Testimony

Before

Subcommittee on Financial Institutions and Consumer Credit

Of the

COMMITTEE ON FINANCIAL SERVICES

Regarding

"Helping Consumers Obtain the Credit they deserve"

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Chairman Bachus and distinguished members of the Financial Services Committee, my name is Mark F. Catone, Senior Vice President with The First American Corporation. Thank you for inviting us to testify today on the topic of "Helping Consumers Obtain the Credit they deserve".

The changing demographics of the population in the United States are reshaping the demand for housing, automobiles and other goods and services. As a result, these changes are having a significant impact to the credit markets. According to many sources, including prior testimony to this committee has shown that immigration has accounted for more than a third of household growth since the 1990s[1]. Also, in general, we are seeing many more consumers, immigrants or otherwise, striving to make major purchases, such as the purchase of a home, earlier in life or very soon after their establishment in the United States.

One of the barriers confronting immigrants, low-and moderate-income borrowers and other consumers entering our credit system in the United States is the problematic issue of little or no credit file information.

Consumers who are part of the system, who are established and who have a credit report flow through our financial institutions relatively smoothly and in an automated way. No where else in the world today does the credit system allow a consumer to buy a car in under an hour or qualify for a home purchase on-line in the time it takes to fill out an application and click a button.

However, consumers who have not been part of the system, who do not have established credit, who have not, because of cultural norms, immigrants or otherwise, or disadvantaged consumers – are not well served by the industry today.

In some ways, it has become a "condition", a stigma. When a consumer applies for credit and does not have a credit report, or has too little data in their credit report, the automated underwriting technology the industry has invested in within the last 20 years is either impaired or not useful. The lender must expend more time and resources working and evaluating these applicants versus applicants who move through automated systems.

From a consumer's perspective, it becomes difficult to explain why their application for credit takes longer than their neighbors across the street or that of their co-worker. They become confused about this, and accuse the lender, the industry and others of discrimination because they believe they are not being treated the same as everyone else.

For example, and I will use the mortgage lending industry as my reference point, consumers who have little or no credit report information at the national credit bureaus

[1] Harvard Joint Center for Housing Studies, 2004, and other sources.

are referred to as needing a "non-traditional" credit report. This term is well known and understood in the mortgage industry[2].

The mortgage industry has had a well defined method of establishing a Non-Traditional credit history when a consumer has little or no creditor reported information residing at the national credit bureaus. These methods were established to address the no-file and thin-file issue and have been with us since HUD, FHA and other agencies began guaranteeing home loans. Through the years the industry has adopted these general standards, with some variation, including Fannie Mae and Freddie Mac at the federal level and agencies like Mass Housing at the state level, and subsequently, the majority of mortgage lenders in the market today.

Credit bureau data, being very standardized and efficient for the most part, facilitated and made possible credit scoring, a process of summarizing risk and creditworthiness in a three digit score and factor codes. By having little or no credit file information, no credit score can be calculated.

Consumers whose files contain insufficient information to calculate a credit score are not considered in systems that rely on automated underwriting, resulting in a "manual underwriting" processes, which is more expensive and time consuming. Not only are mortgage lenders more likely to process automated loans first, leaving the manual loans until later, these consumers are placed into higher risk categories and matched to different loan programs.

This further encourages the outcries of discrimination by consumers, simply because they have not participated in our financial system for either enough time or in the same way as established consumers.

There are also other consequences when no credit file is available, which includes the automatic assignment of the consumer to a higher risk category, even though the consumer may be able to demonstrate creditworthiness by producing his or own records showing mom-traditional creditor references.

In summary, and as far as recommendations, there is no one answer or quick fix to this issue because of the existing built up infrastructure around what we know as the credit reporting system, credit scoring and non-traditional credit. There are however, several areas that can be addressed that may lead to more comprehensive solution in the long run:

1. <u>Making More Data Available</u>

    The December 2004 Report by the FTC to Congress under sections 318 and 319 of the Fair and Accurate Credit Transactions Act identifies data in the form of bill payment histories at utilities and telecommunications carriers to be a

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[2] Fannie Mae Sellers Guide; Section X, 804: Using Nontraditional Credit History to Assess Credit Risk (06/30/02)

rich source of data indicative of credit behavior. Utilities and carriers however, only provide limited reporting to the credit bureaus.

There is no doubt that the addition of a substantial amount of utility payment data to the national credit reporting system would result in lowering the number of no-files and thin-files. Consumers, who pay rent, in most cases, also pay utility, phone and cable bills.

