Helping Clients Build Credit

by Vikki Frank, Credit Builders Alliance

In today's economy, access to financial services is increasingly determined by an individual's credit score. People with a good credit rating will pay approximately $250,000 less in interest throughout their working lives than those without.[1] The impact of a credit score on financial well-being goes beyond access to credit and debt. Credit not only helps families buy a home, a business, or an education, but impacts opportunities for rental housing, transportation, employment, and access to checking, savings, and investment accounts.

Consider the challenge for Rita, an entrepreneur who has always paid loans, rent, and bills on time–but not through channels that record her payment history. Rita never had a credit card. She financed a car through a lender that did not

Illustration: Getty Images

report her payments to a credit bureau (it *would* have if she had defaulted). Rita now wants to buy a home. When an applicant has no credit score, mortgage lenders must consider "alternative data." Unfortunately, that's a lot of work for both the borrower and the bank. Rita needs to document 12 months of on-time bill payments to at least three vendors, and the bank needs trained alternative underwriters to manually assess the risk of lending to her.

LEDC courtesy photograph

Robert Vickers and Susan Lopez at Washington, D.C.-based Latino Economic Development Corporation present a loan check for $12,250 to Oswaldo Acosta-Corrales, owner of Picante Foods, a wholesaler of Hispanic food products.

Lending to the Underserved

In the past decade, community and regional banks have merged into national financial institutions, and the banking sector has become increasingly dependent on credit scores and the automated underwriting system (AUS). AUS allows banks to quickly and efficiently offer credit, but it doesn't help everyone.

People without a credit score or with a poor score borrow from high-cost creditors that don't generally report repayments to credit bureaus and don't have any interest in helping borrowers build credit and graduate to mainstream financing. It's a Catch-22. The system helps families with good scores access affordable financing and gives them continued opportunities to access affordable credit and build wealth. The financially excluded, however, are nearly always obliged to use high-cost, unreported products, and have few opportunities to build a score and break the cycle.

About 40 million people—more than 15 percent of the U.S. population—either have no credit files or very thin files and are "unscoreable."[2] Another 25 percent of the population have poor scores (lower than 650) that prevent access to prime lending products.[3] With few opportunities to create or improve their credit scores at credit bureaus, these borrowers have less access to competitive interest rates and safe loan products. They also are more vulnerable to predatory lenders.

People without a credit score or with a poor score often borrow from high-cost creditors that don't report repayments to credit bureaus or care about helping borrowers build credit.

The underserved do access credit through their personal networks or alternative creditors like payday and subprime lenders. Or they can turn to community development financial institutions (CDFIs) and other microenterprise and housing development lenders. Unfortunately, few alternative lenders have been reporting their clients' credit behavior to the three major credit bureaus.

Credit Reporting Needed

Credit Builders Alliance (CBA) is a coalition born out of a challenge that community financial lenders and their clients have long faced. Many of the estimated 1,000 CDFI and microenterprise lenders in the United States that want to report the repayment history of their borrowers have been unable to meet credit bureau requirements. CBA surveyed 115 microlenders in 2006 and learned that only 17 percent were sending client repayment behavior to a major credit bureau. Of the remaining lenders, half had fewer than 50 active loans, and only 20 percent had more than 100. Credit bureaus require 500 open accounts.

Enter Credit Builders Alliance. With seed funding from the Center for Financial Services Innovation and with a founding board that included Central Vermont Community Action Council (CVCAC), RUPRI Center for Rural Entrepreneurship, and the Association for Enterprise Opportunity (AEO), CBA launched an effort to aggregate data from small lenders and furnish the information to the major credit bureaus.

A Membership-Partnership Model

In April 2006, CBA principals approached the three major credit bureaus—Experian, Equifax, and TransUnion—to learn more about the barriers to their accepting data from small community lenders. One challenge is that the U.S. credit system is a completely voluntary arrangement. Creditors must want to report, and it can be expensive for them to do so. Additionally, credit bureaus must be able to cost-effectively verify creditors' information.

In August 2006, Experian agreed to a pilot project with CBA. CBA signed up 12 community lenders from across the country to upload data to Experian. CBA developed membership criteria unique to community lenders which would assure Experian that CBA members are reputable, longstanding community entities. Most community lenders are underwritten by foundations, after all, not to mention federal and local government entities, such as the CDFI Fund, Small Business Administration, and housing departments. In addition, community lenders are not only willing but proud to provide information on their affiliations, staff accreditations, client demographics, loan portfolio management, and annual turnover.

Equally important, CBA gives small lenders technical assistance to help them set up the appropriate technology, client services, credit bureau relationships, and organizational infrastructure to efficiently report and verify data. CBA also has benefited from the assistance of DownHome Solutions and CommonGoals software companies, both of which invested in useful credit-reporting add-ons to their loan-management products so that the CBA pilot groups could upload test data to Experian.[4] As a result, Experian has been able to receive the data with few disruptions or demands on staff time.

As Experian senior vice president Zaydoon H. Munir puts it, “Enabling CBA’s clients to report data to us expands the credit system to many individuals who have not had the benefits of an established credit history in the past.”

In May 2007, CBA began offering all community lenders the opportunity to join the organization and report data to Experian. It hopes to add other credit bureaus in 2008. CBA is getting the word out to national conferences and through its web site, its software partners, and industry listservs. More than 75 community lenders made inquiries as of May 15, 2007, and CBA hopes to have at least 300 members by 2010.

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Investing in an Asset

Simultaneously, CBA is conducting a campaign to promote increased public awareness about credit scores and to disseminate information about the benefits of adding new and positive lines of credit. It believes that the best and quickest way for people to remediate a poor or nonexistent credit history—and get access to mainstream financing and safe, affordable lending products—is to show a positive payment history on current open accounts. This is an asset-based approach and is a departure from credit-repair interventions focused only on negative accounts and debt consolidation. A Credit Builders Toolkit funded by the Annie E. Casey Foundation equips community financial educators with tools, strategies, and best practices to help low- and moderate-income families build credit and improve their financial independence and economic well-being.

CBA also plans to work with its credit-bureau partners to evaluate and strengthen the wealth of credit-risk data that community-based financial organizations measure. If conventional financial institutions must have credit scores to evaluate creditworthiness, then finding reliable new data is critical to leveling the playing field for all families.

CBA believes that enabling U.S. community lenders to report client repayments is a cost-effective and efficient strategy for asset building and moving unbanked and underserved families to economic self-sufficiency.

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Endnotes

1 “Improving Credit Can Save,” CBS MarketWatch, January 13, 2004.

2 “Give Credit Where Credit Is Due,” Political and Economic Research Center, http://www.infopolicy.org/pdf/alt-data.pdf.

3 See http://www.myfico.com/CreditEducation/CreditScores.aspx.

4 See http://www.commongoals.com and http://www.downhomesolutions.com for descriptions of software designed specifically for microbusiness and housing community development lenders.