White paper

2020 state of alternative credit data

Introduction

Since last year's annual report, alternative credit data* has continued to gain popularity among financial institutions. In both times of growth and economic volatility, Experian® is constantly pursuing more ways to both extend and improve the methods by which lenders evaluate borrowers' risk. By leveraging alternative credit data, lenders can get a more complete view of creditworthiness, allowing them to make better decisions and consumers to more easily access financial opportunities.

In this white paper, we'll take a closer look at why alternative credit data is essential to consumer lending. We'll explore:

- How alternative credit data is being used across the lending marketplace
- What regulations have come out since last year pertaining to alternative credit data
- How to reduce financial volatility in times of extreme uncertainty
- What the future of alternative credit data holds

The better you understand what this data can provide and how it can be used to enhance your decisioning, the sooner you can unlock your portfolio's growth potential and expand your consumer universe.

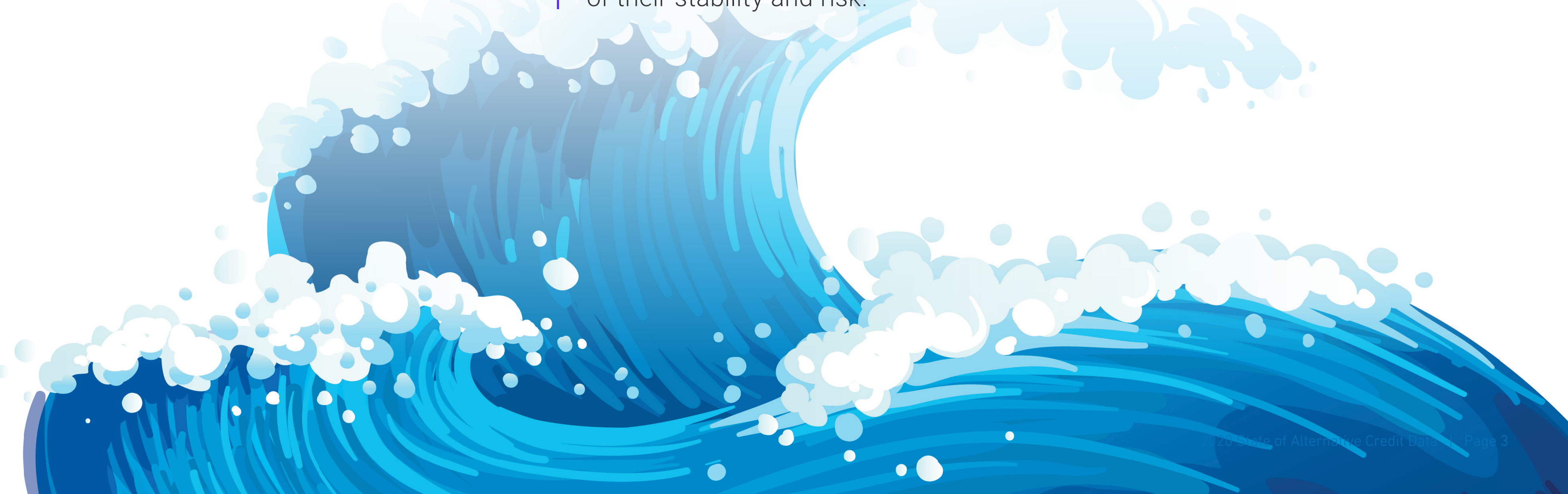
Ready? *Let's take a deep dive into the world of alternative credit data.*

* *When we refer to "Alternative Credit Data," this refers to the use of alternative data and its appropriate use in consumer credit lending decisions, as regulated by the Fair Credit Reporting Act (FCRA). Hence, the term "Expanded FCRA Data" may also apply in this instance and both can be used interchangeably.*

Riding the wave of **alternative credit data**

For millions of “credit invisibles” who may not have access to mainstream credit options due to limited credit histories, alternative credit data may be primary data — especially, if it can help them qualify for their first line of credit or personal loan. For others, such data might be considered supplemental. It can be matched with an applicant’s traditional credit bureau file to provide a richer credit profile and lead to better lending decisions.

