Asset Builders of America, Inc.

Utility Payments as Alternative Credit Data: A Reality Check

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Introduction

Access to credit is one of the cornerstones of wealth-building in the United States. However, recent consumer research shared at the U.S. House Committee on Financial Services hearing held 12 May 2005 identified a consumer base of 50 to 80 million persons who are not participating in the credit market. The continuing growth of an already very large unbanked and underserved credit market[1] is triggering the use of new data sources and the design of expanded credit scores to enrich the thin and null credit files of this market.[2] These new or alternative data sets and scoring methods focus on automated consumer payment histories not historically included in credit reports, and a calculus of the meaning of such data among other factors comprising credit scores. In the case of persons who do not or rarely participate in the credit economy, and therefore may not have much of a credit history, the idea is that inclusion of payment history data not typically reported to credit bureaus will produce a more accurate profile of an individual's payment behavior, helping to predict that person's likelihood of repaying debt. The credit industry is exploring a variety of data sources including utility and telephony payments which are typically recurrent and possess other "credit-like" qualities.[3]

The Federal Trade Commission, exploring "whether there are any common financial transactions not generally reported to the nationwide consumer reporting agencies (CRAs) that would provide useful information in determining a consumer's credit rating"[4] concluded that utility payment

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[1] Jacob, Katy, "Reaching Deeper: Using Alternative Data Sources to Increase the Efficacy of Credit Scoring," The Center for Financial Services Innovation, Chicago, 2006.
[2] Horan, Janice, "FICO® Scores and the Credit Underserved Market, Roundtable on Using Alternative Data Sources in Credit Scoring," The Brookings Institution and Asset Builders of America, Washington DC, December 15, 2006.
[3] [3]Turner, Michael. "Giving Underserved Communities Better Access to the Credit System: The Promise of Non-Traditional Data." Information Policy Institute, July 2005.

[4] 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) about the completeness and accuracy of consumer credit. Federal Trade Commission, December 2003, cite website and full title of report. See also, McEneney,

data are promising. From a consumer perspective, the FTC's idea is that vendors doing business involving recurring payments made following receipt of a product or service like electricity could potentially supply that payment history to fill out "thin" and "null" files so that they become "scoreable." Consumer advocates also view this strategy as a way to balance an individual's credit file with positive payment history that not only fleshes out a thin or null file but also offsets any negative data.[5] For example, utility companies typically do not report all payment history for each customer (full file reporting) but do refer collection problems to collection agencies which report the negative information to credit bureaus. Therefore, when a nonpaying utility customer possessing a thin credit file is referred for collection, that customer's file will contain a report of nonpayment from the collection company), while at the same time that report will not be balanced by the consumer's history of positive payments, which might be extensive. Balancing negative data with positive payment history data would provide a more accurate picture of the consumer's capacity to assume credit, and improve a creditor's basis for estimating risk.

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 actively used by banks and other lending institutions today. Utility companies are interesting to the credit industry and consumer groups because of their potential to contribute "efficiency" in the credit market by furnishing automated payment data that may be predictive of credit risk. If this correlation proves to be the case, utility data will help creditors make better decisions, and will enable creditors to reach into the underserved market with less demonstrable risk.

Is a utility payment a credit payment? Yes, in that the consumer receives energy and pays for it afterwards. Utility payments are also credit-like because utilities serve a very high proportion of consumers on a monthly (regular) basis, thereby creating a "regular stream of information" that is automated.[6] Consequently, automated utility payment history potentially has a meaningful value for the credit data industry.

The Role of Utility Companies in the Credit Market

On the other hand, what business motive do utilities have to become data furnishers? Are there barriers to or market incentives for utilities to accept this new economic function?[7] If so, what are the consequences for their operations and their relationships with their customers, particularly if utility companies not only supply full file reports but also apply credit scores to their pricing models?

The case of the Texas utility TXU demonstrates some interesting issues that arise when a utility actively behaves like a credit provider. In 2004, TXU initiated a new pricing policy based on customer credit scores, discounting energy costs for those with the best credit scores. However,

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Michael F. and Kaufmann, Karl F. "Fair Credit Reporting Act developments: 2004 annual survey of consumer financial services law." *Business Lawyer*, vol. 59, no. 3 (May 2004).

[5] Entenmann, Richard, Asset Builders of America, Madison Wisconsin, Interview December 2005.

[6] Turner, Ibid, p. 16. The Information Policy Institute and the major CRAs (Experian, TransUnion, Equifax) are presently studying the predictive character of utility and telecom data for credit analysis.

