

# Giving Underserved Consumers Better Access to the Credit System:

## The Promise of Non-Traditional Data

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## Executive Summary

For borrowers, creditors, and data furnishers, the use of non-traditional data in consumer reports is likely to be a “win-win-win” scenario.

- **Borrowers:** Alternative financial data could enable the estimated 35 to 50 million American borrowers who don't have credit accounts, or whose credit histories have too little information to be used in allocating credit, to qualify for credit from mainstream lenders. The use of non-traditional data may also have an impact on consumers who are already part of the credit reporting system. By optimizing risk assessment, costs could be more equitably distributed among borrowers, reducing costs to responsible borrowers.
- **Creditors:** Alternative financial data would increase the ability of creditors to accurately assess lending risk. The results could include a reduction in bad loans, an increased ability to price loans to match risk, and higher performance rates for the entire loan portfolio.
- **Furnishers:** Alternative financial data would result in fewer delinquent payments and reduced charge-offs.

Despite its great promise, there are impediments to this type of information sharing. Both economic and regulatory barriers may deter many prospective data furnishers from reporting.

- Some would-be data furnishers unfamiliar with the reporting systems and the practices that mitigate customer poaching fear that sharing data will enable competitors to steal their customers.
- Some firms may have complex and incompatible legacy IT systems in place that would make the cost of updating their systems in order to report greater than any perceived benefits.
- Some states have statutory prohibitions on the onward transfer of customer data by regulated utility companies. In those states, no customer data from telephone companies, electric, gas, or water companies can be shared with credit reporting agencies as a matter of law.
- Utility providers in many states confront great regulatory uncertainty as to whether they are permitted to report data. Without clarification from state legislators or regulators, the fear of potential legal liability and public relations fallout acts to block sharing of customer data with CRAs.

Our findings in this study show that:

- **Utility and telecom data is likely to be most useful for Americans with little or no credit history:** Data from utility companies, especially telecommunications and energy firms, possess “credit-like” attributes. Therefore, it is potentially most useful in helping bring these Americans into the mainstream credit system.
- **Non-traditional data is very unlikely to negatively affect the credit scores of most Americans:** Serious negative information is already reported by utilities, telecommunications firms, and many other sources of non-traditional data through collection agencies. However, positive information, such as on-time payments, is not reported. Inclusion of positive information stands to reward most consumers by improving credit scores, and it promises to help those left out of the system altogether develop a payment history, thereby easing their access to traditional credit sources.
- **Prospective data furnishers need regulatory certainty:** Public service companies, such as utilities, are among those with the greatest potential to help underserved consumers gain access to credit. Yet, they confront great regulatory uncertainty concerning data sharing and would benefit from affirmative clarification from regulators or legislators of their ability to report data.

## Introduction

### Credit reporting fundamentals

#### *How it works*

In the late 1960s and early 1970s, a wave of consolidation swept the consumer reporting industry in the United States. The national credit reporting system that resulted, comprising the “big three” national bureaus, helped facilitate massive expansion of the credit card market observed in the late 1980s. By the 1990s, three factors, enabled by better risk assessment, contributed to yield a market for consumer credit in the United States, which is, by most standards, the envy of the world.

These factors were:

- (i) Increased competition in part facilitated by the use of “prescreen lists”;
- (ii) Widespread use of credit scores to efficiently analyze lending risk and accurately establish pricing appropriate to the level of risk;
- (iii) The growth of secondary markets as a means to refresh capital.

U.S. consumers have benefited immensely from these developments. While it is difficult to quantify the precise contribution of the changes in consumer credit described above, there is little question that they have played a significant role in homeownership growth observed during the past two decades, particularly among the “historically underserved.” Between 1983 and 2001, the home ownership rate increased 25% generally and increased 65% among minorities during the same period.<sup>1</sup>

Access to credit brings additional benefits. Consumer credit helps new entrepreneurs launch their businesses. Small business owners often use revolving credit to finance their activities, either as a primary means or as an adjunct to other forms of credit.<sup>2</sup> Increased access to revolving credit, and increased ability to refinance home mortgages, gives families an ability to “smooth over”; periods of financial challenge. And finally, credit cards offer unparalleled convenience in the purchase of consumer goods.

#### *Barriers to market entry for consumers with thin or no credit files*

In addition to identifying information such as name, age, and address, traditional sources of data in a consumer report include:

- Information about credit accounts held by the consumer, including how long the consumer has had the line of credit, the credit limit or loan amount, balance, whether the account is a joint account, monthly payment, and payment pattern;

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1 Federal Reserve Board, Survey Consumer Finances, 1983 and 2001. [www.federalreserve.gov/pubs/oss/oss2/scfindex.html](http://www.federalreserve.gov/pubs/oss/oss2/scfindex.html). Also see Hollis Fishelson-Holstine. “Role of Credit Scoring in Increasing Homeownership for Underserved Populations.” Joint Center for Housing Studies of Harvard University. February 2004. [www.jchs.harvard.edu/publications/finance/babc/babc\\_04-12.pdf](http://www.jchs.harvard.edu/publications/finance/babc/babc_04-12.pdf).

2 In 1998, nearly 45% of small businesses (defined as those with fewer than 500 employees) used personal credit cards as a financing source. Marianne Bitler, Marianne Robb, Alicia Robb, and Wolken, John D. “Financial Services Used by Small Business: Evidence from the 1998 Survey of Small Business Finances.” Federal Reserve Bulletin, April 2001, p. 192.

- Public records including tax liens, bankruptcies, state and county court judgments, and, in some states, child support payment delinquencies;
- A list of those who have obtained a consumer's credit report.

Access to credit depends on the ability of lenders to assess the risk associated with extending credit to a particular person based on the information in their credit file. This information is scored, then is evaluated by algorithms that measure the risk of lending. Credit scoring has become the principal means of risk assessment and is an important tool in determining appropriate account terms, including price. Scoring is an empirical and pragmatic process through which complex indicators of risk are objectively identified and evaluated to estimate with great accuracy the risk associated with a given loan. Credit scoring methodology is not the subject of this study and so is not discussed here. However, credit scores are the primary tool used by lenders today to evaluate credit risk and are an important aspect of underserved consumers gaining access to the credit marketplace.

A credit score cannot be calculated or lending risk be otherwise assessed if there is little or no information in a consumer's credit file. These consumers are often described as having a "thin-file" and have a difficult time accessing credit. Paradoxically, without credit to begin with, it can be difficult for such consumers to establish that they are creditworthy.

In most cases there are mechanisms by which thin-file consumers or those who lack credit history altogether may enter the credit market fairly easily. For example, parent-child joint accounts for bankcards help many of the young participate in the credit marketplace. Others, by contrast, do not transition so easily into the system. Uncovering the full set of causes as to why some do and others do not make that transition awaits research. Whatever the causes, the consequences can be significant for living standards, purchasing opportunities, and asset formation.

For most Americans, homeownership accounts for the bulk of savings. Rent is turned into equity through ownership and to a large extent becomes savings in the form of real estate assets. The irony is that because homeownership accounts for the bulk of assets, most Americans need to have access to credit in order to build substantial savings. This is especially true for poorer households, as the Survey of Consumer Finances regularly shows. For the whole of the American population, home equity accounted for 42% of all assets of those who owned their homes. This share increases as household income decreases. For the homeowner population in the bottom 20% of income, home equity accounts for 80% of their assets.

A second and equally pressing dilemma that stems from having no file or an unscorable file is the lack of access to revolving credit. The issue of revolving credit is thornier, as it raises fears of rising debt burdens. The other face of revolving credit is its use in small business activity. Many small business owners use personal credit cards to finance much of their activity, especially to manage cash flow bottlenecks. The Federal Reserve's survey of small businesses found this to be increasingly true in the 1990s. The share of small businesses using personal credit cards increased nearly 10% (or 4 percentage points) from 41% in 1993 to 45% in 1998.<sup>3</sup> This is particularly true for the smallest and newest of the small businesses.

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

Inability to access credit may help explain lower levels of entrepreneurial activity among poorer segments of the population. Lack of information about credit risk, in turn, helps partly to explain the lack of credit for these consumers. It's clear that low levels of capital act as a hurdle to acquiring credit, just as lack of access to credit acts as a barrier to building assets. Helping consumers build assets then becomes an issue of helping them enter the credit system.

This structure creates serious challenges for many with thin or no files, though low income levels may explain the exclusion of substantial numbers from the credit reporting system. Without a credit history, lending risk cannot be assessed, typically through credit scoring. If their credit risk cannot be assessed, again, usually with a credit score, consumers cannot obtain the credit accounts necessary to build a credit history. Building a credit history initially is not especially difficult for most consumers, but for some, particularly those who lack an understanding of the credit system or who have few financial resources, it can be a significant obstacle.

Those with low incomes and who are left out of the credit system have a difficult time building assets. To a considerable extent this is because they cannot borrow. They have a hard time borrowing because there is far too little information on their credit history to predict risk. Note that this is true of those consumers with "thin-files" who are credit risky as well as those who are creditworthy.

*The majority of those with unscorable thin-files or without files at all do in fact engage in activities that can be thought of as "credit-like." While not traditional credit agreements, most consumers have recurring relationships that entail periodic payments.* Those relationships may include service provision agreements that require regular payment for the services or goods received. The regularity of these payments is often an indicator of how risky the prospect of lending to the consumer might be. That is, the vast majority of people in the thin-file segment of the population do demonstrate their sense of responsibility through various agreements to pay for regular services. For instance, virtually every consumer makes regular payments for rent, utilities (such as electricity, gas, telecommunications, and cable), and auto insurance. Payday loan installments are another possible example.

