



PAID Roundtable on Using Alternative Data in Credit Scoring – December 15, 2005
SYNOPSIS AND FINDINGS

Four major themes emerged from the roundtable in its concluding discussion. The roundtable opened with a challenging address from Congresswoman Loretta Sanchez (D-CA), who suggested that this area of work was of critical concern to the Congress as it continues to grapple with the growing importance of the credit score as a tool used by a wide variety of potential employers, insurers, businesses and lenders. She indicated that the Congress is eager for workable proposals on how to make credit scores more accurate and a better tool to reach the 50 million individuals for whom access to credit is not possible because they operate in a cash economy or do not have the records to support a conventional credit score.

First, the value proposition for “full file” reporting needs to be better stated to reflect the realities of experience. For utilities and telecommunications providers moving to full file reporting, 80% of their customers pay on time, and a move to “full file” reporting for them is actually a consumer benefit because their good payment records are being recognized for the first time. Thus, the real “payback” for full-file reporters is for “moderate risk” consumers. Making it clear to consumers that there are credit record implications to late or delinquent payments provides an incentive for slow payers that makes them into a far better risk, and cleans up balance sheet for the reporting company.

Second, for credit bureaus, the regulatory barriers are complex that inhibit full file reporting by utilities and telecommunications firms. Contradictory federal and state regulations, and state rules that positively ban the use of consumer payment data on utility bills to credit bureaus stand in the way of implementing full-file reporting in a universal manner. Additionally, new hurdles can emerge in new legislation being drafted for completely different purposes. An example cited was the case of broadband legislation being drafted that may prohibit credit reporting of cable, telephony and broadband delinquencies. Clearly, a unified approach is required to educate legislators and others on the benefits of full file reporting.

Third, there are clear cultural issues that result in varying levels of participation in credit markets by many Americans. For many new immigrant groups, credit is rarely used as a financial tool for advancement. To the extent that the credit score is more and more universally used to make choices about the relative risk of a particular customer for a wide variety of purposes for which it was not originally designed—for example, for telephone service, auto insurance, health care, employment or other non-credit type decisions—a customer’s “thin file” will be an obstacle to their full participation in American work and society. We need to be aware that the risk we run is to create multi-tier credit system, rather than a universal system that is “culture blind”.

Fourth, while there is often a broad push for more “transparency” about the way in which credit scores are calculated and used to value a particular person’s credit risk, it seems the more profound problem is in the area of basic financial literacy for consumers. At a time when 70% of consumers believe that “credit repair” will actually remove bad credit scores from a consumer’s records, clearly there is a lot of work to do to educate consumers about the impact of credit behavior on their credit score to ensure that our credit system works for all its participants.

Finally, we summarize below some additional observations gleaned from the real-life experiences of companies engaging in full-file reporting which further illuminated the barriers and opportunities facing those with an interest in moving to this type of system:

- (1) Complex Contracting is a Deterrent to Providing “Full File” Data—one large telephone utility provided its customer data in the information industry preferred Metro 2 format, and agreed to utilize the information industry specified e-Oscar verification platform. Despite the fact that it would be furnishing exactly the same data, in exactly the same format, with the same means of verification to all three national credit bureaus at the same time, each of the three national repositories presented the prospective furnisher with radically different legal contracts ranging from a single page to nearly 20 pages.
- (2) Misinformation and Scare Tactics by Lenders can Impede Progress—Extra customer service expenses can occur if a company’s customers are informed by various creditors and lending institutions that having their payment data reported to a credit bureau would only harm their creditworthiness. Considerable education was required to convince customers of the potential benefits of reporting positive payment history to the national credit bureaus.
- (3) Benefits to the Bottom Line—one large telephone utility company that had been reporting millions of landline service tradelines to the three national credit bureaus indicated that the biggest impact on their bottom line was from improved cash flow from quicker payments from moderate risk or traditionally tardy customers. The decline in delinquencies attributable to the “poke factor” of reporting customer data is consistent with the experience of Nicor Gas, which reported a 20% reduction in delinquencies and arrearages as a direct result of reporting customer data.
- (4) Customer Communications are Vital—one energy utility and one telephone utility company reported a decline in delinquencies which track largely (with a lag) with the commencement of reporting customer data to a national credit bureau or bureaus. Both of these firms engaged their customers before they began reporting, and routinely thereafter. Communications included statement stuffers and conspicuous notifications on monthly statements. As a result, awareness among their customers about the policy of reporting payment history to a credit bureau or bureaus increased dramatically. Evidence from formal and informal surveys of the energy utility industry suggests that those firms that reported customer data to one or more credit bureaus, but did not educate their customers to this new policy, did not benefit from reporting as measured by reduced delinquencies and defaults.
- (5) Reporting Utility Data Reduces Delinquencies—one credit bureau reported that those states with the highest rates of energy utility reporting—roughly Illinois, Wisconsin, Pennsylvania and Massachusetts—have the lowest incidence of delinquencies among utility subscribers. By contrast, those states with the lowest volume of reporting utility tradelines to the credit bureau—including California owing to statutory prohibitions—ranked among the states with the highest delinquency and default rates for energy utility subscribers. These findings were significant at a high confidence level and had substantial explanatory power.
- (6) Obstacles to Pervasive Non-traditional Reporting Considerable—First and foremost, the legal and regulatory barriers proscribing the onward transfer of utility customer data to third parties (including credit bureaus) are complex and significant. While the statutory restrictions in a handful of states—and potentially on the federal level for telecoms data—are serious, more problematic is the environment of regulatory uncertainty that exists in the states. Utility companies want assurance from their regulators that reporting customer data to a credit bureau is permissible, but regulators won’t provide a concrete assurance without a nod

from the state legislature. Legislators, by contrast, are loathe to permit additional data sharing in an environment of heightened concern about data privacy and data security. Furthermore, many energy and telephone utility companies do not see the benefit of reporting, but do clearly see the public relations and public policy risks from reporting in a privacy-sensitive environment. This creates a formidable educational challenge for not only the credit bureaus, but also all parties that stand to gain from bringing non-traditional data online in an automated format—including lenders.

Next Steps and Future Work

The Urban Markets Initiative, PAID and the Information Policy Institute will be continuing to work on these issues in the future. In particular, PAID will be completing work on a paper that will summarize its work, the status of the field and many of the observations gleaned from this Roundtable. The Information Policy Institute and the Urban Markets Initiative are also investigating the impact of credit scoring on the provision of credit and capital to small businesses, particularly in urban areas. Please contact Pari Sabety (psabety@brookings.edu) or Brian Nagendra (bnagendra@brookings.edu) for more information.