Alternative data & financial inclusion

Data mining to expand access to credit

By Ruth Susswein

O ne in ten Americans is “credit invisible,” according to the Consumer Financial Protection Bureau (CFPB), because they have either old, limited or no credit history. For the 26 million U.S. consumers without a credit file or credit score, that translates to little, if any, access to affordable loans and credit cards.

FICO, the credit scoring giant, estimates that when you exclude those consumers with “inactive” credit—meaning old payment histories and too little new data—the figure jumps to more than 50 million people who are deemed “unscarable.” That’s a lot of people with no access to credit.

Lenders traditionally have relied on credit history and associated credit scores to make lending decisions. A traditional credit score includes credit bureau data about your credit history and associated credit evaluations, 15 to 20 million additional consumers could have access to auto loans, credit cards and other bank products.

For someone who consistently makes rent and utility payments on time, inclusion of alternative data could improve the chances of receiving a loan. LexisNexis estimates that when alternative data is included in credit evaluations, 15 to 20 million.

While not well-defined, alternative data includes payments not found on a traditional credit report, behavioral information, or trends in how you handle your finances. Alternative data is used to verify identity, interpret individuals’ credit risk and judge a person’s character to reduce default and fraud.

These alternative data sources include rent, cable, cellphone use or gas and electric payment histories, typically not on a credit report, but which can prove a record of timely, regular payments. Other alternative data, such as occupational licenses, bankruptcies, collections activity, homeownership status and property values, are drawn from public records.

For someone who consistently makes rent and utility payments on time, inclusion of alternative data could improve the chances of receiving a loan. LexisNexis estimates that when alternative data is included in credit evaluations, 15 to 20 million additional consumers could have access to auto loans, credit cards and other bank products.

However, some alternative data

“Data mining” continues on page 2

Survey: Don’t use ‘behavioral data’ to assess credit risk

96 percent of consumers polled think it’s unfair to evaluate based on social media habits

By Alegra Howard

C onsumer Action conducted an online survey in April, April 6 to April 21, 2017. Ninety-six percent of respondents said no. A similar penalty-pricing model can be found in auto insurance quotes—several respondents freely mentioned that they had been quoted higher insurance rates because of bad credit, and they objected because credit was unrelated to their driving history.

Another concern consumers voiced repeatedly, in the optional comment field, related to inaccuracies found in traditional credit reports. (A 2012 study by the Federal Trade Commission found one in five consumers had an error in at least one of their three credit reports (bit.ly/26nV2z4). Many worried that the use of alternative data might further compound inaccuracies due to errors and disputes in their utility and cellphone bills, negatively impacting their credit profiles. The survey (bit.ly/3h5t1u5) was conducted online and received 2,410 responses between April 6 and April 21, 2017. ■

The eight alternative data choices the consumer might pay all monthly bills on time and carry less debt.

When credit scores don’t reflect timely and honest payment of bills or a lone tenure in a single job or home, they can present an incomplete and undeservedly negative appraisal of a consumer.

Alternative data advocates argue that this is particularly problematic for low- and moderate-income consumers, who have fewer opportunities to demonstrate a pattern of responsible behavior and build a positive credit history. The non-profit Credit Builders Alliance (CBA) tested the effectiveness of rent payment reporting to help low-income housing residents improve their credit scores. In its pilot project, the CBA found (www.creditbuildersalliance.org/downloads/4f490) that nearly 80 percent of participants experienced an increase in credit scores, by an average of 23 points, due to rent reporting, and 100 percent of those who had no score before the project ended up with a credit score in the upper subprime or prime tiers.

Conversely, the National Consumer

“Helpful” continues on page 3

Consumer Action
1170 Market Street, Suite 500
San Francisco, CA 94102

Non-Profit Org.
U.S. Postage
Paid
San Francisco, CA
Permit # 10402

Change Service Requested

www.consumer-action.org • Summer 2017
Behavioral data may affect access to credit

By Alegra Howard

Traditional lenders in the U.S. have shed away from using some of the more counterintuitive alternative data sources, like educational attainment and social media profiles, to score consumers. But these data points are being examined to their potential in gauging credit risk.

