



Testimony before the
U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES
Task Force on Financial Technology

Regarding

“Examining the Use of Alternative Data in Underwriting and Credit Scoring to Expand Access to Credit”

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Introduction and Summary

Chairman Lynch, Ranking Member Hill, and Members of the Financial Technology Task Force, thank you for inviting me to testify today regarding the use of alternative data in underwriting and credit scoring to expand access to credit. I offer my testimony here on behalf of the low-income clients of the National Consumer Law Center.¹

Alternative data has the potential to benefit millions of consumers, whether they are “credit invisible” or they have impaired records with the traditional Big Three nationwide consumer reporting agencies or “credit bureaus” - Equifax, Experian, and TransUnion. However, alternative data is not without its risks.

Much of the analysis of whether alternative data will benefit or hurt consumers depends on several key factors –

- What kind of alternative data is being used?
- How is the alternative data being used?
- What is the accuracy and predictiveness of the data?
- What level of disparate impact does the data have on protected groups, especially communities of color?

If alternative data is used for credit decisionmaking, its use must be regulated by the Equal Credit Opportunity Act (ECOA). Unless the data represents direct experience between the lender and the consumer, it should also be regulated by the Fair Credit Reporting Act (FCRA). Compliance with both these laws will be critical for the purposes of accuracy, predictiveness, transparency and minimizing disparate impact.

¹ The National Consumer Law Center is a nonprofit organization specializing in consumer issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys, as well as community groups and organizations, from all states who represent low-income and elderly individuals on consumer issues. As a result of our daily contact with these advocates, we have seen many examples of the damage wrought by abuses from credit reporting agencies from every part of the nation. It is from this vantage point that we supply these comments. *Fair Credit Reporting* (9th ed. 2017) is one of the nineteen practice treatises that NCLC publishes and annually supplements. This testimony was written by Chi Chi Wu.

A. Introduction

Consumers are “credit invisible” if they either (1) do not have any credit history with Equifax, Experian, or TransUnion; or (2) if their histories are too scant or old (“thin”) to generate a credit score. According to the Consumer Financial Protection Bureau (CFPB), 26 million Americans (or about 1 in 10) do not have a credit history, and another 18 million are unscorable.²

There are significant racial disparities with respect to credit invisibility. About 15 percent of African American and Latinx consumers have no credit history compared to 9 percent of Whites. Another 13 percent of African Americans and 12 percent of Latinx consumers are unscorable, compared to 7 percent of Whites.³

For young consumers or those who are new to this country, credit invisibility may be a temporary status. Some consumers may deliberately avoid using credit and others, such as older consumers, may no longer need or use credit. A few consumers may even want to avoid the credit reporting system altogether, especially after the massive Equifax data breach of 2017.

For some purposes, the lack of a credit history could be better than a negative history. Employment and insurance are two uses of credit report information where no history may be better than solely negative information, and where invisibility may be a benefit. For example, a number of state insurance laws are designed to ensure that a consumer with no credit score is not treated worse than someone with an average credit score.⁴

However, credit invisibility poses real and significant problems for some consumers seeking affordable credit in order to buy a home, start a business, or simply open a mainstream credit card account. Policymakers, advocates, and industry members have all proposed alternative data as solution to credit invisibility. The term encompasses many different types of data, used in many different ways – examples range from monthly payment obligations like rent and cell phone bills to social media data. The CFPB has defined alternative data as information not in the traditional credit reports provided by Equifax, Experian, and TransUnion.⁵ The Government Accountability Office further distinguishes financial and non-financial alternative data.⁶ The latter is sometimes referred to as “Big Data.”

² Consumer Financial Protection Bureau, Data Point: Credit Invisibles, May 2015, http://files.consumerfinance.gov/f/201505_cfpb_data-point-credit-invisibles.pdf.

³ *Id.*

⁴ The Supreme Court observed the existence of these laws in *Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47, 73, 127 S. Ct. 2201, 2217, 167 L. Ed. 2d 1045 (2007)(“[a] number of States permit the use of such “neutral” credit scores to ensure that consumers with thin or unidentifiable credit histories are not treated disadvantageously”).

⁵ Consumer Financial Protection Bureau, Request for Information Regarding Use of Alternative Data and Modeling Techniques in the Credit Process, Docket No. CFPB-2017-0005, 82 Fed. Reg. 11183, May 19, 2017. [hereinafter “CFPB Alternative Data RFI”]

⁶ Government Accountability Office, Financial Technology: Agencies Should Provide Clarification on Lenders’ Use of Alternative Data, GAO-19-111, Dec. 2018, at 34.