Data on these types of transactions, which are currently excluded from traditional consumer credit reports, comprises what is referred to as "non-traditional" or "alternative" data. Though this information is potentially predictive of an individual's credit risk, this information rarely reaches the credit reporting agencies. Moreover, this information may speak to the creditworthiness of consumers with little or no credit history. But were this information catalogued by credit bureaus, and, by extension, evaluated by lenders through credit decision models, these consumers may have less difficulty acquiring credit through conventional means.<sup>4</sup>

It is important to note that a history of positive information is what enables credit score developers, also called modelers, to develop systems that fully assess a consumer's likelihood of repayment. In other words, both negative and positive information is necessary for credit scoring systems to be effective. In many sectors that do not currently report positive information regularly, some negative data, such as defaults, are reported to credit bureaus. Most collection agencies report defaults to credit bureaus, so this information is available in credit files. The problem for those outside of the credit system is less the access to negative information about their

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



payment history than the absence of positive information on credit files. Concerns that reporting by utilities may lead to negative consequences overlooks the fact that most serious negatives are either already reported directly to the bureaus or are reported via collection agencies.

The following is an analysis of the information sources that are the focus of attempts to bring underserved consumers into the credit system by reporting non-traditional data and the constraints facing these efforts. The Institute is planning a more thorough and quantitative analysis that will estimate the number of consumers who could enter the credit market and the amount and price of credit that can be extended by reporting non-traditional credit information. That analysis will quantify results by data type. The focus of this study, however, is generally qualitative. The first step of this study includes:

- An identification of the full range of prospective alternative data;
- An analytical framework for assessing the potential usefulness of each of the identified alternative data sets;
- A discussion of which parties may benefit from the use of alternative data in consumer credit reports and the nature of those benefits;
- A discussion of which parties may incur costs from the use of data in consumer credit reports and the nature of those costs.

After a discussion of the use of non-traditional data in consumer credit reporting and its potential benefits, the study examines the economic, technological and regulatory hurdles to doing so by sector and type of information. We examine the current treatment of non-traditional data sources and explore regulatory and practical concerns associated with the use of non-traditional data in consumer credit reports and scoring. Specifically, we look at problems of reliability, verifiability, and predictability (relative to traditional sources) of prospective sources of non-traditional data.

Keep in mind that the successful use of alternative data may not only help extend credit to currently underserved groups, but it may also move them into spheres where traditional data furnishers would also have information about them. In short, it promises a means to help many of the underserved clear current barriers to the credit market.

Should alternative data be integrated into consumer credit reports, the effect of this new data will not be limited to thin-file and unscorable Americans. For those with scorable files, non-traditional data can help to generate a better risk profile. A wider view of a consumer's payment habits, including rent, utilities, cable, etc., potentially could paint a better picture of a consumer's overall risk profile. The use of non-traditional data for thick-file consumers, in creating more accurate risk profiles, can help to reduce cross-subsidies from less risky consumers to riskier ones. That is, it can help make the system fairer by limiting the extent to which responsible consumers pay the cost for less responsible consumers. However, the effect of non-traditional data on the risk profile of "thick-file" consumers may be very small.

## Population of thin-files

Estimates of the size of the population with “thin-files” or with no files vary. Yet, even the most conservative estimates place the number in the tens of millions. Fair Isaac Corporation estimates that 54 million Americans lack credit files that can be scored in order to access credit. Of these, 32 million have files that are too thin to score, and 22 million have no files at all. Experian® estimates that nearly 18 million Americans have files too thin to score and that another 17 million have no files at all.<sup>5</sup>

These consumers form the “underserved” market. Surveys find them concentrated among minorities (notably, among African Americans and Latinos), the poor and other low income segments, the elderly, recent widows, and new immigrants (including illegal immigrants).

A demographic breakdown of those without bank accounts serves as a proxy for unscored thin-files and no files. Approximately 9.7% of households in the United States have no bank accounts. Of these, 32.9% are African American. Compare this to the fact that African Americans represent 12.2% of the population.<sup>6</sup> Similarly, Latinos account for 19.6% of those without a bank account but represent 13.7% of the population. By income segment, those without bank accounts are predictably concentrated among poorer households. More than half (50.5%) of these households make less than \$10,000 annually, and another 35% earn between \$10,000 and \$25,000 per year.

## Alternative data use for modeling

It is impossible to assess the predictive value of non-traditional data ex-ante — in other words, without actually collecting the information, constructing models, and assessing their performance. However, it is possible to make some reasoned speculations as to which types of data are likely to have the greatest usefulness for credit risk modelers.<sup>7</sup> One of the most important ways to look at alternative data is to assess whether or not that data type is “credit-like.” In essence, the question of whether or not a category of data is “credit-like” hinges on a simple question: Were goods provided at the time of payment? If a service or good is provided in advance of the receipt of payment, then we deem it to be “credit-like.”

By virtue of this quality, not all regular payments are “credit-like.” A second aspect of some of these relationships is that, even if they are not strictly credit-like in the sense described above, there is an agreement to pay for services over time on a regular basis. If in these cases the service provider may terminate services for non-payment immediately, it can be thought of as somewhat more “cash-like,” as sanction for non-payment is immediate. Conversely, the more difficult it is for a service provider to terminate the provision of service to a delinquent consumer, the more “credit-like” the relationship. The quality of being “credit-like” is therefore not simply a formal aspect of the payment structure but also results from the practical aspects of sanctions in the event of non-payment at the agreed-upon time.

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5 The estimates vary widely because two different proxies are used. FICO uses the proportion of “unbanked” consumers as measured by the Federal Reserve as a proxy for unscorable files. W. A. Lee, “Eyeing the Unbanked: Fair Isaac Starts Bureau of its Own.” *American Banker*, July 8, 2004. Experian bases its estimate on the number of credit-eligible people in the United States and subtracts its estimate of scorable files.

6 Federal Reserve Board, “The Unbanked — Who Are They?” *Capital Connections*, Vol. 3, No. 2. (Spring 2001) [www.federalreserve.gov/dcca/newsletter/2001/spring01/unbank.htm](http://www.federalreserve.gov/dcca/newsletter/2001/spring01/unbank.htm).

7 The CRAs, as well as some lenders, have some preliminary assessments of the predictability of some classes of non-traditional data for some credit instruments. These are still being developed and, moreover, can be expected to vary by credit type. Although, all of those who have run tests with utility information indicate that it is predictive.

We can expect that consumer behavior on credit-like services is likely to be predictive of their behavior on actual credit products. It is also possible that data on regular payments where the transaction is more cash-like may also strongly speak to a consumer's creditworthiness, in so far as these activities may serve as a proxy for a consumer's financial responsibility. Ultimately, whether or not and to what extent a particular category of data is predictive of a borrower's likeliness to repay a loan is an empirical question. But the universe of credit-like data that theoretically could be used to assess one's creditworthiness is larger than one might think.

In this paper we consider a number of broad categories of data that are currently absent from credit reports but might be sufficiently credit-like to have predictive value for lending decisions. The categories of data that some have considered as potential sources of non-traditional data are:

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

Energy, telecommunications, payday loans, and retail installments are credit-like in the sense described above. Auto liability insurance and child care payments are not. Regular payments that are not *credit-like may be of use to modelers at some point, but credit-like information offers the most promise*. Credit-like services are most promising not necessarily because they are more predictive, but rather because those who offer credit-like services have a greater incentive to report than those who offer cash-like services. In a voluntary reporting system, it is important to take into account the incentives to report. It offers the most promise in so much as those who offer credit-like services have a greater incentive to report than those who offer cash-like services, not that they are necessarily more predictive. And in a voluntary reporting system, it's important to take the incentives to report into account.

While the pros and cons of these data types are considered more rigorously below, it is useful to think about these data types in terms of how they might or might not be credit-like. For example, consider rental payments. While rental payments are typically paid in advance, often on the first of the month, it is rare that eviction proceedings will immediately follow non-payment. But because renters often do fall behind in their rent without immediately being evicted, there is a credit-like quality to rental arrangements. Furthermore, not only is rental data often credit-like, rental payments are analogous to mortgage payments in that the sanction mechanism is almost identical: failure to repay one's mortgage will ultimately culminate in foreclosure, whereas failure to pay one's rent will result in one's eviction.

A stricter, less credit-like logic is at play where the sanction is severe and immediate. For instance, were telephone companies permitted to terminate service for non-payment immediately, it is unlikely that consumers, except those in the most dire financial situations, would fail to make timely payments. As such, it is likely that, in general, services where non-payment results in immediate and severe sanction are decidedly more cash-like than credit-like. As mentioned, in these instances the disciplinary effect of reporting is seemingly small — moreover, service providers do not take a loss — thus the incentive to report is small.

Open questions regarding the credit- or cash-likeness for some types of data remain. For example, people may be far more responsible with payments for daycare, as concerns for children and for getting to work are affected immediately. Experience may show that payday loans are a good predictor of consumer payment behavior. But then again, it may not. There is no systematic evidence as to whether one type of information is more predictive than another. *Ultimately, these are pragmatic and empirical questions that can be answered only in practice.* Modelers have incentives to select those data types that are predictive and reject those that are not, as access to credit, the pricing of credit (and thus profit), and the security of the principal depend on the reliability of the information.

