0.78	8.16	7.79	3.22
>99	1.99	1.04	30.68	12.13	2.96
Sample Size	499,050	373,350	68,787	60,124	226,082
<p>Group I: Those with only alternative trades prior to March 2005 that subsequently opened an additional trade between March 2005 and March 2006. Group II: Those with only alternative trades prior to March 2003 that subsequently opened a traditional trade between March 2003 and March 2005. Group III: Those with alternative trades and only 1 traditional trades prior to March 2003.</p>					

In Table 3, comparing columns I and II in particular, we see that the longer individuals in the group had the alternative data (and opened a new account) the higher the score. This is the case for all of the segments shown. Taken together, *we find evidence of a very small short-term decline (no real material change) in credit scores followed by longer-term increases for those who ‘use’ alternative payment histories to open new accounts.*

A curious observation (not in the tables) which we do not attempt to explain is that the 2005 credit scores of those who only have alternative data as of 2005; and then open a new account within the following year; is 612 while those that do not open

a new account the following year is 652. So, the two groups appear different and one should be cautious if trying to compare credit score levels between them, something we avoid, only comparing levels within groups and changes across the groups.

Another observation that should also be considered is that only 12 percent of those with only alternative data as of 2005 had opened a new account by the following year. This compares to a rate of about 42 percent from a national validation sample of all consumers. So, by no means do we witness a mad rush to open new accounts among those with only alternative data.

Table 3:
March 2006
Vantage
Score

(Source: Authors’ calculations using TransUnion credit files appended with socio-demographic data from Acxiom)

	Group I New Account less than a year old	Group II New Account 1-3 years old	Group III Alternative and 1 Traditional account over 3 years old
Average	613	637	660
Ethnicity			
Asian	664	689	677
Black	573	587	602
Hispanic	627	643	628
Other	640	668	699
White	611	635	674
Age			
18-25	587	614	606
26-35	586	608	608
36-45	600	622	627
46-55	615	640	658
56-65	639	662	691
>65	698	739	773
HH Income (000)			
<20	596	628	649
20-29	608	637	668
30-49	620	649	676
50-99	642	666	698
>99	697	695	732
Sample Size	68,787	60,124	226,082
<p>Group I: Those with only alternative trades prior to March 2005 that subsequently opened an additional trade between March 2005 and March 2006. Group II: Those with only alternative trades prior to March 2003 that subsequently opened a traditional trade between March 2003 and March 2005. Group III: Those with alternative trades and only 1 traditional trades prior to March 2003.</p>			



Policy Issues and Recommendations

The results from our study *Give Credit Where Credit is Due* and the analysis above suggests that increasing the full reporting of utility and telecom payments to consumer reporting agencies will:

- (1) have little effect on most individuals;
- (2) improve financial access for those who only have limited payment history 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.

In this section, we discuss three concerns: (i) the regulatory concerns that would allow the reporting of utility and telecom payment data: (ii) whether it should be opt-in or not, and (iii) finally, coping with extenuating circumstances in the utility sector.

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 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 consumer reporting agencies.

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 consumer reporting agency 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.

Some Considerations in the Wake of the California Opt-in Proposal

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 (CA AB 588).

While this is certainly movement in the right direction, there are at least two major problems with an opt-in scheme. 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 its end-users, 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”¹⁰.

At a larger level, policy makers should keep in mind the fact that default settings matter. Automatic enrollment in retirement plans is one example. Systems that automatically enroll an employee (with and opt-out) when s/he becomes eligible for retirement plans have greater enrollment rates than those where the default is no enrollment (and the employee has to opt-in). Examining 401(k) plans, Brigitte Madrian and Dennis Shea found initial enrollment rates in an opt-in system to be 20% rising to 65% over three months. In opt-out systems they found the initial enrollment rate to be 90%, rising to 98% over a few months¹¹. Similarly, Eric Johnson and Daniel Goldstein found that rates of organ donation vary across different European countries according to whether the default is set as presumed consent or as opt-in¹². They find that countries that are very similar have very different rates of organ donation, owing to the default setting. Thus, the Scandinavian country of Denmark, which is opt-in, has an effective donation rate of 4.3%, which is 1/20th of the rate seen in the Scandinavian country of Sweden, which is opt-out. Similarly, the Germanic country of Austria witnesses a donation rate of nearly 100%

¹¹ Brigitte Madrian and Dennis Shea, “*The Power of Suggestion: 401(k) Participation and Savings Behavior.*” *Quarterly Journal of Economics*. Vol. 116. pp. 1149-1225. 2001

