Executive Summary

Credit risk models perform better when they are able to utilize greater amounts of predictive data. For example, a generic credit score based upon a relatively thicker credit file (more accounts) with longer credit histories, a greater variety of account types, across more credit amounts (high value and low), and more key fields (balances, account type, credit limits, on-time or late status of payments) yields a higher degree of confidence and better predictions than one based upon a very thin-file credit file that are missing important types of accounts and fields. While both credit file scenarios are technically scoreable using some generic credit risk models, a lender would be taking undue risk extending credit to a prospective borrower based on the partial information case if they had access to the fuller information.

Decades of theoretical and empirical economic research bears out this proposition. Lenders are able to make better decisions when given access to more predictive data, benefiting borrowers, lenders, and the economy. This is a foundational premise of the national credit information sharing (CIS) system in the United States and in most countries around the world. There are instances, however, when predictive data sharing must be limited. For example, the wave of privacy laws passed in state after state during the 2000s redacted enough personal identifying information to make matching credit judgments and other public records with credit reports challenging. Due to this, nationwide consumer reporting agencies and States' Attorney's Generals Office agreed to the National Consumer Assistance Plan (NCAP), that restricts the inclusion of such government-sourced predictive data points to scenarios where sufficient matching data is available. The consequence was the removal of a considerable quantity of known predictive data from the national CIS system in an effort to improve data quality as per the maximum possible accuracy obligation under the Fair Credit Reporting Act.

Similarly, industry and regulators/policymakers have established practices and guidelines for managing exogenous shocks—natural disasters or other systemic crises—which may cause widespread and enduring duress upon a borrower population through no fault of their own. This is precisely what has happened with the COVID-19 pandemic, where the global healthcare crisis forced a closing of large sections of an economy, resulting in an immediate and pronounced spike in unemployment. At the beginning of the pandemic, lenders were counseled by federal and state lawmakers and regulators to offer borrowers who may be experiencing duress accommodations such as loan forbearance, deferrals, or modifications, among other tools. Further, the CARES Act prohibited the reporting of late payment or other derogatory indicators for all federally guaranteed student loans, and on all other credit accounts receiving accommodations. With such accommodations, a borrower was not required to make a payment, and so was not late if they chose not to make it.

Predictably, the results of this policy protected many borrowers from having their credit scores tank owing to the pandemic if they did not make their payments as outlined in their pre-pandemic loan agreements. Over the first five quarters of the pandemic, the national average credit score in the US has risen. No doubt some of this may have been due to the

non-reporting of late payments and other accommodations. But the majority of those extended a mortgage forbearance have already exited. In addition, there is now a strong job market, personal incomes are up, and credit card balances are down. So, consumers may also be in better real financial shape now thanks in part to the myriad relief and stimulus in the CARES Acts and other Covid relief bills.

At the beginning of the pandemic, some argued for much broader interventions in credit reporting. These proposals would have prohibited derogatory data reporting in general, for all consumers. These are based on a naïve and superficial understanding of the impacts of such policy

Take but one example, younger borrowers (aged 18-24). Simulations demonstrate that such a suppression/deletion approach concerning open and closed accounts and a likely increase in the moral hazard could result in over a 90% reduction in credit access. This is because lenders would raise credit score cutoffs to compensate for degraded credit information. Given that Millennials, the oldest of whom are turning 40 this year, are just 80% as wealthy as their parents were at this stage in their lives, and that the younger generation is doing even worse in terms of wealth generation and asset building, erecting a substantial barrier to credit will set back efforts to catch up for all persons in the US 40 years of age and younger relative to Gen-Xers and Baby Boomers.[1]

This report quantifies the impacts of proposed policies of suppression/deletion on lending in the US, paying specific attention to impacts experienced by different borrower groups. The simulations use millions of actual credit data from two time frames, 2010-2012 and 2017-2019. The first reflecting the initial recovery from a crisis (2008 Financial Crisis) and the second a recovered economy. Such results should be considered by policymakers exploring changes to current credit reporting practices in the US and elsewhere.

Key findings include the following.

Suppression Degrades Credit Report Data: Removing accurate predictive data from a person's credit report reduces the value of the data as a tool to predict future credit risk. The longer the accurate predictive data is suppressed, the greater the degree of degradation. Suppressing negative payment information from active accounts in credit files for 12 months results in a 14% reduction in credit access using a 2010 sample, this grows to 18% with 48 months of suppression. Controlling for a target default rate of 3%, the needed cut-off credit score increases from 681 to 721 in the 2017 sample. But the 48 months of active account suppression only results in the average credit score rising from 687 to 702. So, while the suppression does raise credit scores, it is an illusion as consumers are actually worse off and have reduced access to credit.

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[1] See: https://www.bloomberg.com/features/2021-millennials-are-running-out-of-time/

Youngest and Lowest Income Persons Hit Hardest: It's one thing to establish that fewer people in the aggregate will be able to access affordable mainstream credit the longer a suppression/deletion regime exists, it's another altogether to identify which groups will be relatively more/less impacted. The evidence shows that younger borrowers and lower-income borrowers will experience the greatest negative impacts. In one example, while credit acceptance for the entire population decreases 18%, it drops 46% for the youngest borrowers (aged 18-24). By income it dropped 19% for the lowest income group but 15% for the highest—a 27% difference. This pattern of the youngest and lowest income consumers being hardest hit by the suppression-induced credit crunch persisted across the 2010 and 2017 samples and for different length of data suppression.

Also Suppressing Closed Accounts and Accounting for Moral Hazard Results in a Devastating Credit Crunch: The above findings do not include the suppression of closed accounts during the suppression period. Nor does it include the likelihood that if derogatory credit reporting was suppressed in general, that delinquency rates would rise. In the 2010 sample, assuming a 3% target delinquency rate, with 24 months of suppression and assuming a 50% increase in delinquencies we find the following. Credit acceptance drops to 83% of the no suppression levels with the reduced risk assessment abilities by lenders when negative data on active accounts is suppressed. It drops further to 71% when negative data on both active and closed account is suppressed. It then drops to 49% when we add an increase in delinquencies (moral hazard). As previously shown, lower income households and younger borrowers fare even worse.

Evidence Supports the Theory: Prominent economists have developed theories about the impacts of information asymmetries in credit markets, and the impact of credit payment information sharing to mitigate the consequences of information asymmetries in credit markets (specifically the reduction of moral hazard and adverse selection). Such theories speculate that information asymmetries in credit markets result in lenders rationing credit and raising the cost of credit to account for the increased systemic risk. Evidence from this study is consistent with credit rationing, especially for those with lower credit scores and thinner credit reports.

Adding More Predictive Data Helps: Over the past 20 years, much research has been produced (including by authors of this report) demonstrating the predictive value of non-financial payment data in credit risk assessment. Abundant research shows including non-financial payment data (such as from rent, telecoms, utilities) in consumer credit reports increases access to credit dramatically for credit invisibles (primarily lower income persons, younger and elderly Americans, members of minority communities and immigrants). The inclusion of predictive data through consumer-permissioned channels may also help offset any degradation of traditional credit file data that may result as a consequence of COVID-19 crisis.