Financial technology (fin-tech) firms seeking to capture a bigger slice of the traditional U.S. lending market make use of alternative data in their predictive consumer credit models. Lenders in emerging markets in Africa, Asia and Central America are also quick to sources to provide financial services to millions of people who don’t have traditional credit histories.

In some cases, consumers in developing regions around the world are sacrificing their privacy to obtain loans they might not otherwise qualify for. Because some of the data points being used and studied and what they may help decision makers glean about consumers:

Education levels. Higher level of education and the schools you attended can be used to assess credit risk. Why? Those with advanced degrees, for example, or those who attended by League schools, will likely have higher earning potential than high school grads or those who attended a two-year college.

A Federal Reserve Bank of Boston study showed that consumers with, out a college degree tend to have lower credit scores. The study found that one additional year of school—raising an individual’s credit score by eight points and reduces the probability of bankruptcy by 3.3 percent.

Student loan debt also was consi considered. A 2015 report by student loan servicing company Earnest showed that graduates with the highest levels of student loan debt, associated with advanced degrees in the medical or legal fields, had substantially lower credit scores than borrowers with medium-sized student loan debts.

Cellphone and mobile phone usage, the time of day you make calls, how long you talk, your texting frequency, text length and even the model of your phone are data points that could help determine your credit risk.

Fin-techs like Branch and Tala factor in the apps you download, Wi-Fi network access and your mobile wallet balances to help determine if they’ll give you a loan. Microlender Tala, offering credit in emerging markets in Africa, Asia and Central America, states that consumers who organize more than 40 percent of their payments and transactions by both first and last name are more likely to be “good borrowers.”

The grammar or punctuation you use in a text message may deem you more creditworthy. Fin-tech lender Lenddo, operating in 20 developing nations, claims your battery level is useful in determining your likelihood of defaulting on a loan. If your battery’s always empty, they surmise you are less likely to plan ahead—a potential sign that you’ll miss payment credits.

Social media usage: While Facebook may not record the amount of personal information it makes available to third parties last year, potential employers and landlords in the U.S. and banks in developing nations may ask your permission to search your social media profiles.

Micro-lenders operating in emerg ing nations argue that whom you’re friends with might suggest how trustworthy you are. Peer-to-peer lenders in China are giving loan applicants the option to use their friends list to help get their loans approved.

Conversely, lenders in developing nations considering consumers for credit will assess whether you post photos and videos with friends and followers are already bank customers. The social network is a platform to expand credit history and credit stability of its customers and might judge you by association. If your social network is filled with friends with bad credit, companies that use such data could label you a credit risk.

Keyword searches from your online activities also could be evaluated.

To date, we’ve seen no evidence that conventional lenders in the U.S. are using these unconventional methods to determine credit risk.

However, U.S. credit analysts and credit card companies are studying the value of behavioral information in predicting a consumer’s ability to repay debt. If such information were ever used to vet customers, current financial regulations, such as the Fair Credit Reporting Act (FCRA) regulations, which give consumers the right to receive a written explanation contest inaccurate information and to receive a written explanation when they ask for one, could be overhauled to ensure that they address accuracy and fairness for all types of loans.
Credit scores for those without traditional credit

By Lauren Hall

The Consumer Financial Protection Bureau (CFPB), the federal watchdog for consumer safety in financial products, is keenly interested in encouraging lenders to open access to credit for more consumers.

In the months ahead, the CFPB will be measuring the benefits and risks of using unconventional, non-credit-related sources of data to underwrite loans. Currently, lenders use credit scores that draw on an individual’s history of repaying extensions of credit. The CFPB is hoping that new lending practices using alternative information will help underserved consumers access affordable credit, auto, and personal loans.

The Bureau is encouraging these new ideas through its Project Catalyst program (www.consumerfinance.gov/about-us/project-catalyst/)

which gives companies extra leeway to create products and services, particularly if they will help under- served individuals gain access to financial opportunities.

Credit scores for those without traditional credit

In April, Consumer Action (www.consumeraction.org) and others who have suggested that alternative data is being used and have outlined the limitations of traditional credit scores and expressed support for the responsible use of non-credit-related information to help the millions of consumers who are “credit invisible.”

