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Beyond the Score: Navigating the New Frontier of Alternative Credit Data

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LexisNexis® RISK SOLUTIONS

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Executive Summary

This research report examines the current state and future potential of alternative credit data in lending decisions. Alternative credit data includes information not found in traditional credit reports, such as utility bills, rental payments, professional licenses, and public records. The report is based on survey responses from 150 U.S. consumer lending institutions. The key findings from this paper follow:

- Alternative credit data, such as utility bills, rental payments, professional licenses, and public records can provide a more comprehensive view of a borrower's creditworthiness, particularly for those with limited traditional credit history.
- Seventy-six percent of lenders reported improved predictive performance from traditional credit data compared to a year ago. However, 60% are less confident in relying solely on it for future lending decisions, implying a growing appetite for alternative data.
- Lenders are actively exploring alternative data sources; 68% are considering employment/professional licensing data, and 56% are looking at public records in the next six to 12 months to expand their addressable market and gain a competitive edge.
- Alternative data can be valuable throughout the credit life cycle, not just in underwriting. Sixty-two percent of lenders see collections as extremely challenging in the next two years, and alternative data can help prioritize at-risk accounts and personalize outreach.
- The adoption of alternative credit data is likely to accelerate in the coming year as lenders seek to responsibly expand access to credit, mitigate risk in an uncertain economy, and drive growth.

Introduction

In today's rapidly evolving lending landscape, financial institutions (FIs) face unprecedented challenges in accurately assessing creditworthiness, expanding access to credit, and managing risk. Traditional credit data, while still a cornerstone of lending decisions, is increasingly recognized as insufficient to capture the complexities of modern consumer financial behavior fully. As a result, lenders are turning to alternative credit data—a broad category of nontraditional data sources (e.g., utility bills, rental payments, professional licenses, public records) to gain a comprehensive, nuanced view of borrowers' financial lives.

This report delves into the current state and future potential of alternative credit data in lending decisions, drawing on proprietary survey data from 150 U.S. consumer lending institutions. It explores the types of alternative data lenders are considering, the benefits of implementation, and the impact on key stages of the credit life cycle, from marketing to origination to collections. The report is designed to provide actionable insights for senior credit and risk management executives seeking to harness the power of alternative data to drive growth, manage risk, and better serve customers in an uncertain economic environment.

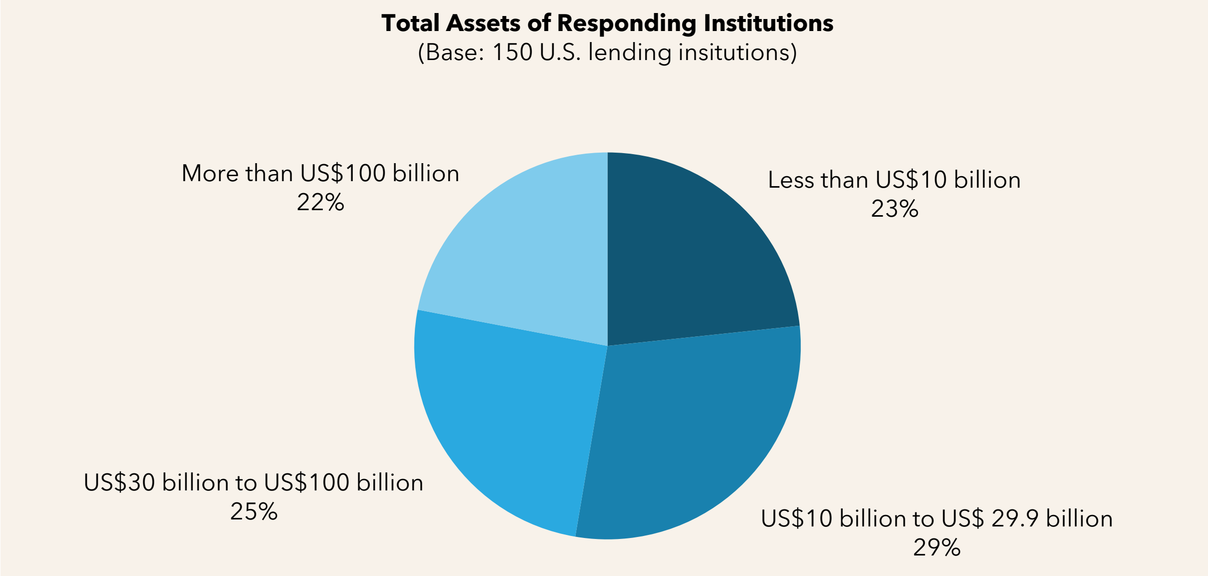
The majority of lenders already express increased confidence in alternative data compared to a year ago; the findings underscore the urgent need for FIs to develop and execute strategic approaches to alternative data adoption or risk being left behind in a rapidly evolving market.

Methodology

The findings presented in this report are based on a comprehensive survey of 150 U.S. consumer lending institutions, including 85% banks, 15% credit unions, and 1% nonbank lenders, conducted by Datos Insights, a leading provider of market intelligence for the financial services industry.

The responding FIs are a cross-section of Tier-1 through Tier-4 organizations (Figure 1).