In our data-driven industry, “alternative” data may best be summed up as FCRA-regulated (displayable, disputable and correctable) data that isn’t typically included in traditional credit reports. Hence, the term “expanded FCRA data” may be used interchangeably. **For traditional data, think loan and inquiry data from traditional lenders on bank cards, auto, mortgage and personal loans; typically trades with a term of 12 months or greater**. While traditional credit data contains core information about a consumer’s credit behavior, it may not be enough for a lender to formulate a complete evaluation of their stability and risk.



Discovering **new lending opportunities**

Lenders leverage alternative data to enrich decisions across the entire credit lifecycle and meet the financial needs of their customers. Some examples of alternative credit data include alternative financial services data from nontraditional lenders, consumer-permissioned account data, rental data, fullfile public records and aggregation. Because this data shows a holistic view of the customer, it can drive greater visibility and transparency around inquiry and payment behaviors. These insights help lenders expand their consumer lending universe — all while improving profitability and mitigating risk.

Not only can the addition of alternative credit data help thin-file consumers by dramatically increasing their ability to meet lenders' eligibility requirements, but it can also help applicants on the cusp of approval move to higher score bands and qualify for better loan terms and conditions. Additionally, insights from alternative data sources can provide a more accurate assessment of marginal consumers whose ability and willingness to pay aren't wholly recognized by traditional data and scores.

How non-prime consumers **can benefit**

Securing traditional credit can be challenging for non-prime consumers, whether it's due to limited credit history, high-risk credit behavior or an unexpected financial burden. Fully understanding industry trends and consumer behavior is key to providing your consumers with the financial services they need.

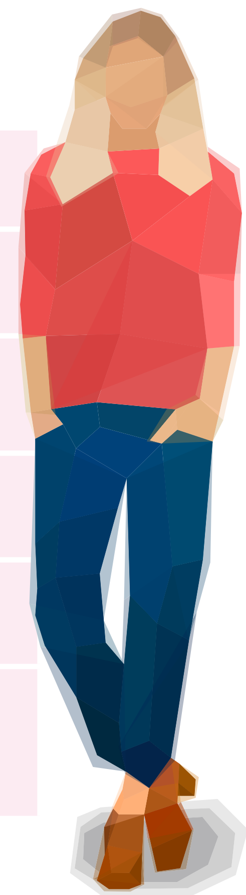
Alternative credit data can help align these consumers with the right credit products and provides lenders with a deeper view of each consumer's unique situation.

Let's explore the demographics of online applicants with alternative financial data available, with a first-observed application in 2019.

When compared to brick-and-mortar borrowers in 2019, online borrowers were more likely to be female and married.

Experian's Clarity data provides a deeper view of non-prime borrowers so lenders can make better and more informed decisions throughout the entire consumer life cycle. By leveraging Clarity alternative data attributes and insights, including income and employment data, financial institutions can grow their portfolios while managing risk.

Average age:	39
Median annual net income:	$31,500
% female:	49%
% married:	65%
Average VantageScore® 4.0:	582
% with any delinquent or derogatory traditional trades in last 12 months:	28%



Findings from application and loan data in Clarity's specialty credit bureau from 2015 through 2019. Study sample of 500 million consumer loan applications and 30 million loans.

Reducing portfolio volatility in today's economic environment

Today's rapidly changing economic environment directly impacts consumers' financial behavior, causing a need for lenders to be able to gain deeper insight into consumer sensitivities for more precise credit decisioning. By pulling in alternative credit data, **you can further evaluate current applicants and the performance of portfolios at any point in the economic cycle, particularly during periods of economic uncertainty**.

As an example, let's look at the impact of the ongoing coronavirus (COVID-19) pandemic on consumer lending. When it comes to consumers...

69% are worried about their finances, including disposable income.

59% fear they may not be able to pay down existing debt.

78% say their household income has been negatively impacted.

1 in 5 plans to open a credit card within the next six months.

28% have contacted a lender to make payment arrangements.

69% of those who had contacted a lender were granted an acceptable repayment option for at least one of their bills.

