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Alternative Data in Financial Services

Alternative data generally refer to information used to determine a consumer's creditworthiness that the national consumer reporting agencies—Equifax, Experian, and TransUnion—do not traditionally use to calculate a credit score. These reporting agencies generally create consumer reports containing historical information about repayment on credit products such as mortgages, student loans, credit cards, and auto loans. Credit applications, bankruptcies, and debts in collection also are regularly included. In contrast, alternative data include additional consumer financial data not regularly contained in traditional credit files. New technology makes it possible for financial institutions to gather other information, including financial and nonfinanical data, from a variety of sources.

The Consumer Financial Protection Bureau (CFPB) included the following list of alternative data examples in a 2017 request for information:

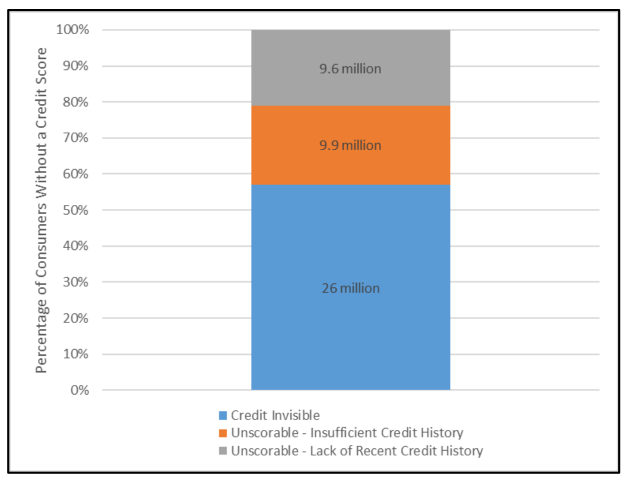
- Data showing trends or patterns in traditional loan repayment data.
- Payment data relating to non-loan products requiring regular (typically monthly) payments, such as telecommunications, rent, insurance, or utilities.
- Checking account transaction and cashflow data and information about a consumer's assets, which could include the regularity of a consumer's cash inflows and outflows, or information about prior income or expense shocks.
- Data that some consider to be related to a consumer's stability, which might include information about the frequency of changes in residences, employment, phone numbers or email addresses.
- Data about a consumer's educational or occupational attainment, including information about schools attended, degrees obtained, and job positions held.
- Behavioral data about consumers, such as how consumers interact with a web interface or answer specific questions, or data about how they shop, browse, use devices, or move about their daily lives.
- Data about consumers' friends and associates, including data about connections on social media.

These data can be used either in credit reports or by lenders directly to underwrite a loan (i.e., to determine whether to lend to a consumer and at what price). Recent findings suggest that some types of alternative data—such as education, employment, and cash-flow information—might offer a promising way to expand access to credit. However, the collection and use of alternative data raise policy concerns related to consumer protection and privacy.

Using Alternative Data in Credit Reports

Alternative data have the potential to expand the number of consumers in the traditional credit reporting system. According to the CFPB, credit scores cannot be generated for approximately 20% of the U.S. population due to their limited credit histories. The CFPB categorizes consumers with limited credit histories into several groups. One category of consumers, referred to as "credit invisibles," have no credit record at the three nationwide credit reporting agencies and, thus, do not exist for the purposes of credit reporting. Credit invisibles represent 11% of the U.S. adult population, or 26 million consumers. Another category of consumers have a credit record, but they cannot be scored or are considered "unscorable." Unscorable consumers either have insufficient (short) histories or stale (outdated) histories. The insufficient and stale unscored groups, each containing more than 9 million individuals, collectively represent 8.3% of the U.S. adult population, or approximately 19 million consumers.

Figure 1. Credit Invisible and Unscorable Consumers as of 2010



Source: See Kenneth P. Brevoort, Philipp Grimm, and Michelle Kambara, *Data Point: Credit Invisibles*, CFPB, May 2015, p. 6, at http://files.consumerfinance.gov/f/201505_cfpb_data-point-credit-invisibles.pdf.

Alternative data could be used to calculate scores for some consumers with limited credit history, which would allow lenders using these scores to better determine the creditworthiness of people in this group. Moreover, alternative data used in the credit reporting system could increase credit reporting accuracy for all consumers by including additional information beyond that which is traditionally used. Arguably, this could increase access to—and lower the cost of—credit for some individuals, in cases where alternative data are able to identify new creditworthy consumers. However, in cases where the alternative data include negative information, some consumers face the possibility of being denied credit.

