UTILITY PAYMENTS AS ALTERNATIVE CREDIT DATA: A REALITY CHECK

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The Urban Markets Initiative (UMI) at the Brookings Institution Metropolitan Policy Program aims to improve the quality of the information available on urban communities and use it to unleash the full power of those markets while connecting them to the economic mainstream. Information influences investment decisions made in communities every day—whether the opening of a new store, to expand a warehouse, a bank's decision on personal and business loans, or a family's decision to purchase a new home. When information to make these decisions is not accurate, available, or accessible to urban investors, urban markets fail to thrive.

UMI invested in pilot projects and scalable models like the Payment Aggregation and Information Dissemination (PAID) project, an economic equity initiative addressing access to credit, that produced this discussion paper. The intent of these pilot projects is to demonstrate how interventions in the information cycle can facilitate urban markets. Learn more about UMI's pilot projects and work on access to credit and capital visit us at www.brookings.edu/metro/umi.htm.

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ABSTRACT

Access to credit is one of the cornerstones of wealth-building in the United States. Yet, between 35 million and 54 million persons are not participating in the credit market. Many individuals outside the credit mainstream are unable to access credit, or credit at competitive rates, because of the lack of traditional information, such as mortgage and credit card payments, available on their credit files. However, there is evidence that the inclusion of alternative data on credit-like payments, such as utility payments, in credit reporting can help bridge this information gap.[1] The first step toward filling this gap requires utility companies to systematically report these data to the major credit bureaus.

This report offers some initial insights into the possibility, experience, and hurdles of data reporting for utility companies. The authors surveyed 64 members of the Edison Electric Institute members and drew from roundtable discussions on alternative data held at the Brookings Institution in 2005. This report articulates several preliminary findings that warrant further investigation. These findings include:

- There are currently few regulatory restrictions against full file reporting; however, the lack of clear guidance on full file reporting by state regulatory commissions creates a disincentive for utility companies to report.
- Of the electric companies surveyed that are currently reporting data to credit bureaus, half are full file reporting (i.e. reporting both timely and delinquent payment records versus only reporting delinquent payment records).
- Full file reporting is used by some companies as a management strategy for reducing late payments (arrearages).
- The costs of data reporting are minimal once an automated data reporting system is put in place; yet, dedicating the necessary information technology resources to establish an automated system is a challenge.
- A perception of utility companies not reporting is a marked rise in customer service calls regarding credit report inquiries, resulting in an increase in customer service time.
- Increased consumer education on managing the credit consequences of utility payment practices could help address some of the concerns reported by the utility companies.

Further research needs to be undertaken to investigate incentives and disincentives to full file data reporting and identify paths to overcome these barriers. The inclusion of alternative data in credit risk modeling has the potential to create a more fair and accurate system for assessing individuals' creditworthiness in the U.S.

[1] Michael Turner, Alyssa Stewart Lee, Ann Schnare, Robin Varghese, and Patrick D. Walker "Give Credit Where Credit is Due: Increasing Access to Affordable Mainstream Credit Using Alternative Data" (Washington DC: Political Economic Research Council & the Brookings Institution Urban Markets Initiative, December 2006).

TABLE OF CONTENTS

I. INTRODUCTION

Access to credit is one of the cornerstones of wealth-building in the United States. Yet, between 35 million and 54 million persons are not participating in the credit market and thereby suffer a relative disadvantage in their efforts to build assets.[2] The very fact that so many Americans remain outside the credit mainstream concerns policymakers seeking to remove barriers to economic growth.

In recent decades, access to credit has dramatically expanded for the great majority of Americans with the spread of automated "credit scoring" systems that make credit decisions easier and more consistent. Through sophisticated statistical methods these systems have lowered the costs of loan processing and improved risk assessment. This revolution in lending itself has been enabled by the development of a national credit reporting system. Creditors report the timeliness of payments to national bureaus. Comprehensive, standardized, and reliable consumer payment histories allow lenders to efficiently and automatically assess the risk associated with a borrower, allowing the lender to decide both whether to extend the loan and at what price.

For many of those outside the credit fold, the dilemma is in one sense simple and difficult in another. It is simple in that the problem of access is often a problem of information. That is, many of those with a credit disadvantage lack information in their credit files (are "thin-filed") or lack files altogether ("null-filed"). The problem is complex in that access to credit, at reasonable prices, requires payment information, which, in turn, requires credit. One solution to this hurdle is to use payment information not from lenders but from providers of "credit-like" services. These services, such as utilities, are often supplied in advance of payment, are automated and recurrent, and thereby provide sufficient information to establish patterns. Alternative or nontraditional data provide lenders with information to help evaluate the risk of lending to a consumer. They also enable analytic companies to develop scoring systems that can make use of this information in lending.[3] Appendix B explores some issues surrounding the market drivers for alternative credit data.

More prominent among these alternative but credit-like services are utility and telecommunications payments.[4] Consumption of electricity is nearly universal in the United States, suggesting that utility payment information reaches far more individuals than data from any other sector, save perhaps telecommunications. Moreover, energy services are provided by a relatively small number of firms, unlike, rental payment information, which simplifies outreach efforts. The Federal Trade Commission concluded that utility payment data are among the most promising for

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[2] Helping Consumers Obtain The Credit They Deserve: Hearings before the Subcommittee on Financial Institutions and Consumer Credit of the House Committee on Financial Services109th Cong., 1st Sess. 10 (2005) (testimony of Michael Turner) (Washington D.C.: Government Printing Office, 2005).

[3] Katy Jacob, "Reaching Deeper: Using Alternative Data Sources to Increase the Efficacy of Credit Scoring" (Chicago: Center for Financial Services Innovation, 2006). Also see Janice Horan, "FICO® Scores and the Credit Underserved Market." Paper presented at the Roundtable on Using Alternative Data Sources in Credit Scoring (Washington: Brookings, and Asset Builders of America, December 15, 2006).