In the face of severe financial stress, the adoption of alternative credit data allows lenders to more closely assess a consumer's creditworthiness and reduce their credit risk exposure without unnecessarily impacting financially stable or more "resilient" consumers.

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[1] *Findings from Experian survey of over 1,400 consumers throughout the United States. The survey was fielded March 27–April 3, 2020 and was among consumers age 25+, representative of census (on age, ethnicity, region, gender and household income).*

Fortifying **commercial lending**

Small businesses are living in unique times, tested with macroeconomic pressures, public health closures and supply chain challenges impacting their ability to operate at full capacity. The current economic environment mandates that lenders and trade creditors take proactive steps to analyze exposure within their commercial portfolios, assess account-level performance and create a strategy to manage future risk. **Core commercial credit data is powerful in helping to establish commercial identity and firmographics, identify corporate linkages and monitor businesses' payment behavior and stability.**

Let's look at COVID-19's overall impact on commercial small business lending:

10%+	13%	37%	$600B+	30%
increase in commercial delinquencies	decrease in consumer spend	of small businesses with supply chain disruptions	in government assistance through federal programs	of small businesses with less than four weeks of operational cash on hand

When evaluating a business's risk, alternative data helps lenders gain a more holistic view of stability and resiliency. For example, social media data can be used to assess the velocity of foot and digital traffic. Better understanding a business's capacity to operate efficiently, both digitally and as a storefront, can be critical in assessing their ability to generate cash flow when presented with external challenges.

Additionally, leveraging macro event data, which includes virus spread data, municipal closures data, industry impact data and macroeconomic data, can enhance the core lending decisioning process to broaden small business risk assessment and forecasting.

The CARES Act Provides Assistance to Small Businesses.

Census, U. (2020, June 18). Small Business Pulse Survey.

Exploring the **collections ecosystem**

With alternative credit data, you can more easily identify those likely to miss payments, better predict future behavior and deliver the best treatment option based on a consumer's specific situation.

With a deeper understanding of overall credit risk, you can apply more targeted engagement strategies that are specific to each borrower so you can be confident your collections process is individualized, efficient and fair. The result? **A cost-effective, compliant process focused on retaining valuable consumers, reducing losses and improving collection rates.**

The benefits of integrating alternative credit data into your collection efforts include:

- A more robust data management strategy to proactively design post-deferment and post-forbearance collection treatments
- Enhanced model performance through unique behavior and account information related to short-term loans and other alternative loan products
- Better assessment of consumers' ability to pay with deeper insight into place of employment, banking information and income
- Increased right party contact rates using updated, supplemental consumer contact information

The combination of our alternative credit data attributes and advanced analytical techniques (e.g., different types of machine learning) will help you proactively manage your portfolio and enhance your collections and recovery strategies.

Experian (2019). The Next Big One.

Aite (2019). Alternative Data Across the Loan Lifecycle.

Lender results are in

A growing number of lenders are beginning to realize the numerous benefits of layering alternative credit data, which would allow them to more easily identify consumers they would like to target, as well as those who are higher risk. **Experian conducted online surveys with lenders and consumers to better gauge usage and perceptions of alternative credit data.**

The primary benefits of using alternative credit data:

- Assess ability to pay
- Manage account portfolio
- Universe expansion

74% of financial institutions claim to currently **use other information** in addition to traditional credit reports when reviewing an application for credit.

89% of lenders agree that alternative credit data allows them to **extend credit** to more consumers.

96% of lenders agree that in times of economic stress, alternative credit data allows them to more closely evaluate consumers' creditworthiness and therefore **reduce their credit risk** exposure.

98% of lenders agree that digitally connecting financial account data would allow them to **streamline their lending process**.

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At WSECU, we strive to help our member’s reach their financial goals. Alternative credit data allows us to help more members without taking on additional credit risk and improve the speed and accuracy of our credit decisions.

Stacy Lucero, VP of Loan Administration, WSECU

Leveraging alternative credit data is critical to our innovation efforts. It helps us gain a better understanding of consumer behavior and identify consumers that are potentially in distress before their bureau scores reflect it.

