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Viewpoint: Why Now's a Great Time To Court the Unscored

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The subprime mortgage meltdown continues to cause financial ruin for both consumers and lenders.

But while lenders contemplate how to recalibrate their operations, the credit needs of consumers live on.

In fact, the decline of independent mortgage companies and the rise of new underwriting tools make this an opportune time for banks to make a play for the business of underbanked consumers.

Banks and thrifts already are reaching deeper into the credit markets. According to the Federal Reserve's most recent Home Mortgage Disclosure Act report, the 2006 share of high-priced mortgages made by depositories and their subsidiaries increased 6 percentage points over 2005, to 54%. This suggests an increasing number of originations to nonprime customers.

As independent mortgage companies continue to fall by the wayside, banks are in a position to pick up some of the slack, albeit in a more responsible fashion. Whether they do will depend in large part on whether they can get comfortable with the credit risk.

Unbanked and underbanked consumers generally are perceived to be subprime and often end up in subprime products, because a lack of traditional credit data makes them unscorable by traditional methods. But a wave of new research and analytical tools suggests that the perception is not the reality.

Research by Edgar, Dunn & Co. and TransUnion, for instance, suggests that 33% of the unbanked are subprime and below. Yet 45% of the unbanked consumers in the PaymentDynamics 2007 Preferred Payments Study are unscorable, because they have either too little credit information on file with the bureaus or none at all. And 23% have profiles that qualify them as prime or superprime.

The industry estimates that 35 million to 50 million consumers are unscorable. Not all of these consumers are good credit risks, but unscorable does not automatically mean subprime.

A report this year by the Political and Economic Research Council demonstrated that including data on how consumers pay their utility bills in their credit scores dramatically increased credit acceptance rates for lower-income and minority borrowers. In many cases, the addition of utility data turned consumers without a credit score into prime borrowers.

This kind of thinking has led to the creation of a cottage industry of credit bureaus, analytical companies, and scoring systems aimed at finding and underwriting consumers with thin or no credit files. The companies gather and

analyze data that typically does not appear in credit bureaus' files, such as utility payments and remittance activity.

Gathering this data efficiently and systematically can be difficult. The mortgage industry still underwrites some loans manually, especially those that rely on nontraditional credit data. One of the most promising developments for mortgage lenders, then, involves the collection of rental payment information.

MoneyGram's recent announcement that it was purchasing PropertyBridge is an indication of the potential. Most people pay their landlords with a check or a money order. PropertyBridge's system enables people to pay their rent online or at MoneyGram locations, increasing efficiency for property owners. The byproduct is an electronic clearing house of rental payment data.

RentBureau, a start-up credit reporting agency in Atlanta, offers another model. In the last year it has collected payment data on 3 million renters, making it available to property managers to improve their screening processes. Ultimately, the company plans to make the data available to lenders.

On average, 48% of the renters in RentBureau's database live in affordable housing units as defined by the Department of Housing and Urban Development. A company analysis shows that 25% of the renters are unscorable, with one tradeline or less.

New data and analytics alone are not enough for banks to penetrate the underbanked market. Creditworthy consumers aren't necessarily mortgage-ready consumers, and lenders would be wise to build broader financial relationships as a first step to building their mortgage pipelines.

Relationship building is more feasible in a marketplace with tighter credit and fewer unscrupulous mortgage companies. Bankers have more time to work with potential borrowers on saving for a down payment and building a cushion to help weather emergencies without worrying that the consumers will bolt to another lender for a quicker yes.

The subprime meltdown may seem like a good time to bar the doors and ride out the storm, but forward-looking banks will see it as an opportunity to develop business in new markets.

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