White paper

ALTERNATIVE CREDIT DATA

State of alternative credit data

experian

The state of alternative credit data is changing. Since the launch of our inaugural report last year, alternative data has gained usage in the lending space. At Experian®, we're at the forefront of data accuracy, analytics and innovation. With more than 220 million credit-active consumers in our traditional credit universe, we're constantly pursuing more ways to accurately assess the creditworthiness of the entire universe of credit-eligible consumers. That's why alternative data is the answer. Traditional credit data and scores have long been a staple in the financial services space, and it's time to address the different ways consumers are accessing credit. From the online lending boom to the rise of fintech lenders and providing credit in non-conventional channels, there are now more ways to evaluate a consumer's stability, ability and willingness to repay.

We're taking a closer look at why alternative data, specifically alternative credit data, is essential to consumer lending.

What are the different types of alternative data? What is the difference between alternative data and alternative credit data? What types of regulations relating to alternative data have come out since last year? And most importantly, **how are lenders using this data?**

By having a deeper understanding of what this data can provide and how it can be plugged into your lending cycle, lenders can be better equipped to evolve their credit models for the future. **Let's dive into the universe of alternative data.**

Alternative credit data for consumer lending

In this universe, there's a distinct difference between alternative data and alternative credit data.

Alternative data is anything beyond your traditional credit data: loan and inquiry data on cards, auto, and student and mortgage loans, typically with a term of 12 months or greater. Alternative data can be used in many different ways, including in the investment world. Some fintechs have also used social media as alternative data to drive their business.

However, in this case, we'll specifically focus on alternative credit data for the consumer lending universe. **Alternative credit data is set apart in that it's Fair Credit Reporting Act–compliant in its usage;** that means it's displayable, disputable and correctable by the consumer. Each planet below represents a key data asset in the alternative credit data universe.

Alternative Financial Services (AFS) data

- Includes loan types such as online and storefront, short-term unsecured, non-prime installment, auto, rent to own, and buy here pay here
- Often includes real-time data

Full-file public records data

- Goes beyond basic reportable data in the traditional file
- Includes property and asset information, address stability, education, identity verification, risk factors, and professional licensure at the state and local levels

Consumer-permissioned account data

- Facilitates real-time access of consumer and commercial bank data at the transaction level
- Features verifications of income; account ownership; cash flow; assets; and bill payments, including utility and telecommunications

Rental data

Data from property managers, rental collections agencies payment processors that includes lease terms, on-time payments and late payments

Consumer-permissioned:
The next frontier of alternative data

Account aggregation. Consumer-permissioned. Open banking.

We touched on the future of alternative credit data in last year's report. Since then, there have been some exciting developments in this space. Most notably, an entirely consumer-driven product, Experian Boost,™ aims to improve credit scores by adding telecommunications and utility data to traditional credit reports.

Experian **Boost**™

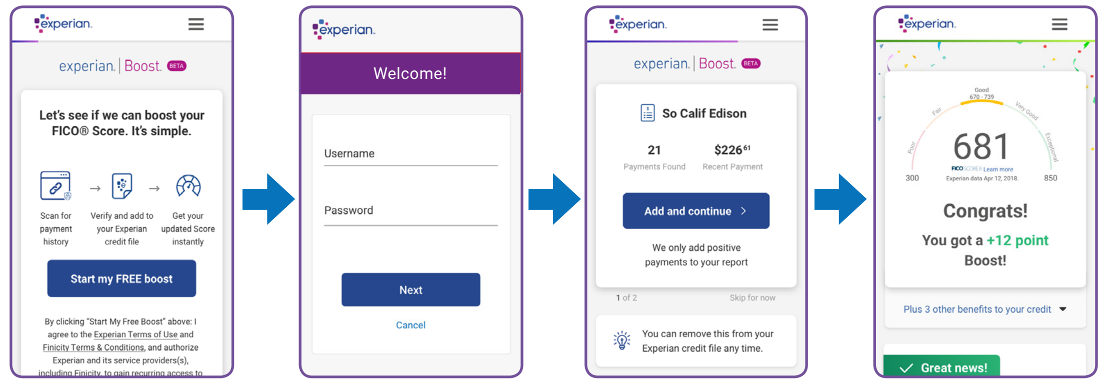
Experian Boost is an entirely consumer-driven process that allows consumers to give read-only access to their bank accounts and add in positive utility and telecommunication bill payments to their credit file to change their scores in real time.