[4] Michael Turner, "Giving Underserved Consumers Better Access to the Credit System: The Promise of Non-traditional Data" (New York: Information Policy Institute, July 2005).

determining a consumer's credit rating.[5] Consumer advocates also view this strategy as a way to fill out the credit files of thin- or null-file consumers and to offset purely negative data. At the same time, they recognize some risk for consumers in full file reporting in which both negative and positive payment histories would become part of the consumer credit file. Credit bureaus and credit scoring companies are actively exploring the "predictive" value of certain kinds of payments not traditionally included in the statistical programs or models most frequently used by banks and other lending institutions today.

This report examines the possibility, experience, and hurdles of reporting utility payment information. The report draws its analysis largely from a survey of 27 of the 64 electrical companies that are members of the Edison Electric Institute (EEI), an association of U.S. shareholder–owned electric companies, and a roundtable discussion on nontraditional payment reporting held at the Brookings Institution in 2005. The report first describes the survey, its respondents, and the regulatory and economic context they face. It then assesses the incentives and disincentives to furnish information. (In a world of voluntary reporting, the benefits of reporting must be visible and substantial.) Chief among the potential benefits are reductions in arrearages. The report examines some of the effects of reporting on payments and evidence of other factors that help determine how reporting affects payments. It next examines some hurdles to reporting by the energy sector, followed by the implications of utility payment reporting for creditors and consumers. Finally, the study lays out next steps to better understanding these hurdles to reporting and how to address them.

[5] In response to the Fair and Accurate Credit Transactions Act of 2003 (FACTA), which amended the Fair Credit Reporting Act (FCRA), the Federal Trade Commission (FTC) reported to Congress (as required by FACTA, Section 319, and as an interim report from its ongoing, 11-year study) on the completeness and accuracy of consumer credit. Federal Trade Commission, ***First Interim Report of the Federal Trade Commission to Congress Under Section 319 of the Fair and Accurate Credit Transactions Act of 2006*** (December 2003), www.ftc.gov. See also Michael F. McEneney and Karl F. Kaufmann, "Fair Credit Reporting Act Developments: 2004 Annual Survey of Consumer Financial Services Law," *The Business Lawyer* 59 (3): 1215-26 (May 2004). (Can also be found at www.abanet.org)

II. SURVEY SAMPLE AND RESPONDENTS: CONTEXT AND EXPERIENCE OF REPORTING

Prior to any assessment of the promise offered utility payment information, one basic question must be answered: do utilities have any incentive to become data furnishers? If so, are there barriers to reporting these data?[6] What are the consequences for their operations and their relationships with their customers?

To gain insight into these issues, we surveyed members of the EEI on the experience and practice of full file reporting.[7] In addition, the Urban Markets Initiative of the Brookings Institution and Asset Builders of America hosted a roundtable in December 2005 on alternative data in credit scoring, which brought together industry representatives, lenders, academics, and policy experts to discuss the issue and supplement the survey.

The objective of the survey was to assess the scope of reporting by energy companies and examine the experience of and business rationale for reporting payment history data to credit reporting agencies (CRAs). The survey asked questions regarding: (1) whether a firm reported or had reported on payments; (2) implementation costs; (3) the effects of reporting on payments; (4) consumer communication; and (5) consumer responses.

There are 64 members of the EEI (that) serve 97 percent of the ultimate customers in the shareholder owned segment of the industry, and 71 percent of all electric utility ultimate customers in the nation. They generate almost 60 percent of the electricity produced by U.S. electric generators with revenues of about $225 billion.[8] Of the 64 members, 27 (42 percent) responded to the web-based survey conducted in the summer of 2005 by the University of Wisconsin-Milwaukee Center for Urban Innovation Research (CUIR). Table 1 provides an overview of their reporting histories.

[6] Three-fourths of electric utilities do not report. Interview with William Mayer, Manager of Customer Operations, Edison Electric Institute, by Wynn, Robert W. and Sara Burr, Asset Builders of America, Inc. November 2004.
[7] The data and experiences reported are only characteristic of the 27 respondents, and not necessarily of all utility firms in the EEI.
[8] Edison Electric Institute, http://www.eei.org/about_eei/index.htm , verified in personal correspondence with William Mayer, Manager of Customer Operations, Edison Electric Institute, November 2003, and in personal interview with Mayer by Wynn, Robert W. and Sara Burr, Asset Builders of America, Inc.

TABLE 1. BREAKDOWN OF RESPONDENTS

Of Total (27)	Number	Share		Number	Share (of total respondents)
Reporters	10	37.0%			
			Currently reporting	5	18.5%
			Formerly reporting	4	14.8%
			In implementation stage	1	3.7%
Nonreporters	16	59.3%			
			Have decided to report	7	25.9%
			No plans to report	9	33.3%
Other	1	3.7%	*Reports only commercial accounts*	1	3.7%
TOTAL	27	100%		27	100%

Two-thirds, or 18, of the 27 survey respondents are subject through state legislation to moratoria, during which they may not cut off service to nonpaying customers, typically beginning in November and lasting four or five months through spring. Two companies reported a summer moratorium in July and August, or when temperatures exceed 95 degrees. Respondents indicated that customers in a range of income brackets are known to take advantage of these moratoria months, including those who are not destitute but want to catch up with other bills. Moratoria are established by state legislatures, and we lack information to compare the payment behavior of those customers whose utility provides full file reporting to credit bureaus and those that don't.

Those companies that report year-round have been doing so for more than two years, and responded that, once their reporting software system was installed, monthly operation costs of full file reporting are "minimal" because updates are automated. (Survey respondents who do report were unable to provide cost information.[9])

The reported data and experiences are characteristic of the respondents and not of all utility firms that are members of EEI. Because the respondent group is small, rather than describing statistically the state of the industry with regard to full file reporting, the data offer insights and raise questions for further research. In particular, this report helps bring into focus certain industry experience, attitudes and challenges affecting its ability to adopt full file reporting.

