PERC RESULTS AND SOLUTIONS

NCLC Supports the "3 Ps" of Lending:

Pawn Shops, Predatory Lenders, and Pay Day Lenders

(Chapel Hill) OK, they really don't support these institutions, not directly anyway. But by focusing exclusively on hypothetical harms to a small share of consumers from reporting alternative data to major credit bureaus—as they have in their June 2009 issue brief—while ignoring both the harms from not reporting alternative data and years of experience and empirical research proving the considerable consumer benefits for the vast majority, the National Consumer Law Center's (NCLC) position is an effective endorsement of the status quo.[1]

NCLC seems to prefer to force up to 70 million Americans who are financially excluded due to having insufficient credit information to continue to have their credit needs met by high cost lenders, thus racking up an estimated $4.3 billion in excessive costs and fees annually. Many of these consumers could access affordable sources of mainstream credit if certain non-financial data sets were included in their FCRA-regulated credit file. In short, by defending the status quo, NCLC supports a policy that is taking money directly out of the pockets of the most disadvantaged Americans and putting it into the coffers of high-cost lenders. This causes real harm, and it is happening right now.

U.S. Supreme Court Justice Louis Brandeis once quipped, " [T]he greatest dangers to liberty lurk in insidious encroachment by men of zeal, well meaning but without understanding." Though NCLC means well and has a track record of zealously fighting to protect consumer interests, its position paper on alternative data and recent public proclamations demonstrate a lack of understanding of crucial elements of credit reporting, credit scoring, and credit underwriting.[2]

PERC and other proponents of alternative data share many of the same broad objectives with NCLC, including reducing financial exclusion. But make no mistake, in this instance, NCLC's hard line on alternative data is unjustifiable. It is largely a collection of unsubstantiated assertions that are contradicted by hard evidence.

The following is what we believe to be right and wrong with the NCLC paper.

What's right with NCLC's alternative data issue brief:

- ***Identifies unwise LIHEAP policy:*** NCLC points out the ridiculous eligibility requirement for LIHEAP energy assistance grants—using a disconnection notice as proof of need—maintained by some municipalities. Oddly though, NCRC doesn't take issue with this policy. Instead of recognizing that forcing customers not to pay their bills in order to qualify for a grant is wrong and purblind—and that the vast majority of states follow federal law and determine eligibility criteria by income— NCLC exploits it as a scare tactic and a means to discredit the promise of credit reporting alternative data.

[1] See http://www.nclc.org/issues/credit_reporting/content/NontraditionalCreditInfoPaper.pdf
[2] 3 November 2009 National Community Action Foundation conference.

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What's *wrong* with NCLC's alternative data issue brief:

- ***Creates false tensions:*** NCLC points to a moratorium on shutting off heat and electricity in cold weather states during winter months. They reason that financially distressed persons know that their heat and power will stay on when they don't pay their bills, and use the "extra money" generated by the moratorium for food and other essentials. If utility payment data were credit reported, NCLC argues, a cushion for those in need would be eliminated. However, as noble as this position might seem, the logic is seriously flawed. First, utility customers who do not pay will still have power and heat during the winter even if their payment data is credit reported. Second, those who do pay their bills during winter months will be building a good credit history, and to deny them this ability is a harm. Third, those who do not pay because of a winter moratorium will face a large bill in the spring, one that they will likely have to pay eventually. If they do not pay once the weather warms up, they will likely lose their energy and heat. Finally, those who cannot afford to pay for an ensemble of essentials—food, shelter, electricity, gas—are being protected from over-extension by having their energy utility and telecoms payment data fully reported. By so doing, they are prevented from receiving offers of credit that they clearly cannot afford, and they are protected from bankruptcy and other far worse outcomes as a result of having a credit file.
- ***Wrongly understates scale and scope of alternative data:*** By focusing on niche players and newly-introduced solutions in this nascent sub-sector of consumer credit reporting, the NCLC gives the impression that alternative data as a field is fringe and reliant upon questionable data sources, including "payday loans, subprime auto loans, membership club records … and even daycare monthly payments." Interestingly, NCLC also classifies as "non-traditional data" such information as "bank accounts, telephone utilities, bankruptcies and liens." In fact, such data is classified as traditional credit information to the extent that it is already reported to major consumer credit bureaus like TransUnion, Experian and Equifax. By focusing on the most extreme data sets, NCLC misses one of the greatest attributes of the alternative data solution—namely, that it works with an existing and proven regulatory and industry framework, and that it can reach a massive scale almost instantly. The value to the credit underserved is not in self-reported solutions nor in niche aggregators using marginal data sets, but rather in having very large companies—telephone and energy utilities—fully report payment data for inclusion in FCRA-regulated consumer credit files maintained by major credit bureaus.
- ***Wrongly overstates perceived "harms" and potential data problems:*** As evidence of why reporting alternative data may be harmful, the NCLC issue brief suggests that it may foreclose opportunities for tenants to dispute rental payment and other landlord-related issues with landlords. In fact the opposite is true with respect to payment issues. By including rental payment data in FCRA-regulated credit files (and this assumes that rental payment data is shown to be predictive of credit risk, credit capacity, and credit worthiness), consumers are empowered with regulated dispute resolutions procedures that mandate action from the landlord

within 30 days otherwise the dispute will be settled in the consumer's favor by default. Further, it is contestable whether anyone is actually harmed as a result of credit reporting. Those who are financially unable to meet energy utility and telephone payment obligations already have their late payment data reported to credit bureaus. Further, the reporting of such data, as is discussed below, actually is a consumer protection against over-extension, and fully reporting is far more forgiving and helpful to the consumer than only reporting negative payment data or not reporting the data at all.

Even a Low Score Is Better than No Score: Score Forgives and Protects

At the heart of NCLC's concerns is the fear that a tiny number of Americans who are unable to afford both food and their electric bill somehow will be harmed if their payment data is fully reported to major credit bureaus. By its own estimates, which use data more than 10 years old, the vast majority of consumers and subgroups of consumers examined pay their bills on time. NCLC asserts that for those who do struggle to pay their bills on time, having their data fully reported to a credit bureau would be a harm. According to NCLC's flawed logic, having no score is somehow better than having a low score. This is generally not true for a number of reasons.

First, NCLC conveniently ignores the fact that serious late payments already are reported to major credit bureaus—TransUnion, Experian, and Equifax—directly or indirectly via collections agencies. That is to say, Americans already are being punished for many of their delinquencies and defaults, but are not being rewarded for their timely payments—a situation with which NCLC seems comfortable. While a consumer may not have a credit score, he or she may have derogatories such as collections and public records in his or her credit file, so no score does not necessarily mean a blank credit file.

Second, full-file reporting is a more forgiving system. The state of an individual's financial affairs is fluid. A person can be up one month then suddenly and unexpectedly fall upon hard times through divorce, job loss, or medical expenses. Under the status quo, that person's credit report will be tarnished, and it will remain so for seven to ten years. With full-file reporting, when that person's situation changes and he or she is able to start making payments, the individual's credit report will reflect that fact—there will be positives in the file to counterweight the negatives. This is the quickest and only proven way to restore one's good credit standing.

Third, that small segment of the population who cannot meet their non-financial payment obligations are being protected, not harmed, as NCLC incorrectly asserts. A low credit score is the most effective means of preventing an individual from taking on debt that he or she cannot afford, and which may lead to far worse outcomes than merely a low score from late payments on utility bills. Default, collections, and bankruptcy, for example, are all considered major derogatories. Further, those with no score are already shut out of the financial mainstream and struggle to obtain apartments, jobs, and certain types of insurance. Having a low score does not hinder them along these fronts, and may actually help them, as their credit history would then be transparent, explicable, and reparable.

