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# Credit Invisibility and Alternative Data: The Devil is in the Details

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A great deal of attention has recently focused on the issue of "credit invisibility." The Consumer Financial Protection Bureau (CFPB) released a study[i] in May 2015 finding that 26 million Americans (or about 1 in 10) do not have a credit history, and another 18 million are unscorable because their histories are too scant ("thin") or old. The CFPB study also found that African American, Hispanic, and low-income consumers are more likely to have no credit history or to be unscorable.

Policymakers, advocates, and industry members have all proposed solutions to credit invisibility, including promoting the use of alternative sources of data. We urge a cautious and thoughtful approach in developing solutions. As with so many aspects of credit and financial services, "the devil is in the details."

## Help the Invisible or Harm the Masses?

The manner in which alternative data is used is important. For example, using alternative data to create special scores for otherwise unscorable consumers might be preferable to the wholesale addition of the same data to traditional credit reports, where it might damage consumers who already have a credit score.

## Invisibility Is Not Always a Disaster

It's been said that "invisibility is an unnatural disaster."[ii] Credit invisibility poses real and significant problems for many consumers. But in some areas, no credit history is better than a bad one. For employment and insurance – where a negative credit report or low score could harm job prospects or increase rates -- it's often better to have no credit history. A low score could also put a consumer on the radar for lead generators and predatory lenders who target high-cost credit to vulnerable consumers.

## Ensuring That the Cure is Better than the Disease

Not all alternative data used to create a potential credit score is created equal. Each type has unique characteristics that can benefit or burden consumers.

- **Rental data** – Traditionally, rental data is only reported when a tenant is so delinquent that the account is sent to a debt collector. Recent efforts to add positive data appear to be promising, especially those efforts that do not report late payments prior to the debt being sent to collections. Also, tenants who invoke their rights under state or local laws to withhold rent due to poor conditions should not be penalized.

- **Gas and electric utility data** – Most gas and electric companies currently only report accounts on traditional credit reports when they are very seriously delinquent. “Full file” monthly reporting of gas and electric bill payment data has the potential to give millions of low-income consumers bad or worse credit scores by adding payments that are only 30 or 60 days late. Impacts could be especially harsh on families who need time to pay off winter or summer bill spikes. Reporting of late payments could also undermine state consumer protections, such as prohibitions against wintertime shut offs for vulnerable consumers, such as the elderly.[iii]

- **Subprime credit** - Payday loans and other forms of subprime credit are often not reported on traditional credit reports. Adding these types of credit could damage the credit records of these borrowers. High-cost credit is often designed to lead to a cycle of debt, and even merely using a subprime form of credit can negatively affect a credit score. Creating a database of consumers who have used high-cost credit could make them even more vulnerable.

- **Telecommunications data** – Recently, there have been efforts to create scores using data from cell phone and cable providers. Unlike regulated electric and gas service, telecomm industries have fewer consumer protections that could be undermined by monthly reporting. But the jury is still out, and questions include the level of accuracy of the data and the impact on consumers who dispute over issues such as cramming and questionable surcharges. Consumers may also not be aware that their cell phone and cable payment histories are being supplied to traditional or alternative reporting agencies.

- **“Big Data”** – “Big Data” encompasses many types of information, and not all of them are created equal. There are many unanswered questions about the predictiveness and accuracy of these data sources.[iv] “Big Data” used for credit, employment, insurance, or other purposes is covered by the Fair Credit Reporting Act, and providers must comply with that Act. If Big Data is used for credit, the Equal Credit Opportunity Act applies. Lenders must ensure that the use of Big Data does not create a disparate impact for protected groups.

## Credit Score: A Reflection on Society’s Inequities

A more fundamental approach to addressing credit invisibility requires examination of the basic premises and fairness of the current credit scoring paradigm. Minorities are not just more likely to be credit invisible - study after study has found that when minorities do have a credit score, as a group those scores are significantly lower than those of whites.

This is because credit scoring is a reflection of the racial economic divide and wealth gap in this country. Communities of color have less income, and they have far fewer assets to cushion the blow of financial catastrophes such as job losses or sickness. These income and wealth disparities are caused by centuries of discrimination, which still have a huge impact to this day.

As such, credit scoring perpetuates and reinforces the unlevel playing field. With poor credit scores, minority and low-income consumers are denied credit, insurance, and other services, or are forced to pay much more than wealthier whites. The drain on income affects their ability to pay their current bills, let alone build assets to move ahead. These communities move further and further behind, while wealthier white communities get a break on their credit, insurance, and other needs. The addition of alternative data will not address the fundamental inequities reflected in credit scoring, because at best, it is "more of the same" type of information.

We also need a deeper analysis and discussion regarding how our society judges creditworthiness. Credit reporting and scoring assumes that past is prologue, but that is not necessarily true. Extraordinary life circumstances, such as joblessness or illness, can impair the scores of consumers who would not default again.[v] Credit scoring is an overly blunt tool, like a hammer. As a society, we need to develop a better tool – a scalpel – to judge creditworthiness.

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[i] http://files.consumerfinance.gov/f/201505_cfpb_data-point-credit-invisibles.pdf.

[ii] Mitsuye Yamada, 'Invisibility is an Unnatural Disaster: Reflections of an Asian American Woman', in Cherrie Moraga and Gloria Anzaldua (eds), *This Bridge Called my Back: Writings by Radical Women of Color* (New York: Kitchen Table: Women of Color Press, 1981), p. 71.

[iii] See National Consumer Law Center, "Full File Utility Credit Reporting: Harms to Low-Income Consumers", June 2013, available at www.nclc.org/images/pdf/credit_reports/ib_utility_credit_2013.pdf.

[iv] See Persis Yu, National Consumer Law Center, *Big Data: A Big Disappointment for Scoring Consumer Credit Risk*, March 2014, available at www.nclc.org/images/pdf/pr-reports/report-big-data.pdf.

[v] For further discussion, see Chi Chi Wu, National Consumer Law Center, *Solving the Credit Conundrum: Helping Consumers' Credit Records Impaired by the Foreclosure Crisis and Great Recession*, Dec. 2013, pp.9-11, available at www.nclc.org/images/pdf/credit_reports/report-credit-conundrum-2013.pdf.