9 This inability to provide cost information indicates a need to query a different group of professionals within the companies, such as accounting staff, on cost questions.

III. INCENTIVES TO REPORT: THE DYNAMICS OF ARREARAGES

Within the credit reporting system, the incentive for each data furnisher to report credit histories to CRAs is a straightforward one—reporting creates an incentive for the borrower to pay on time. Timely payments result in greater future access to credit on better terms, and delinquent payments result in worse terms. Credit reporting thus shapes what it reports. Utility consumers who are aware that their provider is reporting payment activity to a credit bureau and have an interest in credit access will have a greater incentive to pay bills on time.

Payments owed, or arrearages, are a significant concern for the industry. The scope of arrearages in the industry is rising.[10] Chartwell, a market research firm, reports that utility companies nationally write off $1.7 billion annually; this amounts to $8.50 for every utility customer, with amounts varying by regions. The largest write offs are in the northeastern United States.[11] The National Energy Assistance Directors Association (NEADA) similarly reports, "…there is growing evidence…there are mounting arrearage levels across the country."[12] With few exceptions, state utility commissions do not systematically collect information on arrearages and disconnections.[13] Although some case studies suggest late payments decline with reporting, there has been no systematic study to date.

The results of the survey provide some indication that reporting improves arrearages, but the data are far from definitive. The responding companies that report full payment histories do so as a management strategy to reduce arrearages and improve timely payment from customers. This is a key dimension of the business case for utilities to report all customer payment history. Of the five companies that are currently reporting full file histories, four, or 80 percent, responded that it has helped arrearages "somewhat"; 20 percent have seen no improvement. Those who do furnish full payment histories indicate it is a "sound business decision," or that it helps "increase receivables and reduce arrearages as well as help positive payers build good credit."

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10 William Mayer, "Full File Reporting in the Electric Utilities." Paper presented at the PAID Roundtable on Using Alternative Data in Credit Scoring (Washington: Brookings and Asset Builders of America, December 15, 2005).
11 Chartwell Inc., "Credit and Collections in the Utility Industry" (2004), cited by Peace Software, "Credit and Collections Best Practice: Theory into Practice" White paper, May 2005, p. 2, available at http://www.peace.com/whitepapers.html. Chartwell Inc. is a market research group whose reports are proprietary. Peace is a premier utility company customer software provider.
12. John Howat and others, "Tracking the Home Energy Needs of Low Income Households Through Trend Data on Arrearages and Disconnections." Paper presented at the National Energy Assistance Directors' Association, May 2004, p. 4: http://www.neada.org/pubs/index.htm
13 "With the exception of a few jurisdictions that require systematic reporting of the numbers of customers in arrears, the severity (dollar amount) of the arrearages, the number of customers whose service has been terminated, and the duration of terminations, today's data gathering and reporting does not allow for this determination to be made." Howat and others, "Tracking Home Energy Needs of Low Income Households," p. 1.

IV. DISINCENTIVES TO REPORTING

Hurdles to reporting include start-up costs, public relations, and consumer policy issues. Also, in some environments, utility providers face regulatory barriers. Very few states have explicit barriers to reporting, but many operate in an environment of regulatory uncertainty. Energy providers are extensively regulated and are subject to considerable public scrutiny. Without explicit authorization by lawmakers and regulators, many are reluctant to participate in the reporting system.

A. Demands on Information Technology Resources

Our survey suggests that for both current and past reporters, technology issues are a potential hurdle. One respondent mentioned that the information technology (IT) staff has no additional time, and another indicated it was not an IT priority.[14] In addition to the demands on IT, utilities have encountered data integrity problems. For example, the American Gas Association recently reported that one member ceased full file reporting because of data integrity issues related to collecting customer social security numbers and the demand on IT resources.[15]

B. Customer Service Demands

In addition to concerns about the IT burden, for those who never have or no longer report, the specter of increased customer service demand and volume of inquiries appears to be a barrier. Of the 15 companies responding to the question asking why they did not report payment histories, seven (or 47 percent of 15 respondents) said they "don't want to be responsible for credit report inquiries," and six (40 percent of 15) stated it "would require too much customer service time." Three of the 15 respondents "have an internal policy against it." These companies are concerned that full file reporting will have the unintended consequence of increasing monthly customer complaints about the accuracy of the data in consumer credit reports. This concern includes the worry that short-term customer service costs will increase without an apparent and comparable short-term increase in revenue or reduction in arrearages. The American Gas Association and EEI voiced similar concerns at the roundtable.[16] The American Gas Association also noted informally that those customers objecting to data reporting were often those with negative histories and they were not shy about complaining to their state legislators. Moreover, as a matter of policy, some companies, in the words of one, "only report customers who are 90 days or more past due…to give the benefit of the doubt to those customers who may be having payment problems for the first time or may only have a relatively small amount past due."[17]

C. Regulatory Climate

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[14] The Chartwell report ("Credit and Collections in the Utility Industry") discusses a software solution for utilities for collections management in the context of aging systems that seem to plague the industry.
[15] James Linn, "Full File Credit Reporting in the Natural Gas Utility Industry"; and William Mayer, "Full File Reporting in the Electric Utilities." Papers presented at the PAID Roundtable on Using Alternative Data in Credit Scoring (Washington: Brookings and Asset Builders of America, December 15, 2005).
[16] Ibid.
[17] EEI Survey follow-up telephone interview with L. Harrison at Central Hudson Gas and Electric by Sara Burr, October 4, 2005.

Another key finding at the roundtable was that state regulatory commissions have provided little or no guidance to utilities on full file reporting. The absence of governmental direction creates an atmosphere of regulatory uncertainty for many utilities. Federal law sometimes conflicts with state statutes as well, according to some industry respondents, again reinforcing uncertainty about rights and responsibilities within the industry.[18] Some states, such as California's Public Utility Commission, bar reporting of payment data without the direct approval of the utility customer. Similarly, the 2005 Broadband Bill ties telephony regulation to consent by consumers to full file reporting. The survey indicates these topics, along with credit score management, will bolster consumer financial education as the impetus toward alternative data gains steam in the credit industry.