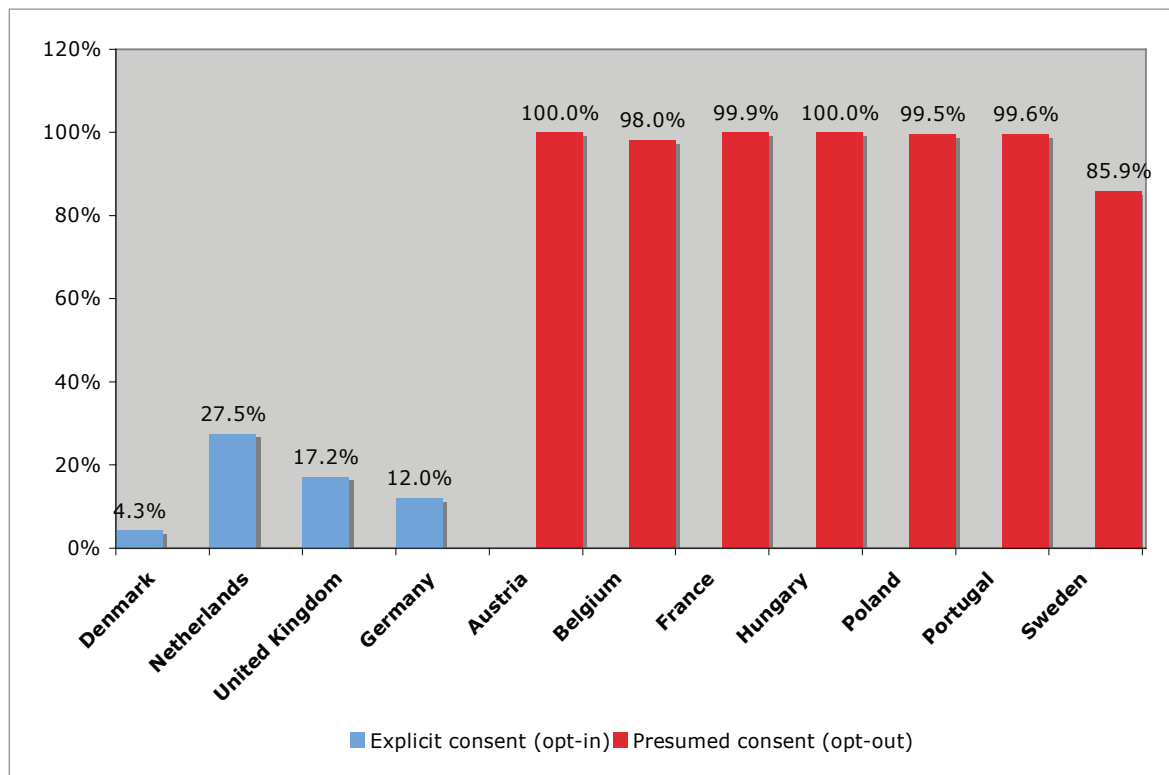
¹² Eric J. Johnson and Daniel Goldstein, “*Do Defaults Save Lives?*” *Science*. Vol. 302. pp. 1338-1339. November 21, 2003.

(99.98%), whereas the Germanic country of Germany sees a rate of 12%. The following chart from Johnson and Goldstein shows the donation rates for a select number of European countries. The most salient factor explaining these differences appears to be whether the forms for licenses at the motor vehicles departments are opt-in or opt-out with respect to participation in organ donation programs. The lesson is that the default position has considerable consequences for what people ‘choose’

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 has proven highly effective for more than three decades, and is widely accepted by Americans. As such it provides a model for the reporting of alternative or non-financial data.

The lesson is that the default position has considerable consequences for what people ‘choose’. Policymakers should consider this very clear dynamic at play. If data sharing is set as opt-in, chances are either too few will opt-in for the benefits to be widely enjoyed—and the data that is reported will

Chart 7: Effective Consent Rates in Organ Donation by Country





The Limits of Reporting Freezes: The case of Illinois and Utility Payment Data

None of the above should suggest that there are not problems to be encountered along the way, especially in an era of rising energy prices. 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.

In the utility sector, the issue of price spikes is a real concern, especially in the wake of rising energy costs. The issue of how to address these as prices climb, given that there are limits to how much energy consumption can be reduced, is a real one. One instance can be found in an Illinois law that froze energy utility rates for a decade. The unintended consequence of this law was a need for a massive rate readjustment years later when the law expired. Lawmakers, worried that consumer credit scores would worsen as consumers face a sharp spike in energy bills, sought to pass a legal moratorium on reporting. Issues such as these 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 the approach would have another unintended consequence of perhaps 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 such as that recently seen in Illinois, rather than the proposed legislative solution, we would encourage lawmakers to work with energy utility companies and consumer reporting agencies to identify a voluntary work around. This approach is not without precedent, as lenders in the Gulf Coast and the national consumer reporting agencies agreed to similar steps in response to the spate of natural disasters in the region during 2005.

In that sufficient time has passed since the electricity rate adjustment, most Illinois ratepayers have adjusted to higher prices. This has reduced pressure for legislation that would prohibit consumer reporting agencies from using utility payment data in credit scores. Recently, the Illinois State Department of Treasury has taken up an interest in this issue, and seems committed to working with industry to find ways to encourage the full reporting of energy utility and telephone payment data to consumer reporting agencies. Treasury convened an industry meeting in May 2008, and held a similar meeting with consumer and privacy advocates the following month.



Conclusions

The inclusion of non-financial payment data—referred to as alternative data—in consumer credit files has been shown to dramatically broaden and deepen access to affordable sources of mainstream credit.