[7] 75% of electric utilities do not report. Interview with William Mayer, Manager of Customer Operations, Edison Electric Institute, November 2004 with Robert W. Wynn and Sara Burr.

the Texas Public Utility Counsel (PUCT) filed a complaint with the Texas Public Utility Commission asking the Commission to prohibit TXU from implementing its credit score pricing and marketing plan. The Counsel argued that energy is "not like any other commodity…it is a necessity and an essential service.[8] However, isn't TXU's discount policy similar to that of an insurance company incorporating credit scores into its discount pricing structure, and also like a lender incorporating the credit score into its loan price? Interestingly, the PUCT cited a study completed earlier that year (2004) by the Missouri Department of Insurance[9] finding that after controlling for income, education, marital status and employment, minority concentration (in specific zip codes) proved to be the single most reliable predictor of credit scores."[10]

As a result of the complaint TXU ceased its new program in order to further analyze the impact of credit score pricing on energy consumers in conjunction with the Texas Public Utility Commission and the PUCT.[11] At the same, the notion is in the public discourse now that the energy industry has reason to participate in the credit industry more fully, not only in its potential use of credit scores for pricing, but perhaps also as a data furnisher. It is already a purchaser of commercial and consumer credit scores, though not for the purposes of pricing) because utilities are creditors looking at ways to manage risk and improve collections if not to fine-tune pricing like other businesses that rely on regular payment streams.[12]

To gain insight into these issues, the authors collaborated with the Brookings Institution and Asset Builders of America who hosted a Roundtable on Alternative Data in Credit Scoring;[13] and with the Edison Electric Institute to survey the Institute's members about questions surrounding the practice of full file reporting. The survey explores with EEI members whether or not a compelling business case exists for utilities to report full payment history data to CRAs. Specifically, the survey probed utilities about the business benefits of implementing this function as compared with the benefit for their customers; and looked for barriers to implementation. The discussion that follows examines regulatory climate, operational impacts on payment timeliness, industry arrears trends, information system issues of furnishing payment data to credit organizations, and customer relations (fostering awareness and positive payment habits from a credit impact perspective). There are 64 members of the Edison Electric Institute, all of which are investor-owned companies, that together serve 75% of the US market with revenues of about $225 billion.[14] Of the 64 members, 27 (42%) responded to a web-based survey conducted with EEI during the summer of 2005 by the University of Wisconsin-Milwaukee Center for Urban Innovation Research (CUIR). Of the 27 respondent companies,

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[8] Docket # 30165, Office of Public Utility Counsel's Complaint Against TXU Energy Regarding Credit Score Pricing and Marketing", Texams Public Utility Commission, September 8, 2004.

[9] Missouri Department of Insurance, Insurance Based Credit Scores: Impact on Minority and Low Income Populations in Missouri (January 2004).

[10] Ibid, p. 11

[11] As a result, the Office of the Public Utility Counsel withdrew its complaint, pending significant discussion betweem the Commission the PUCT, TXU and other concerned parties. See Docket #30165, Office of Public Utility Counsel's Motion to Dismiss without Prejudice to Refile, to Facilitate Participation of PUC Commissioners.

12 http://www.peace.com/industry-watch/whitepapers/Peace-Collections-BestPractice.pdf

[13] Roundtable on Using Alternative Data in Credit Scoring". The Brookings Institution, Dec 15, 2005, Washington DC.

[14] Burr notes of conference call with William Mayer, Manager of Customer Operations, Edison Electric Institute, November 2003, Robert W. Wynn and Sara Burr, Asset Builders of America, Inc.

- 10 (37%) have full file credit reporting experience
- 7 (25.9%) have made positive decisions to report
- 5 (18.5%) currently report to credit agencies
- 1 (3.7%) is actively planning to
- 1 (3.7%) reports only commercial accounts
- 4 (14.8%) used to but no longer report
- 16 (59%) do not currently report

Cost. Those who continue to report have been doing so for over 2 years, and responded that, once their reporting software system was installed, monthly operation costs of full file reporting are "minimal" because updates are automated. (Our survey respondents who do report were unable to provide start-up cost information.[15])

Regulatory climate. 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 non-paying customers, typically starting in November and lasting 4 or 5 months through the 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.

With full file reporting, all late payments are reported as credit data along with all timely payments. As a result, customers of full file reporting utility companies who care about their credit status would in theory be more attentive to timely payment, prioritizing their utility bills, and those companies ought therefore to experience lower arrearages during moratoria and lower costs of collections afterwards. The authors feel their survey provides some indication this is the case, but the data are far from definitive. In three states, electric utility companies are prohibited from full file reporting (the names of these states are not known).[16]

Creditor Functions: Collection of Arrearages

Companies that do 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 100% of customer payment history. Eighty percent of those that are full file reporting indicated it has helped arrearages somewhat (4 respondents) and 20% (1 respondent) have not seen improved collections. Those who do furnish full payment history data 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."

Many electric utility companies (70%,19 respondents) handle collections by referring accounts to a collection agency after a period of time, typically from 45 to 130 days or after the account has been written off. This means that customers of companies that are not full file reporting who occasionally pay late or routinely pay late but catch up habitually within 45 - 130 days (depending on their utilities account referral policy) suffer no negative effect on their credit data.