Moreover, as mentioned above, 18 of the 27 utility companies in the survey are subject through state legislation to moratoria, during which they may not cut off service to nonpaying customers, for four to five months a year; consequently, some consumers make late payments. If consumers are not fully aware of the potential credit consequences of making late payments, they may be disadvantaged by full file reporting.

[18] Pari Sabety and Brian Nagendra, "Synopsis and Findings." Paper presented at the PAID Roundtable on Using Alternative Data in Credit Scoring (Washington: Brookings and Asset Builders of America, December 15, 2005).

V. Weighing Incentives and Disincentives: The Role of Customer Education

Because of the growing problem utility companies face in collections, one important value of choosing to become a credit data furnisher with full file reporting might be the higher propensity among customers to prioritize their utility payments. Our survey results were mixed on this matter. Those electric companies in our survey that stopped full file reporting (four respondents) cited the cost and hassle of "too much customer service time," reporting that "it created more complaints and error follow-ups than benefits," and that reporting did not help with arrearages. Those few who continue to report (four respondents), in contrast, believe it has produced "somewhat" of a reduction in arrearages.

What accounts for the different experiences? It is difficult to isolate any particular influence on customer payment practices. The incremental improvement in arrearages for those reporting may be the result of several factors, including full file reporting. The survey clarified the need for a closer examination of reporting as an arrearages management tool in the face of rising arrearages in the industry.

Both the benefits of and hurdles to reporting may depend on the character and scale of consumer education. The survey found that, in general, consumer education about managing the credit consequences of payment practices is minimal (See WE Energies case study on full file reporting in Appendix A). Regardless of whether they furnish payment history data to a credit bureau, six of the 24 (25 percent) indicated that they supply some kind of financial information, referral, or education to distressed consumers, while 16 of 24 (67 percent) provide none. Those that inform their customers that they report credit histories typically do so via a bill insert or a notice. Two reporting firms provide their late-paying customers with an additional notice about credit reporting on their bill. One company also posts a notice on its website for customers. All the reporting companies provide customers with a special notice when they first sign up for utility services.

As with the reporting of credit payment information, awareness of reporting may alter payment behavior if consumers understand how payment reporting affects credit access and price. Communication can also help customers understand that reporting does not simply punish them for late payment, but also rewards them for timely payments in the form of greater access to credit and better prices for loans.

VI. CONCLUSION: WHAT ARE WE LEARNING ON THE GROUND?

A. Implications for Utility Companies

To improve collections, utility companies and their trade associations would benefit from more and better information about providing data to credit reporting agencies. At the same time, companies may improve collections if they furnish customer payment data while also educating their customers about the potential effects of this reporting on credit scores. The experience of WE Energies (see Appendix A) and other successful reporting utilities suggests that most of the barriers perceived by the industry to full file reporting can be overcome. The main opportunity for utilities lies in the indications that, approached as a receivables management function, full file reporting may reduce arrearages and shorten days payable. In addition, utilities may offset some of the expense of buying credit reports on new commercial and residential customers by furnishing credit data to CRAs.

It appears that some of the resistance to full file reporting in the industry is related more to industry culture. Traditionally, and especially prior to deregulation, utility companies were uniquely bound to their communities. They developed personal relationships with customers and offered collection options that gave customers some latitude. In addition, resulting from the of the "public good" utility companies provide, they are uniquely monitored by state government for pricing, service, and payment moratoria. In other words, utilities are accustomed to looking to government for a certain amount of direction in management, cost containment, and profitability. These civic characteristics may prove to be the greater barrier to full file reporting. As Jim Linn of The American Gas Association stated at the roundtable, it is necessary to "inform utilities of the benefits" both for their customers and their bottom line of full file reporting.[19]

B. Implications for the Consumer

Providing nontraditional data to consumer credit agencies is already underway on some level. Through organizations like Payment Reporting Builds Credit (PRBC) consumers now have an option to provide their payment history data to a service that will automate it and score it for credit analysts. At the same time, certain payment history data that are already automated by a vendor such as a utility or telecom company may be regularly reported, as in the case of Wisconsin's WE Energies. While this is not the case in most markets, the credit industry is looking at opportunities among utilities and telecoms where such data has not been exported to a credit data agency. The jury is still out specific impacts for low- and moderate-income or credit-underserved consumers in regards to the involuntary inclusion of nontraditional data in their credit record in practice.[20] The impact on consumers of automated payment data reporting is not fully understood, but the value to responsible consumers looks promising in light of initiatives like PRBC. These data, in other words, are a source of information about the consumer that helps define his or her unique identity with an

[19] Linn, "PAID Roundtable on Using Alternative Data in Credit Scoring."
[20] See, however, Michael Turner and others, "Give Credit Where Credit is Due" (Washington: Brookings, December 2006).

address or other identifying information. For these reasons, both consumer advocates and the credit industry would see merit in further testing the waters.[21]

At the same time, data furnishing trends highlight the importance of consumer credit education. Traditionally, personal financial education has focused on managing cash flow (budgeting), risk management, savings, and investment. Two partners in this project, Asset Builders of America, Inc., and WE Energies' Low Income Pilot Program, both foretell a shift to credit score management as a new core curriculum element in financial education. Regardless of the source and completeness of both traditional and nontraditional credit data, the consumer's credit score is critical to building net worth through mortgage qualification and loan pricing, and also increasingly to the cost of insurance and to hiring decisions. Educating consumers on credit score management will also enable constituents to have an impact on state legislators, regulatory commissioners, and congressional representatives. Constituents will be better equipped to inform the government of the merits of alternative data furnished by utilities and telecoms.