Fourth, if there is any benefit from having no score, it must come at the expense of others who also don't have a score but who have paid their obligations on time; the "benefit" is simply that of being indistinguishable from others in the group and being assigned the average characteristics of the group. Those who exhibit higher-risk characteristics that are hidden would "benefit" and those who exhibit lower-risk characteristics that are hidden would be harmed. However, it is worse than just robbing low-risk Peter to pay high-risk Paul (since these low-risk consumers would be forced to pay more for credit), basic economic results tell us that in an environment in which individuals exhibit different levels of risk but are indistinguishable from one another, credit is undersupplied, if it is supplied at all. So, not only are individuals in the group, on average, worse off, but also low-risk (underserved and thin-file) consumers are cross-subsidizing high-risk (underserved and thin-file) consumers. To be in favor of this sort of "benefit" from having no score is bizarre and myopic since each "benefit" is associated with greater harms to other thin-file underserved consumers.

NCLC's Flawed Logic Is "Supported" by Unsubstantiated Assertions

NCLC seems to think that everyone is entitled to low-cost credit, and that there shouldn't be consequences for failing to meet your payment obligations. Thus, a person who is unable to pay his or her electric, telephone, gas, and water bills somehow should not have that considered when applying for a loan or credit. But real harm to consumers, lenders, and society occurs when a borrower's risk and capacity are misidentified, not when a borrower is identified as high risk if she or he is truly high risk.

Under the status quo, an economically disadvantaged person who cannot meet his or her payment obligations for whatever reason likely will have stains on his or her credit report. Should circumstances change and that person is suddenly able to pay his or her bills, there is no benefit under the current system, as this data is simply not reported in the vast majority of cases. However, if energy utility and telecoms firms were all fully reporting payment data to credit bureaus for inclusion in FCRA-regulated credit files, then a person's changed circumstances would be captured in real time and his or her good credit would be restored. Thus, a full-file credit reporting system is vastly more forgiving than one that only captures negative non-financial payment data.

Both actual experience and rigorous empirical research have shown that fully reporting energy utility and telecoms customer payment data to national credit bureaus for inclusion in FCRA-regulated credit files dramatically increases access to affordable sources of mainstream credit in the following manner:[3]

- 10% of the general population would have been accepted for mainstream offers of credit who otherwise would have been rejected;
- 22% of Hispanics and 21% of African Americans would have been accepted for mainstream offers of credit who otherwise would have been rejected;
- 21% of those who earn $20,000 or less annually would have been accepted for mainstream offers of credit who otherwise would have been rejected;

[3] *Give Credit Where Credit is Due* downloadable at http://perc.net/files/downloads/alt_data.pdf

- 14% of those aged 25 or younger and 14% of those aged 66 or older would have been accepted for mainstream offers of credit who otherwise would have been rejected, showing benefits for both younger and older generations;
- through alternative data, those who are new to credit were four times more likely to access mainstream sources of credit than thin-file consumers with no alternative data included in their credit report; and,
- through alternative data, those who were new to credit carried less debt on average than the general population, performed better (fewer delinquencies) on average, and saw their credit scores increase over a three year period regardless of income tier, ethnicity, or age.

When one adds these figures, the number of "credit invisibles"—those who are financially excluded owing to insufficient information to be scored—is a staggering 54.5 million people.[4]

PERC Agrees with NCLC on Practical Concerns, but Disagrees on Solutions

PERC and its partners encourage those energy utility and telecoms companies that fully report to do so in a manner that is consumer friendly. For instance, utilities have flexibility in the way they report, so they can decide not to report moderately late payments or small unpaid balances, and they can make decisions on how an account is reported on a one-on-one basis, accommodating particular circumstances.

