Alternative credit scores could open door for loans

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WHAT GOES INTO CREDIT SCORES

Fair Isaac's FICO score is the benchmark for predicting whether a consumer will repay a loan. The score ranges from 300 to 850. Factors that go into a traditional credit score, and how they're weighted:

35%	Payment history for credit cards, retail accounts, car loans, mortgages and similar debts. Late payments will hurt your credit score.
30%	Amount owed. Includes the number of accounts with balances, and the amount you owe versus the amount of credit available. Maxing out on your credit cards will lower your score.
15%	Credit history. Amount of time you've had credit card accounts, a mortgage, etc. The longer your credit history, the better.
10%	New credit. Number of recently-opened accounts and recent inquiries. Opening several credit card accounts in a short period of time can hurt your credit score.
10%	Types of credit used. Number of credit cards, retail accounts, consumer finance accounts, mortgages and other types of accounts. If you have a few credit cards, a mortgage and a car loan, you'll probably get a better credit score than someone who has four credit cards and no other types of debt.

Source: USA TODAY research

By Sue Kirchhoff and Sandra Block, USA TODAY

WASHINGTON — Priscilla Saavedra waited four long years for her husband, Vicente, to earn U.S. resident status. After he finally emigrated from Mexico last year, the couple faced a new challenge: his lack of credit history.

"I had an excellent credit score ... but my income was not too good" in terms of covering a mortgage, says Saavedra, 26. Vicente, also 26, had a healthy income but hadn't built a credit record, as he scrimped and paid cash while waiting to move to California. With the help of a lender, they added Vicente's name to her credit cards and used other strategies to build a financial file. They got a loan and, weeks ago, moved into their San Marcos, Calif., home.

Saavedra is one of as many as 50 million consumers — mainly minorities, young adults and women — who have thin or non-existent credit files. That means big U.S. credit bureaus don't have enough information about their finances to assign them a credit score: a figure generated via statistical models that examine outstanding borrowing, payment history and debt loads. Banks use credit scores to determine eligibility and pricing for mortgages, auto and other loans.

This growing group soon could have more options because of an intensive effort by the financial industry to develop alternative credit ratings — risk profiles based on such data as rent, utility, child care, medical and other payments not now routinely examined by the large credit-reporting agencies.

Banks are pushing the endeavor, eager to tap a lucrative market — particularly the fast-growing Hispanic population. Consumer advocates hope to steer borrowers toward banks and away from high-cost payday lenders. Studies by the non-profit National Community Reinvestment Coalition have found that consumers without traditional credit scores are far more likely to take out high-cost loans, if they can borrow at all.

BREAKDOWN OF CREDIT SCORES

A high credit score indicates a borrower is a low risk and low scores signal a higher risk. If your score is below 620 you can expect to pay above average interest rates on a loan. Above 780 you qualify for the lowest rates available. The percent of the population who scores:

Above 780	20%
740-780	20%
690-740	20%
620-690	20%
Below 620	20%

Source: Fair Issac

"There's no real straightforward way into this market without reliable data. We're talking about an industry (banking) that's increasingly concentrated at the same time it's become increasingly dependent" on computer-based risk assessment rather than more informal decision making, says Michael Turner of the Information Policy Institute, working with banks and others on the issue.

Fair Isaac, which compiles the FICO score, the basis of most credit reports, has started using telephone and utility records, bank accounts and other payments to develop an alternative measure. Credit bureau Experian is trying to broaden its credit score.

A start-up called PRBC (formerly Pay Rent, Build Credit) in Annapolis, Md., lets people self-report data, such as rent records, loans from non-profit groups and payments to payday lenders. In Boston, MassHousing, the state's housing authority, accepts an alternative score by First American Credco. Mortgage giant Fannie Mae may examine whether immigrants who send regular payments home are good risks.

While consumer advocates see promise, they also worry that if new systems are poorly constructed, minorities and low-income workers could become more vulnerable to scams or pitches from pricey lenders. Expanded use of data raises privacy concerns, because credit scores are used for insurance pricing and hiring decisions.

"Not all alternate credit scores are created equal. ... I would at least raise an eyebrow as to any credit score built on high-cost credit," says Chi Chi Wu of the National Consumer Law Center. "Is that going to be more of a sucker list: 'These are people who've gotten high-cost loans'? "

Computer-generated credit scores in just a couple of decades have become the benchmark for lending. Most are based on some variation of Fair Isaac's FICO score, which ranges from 300 to 850. The lower the score, the greater the risk.

The main factors used in a FICO score are payment history for credit cards, mortgages and other retail accounts, the amount a consumer owes, the length of time he or she has held credit and the amount of recently opened credit cards.

Credit-reporting agencies (the big three are Experian, TransUnion and Equifax) say standardization has enabled millions of consumers to get loans quickly and at a low price, without regard to race, gender or residence. But estimates cited by Fair Isaac and others are that 32 million consumers have credit files that are too thin to score, and 22 million have no files at all.