C. Implications for Public Utility Commissioners and Elected Officials

Our research suggests that policymakers paying particular attention to legislation and rule-making that may or may not directly or indirectly impede the flow of alternative payment data into the automated credit system. The potential for consumer and industry benefits is evident, as is the potential for spurring growth in the domestic and global economy. For example, it is worthwhile to encourage pilot programs like those of WE Energies and Verizon that provide "proof" of customer and business benefits (see Appendix A). Constituent involvement seems to be the missing piece in fostering a comfort level among legislators and public service commissioners in leveling the regulatory playing field for nontraditional data furnishers. In addition, state commissions should consider coordination to collect national trend data on arrearages. Such information would allow both industry and consumers to share a performance metric on full file reporting.

D. Implications for Credit Agencies

The credit data industry is highly competitive. Proprietary sources of meaningful, scoreable data enable credit agencies to compete. Regardless of competition for data sources, the study suggests that the credit data industry should collaborate to streamline agreements, contracts, and forms for new data furnishers. As national and global enterprises consider becoming data furnishers, they are confronted with a variety of contracts from a variety of credit reporting agencies to provide the same data. It will expedite their positive decisionmaking if the credit agency industry were to standardize such contracts for alternative data furnishers.

E. Implications for Lenders

[21] Congresswoman Loretta Sanchez, "Sanchez Amendment Included in House Federal Housing Finance Reform (GSE) Bill; Encourages Alternative Credit Scoring" www.lorettasanchez.house.gov. See Press Room, October 27, 2005). Congresswoman Sanchez offered an amendment to H.R. 1416, the Federal Housing Finance Reform Act of 2005. The amendment adds "alternative credit scoring" as an element of the Annual Housing Report, as detailed in Section 1324 of the bill. See www.lorettasanchez.house.gov/issues2.cfm?id=11287

It is the interest of lenders to improve their capacity to assess risk. An emerging tool for lenders is the use of credit scores derived from alternative data provided by utility and telecom companies. Such data may be sufficiently predictive to be “scoreable.” If so, lenders will be better able to move money into the underserved marketplace, while the secondary loan market will be more confident in acquiring that paper. The hope of alternative data are that underserved consumers will qualify for the financing they need at a reasonable price, and will use it to increase their net worth.

Because of the size of the underserved market that will require automation of nontraditional payment histories, bringing this segment of consumers into the mainstream of the credit industry is a challenge for the nation’s economy to date. If furnishing alternative credit data, such as full file reporting of utility payment histories, helps the industry access credit-worthy individuals and helps those individuals access the financing they need to purchase a home or business, the economy will be energized.

Further research is needed. To truly address the hurdles to reporting, changes in billing systems, diffusion of reporting standards, and regulatory relationships are necessary. To the extent that arrearages are affected by reporting itself, how reporting is structured and awareness of it may matter a great deal in the decision whether to report. Given that the economic life chances of millions can be affected, a better understanding is crucial for both public and private policy.

APPENDIX A: TWO CASE STUDIES IN FULL FILE DATA REPORTING

WE ENERGIES CASE STUDY, MILWAUKEE, WISCONSIN[22]

WE Energies in Milwaukee, Wisconsin, a full file reporting company, had growing concerns about rising arrearages in the industry in the past three years.[23] The company serves about 1.1 million electric customers in Wisconsin and Michigan's Upper Peninsula and more than 1 million natural gas customers in Wisconsin. To address its concern, during the summer of 2005, WE Energies, collaborating with a number of advocacy and education groups serving low-income energy customers, and with the approval of the state regulatory agency (Wisconsin Public Service Commission), launched a pilot education program for its low-income Milwaukee customers. The curriculum teaches financial and credit management along with energy conservation. The program, if successful, will provide a model of consumer education practices for utilities. In the same energy market, Asset Builders of America, Inc. (a nonprofit financial education corporation based in Madison, Wisconsin, and serving low- and moderate-income populations) recently piloted a "credit score management" training program for Milwaukee customers of WE Energies. The program trained low- and moderate-income participants and monitored their "pre and post" energy and telecom payment behavior over a 12-month period (January to December 2006). This project explores the relationship between the consumer's understanding of credit data, lenders' perception of credit-worthiness based on trade line data, [24] and the impact of trade lines on consumer credit scores over time. It will also provide data on the effect of education on participant arrearages patterns.

WE Energies began full file reporting in April 1994 in connection with the merger of gas and electric companies operating in the Milwaukee market. The company identified several **customer benefits to furnishing credit data, including:**

- Helps keep rates low for all customers by reducing the number of past-due accounts
- Enables customers to better manage their credit health
- Helps establish credit rating for customers with nontraditional credit sources
- Helps detect identify theft[25]
- Prevents or minimizes the chance of becoming overextended with unmanageable debt
- Assists customers in obtaining loans for large purchases
- Improves ability of customer to broaden credit availability

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[22] Michael Mueller, "Process for Credit Bureau Reporting." Presentation to a meeting of Asset Builders of America, Inc. (Milwaukee: February 2005).

[23] Roman Draba, "WE Energies Low Income Pilot Program." Cover letter to the Wisconsin Public Service Commission, November 29, 2004.

[24] "Trade line data" is non-credit payment data, such as vendor payment data for a commercial account, reported to a credit bureau. In credit scoring formulas, trade lines are assigned different "weights" than traditional credit payment data like bank loan repayment or credit card payment data per se.

[25] Supporters of full file reporting assert that additional detailed data on an individual helps strengthen the uniqueness of an individual's identity, and therefore help with identity theft detection. Presentation at the PAID Roundtable on Using Alternative Data in Credit Scoring by William Mayer "Full File Reporting in the Electric Utilities (Washington: Brookings and Asset Builders of America, December 15, 2005).

