PUBLICATION

CFPB Explores Use of Alternative Data in Calculating Credit Scores

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The CFPB is exploring the use of alternative data in an effort to expand credit access to consumers who lack enough of a credit history to obtain a credit score. Traditionally, a credit score is based on a consumer's history of repayment of loans, such as mortgages, auto-loans, and other loans and credit cards. Alternative data might expand the type of financial payments lenders consider when determining whether to loan to a consumer and at what interest rate, to include information on payment of bills for mobile phones, utility bills and rent payments, for example. In addition, it may expand the type of data considered to include other behavioral based information, such as education, shopping habits and length of time at a job or residence.

The CFPB is considering whether the use of this alternative data will help an estimated 45 million Americans who either have no credit history with a nationwide consumer reporting agency or whose credit information is too remote or insufficient for the reporting agencies to produce a credit score. CFPB Director Richard Cordray explained that considering "alternative data from unconventional sources may help consumers who are stuck outside the system build a credit history to access mainstream credit sources."

However, the CFPB is aware that the use of alternative data is not without potential problems. In its Request for Information, published on February 17, 2017, the CFPB seeks public comment on the benefits and risks to consumers by the use of alternative data and how those risks might be mitigated. Ultimately, whether the use of alternative data will have the intended impact of expanding access to lower cost credit will depend on the cost of using alternative data to make credit decisions, given the risks of using such data. Some of the concerns include consumer privacy, the cost of using the data to analyze credit worthiness and the cost of compliance with existing laws and regulations governing lenders use of credit information.

For example, alternative data may contain sensitive and personal information, and the consumer may not know how the information was obtained or how it will be used and disseminated. Additionally, it may be harder to verify and for consumers to dispute or correct the personal information contained in alternative data sources as opposed to traditional sources.

Whether the use of alternative data will increase or decrease the cost of lending is also a concern. The CFPB, in its news release on its Request for Information, explained that it was seeking comments on the cost to lenders and financial institutions of the use of alternative data in credit decisions, as well as new technologies or ways of analyzing data that might lower the costs of lending.

Additionally, the impact of the use of alternative data on the obligation to report to consumers about credit decisions must be considered. The use of alternative data in making those decisions might be harder to explain and may cause consumers to feel like they have lost control over their credit scores because they no longer understand all the factors considered in calculating their scores.

Given the CFPB's focus on enforcement actions concerning alleged inaccurate reporting and failure to correct reporting errors or investigate consumer disputes, lenders will need to pay close attention to the CFPB's attempts to leverage alternative data to increase market access to credit. The CFPB will take comments on the use of alternative data through May 19, 2017.