Figure 1: Total Asset Size of Responding Institutions



Source: Datos Insights survey of 434 global consumer lending institutions, Q1 to Q2, 2024

The survey was administered online in Q2 2024 to senior executives with direct responsibility for credit risk management, including chief credit officers, chief risk officers, and heads of underwriting. Respondents were asked a series of questions about their current use of alternative credit data, plans for future adoption, perceived benefits and challenges, and impact on various stages of the credit life cycle. The survey data was supplemented with the experience and knowledge of Datos Insights Strategic Advisors supported by the Datos Insights knowledgebase and desk research.

The Current State of Alternative Credit Data

Alternative credit data has emerged as a valuable resource for FIs seeking to enhance their credit risk assessment processes. This innovative approach involves leveraging data not found on traditional credit reports to gain deeper insights into a borrower's creditworthiness, enabling banks to make more informed lending decisions. For senior credit managers, understanding the various types of alternative credit data and their compliance with the Fair Credit Reporting Act (FCRA) is crucial in harnessing the power of this new tool while maintaining regulatory compliance.

Not All Data Is the Same

Alternative credit data encompasses a wide range of information not typically found in traditional credit reports. This data can include utility bills, rental payments, and educational background. By analyzing these diverse data points, FIs can paint a comprehensive picture of a borrower's financial stability and repayment capacity, particularly for those with limited or no credit history.

It is essential to note that alternative data can be categorized as either FCRA-compliant or experimental credit data, which is not currently FCRA-compliant. Information regarding utility and rental payments can be used for credit decisions as long as it is obtained from reliable sources and the borrower is notified of its use. On the other hand, experimental credit data, such as social media activity or browsing history, cannot be used for credit decisions without the borrower's explicit consent (Table A).

Table A: FCRA-Compliant Data vs. Experimental Data

Topic	Differences
Purpose of use	• FCRA-compliant data: Used for specific permissible purposes, such as credit decisions, employment screening, or tenant screening • Non-FCRA-compliant data: Used for a wide range of purposes, including marketing, research, or general business purposes

Topic	Differences
Accuracy and fairness	• FCRA-compliant data: Must be accurate, up-to-date, and fairly represent the consumer's information • Non-FCRA-compliant data: May not be held to the same accuracy and fairness standards
Consumer rights	• FCRA-compliant data: Consumers have the right to access their data, dispute inaccuracies, and be informed of adverse actions taken based on their data • Non-FCRA-compliant data: Consumers may have limited or no rights regarding access, disputes, or adverse action notifications
Consent and disclosure	• FCRA-compliant data: Requires consumer consent for certain uses and disclosures of their data • Non-FCRA-compliant data: May not require consumer consent for use or disclosure
Data sources	• FCRA-compliant data: Must be obtained from reliable sources and be verifiable • Non-FCRA-compliant data: Can be obtained from a wider range of sources, including public records or web scraping, with fewer verification requirements
Compliance and liability	• FCRA-compliant data: Data providers and users must comply with FCRA regulations and can face legal consequences for noncompliance • Non-FCRA-compliant data: May not be subject to the same compliance requirements or legal liabilities

Source: Datos Insights

For senior credit managers, leveraging FCRA-compliant alternative credit data can offer significant benefits. By incorporating professional licenses, public records, and demand deposit account (DDA) data, for example, banks can better assess risk for applicants who may not have been approved. Doing so expands the pool of potential customers and also promotes financial inclusion by providing access to credit for underserved populations. Probably the more significant benefit - from a revenue growth perspective - is the refinement of risk-based pricing, allowing for optimized pricing based on the consumer's enhanced credit profile.

Current Sources of FCRA-Compliant Alternative Credit Data

Alternative credit data falls into two categories that support a broader view of the seven factors of creditworthiness.[1]

Alternative Credit Seeking

- **DDA applications:** By analyzing DDA data, lenders gain insights into an individual's banking history, transaction patterns, and financial stability. DDA applications can provide valuable information for risk assessment.
- **Subprime lending applications:** The data obtained from these applications can shed light on a borrower's creditworthiness, repayment behavior, and financial characteristics. It allows lenders to make more inclusive lending decisions and cater to individuals who may not meet traditional credit criteria.
- **Online lending applications:** Utilizing online lending applications as an alternative credit source allows lenders to evaluate the creditworthiness of individuals who may have limited traditional credit data while considering their digital financial behavior.