The company's **process for credit bureau reporting** contains three main steps:

- A predefined (by the credit bureau) electronic information file contains both positive and negative customer information on the basis of their payment behavior. The Fair Credit Reporting Act (FCRA) requires both positive and negative information. Collection agencies are exempt from this requirement.
- WE Energies transmits updated files weekly, including the customer's name and other identifying information required by FCRA, and the amount owed and age of debt as required by FCRA.
- Credit Bureau updates customer records. Adverse credit information stays on an account for seven years and non-adverse information remains for ten years.

WE Energies administers a **customer inquiry process** in compliance with FCRA in the following sequence:

- Customer contact center receives calls
- Determines whether the credit bureau report should be adjusted
- If not, informs the customer that the information is accurate and no adjustment will be made
- If in need of adjustment, sends an electronic form to the credit bureau representative. For example, a misapplied payment or a bill mailed to the wrong address are both deserving of a credit bureau adjustment
- Sends an electronic form to the credit bureau support representative
- WE Energies sends an online electronic adjustment to the credit bureau
- The credit bureau corrects the individual's credit bureau report.

Information technology set-up and other start-up guidelines.[26] WE Energies' reporting procedures comply with the following guidelines, which apply under FCRA to all reporters of utility company data:

- Report all data in a standard format (Metro 2 Format is the industry standard)
- Report all current and delinquent open accounts monthly
- Report closed accounts at the end of the month in which they occur
- Report the complete name, address, and social security number of the legally liable consumer(s)
- Report the phone number and date of birth, when available
- Report the Equal Credit Opportunity Act (ECOA) Code to designate the account as joint, individual, or other type in compliance with the ECOA
- Report the Payment History Profile, which provides up to 24 months of payment history, as a way to control and maintain the payment history
- Report the internal code that identifies the utility company where information is verified
- All parties reporting credit information must respond to consumer inquiries

[26] Consumer Data Industry Association, *Credit Reporting Resource Guide*: *Utility Company Reporting* (Washington, D.C.: 2004), pp. 12-1.

- All parties reporting credit information must comply with the FCRA and any applicable state laws.

Trans Union, WE Energies' credit reporting agency, provided the company with technical assistance to ensure complete and accurate reporting, including information for new data furnishers, instructions for electronic data transmission requirements, and instructions for receiving and transmitting universal data forms and consumer dispute verifications online (www.E-OSCAR-web.net). WE Energies also signed a "Data Furnishers Reporting Agreement" with TransUnion.

Regulatory requirements: The FCRA imposes the following duties on data furnishers (www.ftc.gov/credit).[27] TransUnion trained WE Energies in the requirements of the FCRA, which as of 2004 consist of the following elements:

- Accuracy guidelines
- General prohibition on reporting inaccurate information
- Duty to correct and update information
- Duties after notice of dispute from consumer
- Duties after notice of dispute from consumer reporting agency
- Duty to report voluntary closing of credit accounts
- Duty to report dates of delinquencies
- Duties when identity theft occurs

Perceived benefits of full file reporting. WE Energies has identified a set of company and customer benefits linked to full file reporting:[28]

- Reduce arrears and uncollectibles
- Become a creditor of choice (customer prioritizes utility payment)
- Reduce need for Utility Letter of Credit
- Contribute utility trade line to credit scoring for customers with nontraditional credit sources
- Helps keep rates low for all customers by reducing the number of past-due accounts
- Improve customer satisfaction.

VERIZON CASE STUDY

Verizon detailed its full file reporting pilot program at the roundtable, solidly locating its program within receivables management for the company.[29] Verizon has since discontinued its full file reporting program to all three credit bureaus due to regulatory uncertainty. Verizon's objectives were to (1) improve payment of slow payers, (2) reduce outside collection agency expenses, and (3)

[27] TransUnion, "Notice to Furnishers of Information: Obligations of Furnishers Under the FCRA; 1000.11f—12/9/2004." (Chicago: TransUnion, 2004)
[28] John Zaganczyk (WE Energies), "Utility Full File Credit Reporting: Evidence From the Field." Paper presented at the PAID Roundtable on Using Alternative Data in Credit Scoring (Washington: Brookings and Asset Builders of America, December 15, 2005).
[29] Marcia T. Johnston, "Verizon: Live Credit Reporting." Paper presented at the PAID Roundtable on Using Alternative Data for Credit Scoring (Washington: Brookings and Asset Builders of America, December 15, 2005).

reduce credit bureau expenses by leveraging the company's position as a data provider. The customer benefit was rewarding timely payments with positive reports to credit bureaus, which would improve customer credit scores and reduce the customer's cost of borrowing. Verizon used the following measurement metrics to determine the value of full file reporting for the company: average final bill balance, days sales outstanding, number of accounts in treatment or collections, risk score distribution, and aging of accounts.

Verizon initiated its pilot program of live credit reporting in Virginia in 2005, with full deployment planned for 2006. Customer communications included a bill insert, "Your Credit Score and You"; a bill message, "Important Credit Reporting Notice"; and a similar message on denial notices. The pilot replaced the company's traditional credit reporting process in which an account in arrears would be closed, service disconnected, and the account referred to a collection agency. Under live credit reporting, customer account and payment data are reported "cradle to grave" to credit reporting agencies with every bill date. The issues facing the company were legal rather than regulatory, and involved the variety of contractual agreements for data furnishers among individual credit reporting agencies, even though each agency requires the identical methodologies, software, and regulatory assurances.[30]

[30] Sabety and Nagendra, "Synopsis and Findings."

APPENDIX B: MARKET DRIVERS OF ALTERNATIVE DATA AND CREDIT SCORING

A. The Alternative Credit Data Market

Both lenders and consumers face challenges and opportunities in the alternative credit data market. For both, the key challenge is whether alternative data have predictive value, that is, will it help predict the consumer's payment of credit as agreed. The answer to this question will open or close market opportunity for lenders and consumers.

Consumer advocates are sensitive to the downside of full file reporting, asit may negatively affect individual credit scores. They also are concerned that data collection will raise issues of personal financial privacy and identity theft.[31] On the other hand, advocates recognize that current credit files for some low- and moderate-income families are "unbalanced" because they fail to reflect a history of positive payment of rent, utilities, and other recurrent obligations.