Individuals who are able to access mainstream credit in whole or in part as a result of having their non-financial data reported to a consumer reporting agency do not find themselves swimming in debt. Evidence suggests that there is a high degree of score stability over time. That is, individuals who have payment data reported do not unduly suffer as a result. Other conclusions drawn from this report include:

- » **Payment reporting is not “new”**—financial and non-financial payment reporting has been occurring in the United States (and other countries) for more than 100 years. A regulatory framework embodying the OECD’s Fair Information Practices—the Fair Credit Reporting Act—has been in place in the US for nearly four decades.
- » **Delinquent data already reported**—a vast majority 91%-MAIN at PERC, forthcoming 2008 of energy utility and telephone companies already report late payment data to consumer reporting agencies and consumer reporting agencies either directly or indirectly through collections agencies.
- » **Significant majority benefit from reporting payment data**—empirical evidence shows that reporting non-financial payment data substantially assists lower income individuals, members of ethnic minority communities, and younger and older Americans with accessing affordable sources of mainstream credit.
- » **Subprime score is better than no score**—a small minority of individuals who are unable to consistently pay their telephone or energy utility bill on time will have their credit scores lowered as a result. This should be expected as some consumers transition to the financial mainstream. To be sure, many of these individuals would have no score—and therefore no chance to access affordable mainstream sources of credit—and no hope of building credit without the inclusion of non-financial payment data in their credit files.

- » **Reporting payment data is protection against over-extension**—just as having the positive payment data (timely payments, amount of payment) reported to consumer reporting agencies helps increase financial inclusion, the regular reporting of payment data acts to prevent lenders from extending credit to individuals that they cannot afford. Thus, fully reporting payment data is a powerful protection against over-extension and potential bankruptcy.
- » **Growing interest in policy solutions**—federal and state lawmakers and regulators are increasingly interested in reducing financial exclusion through the reporting of payment data to consumer reporting agencies. Any bills that reduce regulatory uncertainty by explicitly granting permission to energy utility and telephone service firms to report payment data—in a fashion entirely consistent with the provisions of the Fair Credit Reporting Act—are desirable.
- » **Address perverse tensions**—some states link eligibility for individual assistance grants for utilities to the receipt of disconnection notices. In such states, individuals would be placed in an odd tension between qualifying for assistance that they need to keep their home heated, on the one hand, and protecting or building their good credit on the other. This is patently ludicrous. There are a range of other suitable eligibility criteria that don't create such unnecessary tension, and that would allow consumer to qualify for grants without sacrificing their credit. Lawmakers must move to change these criteria as part of any legislation to permit energy utility and telephone payment reporting.

Alternative Data Initiative

An Initiative of the Markets And Information Nexus (MAIN) at PERC

The Problem

- » An estimated 35 to 54 million Americans have insufficient credit information to qualify for affordable mainstream credit.
(Sources: Experian and FICO)
- » The number of thin-file and no-file Americans may exceed 70 million, if immigrants are included.
(Source: NCRA)
- » Most outside the credit mainstream may only access credit from high-priced lenders including check-cashing services, payday lenders, and unscrupulous predatory lenders.
- » It is estimated that each year Americans spend \$4.2 billion on fees and charges for payday lenders, check cashing services, and predatory lenders.
(Source: Center for Responsible Lending)
- » An individual borrower could save \$40,000 to \$360,000 over the course of a career by opening a simple checking or savings account.
(Source: The Brookings Institution)

PERC's Solution

- » Nearly all energy utility and telecoms firms report negative customer payment data (delinquencies and defaults) to credit bureaus, either directly or indirectly through collections agencies.
- » Under the current system, energy utility and telecoms customers are penalized for late payments, but are not rewarded for timely payments.
- » PERC promotes the full reporting of customer payment data—negative and positive data (timely payments and the amount paid)—by energy utility and telecoms firms to consumer reporting agencies (CRAs) as a way of helping millions of Americans quickly build a positive credit history and enable them to access affordable credit.
- » In 2004, PERC launched its Alternative Data Initiative (ADI) with the goals of: (1) Exhorting energy utility and telecoms companies to fully report to CRAs; and (2) Moving the market by encouraging demand (use by lenders in underwriting) and supply (collection of data by CRAs).

The Roadmap

ADI Phase 1 (Jan 04—Mar 05)

- » Testified before House Financial Services Committee
- » Released “Giving Underserved Consumers Better Access to the Credit System,” (National Press Club)

ADI Phase 2 (Apr 05—Jan 07)

- » Released “Give Credit Where Credit is Due” with Brookings UMI, measuring economic and social impacts of full payment reporting to credit bureaus.
- » Built broad coalition of supporters including lenders, credit bureaus, CRAs, and consumer advocates.
- » Extensive outreach with public and private sectors.

ADI Phase 3 (Feb 07—Dec 08)

- » Survey of energy utility and telecoms firms building business case to report.
- » Study measuring impacts of having rental payment data and other public record data reported to CRAs.
- » Federal and state outreach.



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