Non-Credit Events

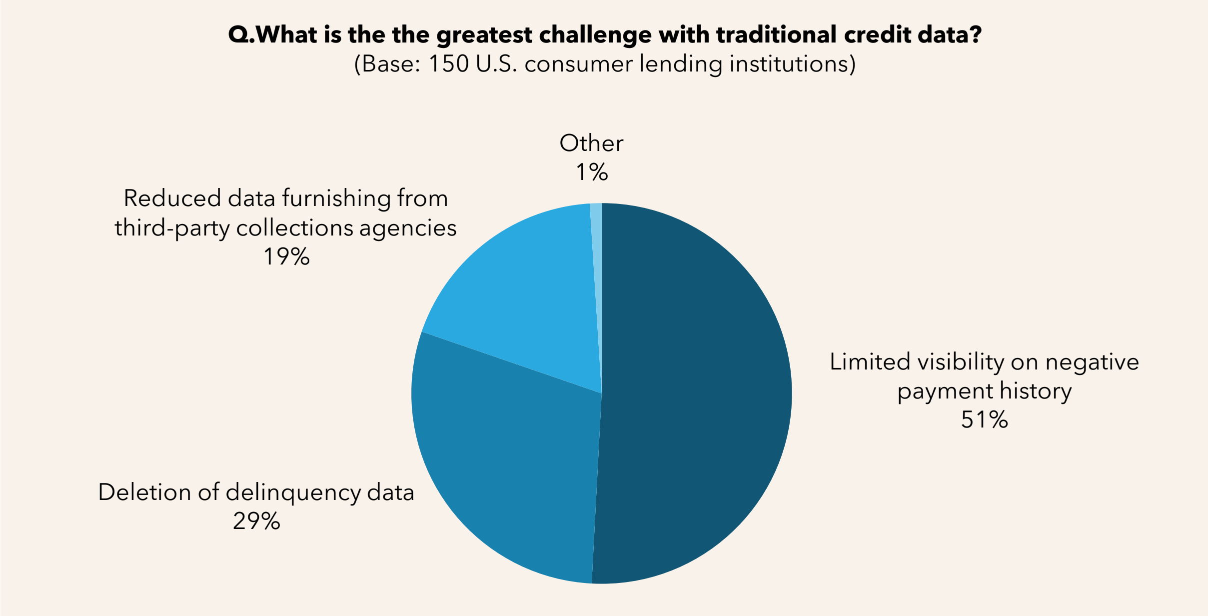
- **Professional licenses:** This information can provide insight into a borrower's expertise, qualifications, and ability to generate income in their field.
- **Public records:** These include information such as bankruptcies, tax liens, judgments, and civil suits. Lenders may use this data to assess a borrower's financial stability, previous legal issues, and overall creditworthiness.
- **Asset ownership:** Ownership of assets, such as real estate or other valuable properties, can indicate a borrower's financial strength and ability to provide collateral. Lenders may consider this information to assess the borrower's overall net worth and capacity to manage credit obligations.

[1] The 7Cs credit appraisal model: character, capacity, collateral, contribution, control, condition, and common sense.

Credit Activity Visibility Gaps

Traditional credit data has been proven to present an incomplete picture of many consumers' financial profiles. These gaps in consumer profiles have encouraged the adoption of alternative data as lending executives have specific concerns about the traditional credit data they are using today. The survey responses reveal that the most significant challenge with traditional credit data is its limited visibility into negative payment history, as cited by 50% of respondents (Figure 2).

Figure 2: Greatest Challenges With Traditional Data



Source: Datos Insights survey of 434 global consumer lending institutions, Q1 to Q2 2024

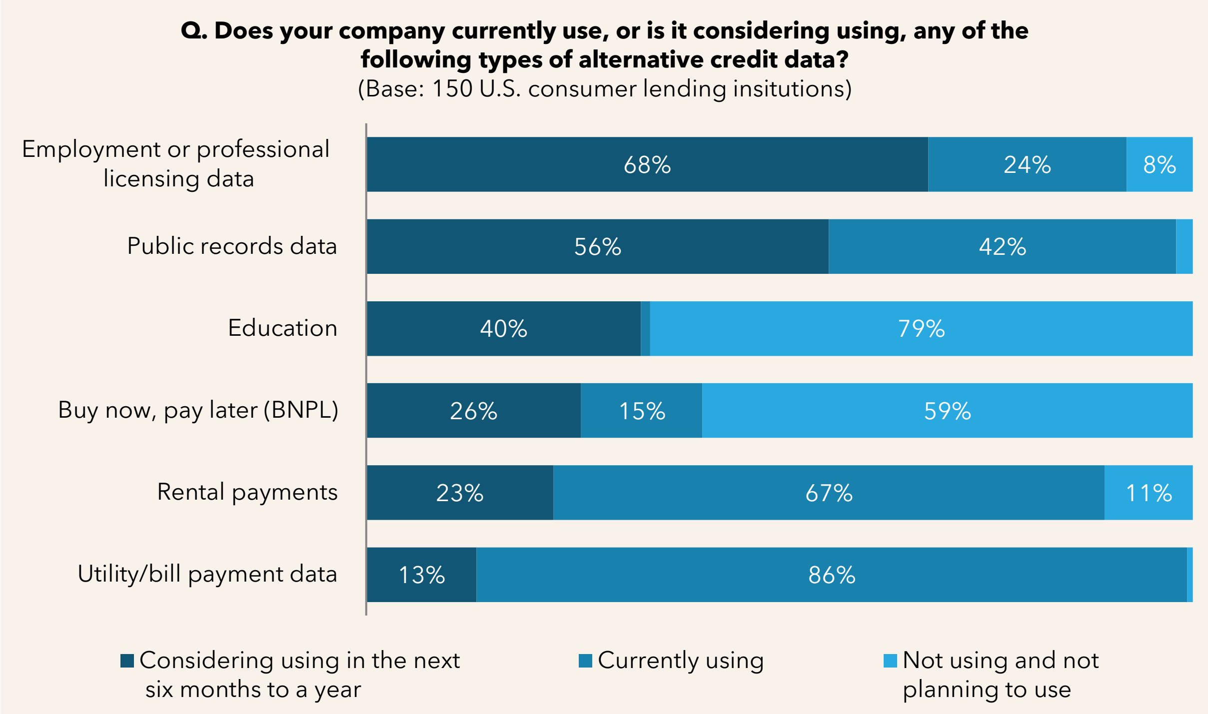
Whether new loan types do not report to the bureaus or increasing regulation reduces what can be reported, the basis on which traditional credit scores are generated is eroding. The gaps likely stem from several factors, including reporting gaps and lags, suppressed derogatory data due to interventions like disaster reporting codes and forbearance programs, incomplete coverage of nonlending bills and emerging finance products, and strategic nonreporting by some lenders.

