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Exclusionary Credit Score Modeling Limits Access to Credit for Millions of Consumers…Even Perhaps Your Next Door Neighbor

Contents

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Exclusionary credit score modeling limits access to credit for millions of consumers... even perhaps your next door neighbor

EXECUTIVE SUMMARY

Since the introduction of VantageScore 3.0 in 2013, annual model validations have affirmed the accuracy of the scores it generates, including those for the "expanded" population of approximately 30-35 million consumers who cannot be scored by traditional scoring models, otherwise known as the "unscoreables."

To get a more detailed financial portrait of this expanded population, including roughly 7.6 million of those consumers whose scores of 620 or higher indicate a high degree of credit-worthiness, VantageScore Solutions studied five million anonymized credit files, supplemented with demographic and economic data. This enabled a comparison of expanded-population consumers to their traditionally scoreable counterparts on a variety of financial characteristics, including income, employment, debt, and general ability to afford mortgages in their geographic regions.

As detailed below, among consumers with similar VantageScore credit scores, traditionally scoreable consumers and those in the expanded population proved strikingly similar with respect to their suitability as borrowers. The findings underscore that it is possible to expand the credit eligible population without relaxing standards.

Nevertheless, the study also revealed a marked disparity in the amounts of revolving credit extended to each group, with the traditionally unscoreable group receiving significantly less credit than traditionally scoreable peers.

INTRODUCTION

In 2015, approximately 30 to 35 million people in the United States could not obtain a conventional credit score, despite having a credit file at one or more of the national credit reporting companies. Consequently, those consumers' ability to access mainstream credit was severely restricted, and many seeking credit were driven to look beyond mainstream channels to other sources, where often only higher priced solutions were available.

A commonly-held belief is that if someone is conventionally unscoreable, it is because they are high risk and unlikely to qualify for credit or because they simply don't need credit. In reality, this is far from the truth. Many of the 35 million conventionally unscoreable consumers are, in fact, highly credit qualified and may indeed be seeking credit. As this study shows, these consumers are in many ways very similar to conventional credit users.

APPROACH

To conduct this study, five million anonymized consumers, representative of the U.S. population, were randomly selected from the Experian credit bureau database. Experian appended certain demographic data from third-party sources, such as age, income and occupation, to each of the selected credit files.

Each consumer's credit file was then reviewed to determine whether sufficient information existed in the file to satisfy the scoreable conditions required by conventional scoring models. To meet those conditions, the credit file needed a minimum of one credit account that was at least six months of age and also contained an update that had occurred within the last six months. Consumers who met those criteria were assigned to the 'Conventional' population.

Consumers who were excluded based on the foregoing scoreable credit file conditions, but whose credit file contained either a trade that was at least one month old, or a public record or an external collection, were assigned to the 'Expanded' population category.

The Conventional and Expanded populations were then compared from a demographic, credit capacity and capability perspective.

INSIGHTS

- The demographic data overlay showed that consumers who are typically unscoreable have financial and credit capability profiles very similar to those consumers who are scoreable using conventional credit-scoring models.
- VantageScore 3.0 scores the expanded population. Significantly, when the portion of the expanded population who scored above 620 using VantageScore 3.0 obtained mortgages, for example, they demonstrated a financial profile that was of sufficient quality to justify a loan amount that was on par with that of conventionally scoreable consumers. In other words, when financial information is considered in addition to the score, both groups of consumers appear equally credit-worthy.
- Conversely, when a credit score is the primary information used to assess risk, as is often the case in bankcard lending, consumers who are unable to obtain a ***conventional*** credit score are generally evaluated as high-risk candidates, despite the possibility that they are simply conservative users of credit who nonetheless have strong financial foundations.
- Lenders' reliance on a single brand of scoring model in automated systems can hinder consumers' access to credit despite their credit-worthiness. (This practice is essentially mandated in the U.S. mortgage market, as a single brand of credit scores must be included with loans submitted for purchase by Fannie Mae and Freddie Mac, the agencies responsible for securitizing the vast majority of single-home mortgages in the U.S.) This mandate limits consumers' access to credit, exacerbates the sparseness of their credit files and perpetuates their conventionally "unscoreable" status.
- Giving lenders the option of using more inclusive credit scoring models in their automated underwriting systems could rectify this miscalculation of consumer risk and open up a highly attractive population to lenders.

Do consumers without a conventional credit score have sufficient capacity to handle major debt?

Average income for consumers in the expanded population is 67 percent of that of conventional consumers (Figure 1). Figure 2 shows a comparable occupation profile between the conventional and expanded groups. Consumers in the expanded population exhibit a reasonable capacity for repaying debt in terms of income and income generation in light of their occupation profile.

