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America's Great Divide

About 73 million people in the U.S. are unbanked or underbanked, a population as diverse as it is unknown. They're often new to the U.S., frequently entrepreneurial and lacking credit histories.

By Michael Sisk

The subprime mortgage troubles have grabbed a lot of headlines this year as delinquencies and foreclosures mount and lenders scramble to head off onerous new rules from Washington. But this story has masked another phenomenon: lending to unbanked or lightly banked consumers, whom some are calling "emerging credit."

Make no mistake, there is a significant difference between subprime and unbanked. The former have established and blemished credit histories that can be viewed through the three major credit repositories, while the unbanked can't be easily tracked because they have never had a credit card, car loan, mortgage or other financial product that would leave a credit trail. However, these two groups do have two major commonalities: risk profiles that fall outside the norm and must be carefully studied before extending credit; each group also represents a deep pool of potential customers.

Reaching the unbanked is a perennial dilemma for banks, but several new technology tools show great promise in helping to bridge this gap. The Center for Financial Services Innovation estimates 73 million people in the U.S. are either unbanked or underbanked. When one considers that that figure is 56 percent of the total banked population of 130 million, it becomes pretty clear how much business is up for grabs.

Major lenders have announced forays into this market-particularly the Hispanic community, a growing entrepreneurial presence in many parts of the U.S. In February, Bank of America began to offer credit cards to people without Social Security numbers, but who have a checking account with the bank. The program includes more than 50 branches in Los Angeles County. JPMorgan Chase, Citigroup, Wells Fargo and Fifth Third also have experimented with programs to offer mortgages to undocumented immigrants by accepting government issued tax-identification numbers instead of Social Security numbers.

Undocumented doesn't necessarily mean illegal. Experts point out that many different groups fall into the unbanked category for a variety of reasons: new legal immigrants, people whose religion discourages credit, young people just out of school, widows and older people with a generational bias against credit.

As enticing as the unbanked are because of this group's size, they are even more alluring thanks to evidence they prove good credit risks. Just how unbanked consumers will perform once given financial products is one of the great unknowns, but some technologies originally released several years ago have finally developed enough historical performance to prove the value of these unbanked consumers. As Carina Bell of First American CREDCO, which has introduced its nontraditional credit Anthem Report, says, "You can't say no score is a low score."

Take Banuestra Financial Corp., a financial-services company with 12 branches in the Atlanta area and a proprietary ASP-based operating platform, Conexion El Banco. It's a scoring system and centralized underwriting center to enable banks and retailers to cash non-customer checks. The company has been perfecting the technology for six years, says CEO Drew Edwards, and in that time it has approved the checks of enrolled users 92 percent of the time and suffered a scant nine-basis-point charge-off rate. "We don't do subprime lending," he says. "We're looking for the new prime."

Other technology outfits looking to pry open this market include First American, Fair Isaac and LexisNexis. First American and Fair Isaac are perfecting



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alternative credit scoring by taking data from nontraditional sources and feeding them into their analytical engines and creating a nontraditional credit score. These "nontraditional" sources don't sound all that unusual—rent, utility payments, phone bills—but they don't show up on the typical credit report because the information is so dispersed. It is very time-consuming to generate these reports, but the upside is they're proving very accurate.

A conference on the unbanked in Dallas in June attracted Warburg Pincus, Pequot Capital Management, and mPower Ventures. David Coulter, a managing director and senior advisor at Warburg Pincus and a former CEO of Bank of America, called financial services for the underbanked "an ideal setting for private equity. ...We are looking across the sector broadly. I think there are real growth opportunities there."

First American CREDCO projects that in the coming years 60 percent of first-time home buyers in the United States will be underserved consumers with less traditional credit histories. The way its nontraditional Anthem credit score works is straightforward. Whenever a lender's customer does not have the credit background to generate a standard credit score, First American suggests the lender upgrade to an Anthem Report for \$65. (It's a cost-effective price point since the company estimates that mortgage lenders spend an extra \$150 per loan applicant to create a nontraditional credit history themselves). If the lender agrees, First American will begin tapping its nontraditional data sources to create an Anthem Score.