Forward-looking risk managers are increasingly incorporating alternative credit data sources to address these limitations and gain timelier, comprehensive views of a borrower's financial position and trajectory. Alternative credit data can be a powerful complement to traditional credit data when used responsibly, enabling lenders to spot early signs of distress and adjust their strategies accordingly. Enhancing predictive accuracy through the prudent use of alternative credit data will be crucial for consumer lenders to navigate the next downturn.

Which Data (and When)

After a review of the survey responses regarding current and planned usage of various types of alternative credit data, several key insights and rationales emerge for the institutions, indicating they are considering using alternative credit data in the next six months to a year (Figure 3).

Figure 3: Uses of Alternative Credit Data



Source: Datos Insights survey of 434 global consumer lending institutions, Q1 to Q2 2024

The types of alternative credit data with the highest percentage of institutions considering near-term adoption are employment/professional licensing data (68%), public records data (56%), and education data (40%). These results suggest that many lenders see potential value in the information for enhancing credit decisioning but are still in the evaluation stage before fully committing to using it.

Why Some Data Types Spark More Interest

Employment and professional licensing data could provide additional insights into an applicant's career stability, earnings potential, and overall financial health that are not fully captured in a traditional credit report. Lenders may feel this supplemental data can help identify lower-risk applicants that may have been harder to approve using only conventional credit data. The fact that over six of 10 lenders are actively considering using this data in the near term points to broad interest in testing its effectiveness.

For education data, 40% of lenders are considering adoption in the near term, believing that an applicant's educational background could provide insights into their earnings potential and financial health. However, the majority (79%) are not interested, perhaps feeling it has limited predictive power. Public records data, such as property records, court records, and professional licenses, are being considered by a small number of lenders, likely to help verify application information and spot risk-relevant public data (e.g., bankruptcies, legal issues). While this data is already used in many verification processes, lenders may be looking to make it a more integral part of upfront credit decisioning.

Gaining Insight Into Phantom Debt

The polarized responses for education and buy now, pay later (BNPL) data types suggest a divide in lenders' perceptions of their value for credit decisioning.

Twenty-six percent of lenders are considering BNPL data, potentially seeing it as a way to assess an applicant's short-term borrowing behavior and ability to manage installment payments, particularly for younger or underbanked consumers. Yet, 59% are not planning to use it, possibly questioning its reliability and predictive value. The inclusion of BNPL data not only pulls in additional credit obligations but also provides another unique data point.

Overall, the survey suggests lenders actively explore the potential of less conventional, experimental credit data sources like employment information and social media to enhance credit decisions. However, they are still in the consideration phase as they evaluate issues such as data quality, integration feasibility, regulatory compliance, and model lift. The coming year will likely see a wave of new lenders testing and adopting these emerging data sources as they seek an edge in identifying creditworthy borrowers and managing default risk in an uncertain economy. Unlocking the full potential of alternative credit data will be a key priority and differentiator for innovative lenders.