[15] …indicating a need to query a different group of professionals within the companies, such as accounting staff, on cost questions.

[16] Burr notes of conference call among Asset Builders of America staff and PRBC staff, 10-31-05

This is in fact the preferred outcome of some companies that, as one respondent wrote, "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." Unlike the credit card and installment loan industry, which has developed a sophisticated legal structure supporting late payment fees and variability of pricing based on customer credit ratings, EEI members tolerate a certain range of payment behaviors with little, delayed or no penalty to those customers who pay late within a certain timeframe. One company commented, "Since we now outsource our accounts, we have very little internal knowledge about how collections are done."

However, the scope of arrearages in the industry is rising.[17] Since arrearages data are tracked on a state-by-state basis, the only source for national trend data is proprietary research like a report done by the market research group Chartwell, Inc. in 2004, "Credit and Collections in the Utility Industry." As cited by Peace, Chartwell states a national write-off amount of 1.7 billion yearly, or $8.50 for every utility customer, with amounts varying by regions, being largest in the northeastern United States.[18] The National Energy Assistance Directors Association (NEADA) similarly reports "there is growing evidence…there are mounting arrearage levels across the country."[19] However, public information about arrearages and disconnection trends is, with few exceptions, not collected by state utility commissions systematically. "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."[20]

Another clue to the growing significance of arrearage collections in the industry is that software companies are designing products for utilities to better manage collections.[21] A further indicator of the trend is that in the public sector low income advocates are asking for policies that will drive data collection on arrearages so that causes of low income arrearages can be better ascertained.[22] Among these organizations, there is an emerging perception that low income non-payment patterns are linked to price volatility for energy as well as to weather-driven energy usage. At the same time, marketing and management consultants are studying better practices for utilities to manage the credit of their commercial (and in the future, residential) customers using credit scores and other measures in addition to the customer's historical payment record.[23] Interestingly, one company responding to our survey has a unique business case for reporting. It

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[17] Mayer, William, "Full File Reporting in the Electric Utilities" presented at the "PAID Roundtable on Using Alternative Data in Credit Scoring", The Brookings Institution and Asset Builders of America, Inc., December 15, 2005, Washington DC

18 Peace is a premier utility company customer software provider. Citation at http://www.peace.com/industry-watch/whitepapers/Peace-Collections-BestPractice.pdf

[19] Howat, John, Jerry McKim, Charlie Harak and Olivia Wein, National Energy Assistance Directors' Association, May 2004. "Tracking the home energy needs of low income households through trend data on arrearages and disconnections." http://www.neada.org/pubs/Tracking_the_Need.odf

[20] Howat, et. al., p. 1.

[21] http://www.peace.com/industry-watch/whitepapers/Peace-Collections Best Practices.pdf.

[22] NEADA, Ibid.

[23] Chartwell, Inc., Ibid

has a "'trade tape' arrangement in return for credit reports on new commercial customers," and furnishes full file reports only on commercial customers.

Tools for Managing Arrearages: The Business Case for Full File Reporting plus 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 impact it has on customers who care about their credit rating and would prioritize their utility payments as a result. Those electric companies in our survey that stopped full file reporting (4 respondents or 14.8% of 27) cited the cost and hassle of "too much customer service time" required, writing that "It created more complaints and error follow-ups than benefits…," and that reporting did not help with arrearages. Those who continue to report (also 14.8% of all respondents) 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, as one executive indicated, so the incremental improvement in arrearages for those reporting may be the result of several factors including full file reporting--which over the long term may distinguish itself as a more predictive factor. Our EEI survey clarified the need for a closer examination of reporting as an arrearages management tool in the face of rising arrearages in the industry.

One of the factors which the authors examined that may interface with full file reporting to improve arrearages is customer credit education. We queried EEI members about the consumer education practices of those for whom reporting helped with arrearages and those for whom it did not. Respondents indicated that in general consumer education about managing the credit consequences of payment practices is minimal. Regardless of whether they furnish payment history data to a credit bureau, 6 of 24 that responded to this question (25%) indicated they supply some kind of financial information, referral or education to distressed consumers; while 16 of 24 (67%) provide none. Those that inform their customers they do full file reporting typically provide that information through a bill insert or print a notice on the monthly bill. 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.

WE Energies in Milwaukee, Wisconsin, a full-file reporting company, like others acknowledges concern about rising rates of arrearages in the industry in the past 3 years.[24] 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. Details of that pilot program are attached as Appendix A. The program, if successful, will provide a model of best consumer education practices for utilities. In the same

[24] Draba, Roman A., WE Energies Low Income Pilot Program, cover letter to the Wisconsin Public Service Commission, November 29, 2004.

energy market, Asset Builders of America, Inc. (a nonprofit financial education corporation based in Madison, Wisconsin and serving low and moderate income populations) is presently piloting a "credit score management" training program for Milwaukee customers of WE Energies,. The program trains low and moderate income participants and monitors their "pre- and post-" energy and telecom payment behavior over a 12-month period (Jan – Dec 2006). This project explores the relationship between the consumer's understanding of credit data, the role of utility and telecom trade line data as it affects the perception of their credit worthiness by lenders and the impact of these trade lines on their credit score over time. It will also provide data regarding the impact of education on participant arrearages patterns.

