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FEDERAL POLICY BRIEF

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Alternative Data Helps Families Build Credit and Wealth

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35-54 million Americans face severe consequences for having no or low credit scores

Access to credit is a cornerstone of financial security and an important asset-building tool. Being able to borrow money under reasonable terms supports long-term household savings and facilitates purchases that contribute to wealth building. In that sense, access to credit is, in itself, an asset.

But millions of Americans are "credit invisible." The Political and Economic Research Council (PERC) found that there are 35-54 million Americans currently outside the credit mainstream because they have a thin credit file or no credit file at all.[1] The consumer credit bureaus lack sufficient loan repayment records to generate these individuals' credit scores. Additionally, CFED has found that 56% of Americans have a subprime credit score, indicating that even those with scores are frequently relegated to more expensive borrowing options.

It's tough to build wealth with no or low credit. Individuals caught in this situation face challenges that those with access to affordable credit don't encounter, including higher rates on car loans, mortgages and small business loans; greater difficulty finding employment and rental housing; and difficulty weathering periods of financial hardship. PERC and the Brookings Institute found that in 2006, more than four million low-income consumers paid higher auto loan and mortgage interest rates due to their thin credit files.[2]

> 4 million low-income consumers pay higher mortgage interest rates because of their thin credit file
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> Source: Policy and Economic Research Council & Brookings Institution, 2006

Alternative credit considers a consumer's full payment history

Many people with thin credit files are low-risk consumers who regularly pay rent, utility and mobile phone bills on time, but these payments are not included in their credit score. Credit reports contain limited information about these and other recurring payments; generally only late payments, defaults and collections are included. In short, payment history on these accounts is used to establish bad credit, while borrowers lack the same opportunity to demonstrate good credit.

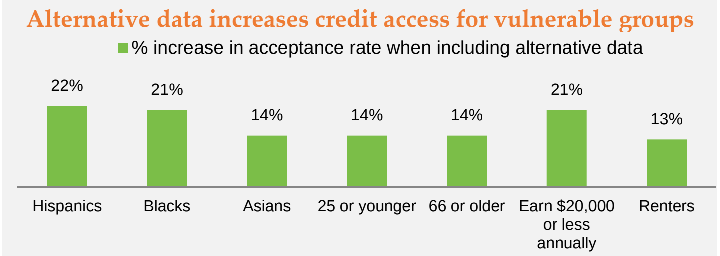
Alternative data includes full payment history for major recurring expenses—most often rent, utilities and phone bills. Although payment history is available from landlords and service providers, the data are considered "alternative" because they relate to non-credit payments that are not reflected in credit reports and are not always considered in underwriting. Alternative data can also include nonfinancial information, such as public records, residence information and potentially social media data. This brief focuses solely on financial data.

Using alternative data provides a more complete view of creditworthiness. In addition to rent, utilities and phone bills, alternative data can incorporate payment history for auto liability insurance, payday loans and prepayment of education expenses. Lenders are finding this information improves their underwriting, and numerous businesses have begun collecting and reporting alternative data. However, because the three largest credit reporting agencies (CRAs)—Equifax, Experian and TransUnion—do not maintain these records, alternative data credit reporting remains the exception rather than the norm.

Alternative data increases credit access for vulnerable groups

Research has found that alternative data increases credit access for vulnerable groups. In 2006, PERC analyzed eight million credit files, focusing on thin-file consumers who were deemed "unscoreable" due to lack of information in their credit files. The data showed that people of color, lower-income consumers, the young and the old are more likely to be thin-file borrowers. These populations are also most helped by adding alternative data into their credit file. For example, consumers who earn $20,000 or less annually saw an increase of 21% in their acceptance rate when utility payments were included in their files. Overall the percentage of unscoreable consumers would decline from 13% to 2% when adding utility data.[3]

The private sector is beginning to work with nonprofits to demonstrate the benefits of alternative data credit reporting. Credit Builders Alliance (CBA) and Experian, in collaboration with CFED and other partners, are teaming up to demonstrate the benefits of mainstreaming alternative data credit reporting through the "Power of Rent Reporting" pilot project. This project aggregates tenants' full rental payments information from partnering landlords and housing authorities serving low- and moderate-income families. CBA reports the data to Experian's RentBureau division, and Experian incorporates the pilot data into its primary credit reporting database.[4]



Source: Policy and Economic Research Council & Brookings Institution, 2006

Alternative data credit reporting faces two challenges

Some consumer advocates are concerned that alternative data credit reporting could harm consumers.[5] However, negative information about failure to pay already makes its way into credit reports and damages credit scores.[6] In addition to the findings from the Power of Rent Reporting pilot, research finds that alternative data credit reporting lowers credit scores for a tiny fraction of consumers while helping millions more raise or establish credit scores for the first time. CBA finds that for every one low-income consumer whose credit rating was damaged by including full rental payment history, 27 more gained access to mainstream credit.

Current law does not address alternative data, leaving firms unsure whether and how they can legally use it. The federal Fair Credit Reporting Act (FCRA) imposes certain responsiblities on those who furnish, collect and use the information contained in consumers' credit reports.[7] Under the FCRA, utility and telecommunications companies are permitted to report on the timely payment behavior of their customers to credit reporting agencies. However, there is no requirement to make these reports, and few companies do so. Because FCRA violations can lead to hefty fines, CRAs and data providers alike are wary of expanding the use of alternative data without additional federal clarification.

Congress and the CFPB can support alternative data credit reporting

Provide incentives for consumer credit bureaus to use alternative data. The Credit Access and Inclusion Act (H.R. 2538 sponsored by Rep. Michael Fitzpatrick [R-PA], and S. 1613 sponsored by Senator Kirk [R-IL] and Senator Manchin [D-WV]) would take steps toward this goal by supporting full reporting of rent, utility and telecommunications (television, internet and mobile phone) payments.

Clearly address how to furnish, collect and use alternative data under current law. The Consumer Financial Protection Bureau (CFPB) should provide guidelines for consumer credit bureaus to work with landlords, utilities and other companies to furnish, collect and use accurate alternative data. This should include criteria firms can use to determine whether certain types of data are acceptable to use in specific situations.

Improve dispute-resolution policies and help consumers better understand their rights. Unfortunately, barriers such as lack of time, limited access to information and not knowing their rights keep many consumers with errors on their reports from disputing the information. CFPB's new complaint process is helping consumers address errors more easily. However, as the amount of data going into the system is expanded, additional procedures are necessary to ensure accuracy.

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[1] Michael A. Turner, Patrick Walker and Katrina Dusek, New to Credit from Alternative Data, Political and Economic Research Council, March 2009.
[2] Matt Fellows, High Cost of Being Poor, Brookings Institution, October 2006.
[3] Give Credit Where Credit is Due, Political and Economic Research Council & Brookings Institution, 2006.
[4] Sarah Chenven, Building Credit through Rent Reporting, Credit Builders Alliance, 2014.
[5] Karen Harris, Alternative Credit Reporting, *Huffington Post*, 2011.
[6] Kate Dole and Rob Levy, Building Consumer Credit: A Winning Strategy for Financial Institutions and Consumers, June 2012.
[7] Margaret Lee, Fair Credit Reporting Act, Congressional Research Service, February 2012.