CRO, multichannel auto finance company

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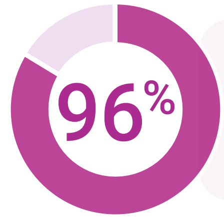
The consumers have spoken

More consumers are becoming comfortable with sharing their data, especially in the face of severe financial stress, provided they see clear benefits for doing so, like qualifying for a loan when they might otherwise be declined or improving their interest rates.

Top financial information consumers are willing to share:

1. Utility bill payment history – 84%
2. Cell phone payment history – 83%
3. Rental payment history – 80%

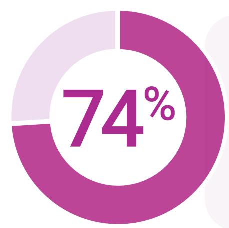


of consumers in the market for credit say that COVID-19 has **negatively impacted** their household income.

3 out of 4 consumers believe they're a better borrower than their credit score represents.

Roughly **half of consumers** fully understand the steps they need to take to improve their credit score.

of consumers would likely share various types of financial information with lenders if it meant **increased chances for approval** or improved interest rates on credit.



of consumers believe that giving lenders access to their financial data via their bank account would be **more convenient** than providing hard copy documents.

Survey details

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

For the lender survey, 136 partial and completed responses were collected from financial institution representatives who have the responsibility of choosing their organization's data services. The financial institutions survey was fielded in April 2020.

For the consumer survey, Experian conducted a nationwide online survey of 504 respondents who were planning to apply for credit within the next three months, with survey invitations balanced to the U.S. Census. The consumer survey was fielded from May 1 to May 5, 2020.

Giving credit scores a **boost**

Last year, Experian introduced Experian Boost™, a first-of-its-kind financial tool that empowers consumers to add positive utility, telecom bill and Netflix payments directly into their credit file to improve their FICO® scores in real time. Through experian.com, this data can be added or removed at any time by the consumer. To date, **over 35 million** total points have been boosted, leading to a credit score increase for more than 2.5 million consumers.

Here's a reminder as to how both consumers and lenders benefit from Experian Boost:

Consumers

By increasing their credit score, consumers can more easily gain access to the loans they need while paying lower interest rates and fees.

Lenders

Lenders capture the value of added tradelines in their current processes (online and batch) and recent scores (FICO® & VantageScore®) that use consumer data, leading to improved risk prediction and approval rates.

Experian's Client July 2020 data deck "Client Existing Portfolio Boost Score Summary"
Experian Consumer Services Demographic Report, September 2, 2020
Experian's Boost Insights Report, September 2, 2020

Use Case

Home equity lender, Spring EQ, recommends Experian Boost to all applicants near credit score thresholds to help them qualify for more desirable loans and terms.

"We're continually striving to unlock the goals of homeowners by providing them with the best possible rates and terms. Experian Boost allowed us to provide our customers with the right loan at the right time."

Jerry Schiano
CEO, Spring EQ

Experian Boost™ quick Stats

65% of consumers have a score increase.

27% of consumers have an **11+ point** increase.

32% of subprime (<680) have an **11+ point** increase.

Average score boost is **13 points.**

12% of consumers move into a better score band.