Some types of alternative data and approaches to using it are helpful or promising, but others are harmful or pose risks. We have urged a cautious and thoughtful approach in developing solutions. As with so many aspects of credit and financial services, “the devil is in the details.”

B. The Type of Alternative Data Matters Greatly

Not all alternative data used to create a potential credit score is created equal. Some data shows promise, other data is a mixed bag, and some data is harmful enough that it should not be used.

1. Financial alternative data

Financial alternative data includes information about payment obligations that are periodic and recurring, similar to the loan payment obligations in a credit report, or reflect other mainstream financial information, such as bank account transactions. Some financial alternative data shows promise, such as bank account transaction or rental payment data. Other financial alternative data could be harmful, such as subprime loan or “no choice” gas & electric utility payment data.

- **Bank account transaction/cashflow data** – The analysis of a consumer’s bank account transactions and cashflow, *i.e.*, credits, debits, and balances, has shown significant potential as a source of financial alternative data. This same data is sensitive, private, and a tempting target for other uses. Because of its importance, there is a need for significant guardrails. We discuss bank account data further and set forth proposed principles for its use in Section C.
- **Rental data** – Traditionally, rental payment data was only reported when overdue rent was sent to a debt collector, usually after a tenant had been evicted or left the unit. Efforts to add positive data appear to be promising, especially those efforts that do not report late payments that are not sent to (and thus not reported by) a debt collector. Any efforts to include rental payment data should not penalize tenants who invoke their rights under state or local laws to withhold rent due to poor conditions.

The most difficult issue is probably getting sufficient amounts of rental payment data, since the vast majority of landlords do not report such data and do not have great incentive to do so.⁷ Many landlords are small property owners who might find it cumbersome to report payments regarding only one or two units.

A variation on using rental payments is to use address stability (*i.e.* number of times a consumer has moved) as a proxy for on-time payments. This is an overly crude measure of rental payment history, because consumers often move due to many reasons other than nonpayment of rent. As the CFPB notes, military servicemembers are one population that moves often.⁸ Another population that moves frequently are students. This lack of precision makes address stability a poor measure.

⁷ FICO, Risk & Compliance Truth Squad: Can Scoring Rental Data Vastly Improve Credit Access?”, May 10, 2017 (rental data makes up less than 1% of data reported to credit bureaus).

⁸ CFPB Alternative Data RFI, 82 Fed. Reg. at 11187.

- **Gas and electric utility data** – Most gas and electric companies currently only report accounts on traditional credit reports when they are very seriously delinquent. The push to add “full file” monthly reporting of gas and electric bill payment data to traditional credit reports, without giving consumers any choice, has the potential to hurt millions of low-income consumers by adding reports about payments that are only 30 or 60 days late. Data from utility companies and regulators shows that the percentage of low-income and energy assistance utility customers who are delinquent can range from 17% to 38%.⁹

The impact could be especially harsh on families who need time to pay off winter or summer bill spikes. Reporting of late payments could also undermine state consumer protections, such as prohibitions against wintertime shut offs for elderly or other vulnerable consumers, by compelling them to pay seasonally high bills even if it doesn’t leave them enough money to pay for other critical expenses such as food.

In contrast, efforts to include utility data on a voluntary basis, for example by collecting the data from bank account transactions with consumer permission, could be useful. These efforts also show there is no need for utility credit reporting in which the consumer has no choice.

- **Subprime credit** – Payday loans and other forms of subprime credit are often not reported on traditional credit reports. Adding these types of credit could damage the credit records of these borrowers, even if they are current. High-cost credit is often designed to lead to a cycle of debt, and even merely using a subprime form of credit might negatively affect a credit score.¹⁰ Creating a database of consumers who have used high-cost credit could make them even more vulnerable. Adopting the use of subprime credit data would likely harm consumers who use such credit.

Furthermore, the necessity of using subprime credit as a form of alternative data is questionable, as most payday borrowers are not credit invisible. The authors of one

⁹ Consumer Groups’ Comments in Response to the CFPB’s Request for Information Regarding Use of Alternative Data and Modeling Techniques in the Credit Process, Docket No. CFPB-2017-0005, May 19, 2017, available at https://www.nclc.org/images/pdf/credit_reports/comments-alt-data-may2017.pdf, at 4.

¹⁰ Experian states:

“When assessing “riskier” consumers, lenders want to know who is likely to pay them back and who is not. What are the red flags to determine the difference between the two?