What most candidates for viable types of non-traditional data share is the character of the obligation. There is an agreement of payment for service of some kind. Ideally, the relationship is regular, though notably payday loans are not regular for the most part. In some instances, payment is received prior to the receipt of services, such as rent, in which payment is for the month following, but the failure to receive payment does not automatically terminate the receipt of service. In other instances, such as utilities and telecommunications and payday loans, payment is received *after* services are offered. In all instances, these relations promise to offer some predictive value to an individual's likelihood to repay a loan.

## The emergence of information sharing mechanisms

Identifying sources of potential, non-traditional data is not enough to bring the underserved into the credit system. Empirical analysis must establish that alternative data holds predictive power with respect to the likelihood of default. Even if the predictive value of non-traditional data is established, there still are hurdles that must be overcome before the data can be used — economic, regulatory, and technological. Moreover, because the system is voluntary, the incentive to report and collect data must be considered.

We know from experience something of how a robust reporting system can emerge. Not only must non-traditional data have predictive value for lenders and other users of credit reports, there also must be some clear rationale for those who have the data — for example, utility companies or landlords — to invest the time and money necessary to provide that information to credit bureaus. We discuss briefly here how these information sharing mechanisms arose among financial institutions.

In Europe, information sharing mechanisms among banks were created more or less by legislative fiat. By contrast, in the United States the credit reporting system arose in the private sector without government intervention. Lenders are not compelled to furnish consumer data to the three national bureaus. Instead, financial institutions have concluded that voluntarily providing such data to the bureaus is preferable to hoarding the data and shielding the information from their competitors.

Credit bureaus offer financial institutions a comprehensive picture of borrowers, improving the ability to predict the likelihood of repayment. This allows lenders to market and price their loans to reflect the risk of the individual applicant.

By contrast, some of the proposed furnishers of data cited as possible sources of non-traditional data have a much less obvious incentive to furnish to the national credit reporting agencies. One argument, in its simplest form, holds that because rental agencies, utility providers, and other oft-cited potential sources of data do not offer traditional credit products, they are unlikely to see any benefit in providing data to the national credit repositories.

The experience of lenders suggests one incentive for non-traditional data sources to furnish information. Beyond providing a means with which to better evaluate applicants, credit reporting also had an additional benefit to lenders. It creates an incentive for consumers to pay loans on time. While a consumer could still default on loans, the price of doing so is an increase in the cost of future borrowing, at best, or denial of future credit, at worst.

A study of Nicor Gas Corporation's experience with credit reporting showed that the utility reduced its number of delinquent payments by 20% when consumers understood that their payment information was being reported.<sup>8</sup> Once aware that payment history has an impact on future access to credit, consumers have incentive to pay on time. They understand that their payment behavior will affect their access to credit and the price they pay for it.

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<sup>8</sup> TransUnion, "TransUnion Case Study: How reporting helped Nicor Gas reduce bad debt." (Chicago, IL: TransUnion, 2002).

## The Analytic Framework to Assess Alternative Data

### Reliability

Credit reporting agencies must be confident that the data they receive from lenders and other sources is reliable for two reasons. First, and by far the more important, any proposed new type of trade line would have to yield usable predictions about “thin-file” or “no-hit” applicants. If the data is not reliable for making sound credit decisions, it is not beneficial to lenders or consumers as part of a credit report. Second, unreliable data increases the rate at which consumers dispute the contents of their credit reports. The dispute process is costly to both bureaus and furnishers who must verify reported data as required by the FCRA. Significant increases in dispute rates would require bureaus to increase their capacity for handling consumer disputes.

In general, the value of any type of data is purely an empirical matter determined by the construction of a model that is subsequently measured against actual loan performance. When considering non-traditional data, there are some additional factors that must be given weight and that we have grouped under the heading of “reliability.” Specifically, these factors are accuracy, standardization, and expected regularity.

For “thin-file” and “unscorable” applicants to become eligible for credit, some sort of regular series of positive credit-like behaviors must be catalogued. For those already served by credit, the most important source of this kind of data is regular loan payments. For both groups, the addition of infrequent, inaccurate, or non-standardized data sources will have little or no positive impact on credit access.

#### *Reliability in the sense of accuracy*

Payment information must be an accurate account of the applicant’s behavior. Has the consumer paid on time? Was the payment in the full amount? If the payment was late, how late was it? Did the consumer in fact default, if he or she defaulted on a payment?

Central to this assessment is the quality of recording payments by the data furnisher. The quality of payment records also eases the reverification process in the event of a dispute. Data furnishers and consumers may have differing accounts of whether a payment was made, in what amount, and on what date relative to when a payment is due.

#### *Reliability in the sense of expected regularity*

In order to model the payment activity of consumers, a decision model requires a steady stream of information on a payment line. One CRA suggests that information that is sporadic decreases the usefulness of the trade line in models.<sup>9</sup> One purpose of a model is to assess how timely payments are likely to be. A reliable and regular history of payments is needed in order to make this assessment. If much of the data associated with a trade line is missing, the account itself tells very little about the risk associated with a consumer.

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<sup>9</sup> Interview with the CRAs.

We should, however, include the caveat that we are discussing ongoing obligations. Financial “events,” such as bankruptcies, tax liens, and collection activities, tell lenders quite a bit about the creditworthiness of a borrower. But with respect to using non-traditional data to expand credit access for the traditionally underserved, the dilemma is the lack of a sufficient amount of positive information about timely payments. Regular positive information helps to “thicken” files and thereby expand credit access.

## *Reliability in the sense of standardization*

The third way in which data is deemed reliable is whether it is or can easily be standardized. Standardization and computerization reduce reporting errors. They also enable the use of software that greatly reduces the marginal costs associated with reporting data. Data furnishers enjoy similar efficiency gains from standardization. For instance, in the event of dispute proceedings, where the veracity of disputed items must be verified by the furnisher, standardized data helps speed the process.

Most important, standardization improves the accuracy of data, making it more useful to lenders and other users of credit reports. Standardized formats of reporting include the Consumer Data Industry Association’s (CDIA’s) Metro2.™ Similarly, standardized reverification formats, such as CDIA’s eOscarWeb™, serve to reduce the cost of disputes and make correction of misreported data easier and faster. These technologies also improve the regularity of reporting by automating the transmission of data from furnisher to bureau.

## **Implementation costs**

There are the implementation costs associated with reporting data. Fragmented industry sectors may have greater implementation costs of standardized business segments than non-fragmented sectors. Some sectors may have legacy systems that do not permit automated reporting and reverification. Their reporting costs may be greater than those of comparable firms with newer systems. Others, though concentrated, may have fragmented billing systems. Finally, some sectors may face greater political pressures, as with public companies or public service firms. These issues must be kept in mind when identifying sources of non-traditional data and when considering regulatory changes.

## **Analytic framework for evaluation**

The following criteria were used to evaluate the potential impact of alternative data sources.

The first consideration was the extent to which a category of data furnishers are concentrated. This is best thought of as a sector’s consumer to data furnisher ratio or the number of consumers per data furnisher, whether we think of these as a single company or as a billing system. Some sectors (for example, leased parking spaces) involve relatively few consumers for each provider (lessor) of a service. By contrast, electricity providers have a very large number of consumers per furnisher, as electricity providers tend to enjoy regional monopolies.

In general all utilities — electricity, gas, cable, water, telecommunications — are generally characterized by a relatively large number of consumers per data furnisher. One utility company can provide service to millions of households. But from an implementation standpoint, it is the number of consumers per furnisher that offers an idea of the initial setup costs. For example, a provider may have dozens of billing systems and cycles, factors that make reporting more difficult. Large providers can unify their systems but will only do so if the perceived benefits of reporting exceed the perceived implementation costs.

The importance of the ratio is that it gives us some idea of:

- The costs of reporting on consumers, especially the average cost per consumer;
- The chances of diffusing standardized and computerized reporting formats and systems (such as CDIA's Metro2 format and the eOscarWeb verification system);
- The reliability of information.

For example:

- Large enterprises, which provide services to tens of thousands of consumers, can reap economies of scale in reporting full file. To see why, compare the limitations to reporting that an electric company servicing a city faces with those faced by an individual who rents out a duplex to two families. The former, in all likelihood, already possesses a computerized and unified billing and payment system, whereas the latter is unlikely to use one. The cost of the reporting system and thus the cost of reporting per customer are small, as scale economies obtain greater size. For the latter, these costs may be significant, especially in terms of time and learning.
- Implementing a standardized reporting format in firms that service a large number of consumers is relatively easy. They possess departments that have expertise in billing and information technology. Small-scale service providers, by contrast, are not integrated so effortlessly. This is not to suggest that large providers with fragmented billing systems and different cycles and/or legacy systems will find the transition without cost. Rather, a centralized billing system that serves thousands of consumers enjoys economies of scale in reporting and reverifying data, in the event of disputes, making reporting easier along a key dimension.
- A major problem with smaller, fragmented service providers, such as lessors, is that there is a great chance that the information they provide may be unreliable. In the case of rental payments to small landlords, payments are tracked largely informally, and cancelled checks serve as receipts. The additional problem of unverifiable disputes (a possibility in the absence of a computerized payment system and institutionalized payment processing) also creates disincentives for small-scale providers, given that expected data furnisher liability may be significant.