Average number of trades added is **2.**

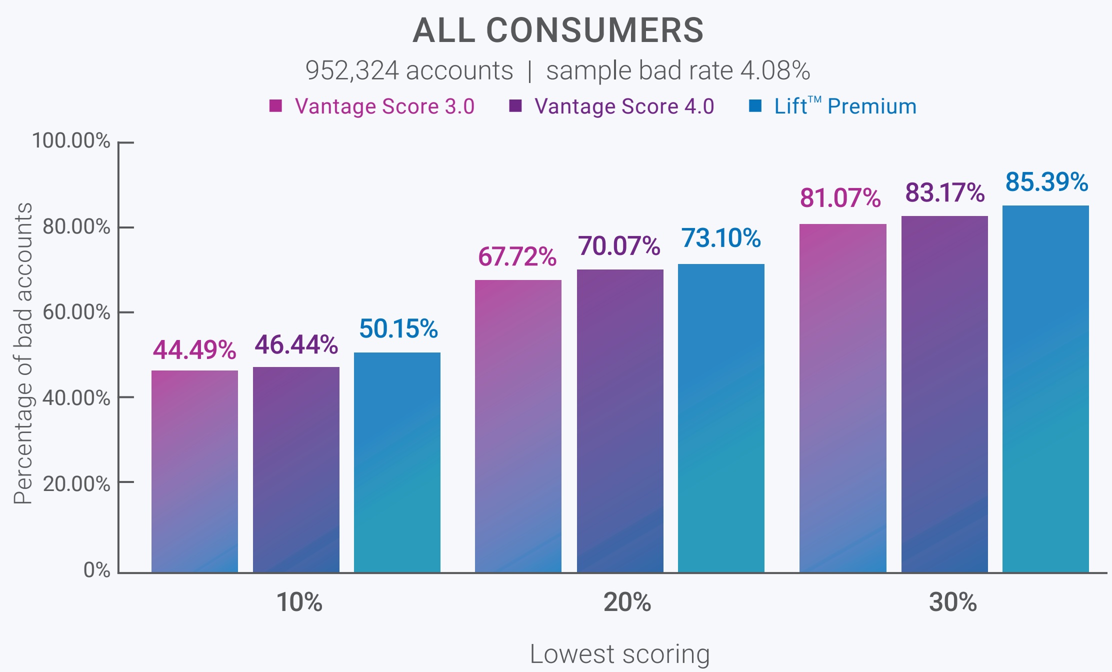
421K consumers have added Netflix on-time payment history to their Boost accounts.

Seeing the **bigger picture**

At Experian, we're innovating how to betterutilize data to identifying ways we can make access to credit faster and simpler for millions of consumers. With the introduction of Experian Lift™ Premium and the FICO® Resilience Index, we've recently hit some significant milestones in the ways that we harness and use alternative credit data to solve pressing business and consumer challenges.

Experian Lift™ Premium

Experian's advanced credit score that aggregates the best FCRA-regulated data assets to unmask lending opportunities and deliver an all-new standard for predictive performance and accuracy.



"Experian's new score is the latest change aimed at helping lenders make more loans to consumers with no or limited borrowing histories."