How to access

Through experian.com, this data can be added or removed at any time by the consumer.

Impact on lenders

Lenders capture the value of added tradelines in their current processes (online and batch) and recent scores (FICO, VantageScore®) that use this data.

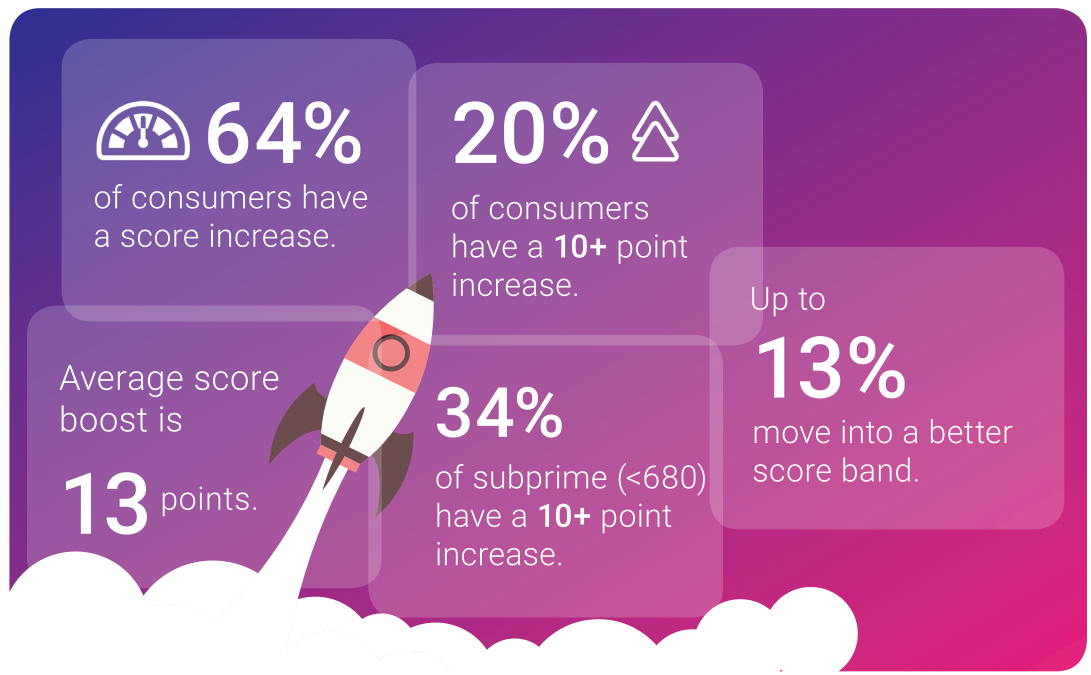


Enroll | Log in to bank account | Validate payments/ Add to profile | Real-time rescore

> "Limited credit activity and history are key barriers for consumers to achieve their financial goals. We fully support initiatives that promote financial inclusion and think Experian Boost could play an important role in overcoming that barrier. We look forward to seeing how Experian's new platform impacts consumers."

Dara Duguay
Executive Director, Credit Builders Alliance

Experian Boost Quick Stats

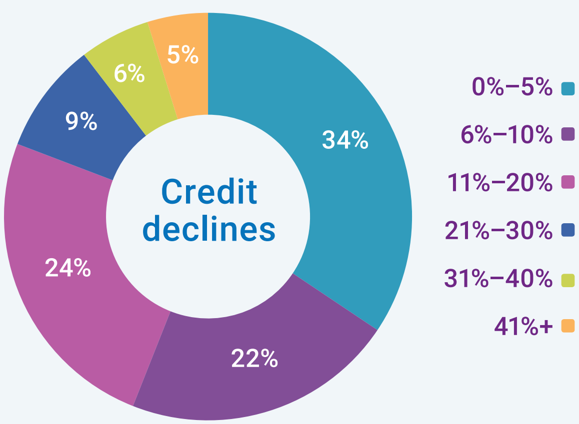


Deep dive into **perceptions** on alternative data

As the lending landscape becomes increasingly competitive, consumers have more choices than ever when it comes to lending products. As a result, both traditional and nontraditional lenders are looking for new insights to help refine their lending models. Adding to this opportunity, more than 45 million U.S. consumers[1] lack a credit report or have too little information to generate a credit score, creating barriers to providing consumers with credit. Unlocking the power of alternative credit data could be the key to maximizing portfolio performance while opening up programs to a new generation of borrowers. **Experian conducted online surveys with lenders and consumers to better gauge usage and perceptions of alternative credit data.**

Lenders

According to Experian's 2019 lender survey on alternative credit data, **two-thirds (66%) of lenders decline more than 5% of applicants** due to insufficient credit history.