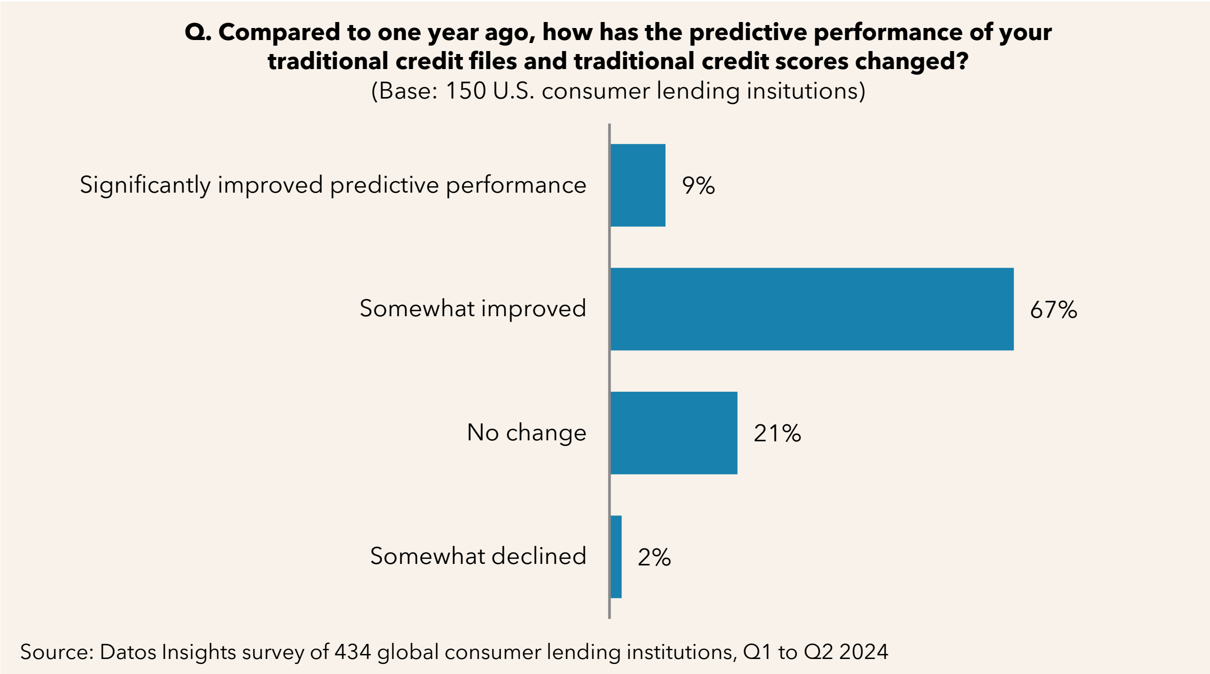
Lenders Are Anticipating Next-Gen Data

Several telling responses explain what credit risk executives are thinking.

Inconsistent Responses

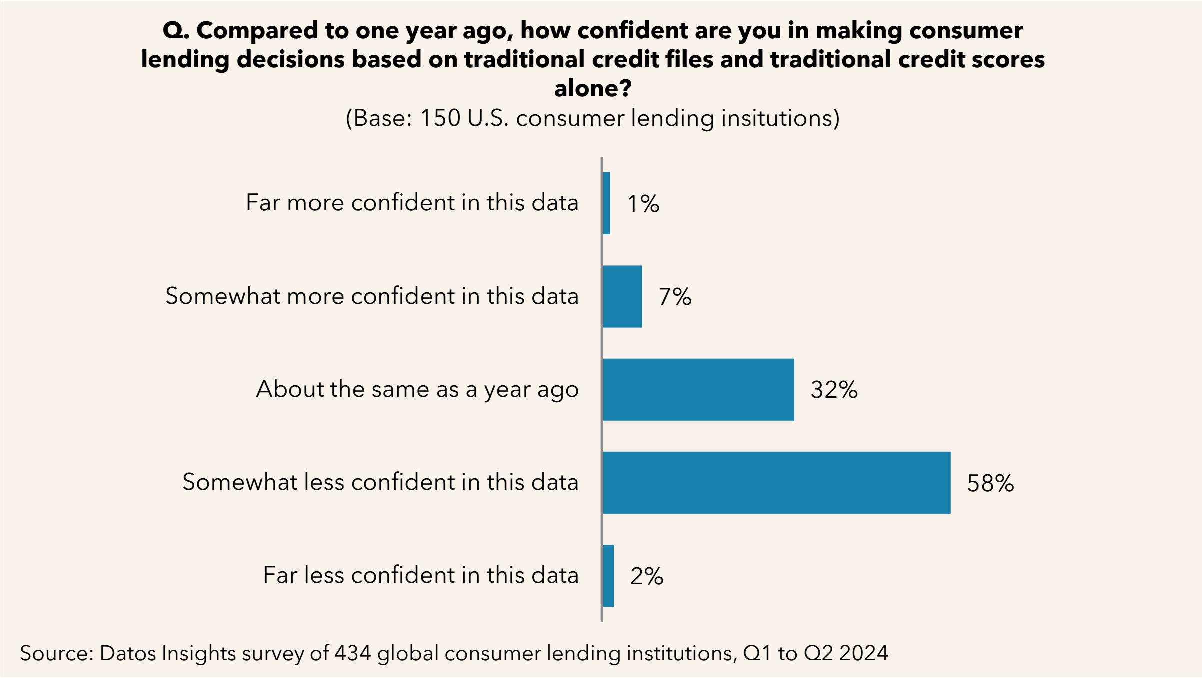
The following reveals an interesting contrast in how consumer lending institutions view their traditional credit files and scores. On the one hand, 76% of institutions feel the predictive performance of traditional metrics has somewhat or significantly improved compared to a year ago, suggesting high satisfaction with the current state and recent enhancements to credit-decisioning data and models (Figure 4).

Figure 4: Credit Data Predictiveness



On the other hand, Figure 5 tells a different story of lender confidence in making credit decisions based on traditional data alone.

Figure 5: Confidence in Traditional Credit Data



A mere 8% of institutions expressed being "far more confident" or "somewhat more confident" in that traditional data for decisioning purposes compared to a year ago. In contrast, a full 60% are feeling "somewhat less confident" or "far less confident."

Lenders acknowledge the improved performance of traditional credit data yet simultaneously lose confidence in relying on it for credit decisioning. What might explain this apparent contradiction? Several factors are at play.