Creditor Function: Why not report full payment histories to credit data agencies?

1. Demands on information technology resources. If utility companies were persuaded that full file reporting offers a useful management tool for collecting arrearages, and provides a benefit to those of its customers who are underserved in the credit market by helping them improve their credit status, are there other perceived or real barriers utility firms face in reporting? Our survey indicates that for both still-reporters and used-to-reporters, technology issues were a possible burden to system start-up. However, we also asked those who do not report how important technology issues are, and a majority of them "don't know." This suggests that we did not get sufficient input from IT staff or others knowledgeable about their company's information technology issues, and opens up an area needing further investigation. On the other hand, one respondent did mention that the IT staff has no time right now and another indicated it was not an IT priority.[25] Besides the demands on IT staff time, utilities have encountered data integrity problems. For example, the American Gas Association recently reported[26] on one member that ceased full file reporting for reasons of data integrity related to collection of customer social security numbers and the demand on IT resources.

2. 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 seems to be a barrier. Of fifteen companies (63% of 27 total survey respondents) responding to the question "Why have you not reported payment histories to credit bureaus?" seven (26% of 27)) said they "don't want to be responsible for credit report inquiries" and six (22% of 27) stated it "would require too much customer service time." Three (11% of 27) of the fifteen 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 regarding the accuracy of the data as it appears in consumer credit reports. This concern includes the worry that short term customer service costs for the utility will increase without an apparent and comparable short term increase in revenue or reduction in arrearages. Similar concerns were identified at the Roundtable by the American Gas Association and the Edison Electric Institute.[27]

[25] The Chartwell report discusses a software solution for utilities for collections management in the context of aging systems that seem to plague the industry., Ibid.

[26] Linn, James, "Full File Credit Reporting in the Natural Gas Utility Industry"; Mayer, William, "Full File Reporting in the Electric Utilities," PAID Roundtable on Using Alternative Data in Credit Scoring" Dec 15, 2005, Washington DC.

[27] Linn, James, "Full File Credit Reporting in the Natural Gas Utility Industry"; Mayer, William, "Full File Reporting in the Electric Utilities." PAID Roundtable on Using Alternative Data in Credit Scoring" Dec 15, 2005, Washington DC.

AGA also noted informally that customers being reported negatively were the ones objecting to the data reporting program, and were not shy about complaining to their state legislators.

3. Regulatory climate. Setting aside the regulatory barrier in three states that have enacted legislation prohibiting utilities from full file reporting, a key finding at the Roundtable supplementing the EEI survey was that regulatory commissions at the state level have provided little or no guidance to utilities about 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 regarding full file reporting.[28] Motivated at least in part by an apparent concern that utility reporting will make identity theft easier, some states like California's Public Utility Commission bar reporting of payment data without the affirmative approval of the utility customer. Similarly the 2005 Broadband Bill ties telephony regulation to affirmative consent by consumers to full file reporting. In the context of this type of consumer worry, the credit data industry and those utilities who are reporting, on the contrary, perceive full file utility reporting as a customer benefit tool that helps protect identity integrity and deflect identity theft. Our study indicates these topics along with credit score management will add value to consumer financial education as the impetus towards alternative data gains steam in the credit industry.

What are we learning on the ground about utilities as alternative credit data furnishers?

Implications for utility companies. To improve payment by slow payers and in other ways improve collections, utility companies and their trade associations would benefit from more and better information about providing the data. At the same time, companies are most likely to achieve their intended impact on collections if they furnish customer payment data while at the same time educating their customers about the potential effect of this reporting on credit scores. The experience of WE Energies 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 will 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 seems as though some of the resistance to full file reporting in the industry, however, is not related to the business case but to industry culture. Traditionally and especially prior to deregulation, utility companies were uniquely bound to their communities. They developed personal relationships with customers and collection protocols that gave customers latitude about timeliness of payment. In addition, because 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 than the weakness of proof for the business case at this time.

[28] Sabety, Pari and Brian Nagendra, "Synopsis and Findings, PAID Roundtable on Using Alternative Data in Credit Scoring" Dec 15, 2005, Washington DC.