Q. Approximately what percentage of applicants were declined during the last 12 months because there was insufficient credit information to make a lending decision?

As lenders strive to improve decisioning, many are already combining the power of the credit profile with additional information.

65% of lenders say they are using information beyond the traditional credit report to make a lending decision.

When lenders were asked what additional sources of information they are currently using to make a lending decision, **the top three additional sources of underwriting information include:**

Verification of income	73%
Verification of employment	70%
Property judgments	68%

But looking to the future, lenders plan to expand their sources for insight. The top three information sources lenders say **they plan to use in the future are:**

25%	Trended data
24%	Rental payment history
19%	Telephone and utility payment history

[1] *Kenneth P. Brevoort, Philipp Grimm, Michelle Kambara. "Data Point: Credit Invisibles." The Consumer Financial Protection Bureau Office of Research. May 2015.*

Consumers

Consumers also see the benefits of sharing additional financial information and contributing positive payment history to their credit file. Convenience and the ability to access more favorable credit terms were seen as the primary benefits of sharing additional financial information. However, security is a concern when it comes to sharing financial information digitally.

54% of consumers agree that **allowing lenders to digitally access financial data** is more convenient than providing hard copies of documents to lenders.

28% of consumers agree that **digitally accessing financial data is more secure** than providing hard copies.

58% of consumers agree that **having the ability to contribute payment history** to their credit file makes them feel more empowered.

Lender insights

Top 3 challenges of using alternative data:

1. Complying with laws/regulations — 19%
2. Data quality — 15%
3. Developing/Testing new models — 14%

75% of lenders believe consumers will agree to permission their data as long as they're permitted access control.

83% of lenders agree that digitally connecting financial account data will create efficiencies in the lending process.

Consumer insights

42% of consumers believe they are a better borrower than their credit score represents.

61% of consumers believe that adding payment history would have a positive impact on their credit score.

Top financial information consumers are willing to share when applying for a home/auto loan:

1. Utility bill payment history — 58%
2. Paycheck stubs — 56%
3. Checking/Savings transactions — 48%

Survey details

Experian conducted two national online surveys with both credit providers and consumers regarding attitudes, awareness and use of alternative data.

For the lender survey, 239 partial and completed responses were collected across industries including banks, credit unions, auto finance, mortgage, bankcard issuers and utility providers. The lender survey was fielded March 25 to April 12, 2019. Fifty-six percent of participants were banks and credit unions. Thirty percent work for organizations that reported asset sizes exceeding $1 billion.

For the consumer survey, Experian conducted a nationwide online survey of 540 respondents balanced to the U.S. Census. An additional oversample of 146 consumers was also gathered to provide insights at the generational level. The consumer survey was fielded April 26 to May 3, 2019.

Regulatory update

Recent regulatory papers on alternative data regulation point to a need for further guidance from the agencies.

A recent research paper[2] released by the Federal Reserve Bank of Philadelphia found alternative data usage on the rise in fintech, which helped some borrowers who would have been classified as subprime by traditional criteria to qualify for lower-cost credit options. The paper also found that using alternative data for extending these loans did not cause higher loan delinquency within a two-year time frame. As fintechs are rapidly adopting these new data assets, traditional financial institutions are partnering to evolve with the new lending environment.
The paper concludes:

> "Certain alternative information could play a key role in allowing lenders to fully understand the credit quality of the potential borrowers and thus be willing to grant certain consumers access to credit that would not have been granted otherwise."

The paper specifically compared loans made by a large fintech lender, Lending Club, and similar loans originated through traditional banking channels. The subject of alternative data, specifically fintechs' usage, and its implications to the rest of the financial services industry continues to be explored in a U.S. Government Accountability Office (GAO) December 2018 report titled "Agencies Should Provide Clarification on Lenders' Use of Alternative Data."[3] The report found that two recent trends in fintech lending include significant growth and continued partnerships with traditional financial institutions such as banks. As such, some of the fintech lenders the GAO interviewed used alternative data to supplement traditional data used in making credit decisions. The report, **voicing the concerns of banks and fintechs, strongly encouraged regulators to provide specific guidance on the use of alternative data in underwriting**.

