Prepared Written Comments of Dr. Michael Turner President & CEO Policy & Economic Research Council (PERC)

Testifying Before the House Subcommittee on
Financial Institutions and Consumer Credit on
"Examining the Uses of Consumer Credit Data."

13 September 2012
2:00 pm
2128 Rayburn House Office Building

Imagine not having a credit card…being unable to rent a car, buy things online, or fill your gas tank late at night.

In the U.S., an estimated 54 million adults are financially excluded. No credit cards, home or auto loans, or money to start a small business.

Most are financially excluded not owing to a bad credit history—but because *they have no credit history*. Mainstream lenders use sophisticated tools like credit reports and scores to assess a borrower's risk. Without enough credit history…a credit score cannot be generated, and the borrower is rejected.

Applying for credit is like applying for a first job, and being told "…we'd like to hire you, but we want someone with more experience." Lenders mostly grant credit to those who already have it. This is the "Credit Catch 22."

Lacking recourse, those who are denied because they don't have a credit history—call them the "Credit Invisibles"—must turn to high cost lenders—pawn shops, pay day, and predatory lenders—to meet their credit needs.

Why is having a credit history so important? People need credit in order to build assets. The two primary means by which wealth is created are owning a home or a small business.

For most of us, this requires convincing someone—usually a bank—to lend you money. Lacking a credit history, the Credit Invisibles remain financially excluded, often trapped in poverty by a heavy debt service burden. The APR on a payday loan can exceed 700%.

There is a solution. Lenders must be able to see the Credit Invisibles. That is, their credit files must be built using non-financial payment information.

Most of the financially excluded—even 85% of the lowest income earners in the US—pay many "credit-like" bills on time most of the time. These include things like gas, water, electric, cable TV, and telephone bills.
Right now, most utilities only report to a credit bureau when a customer defaults. People are punished for bad credit behavior, but not rewarded for their good behavior.

This is known as "negative only reporting," and it is akin to a black list. Negative only reporting is hardest on those with the lowest income, and those who have experienced life setbacks—such as a job loss, divorce, or medical expenses.

Negative items stay on credit reports for 7 to 10 years. Without positive information to offset the credit stains, it is harder to improve your credit score and qualify for affordable credit.

A recent study by PERC and the Brookings Institution found that when energy utility and telephone data—so-called "alternative data"—are fully reported—that is, when firms report timely and late payment data alike—those who are "Credit Invisible" shrink from 54 million to around 5 million.

Evidence of the broad benefits of fully reporting alternative data abounds. In the same PERC and Brookings study, fully reporting alternative data increases credit access by 22% for Hispanics and Blacks, and by 14% for young and elderly Americans.

One global lender estimated that 40% of the financially excluded in the U.S.—nearly 22 million adults—can qualify for credit if their utility or telephone payment data were fully reported.

This is not hypothetical. Those with little credit experience, but who luckily had alternative data in their credit report, were able to access mainstream credit at 4 times the rate of a comparable group—the unlucky majority—without such data.

This is not extending easy credit to unqualified borrowers who cannot afford it. In fact, another PERC study of 12.1 million Americans found that those who were "new to credit through alternative data" were more credit responsible than the general population after just one year, and outperformed the general population for the 3 years examined.

Some skeptics have asserted that including fully reported payment data in consumer credit reports could disproportionately harm lower income persons. Given the recent financial crisis and the Great Recession, this is a reasonable concern.

PERC just completed an analysis on this topic and found this concern to be entirely baseless. In fact, of those in households earning below $50,000 annually, less than 5 percent have a moderately late utility payment (60 days or less) in any amount, and fewer than 1 percent—0.79 percent for the lowest income tier—experience a reduced credit standing. Further, it is estimated that for each lower income person experiencing a reduced credit standing, 27 will gain access to mainstream credit.

Though PERC's efforts began in the U.S., the greatest interest and action around this issue is happening abroad—especially in developing countries where up to 90% are financially excluded.

In part because of PERC's research, over 700 million Chinese citizens are building a credit history with fully reported alternative data. Credit bureaus in Latin America, Africa, and Asia are collecting alternative data on millions more.

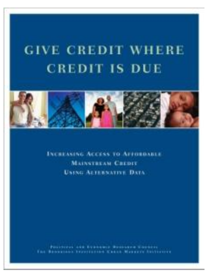
The use of alternative data is not limited to emerging markets. People in Europe benefit from alternative data, and those living in Australia and New Zealand soon will owing in some measure to PERC efforts.

PERC—and the more than 60 organizations like the Ashoka Foundation, C.F.S.I., and Opportunity Nation are working together to help their constituents build a positive credit history.

We see a future where there are no more Credit Invisibles, where the Credit Catch 22 doesn't keep people trapped in poverty, but rather people get the credit they deserve—and need—in order to build assets and improve their life's chances. This is the promise of alternative data.