"We looked at the GSE guidelines and the big lender guidelines and we created a best-of-breed analytics," says Bell. "We started with the traditional data and then added other nontraditional payment patterns. ...From a technology perspective, what we're trying to solve is machine decisioning, automated underwriting." The trick, she says, is that since the data is not from a typical credit repository many banks' automated systems can't read the information, which makes it a manual process on the bank end.

But it's a dilemma First American has just about solved; it will be rolling out an "electronic" Anthem in the fourth quarter, which will allow participating lenders to automate the process, reduce human error and squeeze out more profits. Currently, she says, hundreds of lenders use Anthem; First Franklin and the Neighborhood Housing Services of America will be among the first lenders to be electronically enabled.

Of course, alternative credit scores are not possible for everyone. Having sufficient data depends on whether the rent, utility, or other creditor payment information can be verified and whether the lender is willing to accept data not vetted by an independent third party, according to a report authored by TowerGroup analyst Craig Focardi. Data verification is a key component in alternative credit reporting because of the large potential for use of fraudulent creditor data. Usually to qualify for a mortgage, at least four alternative data sources are required, each with a 12-month payment history. Prospects for this alternative credit score got a big boost last year when Fannie Mae agreed to purchase loans underwritten and originated with the Anthem Report and Anthem Score.

Another player in the alternative credit score space is Fair Isaac. In 2004, it created its own credit reporting company, Fair Isaac Credit Services. FICSI has built a network of third-party alternative data sources to create the FICO Expansion Score. The first users have been credit-card issuers, though some lenders are testing student and auto loans, as well as mortgages.

Meanwhile, LexisNexis has launched RiskView, a tool that also uses public records and non-traditional data—like asset ownership or address stability and tenure—to create a score for consumers and businesses that have been deemed "thin file" or "no hit" by traditional bureaus. The idea behind RiskView is a deeper analysis of this emerging credit market. "Against the backdrop of today's sub-prime/mortgage foreclosure fallout, FIs are looking for better risk-decisioning tools to ensure they are giving credit to only those who are most credit-worthy," according to a LexisNexis statement.

What is particularly great news for banks, aside from a large group of customers to tap into, and aside from the stellar performance of a good many of them, is that the unbanked are extremely profitable customers. As Edwards of Banuestra puts it, "we're looking for new prime, but we're getting subprime yields." His 12 branches take in about \$300,000 a month in check cashing fees—or about \$25,000 in fees per branch per month. To get around Georgia's cap on interest rates that a bank can charge—16.5 percent—Banuestra is not actually a bank, but a financial-services company that offers a range of bank-like services. Thus, it can charge 25 percent to 28 percent on the small-denomination, high-service loans that it makes to its 24,000 (mostly Mexican) customers.

Edwards says that his company views customers in three evolutionary stages—with a fourth to come. The first step is the check-cashing consumer. After enrolling the customer, which involves fingerprinting, the customer is

issued a membership card that allows him or her to cash any check. That's key, Edwards says, because the immigrant population typically has a lot of different personal two-party checks, not a single payroll check. "They're not going to come in if they can only cash a payroll check." The next step is the account type insured by Federal Deposit Insurance Corp., debit cards for instance, that the company opens once it's had some time to score a consumer. Third are more sophisticated consumer-finance products, such as mortgages. And, lastly, which Banuestra will add in the fall, is property and casualty insurance.

Despite the high interest rates and the need for fingerprinting to enroll, Edwards says there is such a desire among his clientele to achieve legitimacy that they are more than happy to take advantage of Banuestra's services. The trick is gaining trust, which Banuestra attempts to do in a number of ways. First, 100 percent of the teller staff are immigrants, from 18 different countries. "They've gone through that scary process" of immigration, says Edwards, who adds that Banuestra only employs legal immigrants, though it banks illegal ones. Banuestra wins trust through consulting services, presentations at churches, the Salvation Army and on the radio. "It's a real grassroots effort," he says.

Banuestra's product and overall approach to the unbanked market has been successful enough that it now offers it to other financial-services companies.

Someday, Edwards hopes, if enough banks adopt his technology and link together, the service could be branded akin to Visa, with a logo on a door indicating to passers-by that they can cash their checks at that location. Such a network would allow banks to nurture new banking relationships among a large underserved group and capture a huge fee-generating market now dominated by check-cashing outfits.

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