No credit, no score

Some without credit histories are people like Gena Non-ini. Her parents were Depression babies, and she watched debt-laden farmers go under during the 1980s farm crisis. Deciding "if you don't have money, you don't buy," she ran her own farm on a cash-only basis. That turned into a problem two years ago, when she sought a loan. "My bank basically said, 'Thank you, but no thank you,' " says Non-ini, 42, who has operated her 80-acre Marian Farms in central California since 1990. "My credit history was transparent. ... You could see right through it."

Non-ini secured federally backed loans through a local thrift and a non-profit women's business group called Count Me In.

About 18 months ago, Fair Isaac started using telephone and utility payment records, bank accounts and other payments to develop a score that resembles its FICO score. The range for the alternative score is 300 to 850, the same as the traditional score. Early results show the data can generate alternative credit ratings most of the time.

"There's obviously a need to determine credit risk of these folks," says Ron Totaro, a Fair Isaac vice president. "There wasn't really a good vehicle to score them on a predictable basis."

Many credit unions and other lenders already look at rent and other data on a case-by-case basis, but Turner and others say a standardized system is a must to really propel the effort forward.

Those who have developed alternative models can find it slow-going. A MassHousing official says private lenders have approved just a handful of mortgages with the alternative FirstAmerican score.

"It does cost a little bit more, and it does involve a little bit more work," says MassHousing spokesman Eric Gedstad. "It's difficult to change the way things have been done."

Others say serving the thin- or no-file market requires far more than a new score, including smarter marketing and guarantees that loans made using alternative scores can be securitized. Mortgages are routinely repackaged as bonds and sold to investors.

"The system should embrace you, welcome you," says Leonardo Simpser, executive vice president of the Hispanic National Mortgage Association, which has its own credit-scoring model and also buys loans banks make using its system.

Simpser says banks "look at a huge segment of the population and they try to cram them into their existing systems, and it doesn't work."

Different strategies are needed for Hispanic consumers, an issue becoming complicated by uncertainty over federal immigration law, says Yamila Ayad of Mission Home Loans, who helped the Saavedras.

Mark Catone, senior vice president of First American, says his company is seeing more interest in his product as mortgage originators outsource work in light of a slowing market, because it lets firms process less-traditional loans faster and more uniformly.

Karen Gross, a professor at New York Law School, says it's hard to judge some of the efforts. For example, she cites a new VantageScore unveiled by the big three credit bureaus in March as a standardized score that also contained extra data to help thin-file consumers. The credit-reporting agencies don't disclose the formulas they use to develop a consumer's score. While they tout their standardized score, they won't say how that will be calculated, either.

"We live in a world without mandatory credit reporting, and there may be very good reasons for that. But in a world where some creditors can elect not to report, those who do report are getting added power," Gross says. "The system is flawed."

Benefits and risks

There are hurdles to developing alternative scores. One is figuring out what types of data predict creditworthiness. A second is persuading utilities and other businesses to report data in a voluntary system.

Rent payments might be a great indicator of whether a person could handle a mortgage. But there are few large landlords across the country, making it tough to collect data. Utility payments could be useful, but some states restrict utilities' ability to share data.

Asset Builders of America, a non-profit group in Wisconsin that focuses on financial education for low-income consumers, is running a Milwaukee pilot project to test whether reporting routine utility payments helps build credit and improve scores of those who already have a credit file. Working with We Energies and the non-profit Brookings Institution, the group also wants to see if consumers pay faster if data is reported.

"I see people who already have a credit score that's unbalanced," because of lack of positive data, says Richard Entenmann, president of Asset Builders. "There's a whole lot of people who don't have a credit score just because there's nothing on their records. ... Our supposition is this would help them."

Wu of the National Consumer Law Center notes that some utilities are not allowed to turn off heat during the winter, prompting strapped consumers to delay paying those bills to meet other needs. Some consumers have to prove they are behind on energy bills to receive special subsidies.

"For a utility to say, 'We can't shut you off, but we'll report you and give you a bad credit score,' we're concerned," Wu says.

Thorny issues remain

Additional use of data adds to privacy concerns.

Clifton Thompson, 49, is a truck driver in Clinton, Md. When he recently applied for a job, he was surprised to see a notation on the application stating his credit score would be checked. A couple of weeks later, after he signed the application, Thompson was told it was denied due to his credit history.

"I thought, 'All I'm doing is driving a truck: I'm not applying for a cash-register job,' " says Thompson, who notes his clean driving record. He wonders what will happen if he ever has to change jobs. "I need a job to pay off things, and now you're going to deny me work (due to my credit score)?" he says.

There are other issues, including the fact that minorities are already more likely to have low credit ratings. But banks and consumer advocates say there are a wealth of possibilities. Gross suggests opening the process and adjusting scores to give extra weight to such payments as child support.

"Create carrots, not sticks," Gross says, "so that not only does a credit score become a predictor of creditworthiness, it becomes a basis for social policy."

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