When consumers from the expanded population obtain mortgages, their average loan amount is just 12 percent less than the average loan amount obtained by conventionally scoring consumers. Average term length for these loans is on par with conventional term lengths (Figure 3). This data suggests that when consumers in the expanded population are approved for mortgages, their

Figure 1: Income

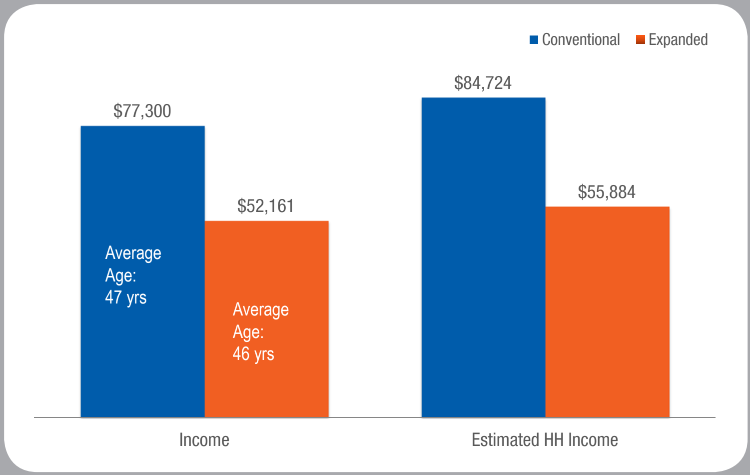


Figure 2: Occupation

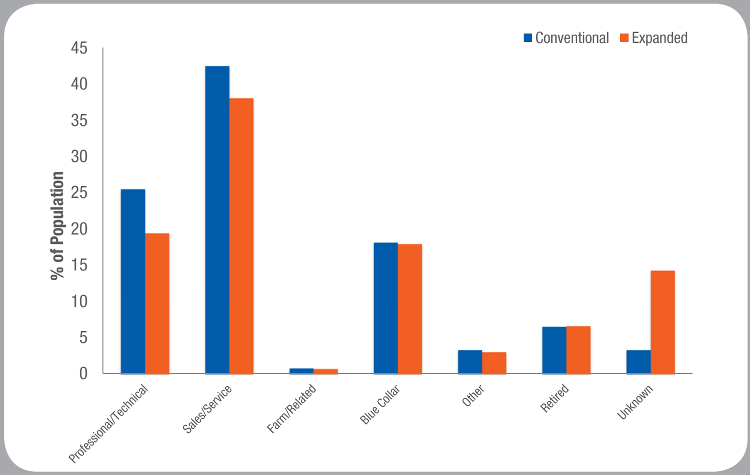
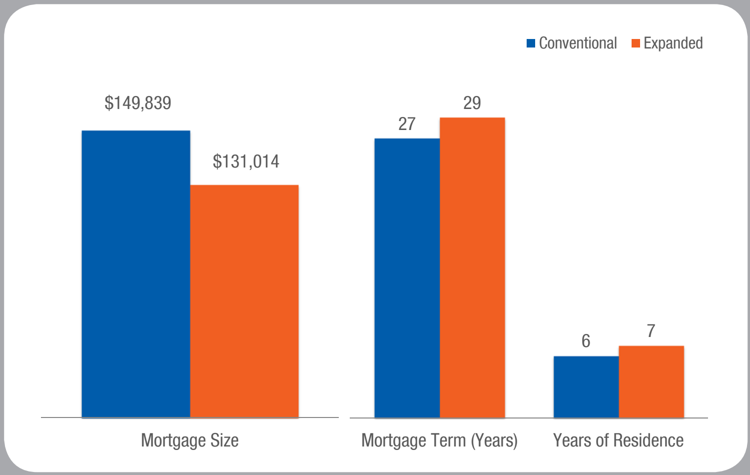


Figure 3: Mortgage holder characteristics



personal asset and income profile is sufficient to obtain loan products that are very similar to those made to conventionally scoring consumers.

The preceding results are born out by comparing product-level loan amounts between the expanded and conventional populations by score bands (Figure 4). Mortgage loan amounts for expanded population consumers with scores above 620 are nearly identical to (on average 99 percent) the loan amounts obtained by conventionally-scored consumers.

Significantly, when automated systems are the dominant underwriting mechanism, as is the case for bankcard products, credit limits are substantially lower for expanded population consumers. Bankcard credit limits for the expanded population consumers are only fourteen percent of credit limits obtained by conventional consumers. Clearly, if the automated underwriting systems rely solely on a single brand of credit scoring model that does not address the needs of the expanded population to assess risk, the system limits exposure because the expanded population is conventionally unscoreable and therefore 'appears' to represent higher risk.

Less transparent is the fact that reliance on a single brand of scoring model in an automated system unnecessarily inhibits a consumer's access to credit despite their credit-worthiness.

Do consumers without a conventional credit score improve their credit-worthiness over time?

Seven percent of consumers with scores below 620 at the beginning of the two-year period had raised their scores to above 620 by the end of the period (Figure 5). Seventy-six percent of consumers with scores above 620 originally maintained a score above 620 at the end of the period.

The consumers who could become your next-door neighbor!

The data clearly demonstrates that many consumers, despite being typically unscoreable, exhibit very similar foundational demographic and financial profiles as those who can be scored by conventional models. For many in this expanded population, they are simply, and wisely, conservative users of credit.