As Jim Linn stated at the Roundtable, there is a need to "inform utilities of the benefits" both for their customers and their bottom line of full file reporting.[29]

Implications for the consumer. The provision of non-traditional data to consumer credit reports has already started to occur in two ways: (1) as with PBRC, consumers now have an option of providing their payment history data to a service that will automate it and score it for credit analysts; (2) at the same time, certain payment history data that are already automated by a vendor like a utility or telecom company may be regularly reported, and if not is most markets, are being looked at by the credit industry where such data has not been exported to a credit data agency. The jury is still out as to whether the vast majority of low and moderate income or credit-underserved consumers will benefit or be harmed by the involuntary inclusion of non-traditional data in their credit record. The impact on consumers of automated payment data reporting is not fully understood but the value to responsible consumers looks promising. In addition, for all consumers there may be the additional important benefit of strengthened protection against identity theft. This data, in other words, is a source of information about the consumer that helps define that consumer's unique identity in terms of address and other identifying information. For these reasons, both consumer advocates and the credit industry see merit in further testing the waters.[30]

At the same time, both data furnishing trends highlight the importance of consumer credit education. Traditionally, personal financial education focuses on management of cash flow (budgeting), risk management, saving and investment. Two partners in our 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. This is because, regardless of the source and completeness of both traditional and non-traditional credit data, the consumer's credit score is critical to the building of net worth through mortgage qualification and loan pricing, and also, increasingly to the cost of insurance and to hiring decisions. Consumer credit score management education will enable constituents to have an impact on state legislators, regulatory commissioners and congressional representatives. Constituents will be better equipped to inform government of the merits of alternative data furnished by utilities and telecoms.

Implications for public utility commissioners and elected officials. Our research suggests that policy-makers pay attention to legislation and rule-making that may directly or indirectly impede the flow of alternative payment data into the automated credit system. There is positive potential for consumer and industry benefits as well as for releasing growth in the domestic and global economy. For example, it is worthwhile to encourage pilot programs like those of WE Energies and Verizon[31] that "proof" the premises of customer and business benefits. Constituent involvement seems to be the missing piece in fostering a comfort level among legislators and

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[29] Linn, PAID Roundtable on Using Alternative Data in Credit Scoring," December 15, 2005, Washington DC.

[30] Congresswoman Loretta Sanchez, "Sanchez Amendment Included in House Federal Housing Finance Reform (GSE) bill; Encourages Alternative Credit Scoring." Washington; October 26, 2005. Congresswoman Loretta 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. http://www.lorettasanchez.house.gov/issues2.cfm?id=11287

[31] See sidebar "Two Case Studies in Best Practices."

public service commissioners for leveling the regulatory playing field for non-traditional data furnishers. In addition, state commissions should consider coordination to collect national trend data on arrearages. Besides having value for other purposes, such information would allow both industry and consumers to share a performance metric on full file reporting.

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, our study, however, suggests that the credit data industry collaborate to streamline agreements, contracts, and forms for new data furnishers. As national and global enterprises particularly consider becoming data furnishers, they are confronted with a variety of contracts from a variety of CRAs to provide the same data. It will expedite their positive decision-making if the credit agency industry were to standardize such contracts for alternative data furnishers.

Implications for lenders. 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 is that underserved consumers will qualify for the financing they need at a reasonable price, and will use it to grow their net worth.

Conclusion. Bringing more consumers into the mainstream of the credit industry is a major challenge for the nation's economy. If furnishing alternative credit data, like 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, that is, to grow their assets, the economy will be energized.

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Sidebar 1: Two Case Studies in Best Practices

1. WE Energies, Milwaukee, Wisconsin[32]

In response to these concerns our research developed a case study of a full file reporting utility in the Milwaukee, Wisconsin: WE Energies. 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:

- Helps keep rates low for all customers through reduction in number of past-due accounts
- Enables customers to better manage their credit health
- Helps establish credit rating for customers with non-traditional credit sources
- Prevents/minimizes identify theft[33]
- Prevents/minimizes the change of becoming over-extended with unmanageable debt
- Assists customers with obtaining loans for large purchases
- Improves ability of customer to broaden credit availability

The company's **process for credit bureau reporting** contains 3 main steps:

1. A pre-defined (by the credit bureau) electronic information file contains both positive and negative customer information based on their payment behavior. FCRA requires both positive and negative information. Note that collection agencies are exempt from the requirement to include positive payment data.
2. WE Energies transmits updated file weekly, including the customer's name and other identifying information required by FCRA, and the amount owing and age of dollars owed, as required by FCRA.
3. Credit Bureau updates customer records. Credit information stays on account seven years for adverse and ten years for non-adverse.

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

1. Customer contact center receives calls
2. Determines whether the credit bureau report should be adjusted
   a. If no, the informs the customer the information is accurate and no adjustment will be made.
   b. If yes, and electronic form is sent to credit bureau representative. For example, a misapplied payment or a case in which the bill was sent to the wrong location are deserving of a credit bureau adjustment.
3. An electronic form is sent to the credit bureau support representative
4. WE Energies sends an on-line electronic adjustment to the credit bureau
5. The credit bureau corrects the individual's credit bureau report.

[32] Mueller, Michael, WE Energies, "Process for Credit Bureau Reporting," Presentation to a Meeting of Asset Builders of America, Inc., February 2005, Milwaukee.