The CFPB outlined the limitations of traditional credit scores and expressed support for the responsible use of non-credit-related information to help the millions of consumers who are “credit invisible.”

The CFPB is keenly interested in encouraging lenders to open access to credit for more consumers with little or no credit history.

CFPB Hearing on Alternative Data

At the hearing, advocates, including the National Consumer Law Center and Americans for Financial Reform, joined financial industry representatives to discuss the pros and cons of using various types of non-credit-related data, from trended cellphone payments to social media posts. Advocates expressed concerns about the value and accuracy of some alternative data sources. The panelists also discussed how government should regulate alternative data collection.

While the CFPB acknowledged that the use of alternative data could benefit some consumers, it also said it recognizes that its use “could make borrowing harder for consumers who have strong credit scores but are weighed down by other factors, such as missed utility payments or frequent address changes, that aren’t traditionally found in credit reports.”

The Bureau will study how alternative data is being used and evaluated for underwriting by both traditional banks and online lenders. It will also look to hear from those who work with programs using alternative data, those underwriting loans and pre-screening applicants, and the public who have views on the non-traditional data in credit decisions.

The CFPB’s “request for information” is currently exploring:

• whether the use of alternative data could increase access to credit;

• whether the use of alternative data could make credit decisions more complex for both consumers and industry;

• what effect the use of alternative data might have on the costs of lending and borrowing;

• how alternative data might affect consumers, and whether personal information is collected, shared and used in credit decisions; and

• whether alternative data could benefit or harm underserved consumers or particular groups (servicemembers, minorities, etc.) when alternative data is used to determine creditworthiness.
Making mortgage credit more available

By Ruth Susswein

A bout five million renters could afford to purchase a home but they lack traditional credit scores, according to mortgage finance giant Freddie Mac. But millions of creditworthy consumers without traditional credit scores do have payment histories. Regular, on-time utility and cell phone payments could help borrowers qualify for a home loan. While there is no consensus on a definition for “alternative data,” there is agreement on the value of using non-traditional information, like rent and cell phone payments, to assess a consumer’s ability to repay a mortgage.

Measures used to evaluate consumers for mortgage credit are beginning to expand so that eligibility can increase for a broader group of borrowers. Fannie Mae and Freddie Mac (the quasi-governmental corporations that purchase mortgages from lenders to keep credit flowing) have been using old-fashioned credit scoring models. Critics say the old models do not accurately predict if people will repay a mortgage. However, there’s been some recent progress. For those with no credit score, Fannie Mae now allows lenders, in certain circumstances, to qualify borrowers for a mortgage using rent payment history plus another form of non-traditional data, such as a 12-month record of utility, telecom, childcare or insurance payments. For first-time homebuyers, Fannie Mae’s system also calculates “trended data,” which examines the proportion of bills paid each month on your credit card bills. Just the minimum, or do you pay in full? Those consumers with a trend toward paying their credit card balances quickly or paying in full every month are considered a less risky bet. This may help some people qualify for a mortgage.

Freddie Mac also allows lenders to qualify consumers using four non-traditional accounts, such as a year’s worth of timely rent and utility payments plus two other accounts, such as regular contributions to a savings account and recurring childcare or insurance payments. About half a million homebuyers without traditional credit scores are obtaining Federal Housing Administration (FHA) loans each year, according to the Office of the Comptroller of the Currency (OCC). However, FHA loans require borrowers to pay for mortgage insurance, which increases overall costs. (Mortgage insurance protects the bank’s investment but doesn’t insure the homeowner.) Meanwhile, lawmakers are trying to require that alternative non-credit-related data be included in mortgage and other lending evaluations.

The Credit Access and Inclusion Act of 2017 (H.R. 435) would require that rent, utility and telecom payments be furnished to credit bureaus to help improve access to credit. The Credit Score Competitiveness Act of 2017 (H.R. 898) was introduced to expand the use of various credit scoring models to increase access to home loans.