- *Number of payday loans acquired within a year*
- Number of first-payment defaults
- Number of inquiries within the past 30–90 days
- Income discrepancies reported by consumer.”

Experian, *The State of Alternative Credit Data*, 2018, <https://www.experian.com/assets/consumer-information/white-papers/alternative-credit-data-paper.pdf>, at 20 (emphasis added).

See also Ruth Lythe, *A Payday Loan Can Stop You Getting a Mortgage: Worrying News for Three Million Who Have Needed Fast Cash*, *The Daily Mail*, July 13, 2012, available at <http://www.dailymail.co.uk/money/mortgageshome/article-2173443/Payday-loans-Worrying-news-million-needed-fast-cash.html#ixzz20beuLWIm> (in United Kingdom, reporting that lenders are refusing to grant mortgages to payday loan borrowers).

research study analyzing payday loan applications noted that the results of their matching payday borrowers to credit bureau files “imply that nearly all of the payday loan applicants had a credit record at the time they applied for their first payday loan.”¹¹

- **Telecommunications data** – Over the past several years, there have been efforts to create scores using data from wireless phone and cable television providers. For example, FICO XD uses data from the National Consumers Telecom and Utility Exchange (NCTUE) as well as LexisNexis to generate an alternative score that can be used for otherwise credit invisible consumers.

Unlike regulated electric and gas service, telecommunications industries have fewer consumer protections that could be undermined by monthly reporting. Thus, they do not raise the same concerns as those sources of data. However, the level of accuracy of the data has not been assessed, nor the impact on consumers who lodge disputes over issues such as cramming, early termination fees, and questionable surcharges.

Transparency is also an issue; consumers may also not be aware that their cell phone and cable payment histories are being supplied to nationwide or specialty CRAs. This is important for low-income consumers because when they juggle bills, they often do so in consideration of multiple factors including credit reporting.

2. Non-financial alternative data or Big Data

Big Data encompasses a far-ranging array of information, including social media profiles, web browsing history and behavioral data. There are many unanswered questions about the predictiveness and accuracy of these data sources. For example, in one study in which NCLC employees ordered their own reports from four data brokers, these reports were found to be riddled with inaccuracies, ranging from the mundane (a wrong e-mail address or incorrect phone number) to the seriously flawed (wrong occupation or salary estimate).¹² Of the 15 records sought, some brokers had as many as 13 reports with errors in them.¹³

- **Educational or occupational attainment.** Use of education or occupation is quite troubling. There are obvious racial disparities in educational and occupational attainment. For example, 93% of non-Hispanic whites graduate from high school, but only 67% of Hispanics and 87% of African Americans do.¹⁴ Over 36% of non-Hispanic whites and

¹¹ Neil Bhutta, Paige Marta Skiba, & Jeremy Tobacman, Payday Loan Choices and Consequences, Vanderbilt Law and Economics Research Paper No. 12-30, October 11, 2012), <https://ssrn.com/abstract=2160947>, at 12.

¹² See Persis Yu, NCLC, Big Data: A Big Disappointment for Scoring Consumer Credit Risk, at 18, March 2014, available at www.nclc.org/images/pdf/pr-reports/report-big-data.pdf (reviewing the accuracy of reports by eBureau, ID Analytics, Spokeo, and Intelius).

¹³ *Id.*

¹⁴ Camille L. Ryan and Kurt Bauman, U.S. Census: Current Population Reports, Educational Attainment in the United States: 2015, March 2016, <https://www.census.gov/content/dam/Census/library/publications/2016/demo/p20-578.pdf> (“In most

nearly 54% of Asians have a bachelor's degree, but less than 16% of Hispanics and 23% of African Americans do.¹⁵ As for occupation, 40% of non-Hispanic whites and 51% of Asians are employed in management, professional, and related positions, but only 30% of African Americans and 22% of Hispanics are similarly employed.¹⁶

The use of education and occupational attainment reinforces inequality, given that a consumer's educational attainment is most strongly linked with the educational level of his or her parents.¹⁷ Use of educational or occupational attainment would probably top the list of mobility-impeding data, and would ossify the gaping racial and economic inequality in our country.