The following are key findings from empirical analyses PERC has conducted on alternative data.

Give Credit Where Credit is Due: Increasing Access to Affordable Mainstream Credit Using Alternative. 2006.



Examined a sample of approximately 8 million TransUnion credit files in 2005 that contained alternative or nonfinancial utility and telecommunications payment information. Two sets of credit scores were captured, one set that included the alternative data and one set that excluded this data. Direct score impacts from the inclusion of alternative data could then be assessed. Credit scoring models included in the analysis include the VantageScore model, the TransRisk New Account model, the TransRisk Bankruptcy model, a Bankruptcy model from a bank, and a mortgage screening model from a bank. An additional 4 million credit files were used as a control, as they contained no alternative data. The study captured actual payment and credit outcomes over the following year (2005 to 2006) for the 8 million files with alternative data. This enabled an examination of how the alternative data impacted model performance. Socio-demographic information from Acxiom Corporation was appended to enable segmentation analysis by socio-demographic characteristics, such as age, income, and ethnicity.

> "Minorities, lower-income consumers, and the young and the old are more likely to be thin-file borrowers, thus they are more likely to benefit from including alternative data in credit reports."

Key findings include:

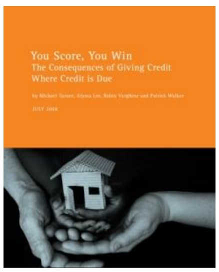
- **Most individuals in thin-file/unscoreable population are not at high risk in terms of lending.** The risk profile of this segment—after energy utility and telecommunications data sets are included in their credit files—is similar to that of the general population (as measured by credit scores).
- **Including energy utility data in all consumer credit reports increases the acceptance rate by 10 percent, given a 3 percent default rate.**
- **Minorities and the poor benefit more than expected from alternative data**
    - Hispanics saw a 22 percent increase and Blacks saw a 21 percent increase in the credit acceptance rate.

- Acceptance increased 14 percent for those aged 25 or younger and 14 percent for those aged 66 older;
    - Those whose household earned $20,000 or less annually saw a 21 percent increase in credit acceptance and those with household earnings between $20,000 and $29,999 saw a 15 percent rise.
- **More comprehensive data can improve scoring models and underwriting.** Increases in credit acceptance resulted from improved model performance and bringing previously unscoreable consumers in to the system, that is better underwriting and more inclusive underwriting, and not looser credit.

"The results from our study *Give Credit Where Credit is Due* and the analysis suggests increasing the full reporting of utility and telecom payments to consumer reporting agencies will improve financial access for those who only have a limited payment history in their credit files."

Located Here:
http://perc.net/files/downloads/alt_data.pdf

You Score, You Win: The Consequences of Giving Credit Where Credit is Due. 2008.



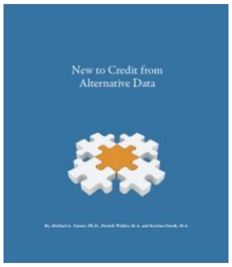
In this follow-up to groundbreaking report on alternative data (Give Credit Where credit is Due) PERC examines the long-term effects of using non-traditional data in credit files using quantitative analysis. This analysis used the same data in Give Credit Where Credit is Due, but looked at longer term impacts on consumers from having alternative data in their credit files. This included consumers with a new account opened for less than a year after having only alternative data, consumers with accounts opened 1 to 3 years after having only alternative data, and consumer with accounts and alternative data older than 3 years in the credit files.

Key findings include:

- **No Score declines over time.** No evidence in our data of deteriorations of credit score over time for those with nonfinancial payment data in their credit files and little or no traditional payment data.
- **No rise in overextensions**. No evidence in our data that those who open new accounts after having only non-financial accounts become overextended and witness declines in credit scores.
- **All evidence suggests that reporting payment data serves both as a consumer protection and a system wide protection.**

Located here: http://perc.net/files/downloads/web_layout-you-score.pdf

New to Credit from Alternative Data 2009



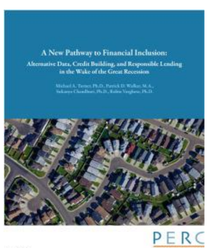
This study summarized and highlighted results from *Give Credit Where Credit is Due* and *You Score You Win* with focus on the credit impacts on those who were new to credit from alternative data. It utilized the data in those studies.

Key findings include:

- **Credit scores rise across income and racial/ethnic groups over time after consumers are new to credit from alternative data.**

Located here: http://perc.net/files/New_to_Credit_from_Alternative_Data_0.pdf

A New Pathway to Financial Inclusion: Alternative Data, Credit Building, and Responsible Lending in the Wake of the Great Recession 2012



This study compares results with data from 2005/2006 and 2009/2010 credit reports to assess the consumer credit impact of including fully reported alternative data in credit reports. The data was selected to capture the period during which unemployment and late payments spiked. Despite the Great Recession, the preponderance of evidence establishing the value proposition of alternative data is overwhelming and in- controvertible.