New reporting rules could boost credit scores

By Monica Steinreich

C hanges in the way credit reporting agencies (CRAs) report certain types of debt are expected to boost the credit scores of millions of consumers by at least a little. Here is how certain debits, or errors, will soon be removed thanks to an overhaul of credit reporting practices.

Tax liens, civil judgments
Beginning July 1, CRAs will remove all reported tax liens and civil judgments from credit reports that are missing complete consumer details, which include name, address and Social Security number or birthdate. On top of that, the big three CRAs—Equifax, Experian and TransUnion—will have to remove liens and judgments if public court records aren’t checked for updates at least every 90 days.

The changes come following mounting pressure on credit bureaus to improve the accuracy and quality of their data. FICO estimates that 12 million U.S. consumers will benefit from the reporting changes. FICO projects that the vast majority of those affected will see a credit score increase of less than 20 points. The credit score boost may make credit more available to those who are close to qualifying.

Medical debt
As part of a settlement with the New York Attorney General’s office, Equifax, Experian and TransUnion agreed to delay reporting medical debts on credit reports for 180 days. The six-month delay allows reasonable time for health insurance claims to be processed and errors or confusion about payment responsibility to be ironed out. Prior to this change in 2016, medical debt could be as little as 30 days delinquent to be reported.

Outstanding medical debts are now also dropped from consumers’ files if a creditor or collection agency or debt buyer reports the debt as paid in full, or as soon as it’s paid by an insurance provider, rather than be stuck on a credit file for the next seven years.

FICO and VantageScore had previously revised their credit scoring formulas to remove medical debt. FICO says this change could potentially increase scores by up to 25 points.

With roughly half of all debt collection items being for medical bills, according to a Consumer Financial Protection Bureau (CFPB) study, these changes affect tens of millions of consumers.

Fines and tickets
The three major credit bureaus also stopped reporting unpaid parking and traffic tickets, including speed camera citations, court fees and fines, vehicle storage fees, toll road fees, library fines and eviction fees, in 2016. With the change, local governments and counties lost the threat of a damaged credit score as leverage to get people to pay. (However, failure to pay vehicle-related citations can still build up onto a registration renewal.

Thanks to updates in some scoring models, newer FICO scores ignore collection accounts with balances of less than $500. VantageScore ignores all paid collections, as well as unpaid collections under $250. These and other significant changes in credit reporting practices—including an improving dispute resolution process—are largely the result of a 2016 settlement with 51 state attorneys general and greater CFPB oversight of credit reporting agencies. The federal watchdog agency’s attention to credit bureau improvements is partially in response to the thousands of complaints consumers file with the consumer agency against credit bureaus each year.

Helpful? Continued from 3
be delinquent payments rather than timely ones, for now.
FICO’s XD scoring system helps to score “credit invisibles” by including even more types of alternative data, such as cellphone and cable payments. (For details, see the story at the top of page 3.)

Risks
Some lenders automate part of the credit approval process to save time and reduce costs. Critics caution that incorporating certain types of alternative data into an automated credit analysis could lead to unintentional discrimination.

The concern is that the use of new, non-traditional factors might paint an inaccurate, negative picture of a segment of the population—for example, characterizing military families whose duty requires them to be away due to military being unstable—or unintentionally discriminate based on race or ethnicity by using ZIP code or similar types of data.

There’s also a concern about the ability of consumers to identify and correct inaccuracies when alternative data is part of the automated decision-making process. Credit reports already are notorious for containing errors. Alternative data may be more likely to contain errors if the standards for accuracy are more lax than those for traditional data. It may also be more difficult for consumers to identify and correct those errors since they may not know that certain non-financial data is being used to evaluate them.

Innovations from financial technology (fintech) companies could help to expand access to credit, but could also increase risks for consumers, at least in the early stages, since fintechs generally aren’t constrained by the same rules as credit bureaus and “furnishers” (those who report consumer payment history to bureaus).

The Consumer Financial Protection Bureau (CFPB) has launched an inquiry into ways to expand access to credit for consumers who lack the credit history needed to obtain a credit score. (For more about this, see “Watchdog weighs risks, benefits of data use” on page 2.)