Lenders and utilities face the challenge of how to identify and attract the best (most predictive) new data and furnishers. The challenge for new data furnishers is whether full file reporting can be a business function that benefits the company's bottom line.

B. The Changing Face of the Market

The underserved credit market is emerging as an economic driver of credit data because of both its size and the cultural characteristics. At the core of this market's U.S. growth is a combination of immigration and resident demographics. The underserved credit market consists of a growing Hispanic and Asian immigrant population, and it also includes long established communities of African-, Hispanic-, and Asian-Americans.[32] Furthermore, the underserved credit market includes senior citizens whose numbers are swelling as the baby boomers age. It also includes the newly divorced and young entrants into the full-time workforce, some of whom moved directly into the workforce from high school and others joining the labor market following postsecondary education.[33] This complex set of populations may have thin or null credit files for many reasons unrelated to their ability to repay debt. For example, some of these individuals may pay cash only and have little banking history. They may be renters rather than mortgage holders, transit riders rather than automobile owners. They may carry a credit line with the small local grocer rather than using a credit card, rely on payday lenders for cash flow, or participate in the informal "friends and family" financing network of their community. They may in fact have withdrawn from the credit market because of their age and lack of need to finance assets such as homes any more.

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[31] James Carr, remarks at PAID Roundtable on Using Alternative Data for Credit Scoring (Washington: Brookings and Asset Builders of America, December 15, 2005).
[32] Lafferty—Intelligence to Bank On, "US Issuers to Target Hispanic Immigrants" (London: October 25, 2005), available online at www.lafferty.com.
[33] Jeffrey Humphreys, "The Multicultural Economy 2003: America's Minority Buying Power," *Georgia Business and Economic Conditions* 63 (2) (2003): 1 - 26.

The rapidly increasing business, consumer, and legal literature examining dimensions of the unbanked population also testify to the rising interest in this underserved credit market.[34] Estimates place the size of this population at between 35 million and 54 million consumers. Uniquely, the same unbanked or underserved market segment is responsible for substantial cash flows into and out of the U.S. economy. Within the United States, for example, the Federal Reserve estimates that the U.S. Hispanic market in 2003 represented about $653 billion in purchasing power (or 8 percent of the U.S. total) while the Asian market represented $344 billion (4 percent).[35] The U.S. Department of Treasury estimates that remittances to developing countries (from resident US immigrants) totaled more than $90 billion in 2003, composing a substantial share of their income. The Fair Isaac Company, which estimates that approximately 50 million U.S. consumers are "underserved," notes that these consumers represent 25 percent of credit-eligible consumers. [36] Substantial real growth (new sales) in the credit industry will come from this market.[37] Recognizing that a meaningful segment of this market has the capacity to assume and repay debt, lending organizations are seeking to demonstrate that alternative credit data are a tool for extending their reach into the unbanked and credit-underserved market.

Supporting lenders' growing interest in nontraditional data, credit rating agencies such as Fair Isaac are developing alternative scoring methods.[38] A parallel trend is the escalating use of credit scores in decision-making and pricing by non-lending actors, such as employers and insurance companies. It is in the interests of all these actors, as well as in the interests of a healthy national economy, that the methods of credit rating are as rational as possible and assess risk as realistically as possible. If there are good reasons to consider data not traditionally calculated in credit scoring that can accurately predict risk, those data should be included in the formula so financial markets are not irrationally constricted and can grow on a solid foundation. As Michael Barr noted, "Despite the depth and breadth of U.S. credit markets, low- and moderate-income communities and minority borrowers have not enjoyed full access to those markets. This lack of access to credit has helped to impede economic growth in these communities."[39] Global markets in China and elsewhere are significantly credit-underserved; as a result, these markets are becoming more competitive for global lending companies. The issue of nontraditional credit data use will soon be, if it is not already, on the international business agenda.

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[34] For example, see Richard Brooks, "Credit Where It's Due: In Praise of Pawnshops," *Forbes,* April 12, 2004, www.forbes.com.

[35] Ben S. Bernanke, "Financial Access for Immigrants: The Case of Remittances." Remarks by Governor Ben S. Bernanke at the conference, Financial Access for Immigrants: Learning from Diverse Perspectives conference (Chicago: Federal Reserve Bank of Chicago, April 16, 2004); Humphreys, "The Multicultural Economy 2003.

[36] Lisa Freeman, "Problems Seen in New FICO Program," *Credit Union Journal*, 8 (33) (August 16, 2004): 5-6 and available at www.cujournal.com.

[37] Fair Isaac, "New FICO Score Extends Lenders' Reach to Credit-Underserved Millions," *Viewpoints: News, Ideas and Solutions from Fair Isaac*, September/October 2004.

[38] As are the three big credit bureaus (Equifax, Experian, and TransUnion) that have created a new credit-scoring system called VantageScore. See Liz Pulliam Weston, "What the New Credit Score Means to You," *MSN Money*, March 20, 2006, available at http://moneycentral.msn/content/Banking/Yourcreditrating/P148045.asp/

[39] Michael S. Barr, "Access to Financial Services in the 21st Century: Five Opportunities for the Bush Administration and 107th Congress," *Notre Dame Journal of Law, Ethics and Public Policy*, 16 (2) (Summer 2005): 447-473, p. 448. See also, Michael Barr, "Banking the Poor," *Yale Journal on Regulation*, 21(1) (Winter 2004): 121-237.

C. The Economic Significance of Traditional and Nontraditional Credit Data

The manner in which the credit and lending sectors implement credit histories and credit scores can be a barrier to participation in the banking and credit markets for unbanked consumers. In a large economy, it is most efficient for the credit industry to build credit files from data that are already automated. Automation eases the difficulty of measuring risk and enables a vast number of rapid and consistent credit decisions. Credit card companies, auto lenders, banks, and mortgage lenders are capable of electronically furnishing payment history data on their customers to credit reporting agencies. These are the traditional sources of credit reports and scores.