[33] Protecting customers from identity theft and helping with identity theft detection is a customer benefit also reported by Mayer, William, "Fill File Reporting in the electric Utilities" at the Roundtable.

Information Technology set-up and other start-up guidelines.[34] 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 on a monthly basis
- Report closed accounts a 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 data of birth, when available.
- Report the ECOA Code to designate the account as joint, individual, etc. in compliance with the Equal Credit Opportunity Act (ECOA)
- Report the Payment History Profile, which provides up to 24 months of payment history, in order 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
- All parties reporting credit information must comply with the Fair Credit Reporting Act (FCRA) and any applicable state laws.

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

Regulatory requirements: The Fair Credit Reporting Act imposes the following duties upon data furnishers (www.ftc.gov/credit)[35] TransUnion trained WE Energies in the requirements of the Fair Credit Reporting Act, 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

WE Energies has identified a set of **company benefits** linked to full file reporting[36]

[34] Consumer Data Industry Association, Credit Reporting Resource Guide, Utility Company Reporting, p. 12-1, 2004.

[35] TransUnion "Notice to Furnishers of Information: Obligations of Furnishers Under the FCRA; 1000.11f—12/9/2004

[36] Zaganczyk, John, (We-Energies) Roundtable on Using Alternative Data in Credit Scoring.

- Improve customer satisfaction
- Reduce arrears and uncollectibles
- Become a creditor of choice (payment priority)
- Reduce need for Utility Letter of Credit
- Establish credit rating for customers with non-traditional credit sources
- Helps keep rates low for all customers through reduction in number of past-due accounts.

2. Verizon[37]

By comparison with the utilities studied for this paper, Verizon detailed its full file reporting pilot program at the Roundtable, solidly locating its program within the function of receivables management for the company. Verizon's objectives are to (a) improve payment of slow payers, (b) reduce outside collection agency expenses and (c) reduce credit bureau expenses by levering the company's position as a data provider. The customer benefit Verizon focuses on is to reward timely payments with positive reports to credit bureaus, which will improve their customer's credit scores and reduce the customer's cost of borrowing. Verizon works with the following measurement metrics to determine the value proposition for the company of full file reporting: average final bill balance; days sales outstanding; number of accounts in treatment/collections; risk score distribution; aging of accounts.

Verizon initiated its pilot program of live credit reporting as a consumer trial in Virginia in 2005, with full deployment planned for completion in 2006. Customer communications focus on "Your credit score and you" through a bill insert; a bill message providing customers with "Important Credit Reporting Notice," and a similar message on Denial Notices. The pilot replaces 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/payment data is reported "cradle to grave" to CRAs with every bill date. The legal issues facing the company, rather than regulatory, were contractual, concerning the variety of agreements for data furnishers among individual credit reporting agencies even though each agency requires the identical methodologies, software and regulatory assurances.[38]

[37] Johnston, Marcia T., "Verizon: Live Credit Reporting" PAID Roundtable on Using Alternative Data for Credit Scoring, The Brookings Institution and Asset Builders of America, Washington DC, December 15, 2005.
[38] Sabety and Nagendra, Ibid.

Sidebar 2: Market drivers of alternative data and credit scoring

There are challenges and opportunities for both lenders and consumers in the emergence of the alternative credit data market. For both, the key challenge is whether alternative data has predictive value i.e., will it help predict the consumer's payment as agreed of credit. The answer to this question will open or close market opportunity for lenders and consumers. Consumer advocates are also sensitive to the downside of full file reporting (reporting the history of all payments of utility bills, for example) because it may affect individual credit scores negatively as well as positively. In terms of negative impact they express concerns about whether increasing the collection of data on individuals will decrease personal financial privacy while raising the risk of identity theft.[39] In terms of positive impact, they recognize that the credit files of a segment of the low and moderate income population are "unbalanced" so not predictive of positive payment potential because those files do not display a history of positive payment of rent, utilities, and other recurrent obligations. On the business side there is a additional set of challenges shaping alternative credit data initiatives: how to identify and attract the best (most predictive) new data/furnishers. While for potential new data furnishers, the challenge is whether full file reporting can be a business function that benefits the company bottom line. This paper reports on recent experience of some utility and telephony companies with respect to full file reporting and reflects on the related credit education needs of their low and moderate income customers.

The underserved credit market is emerging as an economic driver of credit data alternatives 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[40] and it also includes long established communities of African-, Hispanic- and Asian-Americans. Furthermore, the credit-underserved market includes senior citizens whose numbers are swelling as the baby boomers age; it 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 high education.[41] This complex set of populations may have thin or null credit files for many reasons unrelated to their ability to repay debt. For example these individuals may engage in consumer activity that does not generate electronic transaction data (by comparison to their banked counterparts): 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 a payday lender 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 like homes any more.

