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Talking Points for the Panel on Alternative Credit References / Payment History

Alternative Credit History – Definition:

For the purposes of this discussion I would like to keep a broad definition of “alternative credit.”

When I use that term it means any evaluation of past payment activity not covered in a traditional credit report provided by one of the national credit bureaus.

Examples of alternative credit would be: rent, utility bills, monthly insurance payments, child care, rent-to-own agreements, etc...

This type of payment history is generally provided by the applicant but some companies are developing scoring models that will evaluate these types of activities. FICO has developed a “FICO Expansion Score” and LexisNexis had developed its “RiskView” model.

Are banks required to, or prohibited from, using alternative credit history when evaluating loan applicants?

No – Banks are provided the latitude to set their own underwriting standards for any product they offer.

We do expect that whatever standards are set, they would be applied consistently to all similarly qualified applicants.

My experience is that most banks, and the secondary market, will consider alternative credit when traditional credit does not exist. However, alternative credit does not replace “bad credit” so a person who has been late on credit cards or car loans could not use rental payments in place of the bad credit. If there were legitimate explanations for those late payments, such as a onetime event like a job loss or health issue the applicant should make sure the bank knows that.

There have been concerns raised by some community groups that the use of alternative credit could harm people at the lower end of the income spectrum because they often have trouble paying monthly bills on time or are in dispute with landlords or household goods rental companies and the scoring models may not take those legitimate disputes into account.

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While these concerns could be justified in that the model could not know the reason for late payments, it is my experience that applicants can provide reasonable explanations for credit flaws in either a traditional or alternative credit line. As an example, the applicant could explain that late rent was due to a dispute with the landlord because the heat did not work.

It is also my experience that most banks want to make loans but they also want to be reasonably sure they will be repaid. They will consider legitimate explanations for late payments but it is sometimes up to the applicant to request that additional level of review.

If a person is living paycheck-to-paycheck and needing to juggle current monthly bills because they can't pay them all, it would seem the greater harm (to the consumer and the bank) to give them one more payment to add to the list.

If banks were to ignore alternative credit the likely outcome would be a denial of the applicant simply because they had not established traditional credit to a level that can be scored by the credit bureaus. That would seem to be more unfair to lower income people, particularly those that do pay their obligations on time.

If the bank makes a repayable loan to an individual and payments are made on time, the positive information will be reported to the credit bureaus and will begin to build a traditional credit history for that customer.

My recommendation to the attendee at this meeting:

Encourage people to ask their bank if they will consider alternative credit sources and what specific sources they would accept. Remember that banks' practices could vary by product.

If they receive a denial notice – that doesn't need to be the end of the process.

I would encourage a denied customer to contact the bank to discuss the reason for the denial.

If the applicant submitted alternative credit information (and they are still denied for credit reasons), they should contact the bank to discuss the specific concerns noted by the underwriter. They should offer any reasonable explanation for something like landlord disputes. It would be even better if the applicant was up front when they submit payment information and provided the explanation why some payments were late as this will generally shorten the time it takes to complete the review of the loan request.