Contributing Factors

U.S. consumer lenders are realizing better predictive performance from their legacy credit data compared to the previous year. Yet, they are also growing less confident in that data as the sole basis for their credit decisioning going forward. A combination of factors, including recognition of inherent limitations in traditional data's coverage and predictive power, anticipation of better-performing alternative credit data sources, the desire to expand access to underserved borrowers, and concerns about future economic conditions, are likely driving lenders to reevaluate their data strategies. The overall strong confidence expressed by 60% of institutions points to an appetite for change and openness to new and enhanced data sources to power consumer lending decisions.

Anticipation of New and Improved Data Sources

Legacy credit files and scores may perform better, but lenders likely recognize that more advanced, alternative credit data sources are now available or on the horizon. They may feel that, even if improved, traditional data is still inherently limited compared to the insights and predictive power promised by new data types (e.g., DDA applications, asset ownership, subprime lending). So, there is likely some "grass is greener" effect happening.

Expanding the Addressable Market

More FIs are recognizing that legacy credit data tends to exclude many of the 45 million thin-file or no-file U.S. consumers, restricting access to credit products.[2] With a growing focus on financial inclusion as a social and business imperative, lenders may lose confidence in traditional data's ability to help them serve underrepresented segments and expand their addressable market. Alternative credit data is seen as key to solving this.

Changing Economic Conditions

Even if traditional credit data is performing well now, lenders may anticipate that its predictive power will degrade in a shifting economic environment. Factors such as inflation, rising interest rates, and the winding down of pandemic-era government stimulus programs could all impact consumer financial health in ways not fully captured by legacy data and models. Forward-looking lenders are likely already seeking alternative indicators.

Satisfaction With the Status Quo

The 32% of lenders that are "about as confident" in traditional data as they were a year ago may be content with their current performance and hesitant to change course. If results are satisfactory and they aren't feeling intense competitive pressure to change, inertia could lead them to maintain the same confidence level in legacy data for now.

Model Improvements

Some of the reported improvements in traditional credit data performance may be attributable to lenders' efforts to enhance their models and decisioning processes rather than the data becoming more predictive. This could contribute to a perception that traditional data inputs are not the real driver of better results.

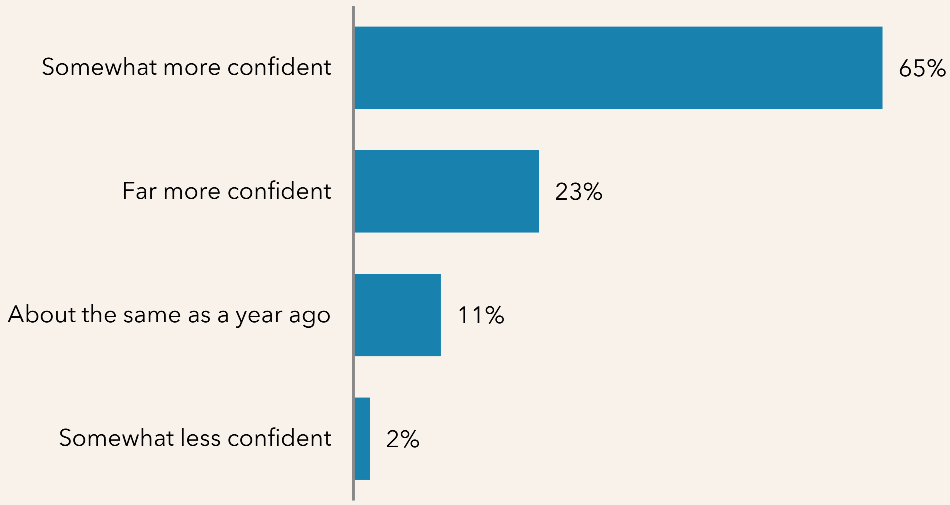
2 "Credit Scoring Alternatives for Those Without Credit," U.S. Government Accountability Office, January 5, 2022, accessed June 20, 2024, https://www.gao.gov/blog/credit-scoring-alternatives-those-without-credit#.

Confidence Is Growing

Several key rationales help explain the lending executives' growing confidence in making consumer lending decisions using alternative credit data and scores. The vast majority of respondents (88%) report being either "far more confident" (23%) or "somewhat more confident" (65%) compared to a year ago. These results suggest a clear positive trend in the adoption of and trust in alternative credit data. Lending institutions are increasingly comfortable leveraging nontraditional data sources and scoring models to assess borrower risk (Figure 6).

Figure 6: Confidence in Alternative Credit Data

Q. Compared to one year ago, how confident are you in making consumer lending decisions based on alternative credit data and alternative credit scores?
(Base: 150 U.S. consumer lending insitution)



Source: Datos Insights survey of 434 global consumer lending institutions, Q1 to Q2 2024

There are a few likely drivers behind this rising confidence level among lending executives:

- As lenders have gained more experience with alternative credit data over the past year, they have likely seen its ability to effectively predict credit risk, especially for traditionally harder-to-underwrite populations like those with thin credit files. Successful outcomes are breeding trust in the alternative approach.
- Regulators may have provided more guidance over the past year on the appropriate use of alternative data, giving lending executives greater confidence that they can adopt it while remaining compliant. Clear rules boost comfort levels.