Key findings include:

- **Massive material impacts for the financially excluded:** Including in this group those who become scoreable when alternative data is added, assuming that not having a score is viewed as very high risk, then 64 percent experience a score tier rise and 1 percent experience a score tier fall.
- **Score impacts are stable over time:** Comparing the 2005 (pre-Great Recession) results with the 2009 (post-Great Recession), those whose scores improved with the inclusion of alternative payment data increased by 4 percent, those whose scores were unchanged increased by 10 percent and those whose scores lowered declined by 19 percent.
- **Credit underserved primary beneficiaries of alternative data:** The largest net beneficiaries in terms of improved credit access are lower income Americans, members of minority communities, and younger and elderly Americans. For example those earning less than $20k annually saw a 21 percent increase in acceptance rates, African-Americans saw a 14 percent increase, those age 18-25 saw a 15 percent increase and those above 66 years of age saw an 11 percent increase.

- **Those with past serious delinquencies benefit from alternative data:** Consumers with a public record including a bankruptcy and/ or very late payments (90+ days late) among the traditional accounts reported to CRAs, witnessed more score increases than decreases (55 percent versus 30 percent) when alternative data were included in their credit files.

Located here: http://perc.net/files/WEB%20file%20ADI5%20layout(1).pdf

The Credit Impacts on Low-Income Americans from Reporting Moderately Late Utility Payments (2012)

"The Credit Impacts on Low-Income Americans from Reporting Moderately Late Utility Payments," is a follow-up to the June 2012 report, "A New Pathway to Financial Access." The new report addressess concerns some had about the impacts of reporting moderately late utility payments for low-income Americans.

Key Findings:

- Including fully reported utility payments in consumer credit reports results in dramatic improvements in credit access for lower-income Americans;
- Including fully reported utility payments in consumer credit reports makes lending fairer, more inclusive, and more responsible;
- It can be misleading to examine only credit score impacts without examining the impact on a person’s credit standing (e.g. a 1-point change could have an impact while a 100 point change may not);
- Given current industry practices, the number of lower-income people who would either experience a dramatic score reduction, or a reduced credit standing, is miniscule (less than 0.8%).

Located here: http://perc.net/files/ADI_ML_Impacts.pdf

To address the issue of credit report accuracy, the following results are from PERC 's 2011 study, "U.S. Consumer Credit Reports: Measuring Accuracy and Dispute Impacts."

This report can be found here: http://perc.net/files/DQreport.pdf

This assessed the accuracy and quality of data collected and maintained by the three major nationwide Consumer Reporting Agencies (CRAs): Equifax, Experian, and TransUnion. It is the first major national study of credit report accuracy to engage a large sample of consumers in a study that interfaces all three CRAs and ultimately the data furnishers. The report enabled consumers to review their credit reports and credit scores from one or more of the three CRAs, to identify potential inaccuracies, and to file disputes as necessary through the consumer dispute resolution process governed by the FCRA, and to report on their satisfaction with the outcome.

Key findings from this research include:

Impact of Modifications on Credit Scores: Of all credit reports examined:

- 0.93 percent had one or more disputes that resulted in a credit score increase of 25 points or greater;
- 1.16 percent had one or more disputes that resulted in a credit score increase of 20 points or greater; and
- 1.78 percent had one or more disputes that resulted in a credit score increase of 10 points or greater.

Material Impact of Credit Report Modifications:
As noted above, less than one percent (0.93 percent)of all credit reports examined by participants prompted a dispute that resulted in a credit score adjustment and an increase of a credit score of 25 points or greater. More significantly, one half of one percent (0.51 percent) of all credit reports examined by participants had credit scores that moved to a higher "credit risk tier" as a result of a modification. This metric is the best gauge of the materiality of credit report modifications, and suggests that consequential inaccuracies are rare. Credit report modifications that result in material impacts are exclusively modifications of tradelines, that is, of credit, collection and public record account data.

Disputants Satisfied with Outcomes:
95 percent of disputing participants were satisfied with the outcomes of their disputes.

Tradeline Dispute Rate: Of the 81,238 credit, collections, and public record tradelines examined, 435, or less than 1 percent (0.54 percent), contained information that was disputed.

It should also be mentioned that 19.2 percent of the credit reports examined by consumers were set aside as containing one or more pieces of header or tradeline data that a consumer believed could be inaccurate. Of note, 37% of these potential disputes only related to header, or "above the line," information that could have no bearing on a credit score (e.g., the spelling of a former street address or maiden name).

Finally, we laud Representatives Renacci and Ellison for their leadership and commitment to helping all Americans get the credit they deserve, and urge members of this subcommittee and full committee to wholeheartedly support this timely, effective, and desperately needed solution.