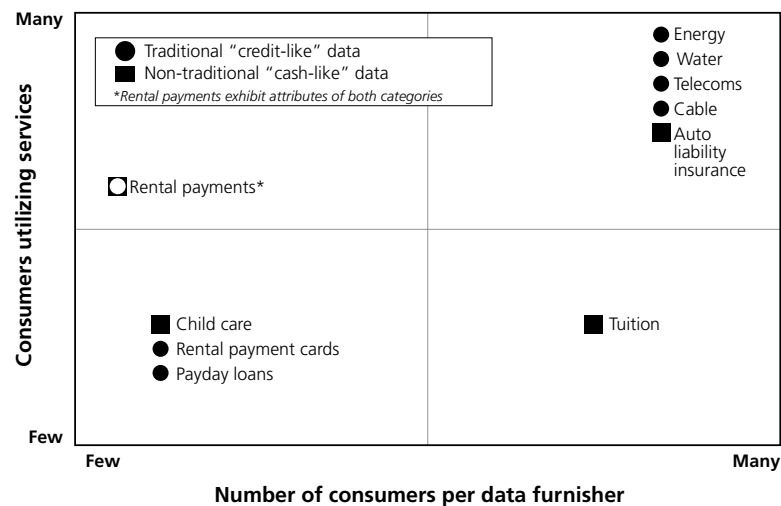


# Information Policy Institute

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The second consideration is whether services targeted as potential sources of alternative data are used by large segments of the population regularly — that is, the extent to which the service covers a significant proportion of consumers. Rent and utilities are relationships that the vast majority of thin-file consumers are likely to have. That is, these are relationships that most of these consumers are likely to have on an ongoing basis that provides a regular stream of information, unlike, say, payday loan advances or tuition payments.

The following figure illustrates the value of various alternative data sources along these two key dimensions: number of consumers utilizing services and number of data furnishers.



Note that the data is far more likely to be reliable and easier to furnish with a high number of consumers utilizing services and many consumers per furnisher. As the scope of consumers who engage in the type of activities (and hence are covered by information) moves from few to many, or near universal consumer utilization, the information category becomes more valuable in bringing the underserved into the mainstream credit system.

Using this schema, it becomes clear that payment information from utility companies and telecommunications firms exhibits "credit-like" characteristics and both would be highly reliable and would cover large shares of those with thin-files and no files.

While the majority of those with thin-files pay rent, landlords are highly fragmented. Thus, a reporting system that produces reliable information and elicits the participation of landlords faces significant hurdles. Potential solutions to these hurdles are discussed later in this study.

The most common example of a non-universal type of payment maintained by reliable sources is tuition. Tuition payments cover a smaller share of the population with thin-files. Most of them, like most people in any income range, are not in school at any given time and, moreover, the data will not be perpetual. Students are largely in school only for a few years, and the value of the data will diminish over time. For those in school, the data can assist in accessing credit and moving from non-traditional sources to traditional ones.

Finally, payments like payday loan advances and child care payments are problematic in that they are types of payments made to many small and often informal service providers. Although payday loan services generally have reliable computerized record systems that track payments effectively, and that market is becoming increasingly concentrated, it still is highly fragmented by any conventional measure.

*The purpose of the schema above is not to discard some types of information and endorse others. Rather it is to help identify the kinds of problems that must be overcome in order to utilize alternative data in the context of the potential value of the information type.*

That said, the framework does allow us to evaluate the relative costs and benefits of different prospective alternative data sets. The analytic typology or framework suggests that data furnished by firms characterized by a large number of consumers per furnisher and that involve are nearly universal services (because most households with thin-files consume them) are good candidates for rapid success.

Data about non-universal services provided by fragmented suppliers, rather than being ignored, should be the focus of resources and further efforts to introduce standardized reporting, or a system of recording payments (perhaps through banks), in order to capitalize on its potential value.

Finally, there is an empirical matter of whether the information itself is predictable and usable. *Predictability*, to reiterate, is an empirical issue and requires that the information itself be tested by various models. *Usability* is a different matter and refers to issues of standardization, regularity, reliability and accuracy.

## Some practical concerns

*Does the data speak to the underserved?*

One key reason for using non-traditional data in a consumer credit scoring model is to help underserved consumers enter the credit system. Therefore, it is important to examine whether or not these types of alternative data capture those with no files or files too thin to score. For instance, health insurance payments may be an excellent predictor of risk, but if there is very little overlap between those who purchase health insurance and the underserved, then the information from this sector is not going to assist them. This is not to say that there are not good reasons to include in reports currently excluded information that covers primarily those with scorable files. As mentioned above, doing so makes the models more predictive and may reduce the cross-subsidy from low-risk consumers to high-risk consumers. But for non-traditional data to help the underserved, it must come from sources that serve these populations.

## *Data furnisher implementation costs and obligations*

There may be sector-specific hurdles and disincentives to reporting. The incentives for data furnishers to report depend on implementation costs and the reliability of information, in order to minimize dispute costs. The costs of implementation of a reporting system include training and the adoption of reporting procedures and mechanisms. As noted, there are standardized formats for both reporting and reverifying information in the event of disputes. These are costs that all potential furnishers have to consider. The average cost of reporting and handling disputes is, as suggested above, smaller for larger companies. Much of the costs are fixed. Those start-up expenses include standardization, training, and the diffusion of techniques and software to report and verify data.

Many costs may be quite peculiar to an industry. Some firms do not know what the level of disputes will be. The practices of some sectors, particularly those seen as public service companies, may be quickly politicized. Energy providers are an example.

Finally, data furnishers are legally compelled under the Fair Credit Reporting Act FACT Act to reverify disputed data promptly in the event of a dispute.<sup>10</sup> The law also imposes certain liabilities on data furnishers. Moreover, FACT Act regulations may ultimately require data furnishers to provide a dispute resolution mechanism directly to consumers. Such a regulation could deter some prospective data furnishers from participating in the voluntary consumer credit reporting system. While these concerns are not all directly related to data reporting, they might give pause to some firms that may expect a higher rate of disputes than firms in the financial sector.

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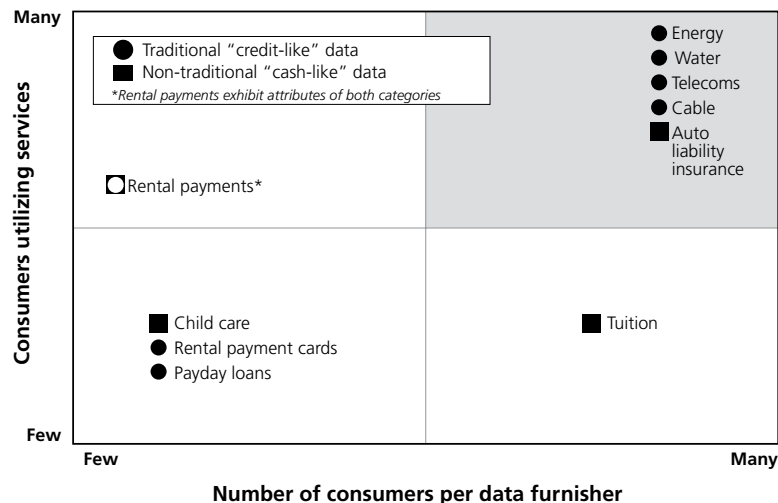
<sup>10</sup> 15 U.S.C. § 1681.

## Analysis

### Evaluation of types of data by category

In examining the different sources of alternative data, we interviewed a number of potential data furnishers and some of their trade associations, especially in the utility and insurance sectors. We also interviewed a number of data repositories and CRAs about their efforts to reach the underserved. Finally, we discussed the issue with prospective lenders who are seeking information on underserved segments. The discussion that follows is organized by sectors, which is in turn categorized by their level of concentration and the scope of the consumer population they service. The sectors we examine looked at the issue and/or had initiatives aimed either to provide data or access data on the underserved. In other words, some firms in the sector and/or industry trade associations had examined sharing consumer data, either as part of efforts to bring the underserved into the credit system or for other business reasons. We did not find any companies with a large number of consumers per furnisher but with non-universal scope that had examined reporting payment information. This is most likely because the sector we categorized as such — tuition — is not credit-like. As we noted, whether a trade relationship is credit-like or not affects the incentive to report.

#### *Many consumers and concentrated sectors: Utilities*



#### Utilities

Of the potential sources of non-traditional data, utilities cover the largest number of people. The vast majority of households (more than 90%) have electricity, water, and telephone service. Nearly 68% have cable television.<sup>11</sup> The former three are, for all intents and purposes, essential services in the United States and are regulated as such. These are also the most likely types of unreported payment information to capture the underserved. Unlike rental data, which similarly promises to reach the underserved, these sectors are very concentrated. That is, a handful of potential furnishers serve a large number of consumers.

11 National Cable and Telecommunications Association, Industry Overview. [www.ncta.com/Docs/PageContent.cfm?pageID=304](http://www.ncta.com/Docs/PageContent.cfm?pageID=304). Source: Nielsen Media Research.

In 1997, there were 1,286 electric power transmission, control and distribution firms,<sup>12</sup> 651 natural gas distributors,<sup>13</sup> and 3,428 water supply firms.<sup>14</sup> Moreover, the 50 largest firms accounted for 77.7% of the market for electric power transmission, control and distribution,<sup>15</sup> 86.2% of natural gas distribution,<sup>16</sup> and 72.3% of water supply.<sup>17</sup> Similarly, six firms account for 90% of the local telephone lines provided to consumers. One consequence of this highly concentrated structure is that the diffusion of reporting and verification technologies is easier.