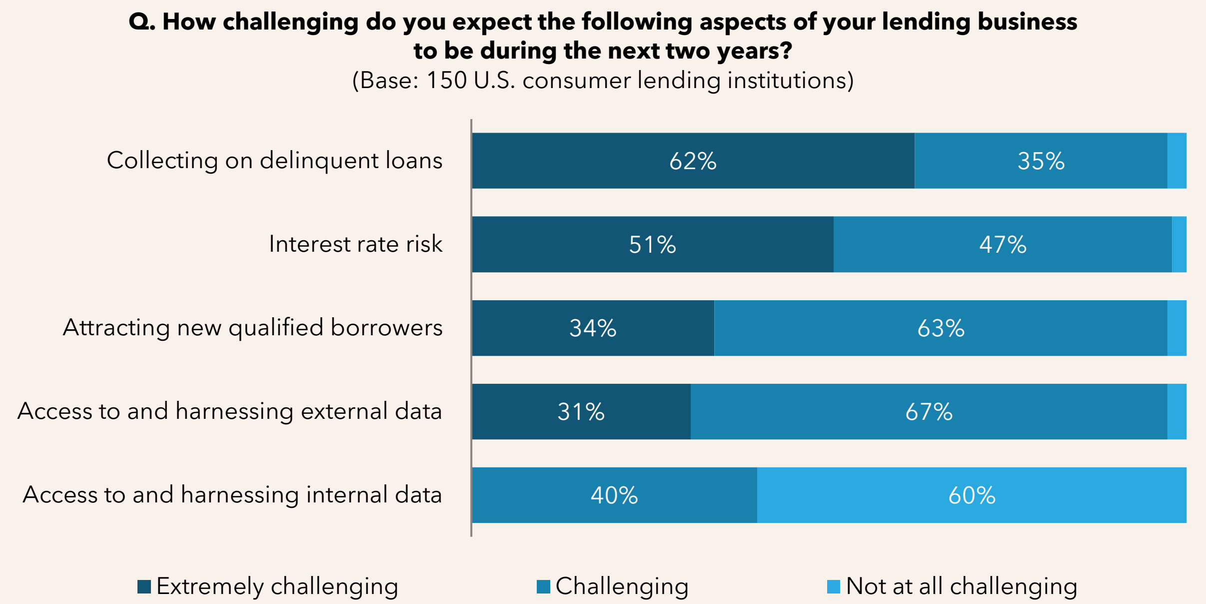
- As more fintech vendors bring alternative credit data solutions to market, the technologies are becoming more robust, standardized, and accessible for lenders to implement. Executives trust solutions with a proven track record.
- Borrowers, especially younger demographics, increasingly expect digital, instant credit decisions. Lending executives recognize alternative data's ability to enable a better customer experience meeting these new expectations.

The survey results paint a clear picture that lending executives are growing increasingly bullish on using alternative credit data to power consumer lending decisions. The combination of proven results, competitive dynamics, regulatory guidance, technological maturity, and customer expectations are all merging to drive a high degree of confidence in this innovative approach to credit risk assessment. This trend will likely continue as the alternative data ecosystem further matures.

It's Not Just About Adjudication

Alternative credit data can solve numerous other credit life cycle issues. The survey found that 69% of U.S. respondents indicated their company's interest in seeking further investment opportunities by leveraging alternative credit data across different phases of the loan life cycle, including marketing, origination, servicing, and collections. The following digs a little deeper into that response (Figure 7).

Figure 7: Challenges for Lending Executives Over the Next Two Years



Source: Datos Insights survey of 434 global consumer lending institutions, Q1 to Q2 2024

Filling the Top of the Funnel

Attracting newly qualified borrowers appears to be at the top of lending executives' minds: 97% find that attracting new borrowers is challenging or extremely challenging. During periods of higher rates and inflation, loan demand will always slow. In the future lenders will lean into alternative data to bolster their ability to acquire creditworthy customers based on new acquisition targeting strategies and expanded product offerings.