Fintech Lending

Some lenders currently use alternative data directly to make credit decisions, in addition to or instead of information in the credit reporting system. These lenders generally gain access to alternative data on prospective borrowers either through publicly available information or with the borrower's permission.

One market segment is particularly illustrative of this practice. With the proliferation of internet access and data availability, some new lenders—often referred to as marketplace lenders or *fintech* lenders—rely on online platforms and frequently underwrite loans using alternative data. Although fintech lending remains a small part of the consumer lending market, it has grown rapidly in recent years. In addition, incumbent bank and nonbank lenders have adopted certain of these technologies and practices to varying degrees and, in some cases, have partnered or contracted with fintech companies to build or run online, algorithmic platforms.

Financial Regulatory Policy Issues

Regulatory Considerations for Alternative Data Providers and Users. Although alternative data could be used to expand access to credit, such data also raise regulatory compliance questions. In particular, the presence of two statutes pertaining to the use of credit reporting and underwriting may be a reason why adoption of alternative data in the credit reporting system and by lenders is currently limited.

The main statute regulating the credit reporting industry is the Fair Credit Reporting Act (FCRA; 15 U.S.C. §1681 et seq.), which establishes consumers' rights in relation to their credit reports, such as the right to dispute inaccurate or incomplete information in their reports. The act also imposes certain responsibilities on those who collect, furnish, and use the information contained in consumers' credit reports. Alternative data providers outside of the traditional consumer credit industry, such as telecommunications and utility providers, may not have an incentive to furnish information to the credit reporting agencies. These companies do not use credit reports in their businesses, so they do not need to be part of the credit reporting system. If these companies were to furnish information, then they would need to comply with FCRA requirements, such as managing consumer disputes. Therefore, some organizations may be discouraged from furnishing alternative data, even if the data could help some consumers become scorable or increase their credit scores.

In addition, the Equal Credit Opportunity Act (ECOA; 15 U.S.C. §§1691-1691f) generally prohibits discrimination in credit transactions based upon certain protected classes, including sex, race, color, national origin, religion, marital status, age, and "because all or part of the applicant's income derives from any public assistance program." Alternative data may pose fair lending risks if they are correlated with ECOA-protected characteristics, such as race or ethnicity. In these cases, lenders' uses of alternative data to make credit decisions could result in disparate impacts.

Privacy and Consumer Protection Issues. Some prospective borrowers may be unaware that alternative data have been used in credit decisions, raising privacy and consumer protection concerns. For example, some consumers may not know what specific information alternative credit scoring systems use and how to improve the credit scores produced by these models. In an effort to address such concerns, many consumer reporting agencies and firms use alternative data only when consumers choose to participate (i.e., opt-in).

Regulator Policy. The CFPB and federal banking regulators have been monitoring alternative data developments in recent years. In December 2019, they released a brief policy statement on the appropriate use of alternative data in the underwriting process, highlighting the potential benefits and risks. The release followed an October 2017 statement from the CFPB, outlining nine principles for consumer-authorized financial data sharing and aggregation. These principles included, among other things, consumer access and usability, consumer control and informed consent, and data security and accuracy.

Selected Legislation: 116th Congress

Using alternative data for credit underwriting continues to be the subject of congressional interest and legislative proposals. In the 116th Congress, the House passed H.R. 3621, the Comprehensive Credit Reporting Enhancement, Disclosure, Innovation, and Transparency Act of 2020 (Comprehensive CREDIT Act). Among other things, this bill would direct the CFPB to report to Congress on the impact of using nontraditional data on credit scoring. In addition, in most cases, it would allow payment history of rent, utilities, and telecommunication bills to be furnished to the credit reporting agencies.

CRS Resources

CRS Report R45979, *Financial Inclusion and Credit Access Policy Issues*, by Cheryl R. Cooper.

CRS Report R46332, *Fintech: Overview of Innovative Financial Technology and Selected Policy Issues*, coordinated by David W. Perkins.

CRS Report R45631, *Data Protection Law: An Overview*, by Stephen P. Mulligan, Wilson C. Freeman, and Chris D. Linebaugh.

CRS Report R44125, *Consumer Credit Reporting, Credit Bureaus, Credit Scoring, and Related Policy Issues*, by Cheryl R. Cooper and Darryl E. Getter.

Cheryl R. Cooper, Analyst in Financial Economics

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