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[39] Carr, James, PAID Roundtable remarks

[40] "US issuers to target Hispanic immigrants", Lafferty—Knowledge to Ban On (www.lafferty.com) October 25, 2005 (re-published from June 2004?)

[41] Humphreys, Jefferey M., "The Multicultural Economy 2003: America's Minority Buying Power." Georgia Business and Economic Conditions, vol 63, no. 2, second quarter 2003. Also see, Brown, Carolyn M. "Ways and Means: A Break for People with Little or No Credit", www.Africa.com (September 8, 2004.

The rapidly increasing business, consumer and legal literature examining dimensions of the unbanked US population also testifies to the rising intensity of the issues triggered by the dynamism of the credit-underserved market.[42] Estimates vary about the size, from 50 to 80 million consumers who are rarely or not at all part of the banking and credit system. Uniquely, the same unbanked or underserved market segment is responsible for substantial cash flows in the US economy and out of the country. Within the United States, for example, "…(t)he total Hispanic market in the US in 2003 represented about $653 billion in purchasing power (8% of the US total) while the Asian market represented another $344 (4% of the US total)."[43] The US Department of Treasury "estimates that remittances to developing countries (from resident US immigrants) totaled more than $90 billion dollars in 2003,"[44] comprising a substantial share of their income. The Fair Isaac Company, which estimates that approximately 50 million US consumers are "underserved,"[45] notes these consumers represents 25% of "credit eligible consumers." Substantial real growth (new sales) in the credit industry will come from this market.[46]

The sheer size of the sub-prime credit market in the US and its potential to drive real economic growth prompts credit industry analysts and academics to explore alternative data that tracks recurrent payment histories whose inclusion in the calculus of credit scoring, it is posited, would improve those scores thereby allowing more consumers access to prime credit markets; and, by the way, allowing more creditors access to these consumers. Recognizing that a meaningful segment of this market has the capacity to assume and repay debt as agreed, lending organizations are seeking to demonstrate that alternative credit data is a tool for extending their reach into the unbanked and credit-underserved market.

Supporting lenders' growing interest in nontraditional data, credit rating agencies like Fair Isaac are developing alternative scoring methodologies.[47] A parallel trend affecting business interest in alternative credit data and scoring is the escalating use of credit scores in decision-making and pricing by non-lending economic 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 overall, if the methodologies of credit are as rational as possible, serving to assess risk as realistically as possible. If there are good reasons to consider data not traditionally calculated in credit scoring, and which is predictive of risk, those data ought to be placed in the formula so financial markets

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

[43] Bernanke, Governor Ben S. "Financial Access for Immigrants: The Case of Remittances." The Federal Reserve Board: Financial Access for Immigrants: Learning from Diverse Perspectives Conference, Federal Reserve Bank of Chicago, Chicago, Illinois, April 16, 2004.; Humphreys, Jefferey M. "The Multicultural Economy 2003: America's Minority Buying Power." Georgia Business and Economic Conditions, vol. 63, no. 2, second quarter 2003.ibid

[44] Bernanke, Ibid.

[45] Freeman, Lisa, "Problems Seen in New FICO Program," Credit Union Journal, vol 8, no 33, August 16, 2004; Horan, J., Ibid.

[46] "New FICO score extends lenders' reach to credit-underserved millions," *Viewpoints: News, Ideas and Solutions from Fair Isaac*, September/October 2004.

[47] As are the three big credit bureaus (Equifax, Experian and TransUnion) that have created a new credit-scoring system called VantageScore. See Pulliam Weston, Liz, "What the new credit score means to you.," March 20, 2006, MSN Money, http://moneycentral.msn/content/Banking/Yourcreditrating/P148045.asp/

are not irrationally constricted and can grow on a solid foundation. As Michael Barr noted, "Despite the depth and breadth of US 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."[48] As global markets in China and elsewhere, which are massively credit-underserved, become more competitive for global lending companies, it is clear the issue of nontraditional credit data utilization will soon be, if it is not already, placed on the international business agenda.

The Economic Significance of Traditional and Non-traditional Credit Data

The manner in which credit histories and credit scores are implemented by the credit data and lending sectors can be a barrier to participation in the banking and credit markets for unbanked consumers. One of the most important characteristics of credit data implementation is that it is automated. Specifically, in a large economy it is most efficient for the credit industry to build credit files from data that are already automated. Today, the credit industry fosters reliance on sophisticated, automated credit data and proprietary credit-scoring technology, recognizing that to manage the huge American credit market, automation of the data facilitates efficiency, that is, 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 data agencies (CRAs). 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 not historically been a part of the automated credit data system. When these payments are the main evidence of a borrower's ability to pay as agreed but they are not contained in a consumer's credit record, the credit file will be "thin" (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 "sub-prime interest rate market") based on the lenders perception of risk regardless of whether they have a history of meeting all their financial responsibilities in a timely manner— because that history is not collected into the automated credit data system.