Utilities, of course, are not all alike. Cable television, despite a significant penetration rate, remains a choice and not a necessity. Furthermore, cable rates are less likely to become politicized than electricity rates. But in terms of the differences that are salient to reporting by utilities, some utilities have a ready disciplining mechanism in the ability to cut off service. This is important because one of the principal incentives for utility providers to provide data to the bureaus is to improve their ability to discipline consumers who pay late and, in turn, to improve the timeliness of payments. Where disciplining mechanisms are already in place, reporting data is less attractive.

In general, the most common disciplining measure is to cut off services. But many utility providers cannot terminate or suspend service very easily. Regulations that view these services as essential require that some measure of service be maintained — for example, dial tone and life line services in telecommunications or electricity during the winter months.

In sectors where it is difficult to turn off service, payment histories may better reflect the risk associated with a consumer. This is because consumers will prioritize payments where services may be cut off promptly by a provider, particularly where they deem that service essential.

The telecommunications and energy sectors are worth examining closely. There are other sectors in this category, such as water and cable. However, we focus here on telecommunications and energy because they clearly illustrate regulatory and economic hurdles that may impede reporting of alternative data.

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12 U.S. Bureau of the Census, Establishment and Firm Size: 1997 Economic Census, Utilities. (Washington, D.C.: US Department of Commerce) p. 24, [www.census.gov/prod/ec97/97t22-sz.pdf](http://www.census.gov/prod/ec97/97t22-sz.pdf).

13 U.S. Bureau of the Census, Establishment and Firm Size: 1997 Economic Census, Utilities. (Washington, D.C.: US Department of Commerce) p. 25, [www.census.gov/prod/ec97/97t22-sz.pdf](http://www.census.gov/prod/ec97/97t22-sz.pdf).

14 U.S. Bureau of the Census, Establishment and Firm Size: 1997 Economic Census, Utilities. (Washington, D.C.: US Department of Commerce) p. 27, [www.census.gov/prod/ec97/97t22-sz.pdf](http://www.census.gov/prod/ec97/97t22-sz.pdf).

15 U.S. Bureau of the Census, Establishment and Firm Size: 1997 Economic Census, Utilities. (Washington, D.C.: US Department of Commerce) p. 46, [www.census.gov/prod/ec97/97t22-sz.pdf](http://www.census.gov/prod/ec97/97t22-sz.pdf).

16 U.S. Bureau of the Census, Establishment and Firm Size: 1997 Economic Census, Utilities. (Washington, D.C.: US Department of Commerce) p. 47, [www.census.gov/prod/ec97/97t22-sz.pdf](http://www.census.gov/prod/ec97/97t22-sz.pdf).

17 U.S. Bureau of the Census, Establishment and Firm Size: 1997 Economic Census, Utilities. (Washington, D.C.: US Department of Commerce) p. 48, [www.census.gov/prod/ec97/97t22-sz.pdf](http://www.census.gov/prod/ec97/97t22-sz.pdf).

## *Telecommunications*

Telecommunications firms have had historically few restrictions against providing information. In previous decades, when telecommunications was dominated by the AT&T monopoly, service providers could deny dial tone service for non-payment. The disciplining effects of credit reporting negatives were extremely small compared to that of cutting off service. Changes in regulation, resulting from the recognition of the importance of telecommunications in everyday life, made it harder to deny dial tone service for late payments. The result is a renewed interest in reporting positive and negative data to reward consumers who pay on time and sanction those who do not.

Like other utilities, telephone service is characterized by a wide coverage rate and relatively few service providers. This is less true of wireless services, but wireless is also characterized by relatively few providers and increasingly wide coverage rates.

Approximately 93.8% of all households have at least one telephone line.<sup>18</sup> Between 88% and 89% of households that earn between \$7,500 and \$12,499 have telephones. Furthermore, the industry, while far more competitive than in years past, is characterized by a relatively small number of players. A handful of firms serve the vast majority of households. The 1997 Economic Census showed that 50 telecommunications firms accounted for approximately 90% of the market. This figure does not distinguish between residential and business markets for telecommunications, but the shares appear consistent for the residential sector.

Nearly 1,300 firms have provided telephone services. Their sizes vary from small, rural, local exchange cooperatives that serve fewer than 100 households to very large firms that serve millions. The FCC counted 28 large telephone service providers (those with more than \$123 million in revenues) and an additional 26 medium-sized ones. These 54 firms accounted for roughly 90% of local telephone lines provided by the local exchange carriers in 2003.<sup>19</sup> Assuming that 10%–12% of telephone lines are provided for by competitive local exchange carriers, between 83 million and 84.5 million households would be covered by these 54 firms. Each firm could report on hundreds of thousands of households. Wireless, while covering fewer American consumers, also shows wide coverage and relatively few providers.

The fact that there are relatively few providers who serve relatively large numbers of consumers means that diffusing standardized reporting and reverification formats can be comparatively easy and quick.

However, there are concerns telecommunications firms wishing to report payment data would have to consider. These concerns include the possibility that providing such data to the bureaus would enable “poaching” by competitors and whether or not consumers would switch providers because of reluctance to have their payment behavior reported.

One large telecommunications provider we spoke to suggested that the fear of “poaching” good customers is, at most, a minor concern. Whether some consumers would switch providers in response to reporting appears to be more worrisome to providers. Given that programs are at very preliminary pilot stages, there is no evidence for consequences in either direction, and the concerns remain based on speculation.

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18 Alexander Belinfante, “Telephone Subscribership in The United States” (Washington, D.C.; FCC, October 2004) p. 6, [www.fcc.gov/Bureaus/Common\\_Carrier/Reports/FCC-State\\_Link/IAD/subs0704.pdf](http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/subs0704.pdf).

19 FCC, “Statistics of Communications Common Carriers.” (Washington, DC: FCC, 2004) pp. iii-iv. [www.fcc.gov/Bureaus/Common\\_Carrier/Reports/FCC-State\\_Link/SOCC/03socc.pdf](http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/SOCC/03socc.pdf).

One possibility is that consumers prone to switching as a result of chronic late payment will switch to a non-reporting service provider. If so, telecommunications companies that report payment data will tend to be left with consumers who pay on time. Another possibility is that reporting may attract consumers who are risk averse and wish to receive the additional benefit of improved credit scores for their timely payments.

By contrast, if consumers switch for reasons of privacy or discomfort about reporting payment data, companies run the risk that reporting will lead to a loss of revenue.

The telecommunications sector appears to be encouraging a trend toward reporting. There are pilot programs and experiments underway that will enable potential furnishers to judge the value of furnishing data. Those examining reporting consumer payments are aware of the results of Nicor Gas's experience that reporting can reduce charge offs.

There are regulations that prevent telecommunications firms from reporting in some states. California's Public Utility Commission, for example, forbids telephone or telegraph corporations from disclosing a consumer's credit or financial information to any entity except to a "electrical, gas, heat, telephone, telegraph, or water corporation, or centralized credit check system, for the purpose of determining the creditworthiness of new utility subscribers."<sup>20</sup> However, these restrictions appear to be quite rare (see Appendix). On the other hand, regulatory uncertainty, even in the absence of legal barriers, may give some potential furnishers pause.

Economic hurdles present the largest concerns for the firms that we interviewed. To the extent their billing systems are current and unified, and their billing cycles are not fragmented, implementation costs are likely to be relatively small. Initial costs may be substantial to the extent that billing systems are fragmented, systems are antiquated, and/or billing cycles are multiple. In any case, once the system is set up, the marginal costs of reporting are very small, as are the costs of computerized reverification systems in the event of disputes. However, a significant reduction of payments in arrears as consumers become aware that their payments are being reported may offset these costs. Some local exchange companies have begun pilot projects to test credit reporting, largely driven by the promise of better economic performance and offering consumers additional benefits.

In short, some major telecommunications providers have begun exploring the idea of furnishing customer data to credit reporting agencies. While competitive concerns don't pose a significant barrier to reporting, there are some inter-related regulatory and economic concerns, particularly those relating to data furnisher obligations and consumer dispute settlement processes. Additional data furnisher obligations, such as enabling consumers to dispute data directly with the furnisher, could deter some telecommunications firms from furnishing in a voluntary system.

### ***Public utilities***

Public utilities are perhaps the most promising of the prospective sources of alternative data that we examined. The vast majority of households make monthly electricity, gas, oil, and water payments. As noted above, the industry is concentrated. However, public utility companies are, by and large, reluctant to enter into the

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<sup>20</sup> California Public Utilities Code Section 2891-2894.10.

reporting system, except as purchasers of credit reports. There have been various attempts over the past decade to bring utility service providers into the reporting fold. Because these services are nearly universally consumed, they are highly likely to yield information on underserved consumers. Importantly, various modelers have suggested that the information is very predictive.<sup>21</sup>

The handful of instances in which utilities have reported to the credit bureaus offers some indication of the consequences. Nicor Gas's experience has been a positive one in the form of lower rates of late payments and relatively low costs in implementing a reporting system. Yet, regulatory and economic hurdles remain, and in some instances these hurdles intersect. Moreover, there are public relations concerns.

Regulatory issues in the states prevent the reporting of information to credit reporting agencies. There are three broad types of regulatory hurdles to reporting. First, there may be a straightforward proscription against sharing consumer information without the consumer's explicit consent. Statutes may forbid the sector from sharing information. Stat law may also prevent state-owned firms from sharing information about consumers in a context in which they own utilities. New Jersey laws present such an instance.<sup>22</sup> As with telecommunications, these are largely rare.