NCLC correctly points out that some consumers who are in need of assistance are required to provide disconnection notices in order to qualify for utility assistance grants. The resolution to this tension is not to disallow credit reporting of non-financial payment obligations—as NCLC would have it—but rather to change the eligibility criteria to individual assistance grants. General energy assistance to those with low incomes should not require a disconnection notice. States with such eligibility requirements should emulate the criteria of those states without such a requirement, such as North Carolina, which bases assistance on a person's income, assets and heating expenses.[5]

Now Is the Time for Credit Reporting Utility and Telecoms Payment Data!

Credit reporting energy utility and telecoms payment data works. PERC and Brookings research has shown that fully reporting this data to a national credit bureau enables the financially excluded, underserved, thin-file population to access affordable sources of mainstream credit at four times the rate of the comparable population for whom the same data is not reported.[6] A recent PERC study found evidence of rising credit scores over time among those who opened credit accounts after only having fully reported utility or

[4] PERC estimates approximately 17.5 million adult persons in the US have no credit file, and a further 37 million have a thin-file (fewer than 3 tradelines or accounts in their credit file) which cannot be scored by many credit scorecards.
[5] http://www.ncdhhs.gov/dss/energy/req.htm
[6] Op. Cit. *Give Credit Where Credit is Due.*

telecom payment data in their credit reports.[7] Thus, increased credit access does not appear to result in those who are new to credit becoming overextended.

Given the current financial crisis and the growing credit crunch, the Obama Administration needs solutions that don't carry a high price tag. Implementing this much-needed solution—permitting the full reporting of non-financial payment data to national FCRA-regulated credit bureaus—*would cost the government nothing* and should be aggressively pursued by Congress.

Not permitting the inclusion of fully reported non-financial payment data in FCRA-regulated databases represents a clear harm to the millions of Americans who are discriminated against in the extension of credit, insurance coverage, apartment rental, and the workforce due to insufficient information.

NCLC would do well to avoid letting the perfect be the mortal enemy of a very good outcome. To do otherwise would be a great disservice to those whom they claim to serve. Instead of recycling outdated arguments that they first advanced in 2005—all which have subsequently been addressed by PERC using empirical evidence and rigorous research—NCLC should understand that the greatest harm is in preserving the status quo, and should productively engage proponents of alternative data to have their legitimate concerns addressed.

PERC supports "3 Ps" that we recommend NCLC consider when assessing this issue.

- **Progress and Not Perfection.** The proposed tool of utilizing alternative data to increase financial inclusion, while very good, like all things is imperfect. When considering the pros and cons, one should give more weight to what has been tested and proven than to that which is asserted and highly speculative. Further, endorsing this approach also requires coming to terms with the fact that not everyone is imminently qualified to take on unlimited amounts of credit at any given point in time.
- **Performance and Not Presupposition.** Alternative data represents an incredible opportunity to improve retail lending systemically, and to dramatically increase access to affordable sources of mainstream credit in the near-term using existing financial services infrastructure and a regulatory framework already in place. Opposing this solution presupposes either that it represents a socially and economically worse outcome than the status quo, or that a better option exists. The former has been refuted by empirical evidence and experience, while the latter is speculative and requires continued suffering for the financially excluded.
- **People and Not Personality.** A common knee-jerk reaction of some organizations is that if it serves the interest of a group that they traditionally oppose, it must be bad. While this simple worldview may be appealing, it is seldom entirely accurate. In this case, there exists a harmony of interests among all key stakeholders—the credit underserved, mainstream lenders, credit bureaus, and utility and telecoms firms. Wouldn't it be great if we could all get along?

[7] *You Score, You Win* downloadable at http://perc.net/files/downloads/web_layout-you-score.pdf

We encourage you to learn more about PERC's Alternative Data Initiative by visiting our web site at www.perc.net.

We invite you to add your organization's name to the growing list of organizations that support full-file credit reporting of energy utility and telecoms payments as one promising tool to promote financial inclusion and better underwriting. Go to http://www.perc.net/supportadi to join the growing ranks of supporters.

To see the complete list of those organizations already supporting the PERC, CFED, CFSI sign-on letter, head to http://www.perc.net/adilist.