[2] *Jagtiani, Julapa and Lemieux, Catharine. "The Roles of Alternative Data and Machine Learning in Fintech Lending: Evidence from the LendingClub Consumer Platform." Federal Reserve Bank of Philadelphia. April 2018; Revised January 2019.*

[3] *"Agencies Should Provide Clarification on Lenders' Use of Alternative Data." United States Government Accountability Office. December 2018.*

Using **Alternative Data**

Understanding how alternative data can be used as part of the lending process is an essential key to success in staying relevant and competitive in the evolving world of consumer lending and credit. For example, analysis of alternative financial services data (as represented by Experian's Clarity Services data) shows that borrowers lean younger than those who are on traditional credit files. It's imperative to adopt these types of data earlier on so that as millennials and younger borrowers mature and desire larger loans as part of their life milestones, such as buying a car or home, lenders will already have a deeper knowledge of their credit risk and competitively price for these loan products.

Marketing

A depository institution looks at demand deposit account (DDA) transaction data to identify customers making payments on loans offered by lenders to see if they can win that business.

Identity verification

Expanding identity verification using document verification, mobile phone account data (name and address of the person to whom the device is registered) and identity data used for alternative lending.

Underwriting

A financial institution uses alternative financial services data to identify good credit risks who have nonprime credit scores but good alternative loan repayment histories.

Account review

A financial institution uses alternative financial services data to see if a normally prime borrow begins using alternative data products.

[4] Parrish, Leslie and Fishman, Judy. *"Alternative Data Across the Loan Life Cycle: How FinTech and Other Lenders Use It and Why." Aité Group in partnership with Experian. December 2018.*

A Closer Look at Fraud

As alternative credit data is revolutionizing the consumer lending marketplace, it's important to recognize the implications on the borrowing population. This expansion of credit will reach far and wide across the socioeconomic spectrum — especially for those under 35 years old, who use less traditional and less credit-visible financing options. Through this revolutionized lending marketplace, they — along with millions of others — will see their borrowing power increase.

As this transformation of the consumer landscape unfolds and lenders pursue these new pools of potential customers, a simultaneous and equally valuable transformation must take place in fraud analytics. New borrowers with newfound borrowing power will make attractive new targets for fraud and identity theft. While the very nature of this new credit data supports the legitimacy of the identity, lenders will need to ensure the identities being presented are the true owners.

Experian is leading a simultaneous revolution in fraud technology. Our award-winning **CrossCore® platform** offers lenders access to a wide range of Experian and third-party tools that deliver the data and capabilities needed for robust identity verification.

From fraud analytics that capitalize on device intelligence, email address and phone ownership to recognizing a customer based on biometrics or authenticating them based on an identity document, **Experian offers capabilities that enable lenders to confidently expand services and unlock borrowing potential in this expanded marketplace from a fraud-risk perspective.**

Learn more about CrossCore and available identity verification tools: experian.com/crosscore

"Best Overall Identity Proofing Platform"
(Javelin Strategy & Research, CrossCore®)

"Fraud Prevention Innovation Award"
(CrossCore®)

Alternative financing
in small-business lenders

Small businesses are impacted by short-term lending in the United States. Nine percent of business owners see value in these injections of capital — gap coverage options for emergency expenses or payroll in a pinch to maintain growth. **Experian sees the benefits these types of products provide to small and emerging businesses in their performance and stability.** In general, new business owners will use consumer credit to fund their business and add stability in the growth phase. In the past, funding a new venture required the business owner to seek investment capital to get the business off the ground. Today, there are many short-term options to choose from — marketplace lenders, fintechs, financial institutions, and more of these lenders are willing to lend to entrepreneurs.