Second, regulations may be contradictory or vague, and jurisdictional authority can be confused. For example, Ohio permits certain public and private agencies to share consumer information "in connection" with credit reporting.<sup>23</sup> Some states share regulatory authority with municipalities, creating confusion. Finally, states may also have to clarify regulatory obligations when state laws govern spheres of activity that are not federally preempted.

The regulated nature of public utilities may create yet another disincentive to furnish information. Savings in many states may have to be passed on to the consumer, given that rates and profits are largely regulated. Benefits for energy providers in the form of the reduction of non-payments may not be reaped by the companies themselves in some settings.

*The overall problem of regulation lies not so much in the existence of laws that prohibit sharing of data but rather in the absence of laws or clear statements that allow the sharing of data.* Because energy providers are heavily regulated firms, regulatory uncertainty makes many of them unsure of reporting. Public utilities are heavily scrutinized by public officials and the public and often need a clear message from legislatures before undertaking reporting trials.

Inquiries conducted by the Institute confirm speculation that the regulatory barriers to utility reporting tend to be *de facto* rather than *de jure*. Our inquiries also confirm that uncertainty about the disposition of regulators is probably the principal "regulatory" barrier to the provision of regular payment data by utility providers. Of 21 states assessed by the Institute, only two states, California and New Jersey, have public utility commission rulings that preclude the reporting of payment data to the bureaus. In the case of California, these restrictions extend

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21 Interviews with CRAs and major lenders.

22 Electric (NJS 48:3-85); gas (NJS 48:3-85); and cable (NJS 48:5A-57).

23 Ohio Admin. Code Sections 4901:1-10-12; 4901:1-21-10.



only to telecommunications. In Texas, a bill is pending that would broadly restrict the ability of utilities to report. Communications with regulators in California suggest that energy providers do regularly request the California Public Utility Commission (CPUC) to officially sanction the reporting of consumer data. The CPUC, in turn, would prefer a clear directive from the legislature. In Delaware, where no regulatory barriers exist, regulators several years ago requested that a gas company cease reporting to the bureaus. (See Appendix for a summary chart of Institute inquiries.)

## **Auto liability insurance**

Insurance payments, the timeliness of which is not reported, are another promising source of alternative information. It should be reiterated that these payments are not credit-like, which affects the incentives to furnish this data. The consumption of insurance is widespread. However, it is unlikely that the underserved (thin-filed and no-filed) consume most insurance products. A major exception is auto liability insurance. Nearly every state in the union requires that car owners have auto liability insurance to cover bodily and property damage in the event of an accident.<sup>24</sup> In 2000, approximately 86% of all American households owned at least one car. While the share of households owning cars drops with income, 63.4% of the lowest quintile and 85.4% of the second lowest quintile of households own a car.<sup>25</sup> It should be noted that there are many uninsured drivers.

Auto liability insurance, like utilities, promises to cover a significant number of households that have no-files or very thin-files. Automobiles are needed for daily life in many parts of the country, and again, nearly every state requires car owners to purchase auto liability insurance.

The incentive structure for reporting, at least on the surface, resembles many utilities. Insurance can be suspended or cancelled upon non-receipt of payment. It differs to the extent that payment is received before coverage begins. However, an insurance company that reports to the bureaus will not improve its ability to discipline consumers who are delinquent on their payments, which is a crucial element of the incentive structure to report. But, reporting may serve to attract very responsible consumers who wish additional benefits for paying on time.

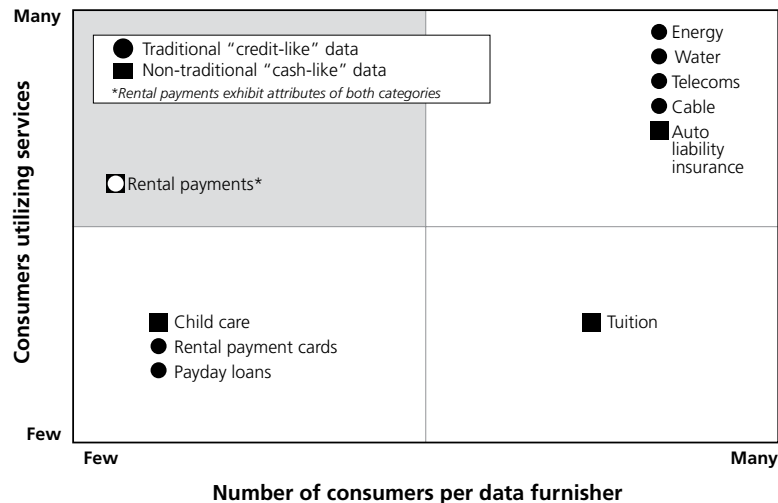
Insurance is heavily regulated, especially at the state level. Furthermore, the issue of insurance and reporting is politically charged, given the use of credit reports in insurance underwriting. Finally, there are competitive concerns of poaching for insurance providers, especially considering that credit reports are widely used in the sector and large players dominate.

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24 New Hampshire, Tennessee, and Wisconsin are exceptions. They all do assign financial responsibility to motorists in the event of an accident. Tennessee requires proof of financial responsibility, even if pulled over. See the summary of state requirements listed by the Insurance Information Institute, <http://www.iii.org/individuals/auto/a/canidrive>.

25 U.S. Census Bureau, "Asset Ownership of Households: 2000." Table 2. Asset Ownership Rates for Households, by Selected Characteristics: 2000 [www.census.gov/hhes/www/wealth/1998\\_2000/wlth00-2.html](http://www.census.gov/hhes/www/wealth/1998_2000/wlth00-2.html). It is possible that the lower rates of automobile ownership among lower income Americans is at least in part attributable to the relatively high portion of which live in urban areas with readily available substitutes, such as publicly funded mass transportation and taxi services.

## Many consumers and unconcentrated sectors: Rental data



Rental relationships, like the purchase of utility and telecommunications services, are widespread. As of 2004, approximately 31.4% of households rented their primary residence. The rate at which households rent, as opposed to own a home, is inversely related to household income. If we use the poverty line as a proxy for the underserved population, 54% of households rent their primary residence.<sup>26</sup> For this reason rental data is likely to cover a large share of thin-file consumers. Homeowners are likely to be covered by the traditional credit reporting system.

Of the approximate 40 million rental units in the United States, 3.2 million are owned by large real estate companies. The remainder is owned by individual investors. Of course, 3.2 million is a sizeable figure. If some non-negligent share of these tenants comprise thin-file consumers, the data can be quite useful. The limits of rental information stem from a host of factors that impact its reliability. First and foremost is that most rental relationships are between a lessee and a lessor, who happens to own one or a small handful of units. These property owners may have little incentive to report in a voluntary system when the average costs of implementing the means to report may be high. We strongly suspect smaller landlords are unlikely to report systematically.

Moreover, even larger landlords may be reluctant to report as the benefits may be small. While renter protection laws often make it difficult to evict a tenant, the threat of eviction is a powerful deterrent to late payments by renters. The additional disciplining effect of credit reporting may be viewed by landlords as negligible in many regions.

26 U.S. Census Bureau, American Housing Survey 2001 Using 2000 Controls Table 2-12. Income Characteristics--Occupied Units [www.census.gov/hhes/www/housing/ahs/ahs01\\_2000wts/tab212.html](http://www.census.gov/hhes/www/housing/ahs/ahs01_2000wts/tab212.html).

Assuming that only large real estate companies are apt to furnish information, the amount of data provided may still be significant. Were this group as a whole to begin furnishing, we estimate that the information provided would total several million pieces of data a month.<sup>27</sup> By contrast, the 30,000 to 40,000 contributors in the traditional data sector provide nearly 1.5 billion pieces of data monthly.<sup>28</sup> While effort per provider varies by number of consumers, given scale economies, it takes more effort to collect a piece of data from the rental sector than from the traditional sector. None of this is to say that it is not cost effective to do so.

Another proxy for the likelihood that lessors will report is the number of units in a structure. This seems reasonable given the declining marginal costs of reporting and the benefits of doing so. If we then assume that those with more than 10 units in a structure are likely to report, the occupants in 30% (12 million) of all rented housing units can be covered. Admittedly, however, this may be a very optimistic assumption.

There are rent-specific issues that must be taken into consideration when assessing the relative value of the information. First, renters move frequently. Tenure in an apartment is relatively short for a large number of individuals. Approximately one-third of all renters surveyed in March 2000, for example, had moved in the previous year.<sup>29</sup> Information on a tenant's payment history will be sporadic. The consequence of this fact must be left to modelers, but it does raise another issue. A large share of the rental market will remain uncovered, and tenants can be expected to regularly move in and out of apartments that would report rent information. As a result, the data may be inconsistent.

Other issues are not so easy to address with modeling. For example, there are problems of how to address disputes between landlords and tenants, legitimate rent strikes, etc. Many local laws require that rent strikes place the withheld amount in escrow. The escrow accounts in the event of a rent strike could in principle be reported; however, the ease of doing so is not clear.