In this final analysis, we assess these consumers' mortgage affordability using VantageScore 3.0 as well as demographic and credit file information. VantageScore 3.0 scores this expanded population of 35 million consumers in addition to the conventional population.

Figure 4: Expanded loan amount as a percentage of Conventional loan amount by product

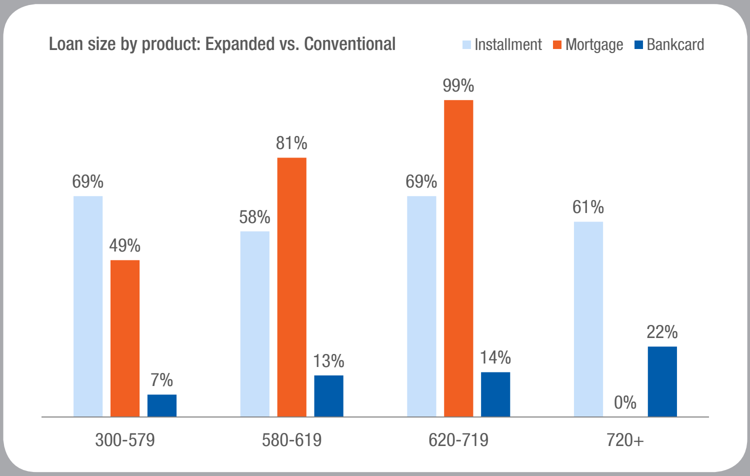


Figure 5: Expanded population consumers' score migration (2012-2014)

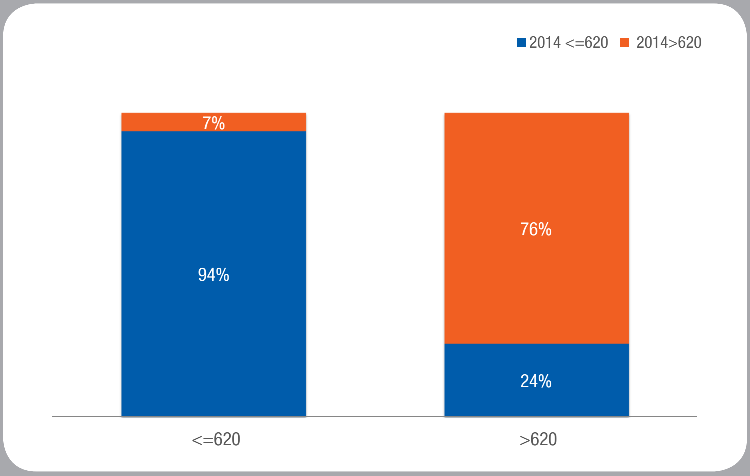
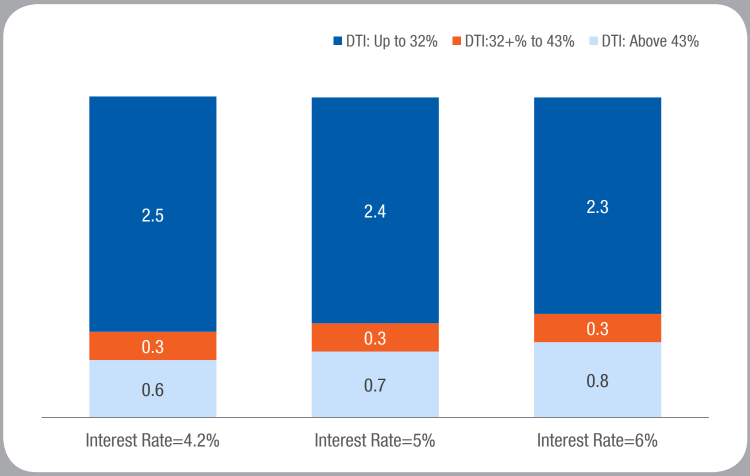


Figure 6: Mortgage affordability Expanded population estimate (Millions)



The following exclusions were then applied to the newly scored, expanded population:

- Age under 25 years or above 70 years
- Presence of Mortgage/Home Equity loan
- Presence of a foreclosure
- Presence of a 90 days' past due event in the last two years
- Indication of homeownership
- VantageScore 3.0 score of less than 620

After applying these exclusions, 3.4 million consumers remain potentially eligible for a conforming mortgage.

Figure 6 is based on median home values from the most recent census data and a 20 percent down payment, with selected interest rates and debt-to-income levels up to 32 percent, 32 percent to 43 percent, and more than 43 percent. We found that the 2.3 to 2.5 million of the 3.4 million consumers described above have sufficient income to support a mortgage in their geographic area.

CONCLUSION

Generic credit scores continue to provide powerful insight into consumer risk profiles. This study highlights the limitations of using a single brand of credit scoring model within underwriting systems and points to opportunities available to the industry from the ability to choose among competing brands of credit scoring models. By any measure, financially stable, credit-worthy individuals are being excluded from mainstream access under the current underwriting system infrastructure. Proactive lending institutions can find and engage these consumers by enhancing their underwriting processes to consider multiple brands of scoring models.

VantageScore
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