The Wall Street Journal

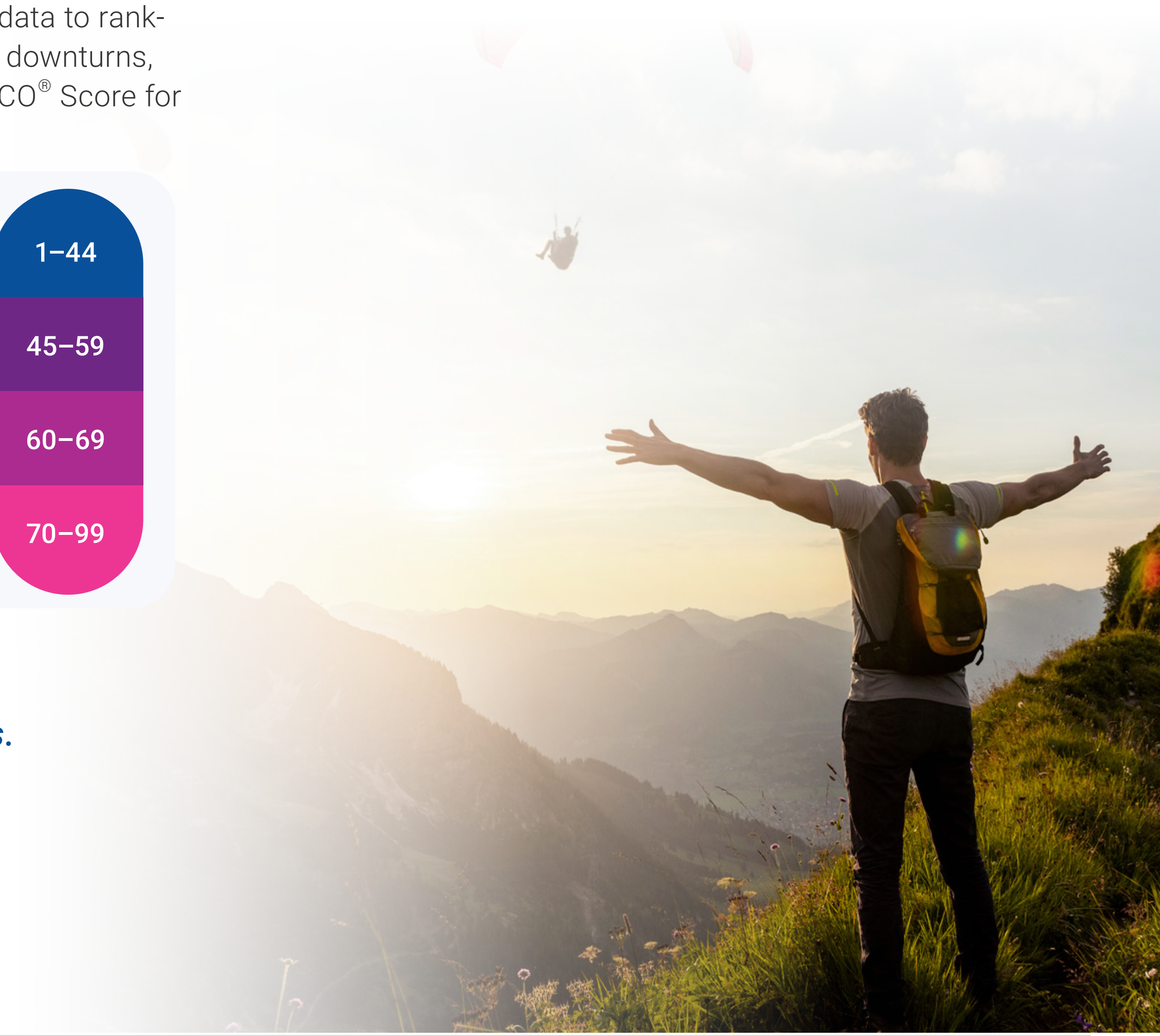
FICO® Resilience Index

This score leverages traditional consumer credit data to rank-order consumers by their sensitivity to economic downturns, offering a simple, powerful complement to the FICO® Score for an array of use cases.

Consumers with a lower index rating are more resilient.

Higher index rating indicates more sensitivity to shifting economic conditions.

More resilient	1–44
Moderate	45–59
Sensitive	60–69
Very sensitive	70–99



We're better together:
More data. More coverage. More insights.

The Wall Street Journal. Hairdresser, Plumber, Lawyer: A Job License Could Help You Get a Loan.

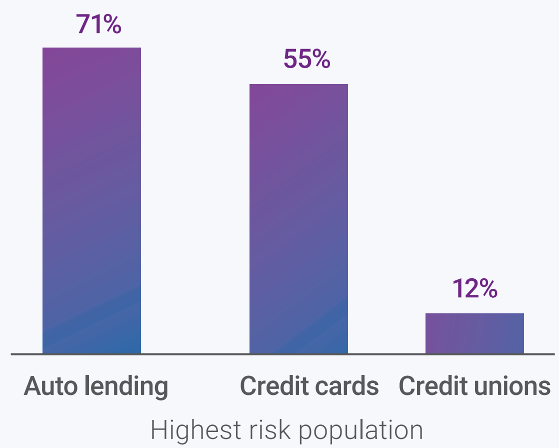
The new **credit profile**

Powerful information from alternative financial services data sources can help lenders identify cyber attackers hiding behind fraudulent credit profiles or synthetic identities. Synthetic identities are made to look like real applicants with good credit scores and histories but are fabricated by cybercriminals to perpetrate fraud. These identities are constructed using a blend of real and fake data, such as an address from one person mixed with another's Social Security number or a credit privacy number.