Furthermore, the credibility of eviction threats varies across regions. Paying rent on time in New York City, when housing laws favor tenants, may be a more accurate indicator of responsibility than rental payments in places where a tenant may be evicted easily. That is, tenants who pay regularly without the risk of such a heavy sanction as eviction may demonstrate a likelihood to pay that may be of more interest to, say, issuers of revolving credit, where the sanction is the denial of future credit. Moreover, the rental sector often considers payments that are more than 5 or 10 days late to be delinquencies. Of course, these are issues for modelers and data repositories. One CRA did indicate that it was creating new fields for rental data, which would cope with the peculiarities of the sector.

There may be a deeper issue potentially confronting the matter of bringing the underserved into the credit system through the use of rental data. The rental corporations and landlords most likely to furnish data are possibly also those who manage rental properties in which the renters already have credit files. Again, this is an empirical question; To what extent are rental units that are more likely to participate in the system inhabited by consumers already in the credit system? If this is the case, then rental data may be of less use than many anticipate, and the hurdles to getting landlords of those renters with thin-files to report may involve

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27 U.S. Census Bureau, American Housing Survey 2001 Using 2000 Controls Table 2-1. Additional Indicators of Housing Quality — Occupied Units [/www.census.gov/hhes/www/housing/ahs/ahs01\\_2000wts/tab21.html](http://www.census.gov/hhes/www/housing/ahs/ahs01_2000wts/tab21.html).

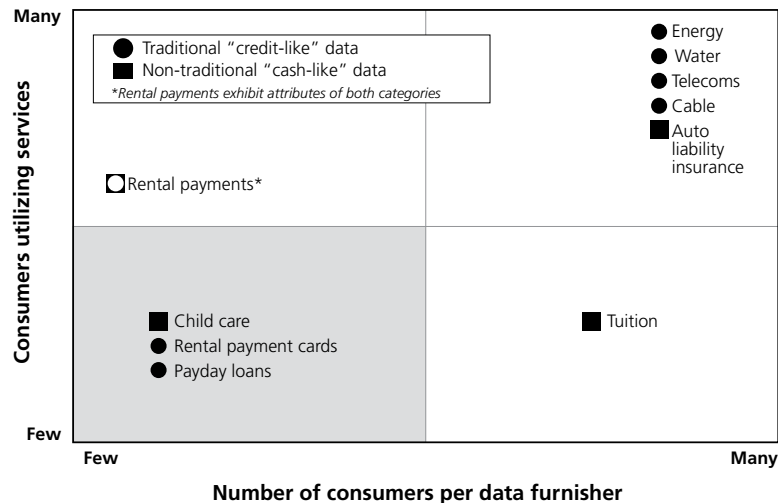
28 Interview with CRA.

29 U.S. Census Bureau, American Housing Survey 2001 Using 2000 Controls Table 2-1. Additional Indicators of Housing Quality — Occupied Units [http://www.census.gov/hhes/www/housing/ahs/ahs01\\_2000wts/tab21.html](http://www.census.gov/hhes/www/housing/ahs/ahs01_2000wts/tab21.html).

considerable investment and a substantial awareness campaign. To the extent that it is not, rental data promises considerable benefits since it is very likely that it would capture those left out of the system.

Discussions of rental information have left out considerations of public housing. Public housing is more likely to service those with thin or no files, given the overlap with low-income groups. There are approximately 1.3 million families living in public housing in the United States, and these households earn between 50% and 80% of the median income.<sup>30</sup> The units are managed by public housing agencies (HAs). Public assistance covers much of the rent in public housing, but to the extent that tenants do pay a portion of the rent, the information would serve to help build credit files. Reporting on the poor to credit agencies could be controversial. But here the image that credit reports are principally about recording negative information is misleading. Positive data is of greater value to lenders than negative data. And the reporting habits of this sub-sector can more easily be affected by public policy.

### *Few consumers and unconcentrated sectors: Payday loan advances*



Payday loans are short-term loans (2 weeks or so) given to cash-strapped consumers in exchange for a post-dated check or automatic withdrawal from a borrower's bank account. Borrowers are advanced money minus the fees for the advance. Payday loan borrowers must be banked. Whether they are low income or moderate income remains a matter of debate. According to one survey, 23% of payday loan users earn less than \$25,000 a year, and 51.5% earn between \$25,000 and \$50,000 a year.<sup>31</sup> Other surveys suggest that they are significantly lower on the income ladder.

30 U.S. Department of Housing and Urban Development, HUD's Public Housing Program [www.hud.gov/renting/phprog.cfm](http://www.hud.gov/renting/phprog.cfm).

31 Gregory Elliehausen and Edward C. Lawrence, "Payday Advance Credit In America." Credit Research Center. Monograph #35, p. 29. <http://www.msb.edu/prog/crc/pdf/mono35.pdf>. However, see the critique by the Center for Responsible Lending, [www.responsiblelending.org/pdfs/Georgetown\\_Study070102.pdf](http://www.responsiblelending.org/pdfs/Georgetown_Study070102.pdf).

The number of people who use payday loans is small relative to the set of consumers without files or unscorable files. However, payday loans may still capture many of those who are thin-filed. More than 5 million consumers use payday loans services on some regular basis. By one estimate, 91% of the 7.6 million payday loan borrowers utilize the service at least five times a year.<sup>32</sup>

At least one firm may be using payday loan data in a new credit scoring model that uses a number of non-traditional data sets. This indicates that modelers at one firm have ascertained that payday loan data possesses at least some predictive power with respect to estimating the probability of default. In the experience of that firm, payday lenders are heavily computerized and keep detailed records. That experience suggests a large number of consumers per furnisher is not crucial. However, this may result from the peculiarity of the industry itself. Making regular short-term loans requires standardization to track instances of payment.

The larger question goes to the extent to which payday loans and payment histories are reliable measures of credit risk. It could be argued that the sector selects for consumers who are desperate and thus bad risks. The extent to which this information is predictive is an empirical one that will have to be judged by the market.

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<sup>32</sup> Keith Ernst, John Farris, and Uriah King. "Quantifying the Economic Cost of Predatory Payday Lending." (Center for Responsible Lending, 2004) p. 2 and p. 9. [65.110.82.226/pdfs/CRLpaydaylendingstudy121803.pdf](https://www.crl.org/wp-content/uploads/2004/08/65.110.82.226/pdfs/CRLpaydaylendingstudy121803.pdf).

## Potential and Existing Approaches to Reach the Underserved

There are a number of other approaches to the problem of providing additional data on consumers with thin-files. We consider the standard approach as well as two alternative approaches below:

1. **The standard model:** alternative data furnishers such as rental agencies and utility providers begin providing data to the national CRAs, much in the same fashion as financial institutions did during the 1970s and 1980s.
2. **The aggregation model:** the data collected by a specialty credit reporting agency is aggregated by a third-party reseller for one-time use. This model depends on the presence of niche data aggregators.
3. **The self-reporting model:** consumers report their own alternative data to a specially configured CRA that is structured to receive this data. In this model, independent auditors ensure the quality of the data.

### The standard model

The standard model is the notion that alternative data furnishers recognize the value of information sharing and begin to provide positive and negative data on consumers to the three national credit bureaus.

There are many advantages to this particular scenario. First, this would maximize the number of consumers about whom data is available, presuming the practice became widespread. Second, this would negate the disadvantages of the self-reporting approach, whereby the self-selection of participating consumers is likely to favor those consumers who are already credit savvy and are therefore already likely to be part of the traditional credit reporting system.

The three national CRAs have been discussing information sharing with large rental companies, utilities, and telecommunications firms. They also have made it easier to append consumer files with information that is not from traditional sources.

### The aggregation model

This model employs the data collected by specialty CRAs that collect data on a variety of niche sub-markets, whether local or service specific. Chief among these sources of data is payday loans but where possible may include checking account overdraft information and retail club membership data. Rather than keeping such data on file indefinitely and incurring the legal obligations of a credit bureau under the FCRA, this data is pooled for one-time use. Lenders who are unable to find sufficient data upon which to base a decision can then utilize the data for that application. The quality of such data may pose a problem for this model. As discussed earlier, payday loans, for example, are often offered at high effective interest rates and so may overstate the rate of default. To the extent there are niche aggregators in other sectors, e.g., rentals, they remain small and serve local markets. As such, they are unlikely to cover any significant share of the underserved. To the extent that information is supplied to them, it is perhaps more economically rational to have the same information supplied to the three national CRAs. As part of a broader file that forms the basis of the vast majority of credit decisions, the inclusion of this information in a three-bureau credit report makes it more likely to be used by credit issuers for less cost and effort.

## The self-reporting model

One creative proposal for non-traditional data has been developed by Payment Reporting Builds Credit (PRBC). PRBC collects payment information on rents, utilities, telecommunications services, auto loans, child care payments, and any regular payments that a consumer may make. The system has consumers report their own information as long as it is verified by a third party. Similar approaches have been used for non-traditional mortgage credit reports—but the process is much lengthier. Consumers may also choose to have their service provider or lender report the information to PRBC. Third parties can be banks, credit unions, non-profit credit counselors, tax preparation services, etc. As customers move to online banking, online records, coupled with terms of leases and bills, can serve as verification of bill payments.

The chief issue with this approach is that its “opt-in” nature suggests that many of those who participate are already credit-savvy consumers. As such, they may already have scorable traditional credit histories. It is unclear how much overlap there is between those who enter self-reporting systems and those who have credit files at the CRAs. The problem posed by self-selection bias — in this instance reaching those who are thin-filed or lack credit files — could perhaps be mitigated by credit literacy programs and awareness campaigns for consumers that are underserved.