Utilities may incur additional expense in becoming compliant as data furnishers under the FCRA, including the expense of disputes. We would recommend examining whether utilities, as a data furnisher, while needing to provide the data in a structured and standard way, should be burdened with the same disputes requirements defined under FCRA.

Landlords, utilities, phone carriers are entities who provide services to consumers for payment, not a creditor who has extended a loan to the consumer such as a bank, Credit Card Company or a mortgage lender, at least not in the same way and to the same degree. We may need to modify existing rules regarding disputes based on this fact.

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For example, and assuming the quality of a utilities record keeping process, if a consumers payment history is in error, or a balance suspect, should that not be a standard customer service call to the utility and not a dispute to the credit bureau? The consumer already must obtain proof of a difference from the creditor currently. This scenario creates two calls and/or letters the consumer must invest in, rather than one.

We will also need to address the issue of additional expense of the credit bureau in adding and maintaining that data on the credit file. Most credit bureaus look at additional data of this type differently, and may treat it as a different product, not integrating or not packaging it with the current credit file in order to recoup the maintenance or capitalize on the new data. If this occurs, reports may not include the data, credit scores may not be reflective of this data, and possibly more and different reports and scores will need to be integrated at high expense across the industry.

2. <u>Create a Uniform Standard of Credit Reporting for Consumers who do not have Credit Reports but can Demonstrate Financial Competency</u>

Standardization will lead to lower overall costs as industry players build the standard into their systems and infrastructure. Provide third-party oversight to ensure these standards are not geared toward specific commercial interests, but allow competition.

Allow this standard to include more diverse sources of data than is available today; very similar to what we are discussing here today in relation to

rent and utility data. For example, most credit reports and credit scoring models fail to adequately take into account important positives or compensating factors, such as the use of pre-purchase and post-purchase housing counseling which many experts believe can affect projected risk, and are in fact required for many agency loan programs.

Allow verified alternative non-reported payment history data such as buy-here-pay-here sources, cash payments and the like as well as, in the case of immigrants, financial and payment history data from other countries.

3. Build the Non-Traditional Standards into The Technology.

As stated before, the non-traditional credit report standards, at least within the mortgage industry, are very well defined. Most organizations who employ automated underwriting technology have not built these options into these platforms due to the relatively low number of loans of this type.

We should find ways to encourage or require that these standards, as the case may be by loan type, similar as it is today for full-file loans, to be built into the various technology platforms. Even the general data interchange standard established and maintained by the Mortgage Banking Association does not include a standardized way to handle non traditional credit type information.

Until then, these types of loans will continue to be kicked out to a manual process and result in the same issues and frustrations as mentioned before.

4. Make More Data Available - Data Must be Predictive

As it is said, the devil is in the details. A host of companies are promulgating various data and related solutions to this and related challenges. We need to be diligent in matching appropriate data and solutions to the problem at hand. For example, a mortgage lending credit underwriting exercise is different than that of underwriting an automobile loan.

As I mentioned before, there is a well-defined Non-Traditional Credit reporting standard in the mortgage lending industry. This standard exists because it is predictive of risk associated with a mortgage lending transaction. For example, the most important element included within this standard is a requirement for a verified twelve-month rental housing payment history. Both rental payments and utility payments attached to the same residence have been widely accepted to be predictive of mortgage payment risk - if a consumer can dependably pay rent, it is likely that he or she can pay a mortgage as a substitute for the rental payment.

This is not necessarily the case when it comes to an automobile loan. It is entirely likely that what works well for mortgage, may not be applicable or

economical for an automobile loan. An automobile loan is usually in addition to a rental housing payment, not a replacement to one therefore, not necessarily predictive of loan success to the degree as a mortgage loan. Other factors would need to be considered. In many cases, automobile loan risk, because of the size of the transaction, is simply managed by the requirement for a co-signer to the loan.

5. Bundled Services in Order to Make the Transaction Economical

Again, the December 2004 Report by the FTC to Congress under sections 318 and 319 of the Fair and Accurate Credit Transactions Act identifies additional sources of data that may be appropriate. The report also notes that most data identified is more expensive to collect and add to the system and closes by noting that this makes ready solutions an economic challenge.

In order to address this, the industry should look for ways to mitigate the expense of sourcing additional data. For example, my company, First American, offsets the higher expense of compiling and verifying Non-Traditional Credit information for a mortgage transaction, by wrapping it in a fixed-cost comprehensive settlement service package, effectively mitigating the higher one-off cost of credit alone.

This concept may make sense for other loan types.

That concludes my verbal testimony and again, I would like to thank the Chairman and the Committee for the opportunity to present to you here today. I would be pleased to answer any questions you may have.