9% of small-business owners find value in short-term lending products

34% decrease in bad rate compared with those small-business owners that did not use short-term lending

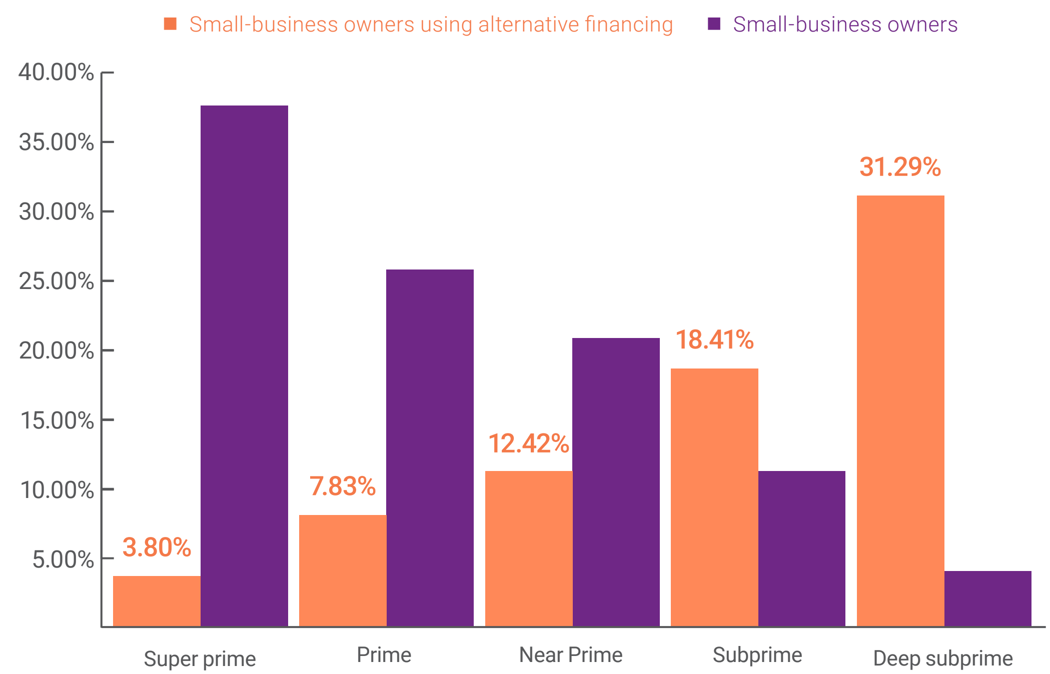
Where we see benefit

- New business owner profile
- Owner income less than $75K per year
- Low-limit high-rate credit cards

Younger generations, Gen X and Gen Y, and small-business owners account for **58%** of those business owners using short-term lending

OVERALL HIT RATES: (GENERIC COMMERCIAL RISK SCORE)[5]

Percentage of business owners in each score band who have alternative finance



[5] *Intelliscore Plus V2 used in this example*

Unique **solutions**

Experian's pursuit of alternative credit data has been driven by its mission to be the Consumer's Bureau. Over the past 10 years, there have been thoughtful steps and innovations that have led to where we are today. Experian Clear Data Platform™ was launched to enable more complete credit decisions and greater access to credit for millions of Americans. This platform pulls together the most extensive forward-thinking assets and products on alternative credit data.

Alternative Finance Data

Featuring Experian's Clarity Services, the largest specialty credit bureau, with more than 62 million consumers on file;

- **Clear Credit Attributes™**
- **Clear Fraud Attributes™**
- **Clear Early Risk Score™**

Rental Data

Featuring Experian® RentBureau®, with more than 20 million consumers;

- **RentBureau data**

Full-File Public Records Data

Featuring exclusive partnerships to gain a clear view of thin-file consumers;

- **Extended View℠ score**
- **Full-file public records attributes**

Consumer-Permissioned Data

Featuring the latest technology and innovations to provide a seamless, secure process for the consumer;

- **Experian Boost™**

To learn more about Experian's alternative data solutions, visit experian.com/alternativedata.

The rise of **Machine Learning and Big Data**

Today, as lenders have the ability to collect more data than ever about their clients and prospects, they are continually finding ways to automate and scale. In the credit decision process, financial institutions are using artificial intelligence (AI) and machine learning (ML) solutions to make smarter and more precise decisions.

ML has evolved in recent decades to encompass improved analytic tools, techniques, and trained data scientists to understand and build the process. For alternative credit data, the combination of these two powerful innovations will fuel successful implementations in scaling this data for precise credit decisions.

Big data is a key differentiator in who can create the best models and test them for maximum impact. Analytical sandboxes are driving the path forward in testing business results. For those who are new to alternative credit data, having the tools and talent to test and validate it will fulfill a big piece of the puzzle that will come into play for the future.

On top of all of this, new platforms and tools are being created to flow this data into one access point. All of these factors may come into play as alternative credit data becomes mainstream, ultimately revealing and creating opportunities for today's diverse consumer base.

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