## The bank alternative

One possible method of reaching consumers who have thin or no files is to have a third party issue a “witness report” on the timeliness of payments related to the provision of a service. Banks and deposit institutions generally are attractive candidates. This method is essentially a variant of the self-reporting approach. Consumers would have to authorize reporting.

The advantage of this approach is that depository institutions witness a large number of payments across many types, provided payments are made with checks or online. Rental information, utilities, insurance payments, daycare, or any other recurring payment made in this fashion would be reported through these institutions. Accounts would have to be verified as belonging to a regular trade line. They may also have to be fixed amounts with a regular payment schedule, so that there are not problems of variation in payment. The bank would regularly send information to a CRA. Given that financial institutions already report loan information, setup costs would be low. There may be costs in setting up verification systems, however.

This method would, in principle, reach far more renters than having large rental unit owners report. Similarly, it would reach many other small service providers. Furthermore, financial institutions would have an incentive to report because they are users of consumer payment information. The finance industry’s experience with credit reporting has been positive for both the expansion of the market and a reduction in charge-offs.

Financial institutions may balk at such an arrangement if there are issues of disputed costs and data furnisher liability. However, there may be a larger limitation. Like the PRBC model, this model would capture a limited share of the individuals about whom traditional data is not available.

## Conclusion: Promise and Limits

### Utilities

As the analysis above suggests, consumer information furnished by utility providers offers the best promise for expanding credit access to the underserved. Utility payments are practically universal, and the sector is heavily concentrated, so relatively few potential data furnishers would have to be convinced of the merits of reporting. As such, utility data promises to capture the many Americans who lack bank accounts, are unscorable owing to a lack of credit data, or have thin credit files. The level of concentration in most utility industries suggests this data can be brought on line with less effort and fewer resources than could data from other sectors such as apartment and housing rentals. Some utility companies, however, have expressed reluctance to begin reporting, and few utility companies report both positive and negative data to the national repositories. In some cases negatives are received by bureaus indirectly, only after accounts that have been remanded to collections.

The reason utilities have been reluctant to report may relate to the history of the sector and its heavily regulated character. Because public service companies are more subject than others to political pressure, their response is understandable. Participation in the consumer credit reporting system is voluntary. For that reason, experimentation, lessons from other firms, affirmative consent from state regulators, and the development of industry practices may be necessary before utilities begin reporting data in meaningful numbers.

There are few regulations that explicitly prohibit utilities from sharing data. Interestingly, interviews with utility companies revealed that a major hurdle to reporting was the absence of a clear authorization from state regulators that they can report data to credit reporting agencies. Given the politically sensitive nature of public utilities, an affirmative authorization from regulators is necessary to quell fears of a public and regulatory backlash.

Despite the seemingly high level of interest in achieving some degree of regulatory certainty, the public utility commissions may be reluctant to issue an explicit statement. Further, commissions that want to be responsive to inquiries need a clear message from legislators before issuing any response. An explicit statement, as part of a public effort to reach the underserved, would do much to bring utility data into the reporting system.

On balance, however, utility providers appear a likely candidate for the provision of alternative data, insofar as they have economic incentives to participate in such information sharing mechanisms. In fact, in some cases they already do. Utility providers currently have data aggregated so that it would not be difficult to migrate to a standard reporting format such as Metro2.

For other potential sources of alternative data, it may be more difficult to participate in the credit reporting system without some sort of legislative or economic intervention. For example, child care providers and health care providers clearly have little incentive to provide data because they don't issue forms of credit or provide credit-like services. Similarly, payments to health care providers are subject to widespread disputes between patients and their insurers. Therefore, they have little need for the type of data contained in credit reports.



## Auto liability insurance

Like utility companies, auto insurance providers also are subject to considerable scrutiny and regulation. Here the limitation appears to be a market-based rationale for non-reporting. Insurance carriers can quickly discipline those who are delinquent with their installments. As a result, policyholder knowledge that late payments are being reported may have only a marginal disciplining effect. Because auto liability insurers rely heavily on data from consumer credit reports in underwriting policies, they may benefit further from richer and more robust consumer credit reports, particularly those that include non-traditional data.

## Rental

We have noted some of the advantages and problems of including rental data in credit reports. Rental data is broadly defined to include housing, apartment, furniture, and consumer durable rentals. To date, most activity around using rental data for credit reporting purposes has focused squarely on housing and apartment rental data. The principal issue with rental data is the large number of landlords in the U.S. rental market. The largest landlords only account for a small fraction of the market. These limitations may be outweighed by the benefits of having available data reported to the bureaus.

Market responsiveness to an opportunity to improve the quality of its product clearly mitigates the need for government intervention. There is, however, room for public policy on rental payment data about the underserved. Those who use public housing are more likely to have thin-files or to be unbanked than the average American. Should rental data prove to be predictive of an individual's risk of default, inclusion of this data into a consumer credit report would help these Americans demonstrate their creditworthiness. If so, Congress or state housing authorities should act to permit this potentially socially and economically beneficial data exchange.

## Approaches to using non-traditional data in credit reporting

As just discussed, alternative data sources hold great promise for helping underserved consumers enter the traditional credit market. The challenge is identifying ways in which such data can be incorporated into the credit granting system. A synopsis of potential techniques follows.

**Self-reporting:** Chances are small that a self-reporting approach will reach consumers who lack files or have files with too few trade lines to score. Our research suggests that the credit savvy, those in some sense furthest away from the underserved, are the most likely to utilize these programs. At the least, substantial investment in awareness programs and financial literacy campaigns would be necessary to reach underserved and unbanked populations.

**The aggregation model:** Under this model, data collected by a specialty credit reporting agency is aggregated by a third-party reseller for one-time use. This model depends on the presence of niche data aggregators such as those that collect payday loan payment information. These aggregators appear to be rare outside of the payday loan industry.

**The traditional credit reporting model:** One benefit of the current system is that the informational and organizational costs of authorizing reporting are not borne by the consumer. Consumers do not have to manage reporting their payment histories. Data furnishers report directly to the CRAs. This information is used when

applying for credit. The system has the advantage of overcoming the selection bias that may be operating in a self-reporting model. Those with less than perfect credit histories but still qualified for credit at reasonable prices are included in the system. As a result this approach would capture those who are not particularly credit-savvy and therefore likely to be part of the underserved population.

## Objections

This study has documented potential benefits of the reporting of non-traditional data. However, the concept of reporting non-traditional data is not without its detractors. Some of the primary objections articulated by a number of critics are addressed below.

There are fears that the use of this information will negatively impact consumers, notably in the form of risk-based pricing. Some worry that additional negative information will raise the price of credit on existing credit lines, as credit suppliers, especially credit card companies, raise interest rates in response. This objection is based on a misunderstanding. Most of the sectors considered in this study already report negative data but do so indirectly. Collection agencies report delinquent accounts, and, likewise, rental disputes are included in credit reports. As a result, the information already weighs into pricing models. What is not currently considered is positive data. Inclusion of positive information has the effect of lowering price and improving access for consumers, especially the underserved.

Others fear that the inclusion of certain data sets — notably data about payday loans — will do more harm than good for low- to moderate-income Americans. The concern about including payday loan data stems from the extraordinarily high APR on such loans and the belief that payday lenders contribute to borrowers' financial duress. Normative judgments about the practice aside, inclusion of payday loan data could prove to be an accurate predictor of default. If so, underserved consumers who use such services and make prompt payments could stand to benefit. On the other hand, due to the high rates of debt service on these loans, they might actually serve only to diminish the creditworthiness of thin-file consumers who use these products.

Finally, there are privacy advocates who oppose information sharing in general, but more so when it concerns sensitive data, including financial and transactional data that comprises the core of a consumer credit report. This concern comes at a high price for the underserved. Access to credit is crucial for consumers who wish to develop assets, given that Americans save primarily in the form of homeownership. This is particularly true of households at the lowest income levels. Arguably, prohibiting the ability to use non-traditional data sources to protect the privacy of the underserved reduces their opportunities to create assets and wealth.

## Future research

Whether or not any information from the identified sources of non-traditional data has any predictive power in consumer credit scoring is purely an empirical matter. Towards this end, The Information Policy Institute is undertaking a project to assess the predictive power of various types of non-traditional data and its potential impact on consumer access to credit. The project will involve the direct participation of credit bureaus, prospective data furnishers, and creditors. This research is expected to be completed during the second half of 2005.

## Appendix: State Regulatory Barriers to the Provision of Payment Data to Credit Bureaus by Utility Providers

The following information has been gathered from exchanges with representatives of public utility commissions and from legal research conducted by the Institute. The information presented reflects the best knowledge of the Institute and of those interviewed. We are deeply grateful for the assistance of James Ramsay at the National Association of Regulatory Utility Commissioners for his assistance in this endeavor.

State	Regulatory Barriers
Arkansas	None
California	Wireline and wireless only (CA PUC 2891(a))
Colorado	None (cannot answer on wireless and cable—PUC does not regulate)
Delaware	None
Florida	None
Hawaii	None
Idaho	None
Indiana	None
Iowa	None
Maine	None
Maryland	None
Missouri	None
Montana	None
New Jersey	Yes; opt-in, electric (NJSA 48:3-85), gas (NJSA 48:3-85), cable (NJSA 48:5A-57)
Nevada	None
Ohio	Publicly owned firms
Pennsylvania	None
Texas	Bill pending (H0412in)
Utah	None
Vermont	None
Washington	None
Wisconsin	None



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