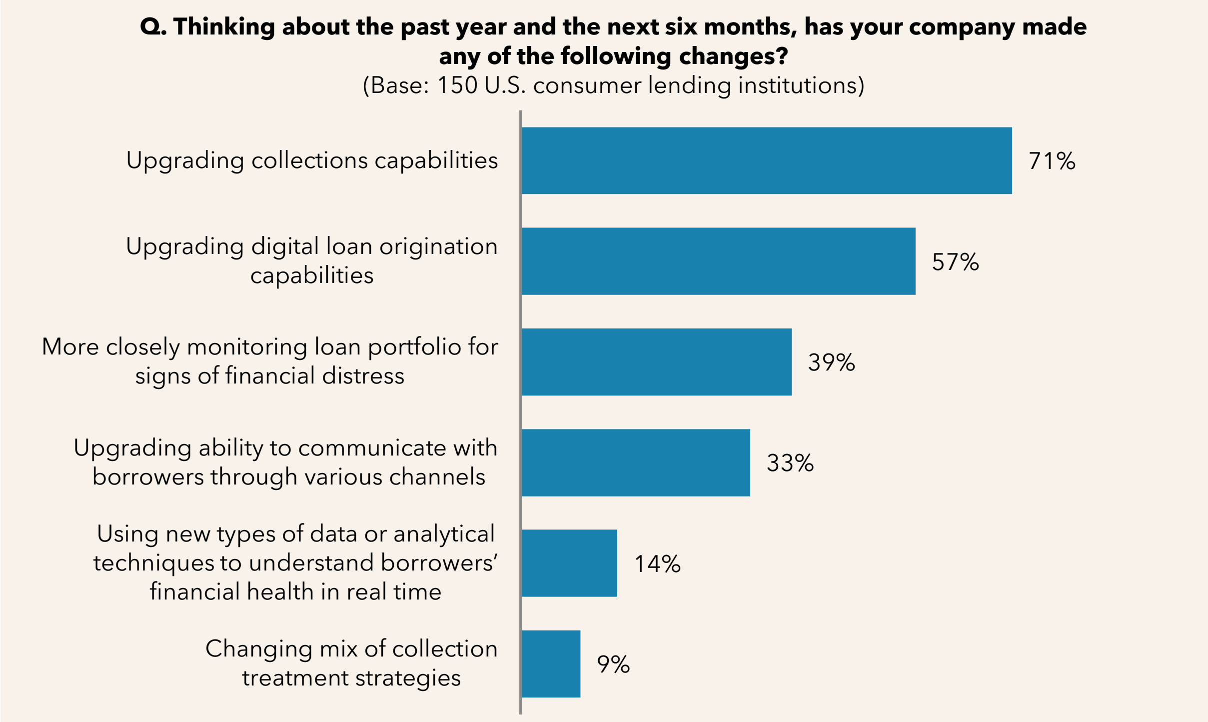
Alternative credit data can help lenders expand their addressable market by identifying creditworthy individuals who traditional underwriting models may overlook. Sixty-five percent of lending executives responded that they were somewhat more confident than a year ago in making lending decisions with alternative credit data. Pricing utilizing alternative credit data can inform more competitive and revenue-optimized offers. At the same time, lenders safely originate loans to underserved segments such as millennials, gig economy workers, and new-to-credit consumers, driving portfolio growth.

Collections

Collecting delinquent loans stands out as the most extremely challenging aspect, with 62% of lenders rating it as such. This result suggests that lenders anticipate increasing loan defaults and delinquencies in the near term.

Several factors could be driving this concern. The economic fallout from the COVID-19 pandemic likely left many borrowers in weaker financial positions and at higher risk of missing payments. Lenders may need to ramp up their collections efforts and consider loan modifications to mitigate losses. Seventy-one percent of lending executives said they were considering upgrading collections capabilities over the past year and the next six months (Figure 8).

Figure 8: Where Changes Are Being Made in the Life Cycle



Source: Datos Insights survey of 434 global consumer lending institutions, Q1 to Q2 2024

Alternative credit data sources can provide valuable insights into a borrower's financial health and ability to repay, even if they have a thin or impaired traditional credit file. By incorporating this data into collections strategies, lenders can better prioritize at-risk accounts, personalize outreach, and offer repayment plans that fit the borrower's unique circumstances. This can lead to higher recovery rates and lower charge-offs.

Conclusion

Based on the findings of this report, senior credit and risk management executives should consider the following key takeaways and recommendations:

- **Embrace alternative credit data as a strategic imperative:** With 60% of lenders losing confidence in traditional credit data alone, incorporating alternative data is no longer optional but essential for competitive advantage and risk management in today's market.
- **Leverage alternative data across the credit life cycle:** While underwriting is the most obvious use case, alternative data can also drive value in marketing (e.g., identifying new segments), origination (e.g., reducing friction), and collections (e.g., prioritizing at-risk accounts).
- **Partner with experienced alternative data providers:** Given the complexity and sensitivity of alternative data, lenders should seek out established, experienced partners that can provide the data and the expertise and tools to integrate it effectively and compliantly into credit-decisioning processes.
- **Monitor and adapt to market trends:** The alternative data landscape is evolving rapidly, with new data sources and use cases emerging all the time. Lenders must stay attuned to market developments and be prepared to adjust their strategies accordingly to stay ahead of the curve.

By following these recommendations and leveraging the insights from this report, lenders can position themselves to unlock the full potential of alternative credit data to drive growth, manage risk, and better serve customers in an increasingly dynamic and competitive market.

About LexisNexis® Risk Solutions

LexisNexis® Risk Solutions provides customers with innovative technologies, information-based analytics, decisioning tools, and data management services that help them solve problems, make better decisions, stay compliant, reduce risk, and improve operations. Headquartered in metro Atlanta, Georgia, it operates within the risk market segment of RELX, a global provider of information-based analytics and decision tools for professional and business customers.

About Datos Insights

Datos Insights is an advisory firm providing mission-critical insights on technology, regulations, strategy, and operations to hundreds of banks, insurers, payments providers, and investment firms—as well as the technology and service providers that support them. Comprising former senior technology, strategy, and operations executives as well as experienced researchers and consultants, our experts provide actionable advice to our client base, leveraging deep insights developed via our extensive network of clients and other industry contacts.

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