At the same time, lenders may lose business by making credit decisions without sufficient data to be fully rational, pricing out of the market or denying credit to a perceived "risky" borrower who may actually be a reliable and timely payer functioning outside the automated credit data system. Michelle Singletary has described two poles defining the "underserved" credit population: (1) those who haven't a credit history due to poverty, immigrant status or divorce, and (2) those who don't have credit histories because they are comfortably well-off and don't believe in using credit.[49] 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 these along the mid-range of the consumer spectrum who don't utilize traditional credit tools like credit cards or mortgage loans

[48] Barr, Michael S. "Access to financial services in the 21st century: five opportunities for the Bush Administration and 107th Congress." Notre Dame Journal of Law, Ethics & Public Policy, vol. 16, no. 2 (Summer 2005) pp 447-473. See also, Barr, Michael S., "Banking the Poor," Yale Journal on Regulation, vol. 21, no. 1, pp. 121-237 (winter 2004)

[49] Singletary, Michelle. "The Color of Money: Credit Scores Aim to Rewrite History," The Washington Post, August 1, 2004, Section F01.

there is no automated record of their payment history available to credit reporting agencies. Fair Isaac estimates 30 million US adults have thin credit bureau records (so thin they are not scoreable) and another 20 million have no credit bureau record. Janice Horan, Director of Global Scoring Solutions at Fair Isaac, estimates "underwriting just 3% of this market creates $2.3 billion for mortgage lenders, that is, in real growth.[50]

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 needed by the lender to evaluate creditworthiness. 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 employment (lacking a flexible work schedule and access to quick communication devices such as fax machines and email), and/or if the "nontraditional" payment history data provided by the applicant prompts loan approval, but one that is higher priced because the lender is unable to make use of the industry's credit scoring system to define risk. Community banks offer this option to potential borrowers in many cases, but it is not a solution that can be successfully implemented for a mass underserved US market of 50 million much less China's looming market.

In response to the ongoing identification of a large underserved credit market, and to advocacy on behalf of low and moderate income consumers for improved credit access, the credit data industry is designing techniques to account for and score nontraditional data. Because the credit industry relies on automation, solutions to credit access by the underserved must not only take into account non-traditional data, but mechanisms for automating that data. The discussion of non-traditional data today looks for automated data that could be provided to a credit bureau by modifying the potential data furnisher's information systems/software, and that would have predictive meaning for the consumer's score—in other words, full file electronic reporting. "Full file reporting" is a term used in the credit data industry to describe the content of an account provided by a data furnisher: the individual customer account report includes all payment history information, positive and negative, for the period reported.

One approach emerging in the credit industry to provide nontraditional trade line data is the start-up of firms or services that collate data provided by consumers in order 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 sign up 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, most notably Fair Isaac has designed a new credit calculation (the Expansion TM Score) that scores nontraditional data such as rent, utility and telephone bills, cable TV and banking records. In Los Angeles, Experian is similarly developing its "Score X" to serve a vital immigrant population.

[50] Horan, Ibid.

It is the confluence of these factors (the size of the underserved market, the bias in the data comprising credit reports, the reliance on automated data by the credit industry and the expanded use of credit scores by non-creditors) that is triggering an examination by scholars, policy-makers, and the credit industry of ways to collect and automate more complete consumer payment histories. The US House Committee on Financial Services held hearings in May 2005, presided over by Congressman Michael Castle (R-Delaware), to learn more about non-traditional data and what responses are emerging in the private sector to add this value into the credit system.[51] Lisa Nelson, Vice President of Fair Isaac Credit Services, Inc. testified on Fair Isaac's leadership in the utilization of alternative credit data, specifically with respect to the launch of Fair Isaac's new Expansion TM Score.[52] Michael Turner, President of the Information Policy Institute (IPI), provided testimony at the hearing based on a paper IPI published on the same topic evaluating "the promise of non-traditional data" in "giving underserved communities fair access to the American credit system."[53]

More and better quality of data will flesh out a consumer's credit report, level the playing field by offsetting negative data with positive payment patterns, and better predict a consumer's likelihood of paying debt as agreed.[54] The question implies another: which alternative data is the best? Of the nontraditional payment history data, 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.

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[51] U.S. House. Committee on Financial Services. U.S. Representative Spencer Bachus (R-Al) Holds Hearing on consumer Credit, Hearing, 12 May 2005. Washington, DC, Government Printing Office, 2005. See also, Congressman Michael N. Castle (R-DE), "Helping Consumers Obtain the Credit They Deserve." At http://www.house.gov/castle/pr_05_Emerging%20Consumers.html

[52] 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, Curry, Pat. "No credit? New credit scores target "underserved" consumers", www.bankrate.com (August 3, 2004).

[53] Turner, Michael. "Giving Underserved Communities Better Access to the Credit System: The Promise of Non-Traditional Data." Information Policy Institute, July 2005.

[54] IPI, Ibid.