With no standard definition in the market, synthetic fraud is often undetected and can lead to significant losses that are miscategorized as credit losses. **To combat the growing threat of synthetic identity fraud, Experian launched Sure Profile™, a, key innovation to the credit profile, powered by the Ascend Identity Platform.™**

By leveraging Experian data on over 220 million consumers, **Sure Profile provides a composite history of a consumer's identification, public records and credit information to determine the associated risk of synthetic fraud.** The ability to pull data from multiple sources into a decision engine helps underwriters identify riskier consumers and supports the aggregations and analysis of identity information and relevant consumer behaviors to better predict synthetic identity traits, beyond that of a traditional credit portfolio.

Industries with increased risk to **synthetic identity fraud**:



Findings from Experian's Precise ID platform demonstrating the percentage of PID-processed applications that fell below the highest 10% rule-score threshold for specific industries from January 1 – May 31, 2020.

Navigating the changing regulatory tides

The influx in the use of alternative credit data is leading to increased regulatory scrutiny and new due diligence questions for lenders. As the use of big data will only continue to grow, financial services providers who leverage data outside of the traditional credit file should implement strong governance frameworks and best practices to remain in compliance.

There are several prominent federal regulators that recognize the positive impact of alternative data on the credit system and approve its use in underwriting by banks, credit unions and non-bank financial firms, including:

- **Federal Reserve System (FRS)**
- **Consumer Financial Protection Bureau (CFPB)**
- **Federal Deposit Insurance Corporation (FDIC)**
- **Office of the Comptroller of the Currency (OCC)**
- **National Credit Union Administration (NCUA)**

To ensure compliance before using alternative credit data, you must adhere to all relevant federal and state consumer protection laws and regulations. Additionally, you should have full comprehension of the associated opportunities and risks.

Organizations are navigating new compliance challenges resulting from COVID-19. The Coronavirus Aid, Relief, and Economic Security (CARES) Act has impacted credit reporting under the FCRA, as has new guidance from the CFPB. To help you keep up, here is a brief FCRA-related compliance overview[1] covering various FCRA requirements[2] when requesting and using consumer credit reports for an extension of credit permissible purpose.

[1] *This FCRA overview is not legal guidance and does not enumerate all your requirements under the FCRA as a user of consumer reports. Additionally, this FCRA Overview is not intended to provide legal advice or counsel you regarding your obligations under the FCRA or any other federal or state law or regulation. Should you have any questions about your institution's specific obligations under the FCRA or any other federal or state law or regulation, you should consult with your Legal Counsel.*

[2] *This FCRA overview is intended to be used solely by financial service providers when extending credit to consumers and does not include all FCRA regulatory obligations.*

COVID-19 and **compliance management**

COVID-19 has created unprecedented business and regulatory disruption, challenging financial institutions' operations. Lenders are still trying to figure out how to assess risk between the broader, longer-term impacts of the pandemic and the near-term Coronavirus Aid, Relief, and Economic Security (CARES) Act that extends relief funds and deferment to consumers and small businesses.

To effectively react to the crisis, lenders will need to look beyond traditional lending processes to adjust their underwriting strategies and workflows as they deploy hardship programs while complying with the CARES Act.

By leveraging alternative credit data attributes, all FCRA-regulated lenders can gain a more holistic view of their consumers' credit utilization, including near-term trends on payments, balances and skipped payments.

In response to newly emerging financial struggles, Experian, along with the other CRAs, has created new guidelines for data reporting to assist data furnishers in addressing refinement of their customer management strategies (e.g., payment holidays, repricing, term amendment and forbearance management).

Sailing into the future

Alternative credit data is the future of financial inclusion, enabling lenders to extend credit to more consumers using next-generation data sources to power both traditional and alternative credit models. Access to expanded FCRA data provides opportunity for growth into an untapped market of reliable consumers and is increasingly being applied in tandem with machine learning and other forms of artificial intelligence.

As alternative credit data has become an essential counterpart to the traditional data already used, new platforms and tools are being created to flow this data into one access point, including Experian's Ascend Analytical Sandbox,™ which will enable access to alternative data sources to provide insights that speed decisions about consumers and businesses.

There's depth beneath the surface. Are you ready for the turn of the tide?

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