Rent payment histories, payday lender repayment data, child support data, utility and telephone payments have historically not been included in the automated credit data system. These consumers may therefore be locked out of the credit market, and lenders may lose business by making credit decisions without sufficient data, pricing out or denying credit to a perceived "risky" borrower who may be a reliable and timely payer functioning outside the automated credit data system. Michelle Singletary has described two poles defining the "underserved" credit population: those who have no credit history because of poverty, immigrant status, or divorce; and those who have no credit histories because they are comfortably well-off and do not believe in using credit.[40] In between these poles are low- and moderate-income consumers, who rent, pay their utility bills, budget their cash, and live within their income. For those consumers falling along the mid-range of the consumer spectrum who do not use traditional credit tools such as credit cards or mortgage loans, there is no automated record of their payment history available to credit reporting agencies. These consumers will likely have a "thin" credit file (too little credit information) or generate "no hits" (no available credit history) and will not be scoreable. Potentially qualified borrowers suffer denial of credit or higher priced loans (the subprime interest rate market) on the basis of lenders' perceptions of risk regardless of a history of meeting their financial responsibilities in a timely manner. Fair Isaac estimates 30 million U.S. adults have thin credit bureau records and another 20 million have no credit bureau record. Janice Horan, Director of Global Scoring Solutions at Fair Isaac, estimates "underwriting just 3 percent of this market creates $2.3 billion for mortgage lenders, that is, in real growth.[41]

D. Furnishing Automated Credit Data

To offset the impact of a "no hits" or "thin file" credit reports, some lenders may work with a customer who manually provides the necessary payment history information to evaluate credit-worthiness. This collection and analysis work is time-consuming (costly) for the lender and the customer. The consumer can also face additional costs if he or she requires time off from work to provide the information or if his or her "nontraditional" payment history data prompt a loan that is higher priced than one generated from the industry's credit scoring system. Community banks offer

[40] Michelle Singletary, "The Color of Money: Credit Scores Aim to Rewrite History," *The Washington Post*, August 1, 2004, Section F01.
[41] Janice Horan, "FICO® Scores and the Credit Underserved Market." Paper presented at the Roundtable on Using Alternative Data Sources in Credit Scoring (Washington: Brookings, and Asset Builders of America, December 15, 2006).

this manual option to potential borrowers in many cases, but it is not a solution that can be successfully implemented on a large scale to reach the estimated 50 million underserved U.S. residents, much less China's looming market.

The credit data industry is designing techniques to account for and score nontraditional data. Solutions, however, must take into account not only nontraditional data, but mechanisms for automating that data. One goal discussed would be to modify the potential data furnisher's information systems or software to create full file electronic reporting (that is, all payment history information, positive and negative, for the period reported).

Another approach is to develop firms or services that collate data provided by consumers as a way to automate and create a supplemental credit score to assist fair lending decisions. Payment Reporting Builds Credit (PRBC) is a start-up company (originally named Pay Rent Build Credit) exemplifying this strategy, financed initially by Citimortgage, Fannie Mae, and the Ford Foundation. PRBC collects and scores data for consumers who provide evidence of all their regular payments, such monthly day care, rent, utilities, car payments, and insurance. PRBC scores and sells these automated data and proprietary scores to lenders and qualified others, who are its paying customers. In a similar vein, Fair Isaac has designed a new credit calculation (the Expansion TM Score) that scores nontraditional data such as rent, utility and telephone bills, cable television, and banking records. In Los Angeles, Experian is similarly developing its "Score X" to serve a vital immigrant population.

E. Summary

It is the confluence of these factors (the size of the underserved market, the bias in the data composing credit reports, the reliance on automated data by the credit industry, and the expanded use of credit scores by noncreditors) that is triggering an examination by scholars, policymakers, and the credit industry of methods to collect and automate more complete consumer payment histories. The U.S. House Committee on Financial Services held hearings in May 2005, presided over by Congressman Michael Castle (R-Delaware), to learn more about nontraditional data and the responses emerging in the private sector to add this value into the credit system.[42] Lisa Nelson, vice president of Fair Isaac Credit Services, testified about Fair Isaac's leadership in the use of alternative credit data, specifically with respect to the launch of Fair Isaac's new Expansion TM Score.[43] Michael Turner, president of the Information Policy Institute, drew on the results of recent research when testifying to the "the promise of nontraditional data," in "giving underserved communities fair access to the American credit system."[44]

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[42] U.S. House, Committee on Financial Services. "U.S. Representative Spencer Bachus (R-Al) Holds Hearing on Consumer Credit, May 12, 2005' (Government Printing Office, 2005).

[43] U.S. House, Committee on House Financial Services. "Consumer Credit Opportunity: Statement of Lisa Nelson, Vice President, Fair Isaac Credit Services," Hearing, 12 May 2005. (Washington: Government Printing Office, 2005). See also, Pat Curry, "No Credit? New Credit Scores Target 'Underserved' Consumers," *Bankrate.com,* August 3, 2004, available at www.bankrate.com/brm/news/credit-scoring/20040803a1.asp.

[44] Helping Consumers Obtain The Credit They Deserve: Hearings before the Subcommittee on Financial Institutions and Consumer Credit of the House Committee on Financial Services109th Cong., 1st Sess. 10 (2005) (testimony of Michael Turner) (Washington D.C.: Government Printing Office, 2005).

More and better-quality data can flesh out a consumer's credit report, level the playing field by offsetting negative data with positive payment histories, and better predict a consumer's likelihood of paying debt as agreed.[45] However, the question remains, which alternative data set is the best? Payments of gas, electric, and telecommunications bills are emerging as data of greatest interest to the credit industry and to consumer advocates because they are already automated internally even though rarely extracted into the credit data system.

[45] Ibid.