- **Social media/friends & family data.** Use of social media profiles, particularly friend networks, raises serious concerns about racial disparities. Although not yet widely used in the United States, one company, Lenddo, which operates in twenty different countries, may deem a consumer to be less creditworthy if he or she is friends on Facebook with someone who was late paying back a loan to Lenddo.¹⁸ Location or geographic neighborhood is another way that creditors have based creditworthiness by association.¹⁹ Given the degree of residential housing segregation that exists in the U.S., location can function as a proxy for race and income and its use by creditors would reflect racial and socio-economic disparities. And most people's friends and family are likely to be of the same race, class, and cultural background.
- **Behavioral data, including web browsing.** Behavioral data includes information about how consumers interact with a web interface or answer specific questions, or data about how they shop, browse, use devices, or move about their daily lives. The use of behavioral data has also shown indications of racial bias, despite relying on seemingly

studies, parental education has been identified as the single strongest correlate of children's success in school, the number of years they attend school, and their success later in life.”)

¹⁵ *Id.*

¹⁶ Bureau of Labor Statistics, BLS Reports, Report 1062: Labor Force Characteristics by Race and Ethnicity, 2015, September 2016, <https://www.bls.gov/opub/reports/race-and-ethnicity/2015/home.htm>.

¹⁷ Anna J. Egalite, How Family Background Influences Student Achievement, EducationNext, Vol. 16, No.2, Spring 2016, available at <http://educationnext.org/how-family-background-influences-student-achievement/>.

¹⁸ Katie Lobosco, Facebook friends could change your credit score, CNN.com (August 27, 2013) available at <http://money.cnn.com/2013/08/26/technology/social/facebook-credit-score/index.html>. See also Matt Vasilogambros, “Will Your Facebook Friends Make You a Credit Risk?” The Atlantic (August 7, 2015), <https://www.theatlantic.com/politics/archive/2015/08/will-your-facebook-friends-make-you-a-credit-risk/432504/>.

¹⁹ Jeffrey S. Morrison & Andy Feltovich, Leveraging Aggregated Credit Data and in Portfolio Forecasting and Collection Scoring, The RMA Journal, Oct. 2010, at 47, available at www.forecastingsolutions.com/publications/RMA_OCT2010.pdf (article written by Transunion researchers stating “...aggregated credit data is...helpful to [debt] collectors because it can identify local credit conditions clustered around common demographics. This is especially true for consumers with little or no credit history. For example, if the consumer is living in a ZIP code where the mortgage delinquency rates are climbing or always high, the chance for collection may be significantly less than for those in ZIP codes where the delinquency rate is relatively low and stable.”).

racially neutral algorithms. In 2013, Latanya Sweeney, a professor of government at Harvard University, led a research project that concluded that Google searches of names more likely associated with black people often yielded advertisements for a criminal records search in that person's name.²⁰ On one website, searches of black-sounding names were 25 percent more likely to yield ads with offers to view the person's arrest or criminal record.²¹

C. Principles for use of bank account transaction data.

Recent efforts to use bank account transaction data have shown potential to help some thin file consumers. Bank account data can reveal whether a consumer has sufficient available funds to afford to take on a loan, since it includes both income and expense information, *i.e.* it can help show whether the consumer has ability to repay. Unfortunately, bank account information may not be able to help the 14 million consumers who lack a bank account.²²

Bank account data may avoid the need to rely on long historical timeframes and thus not consider negative marks from economic hardships from several years ago. Data suggests that many of the consumers with impaired credit were the victims of unfortunate events such as illness or job loss.²³ Bank account data can avoid the need to rely on long historical timeframes such as seven years, given that lenders review 12 months of statements at most when they manually review bank account activity.²⁴ Also, bank account data can show when there has been a healthy sustained recovery from an economic shock such as a job loss or illness.

Currently, the use of bank account data is voluntary, as consumers must actively give permission to a special type of company called a "data aggregator" to access to this information. The exception for the need for aggregators is the consumer's own bank, which obviously has access to the account information. Indeed, a CFPB study has speculated that that one of the primary "on ramps" to a credit report might be the consumer obtaining their first credit card from their

²⁰ Hiawatha Bray, Racial bias alleged in Google's ad results, Boston Globe (February 6, 2013) <https://www.bostonglobe.com/business/2013/02/06/harvard-professor-spots-web-search-bias/PtOgShlivTZMfyEGj00X4I/story.html>.

²¹ *Id.*

²² Federal Deposit Insurance Commission, 2017 FDIC National Survey of Unbanked and Underbanked Households, Oct. 2018, <https://www.fdic.gov/householdsurvey/2017/2017execsumm.pdf>, at 1.

²³ About 70 to 80% of consumers with impaired credit or a low score, such as a 600, will actually not default. These may be victims of extraordinary life circumstances who do not default again once they have recovered economically. *See* Chi Chi Wu, NCLC, Solving the Credit Conundrum: Helping Consumers' Credit Records Impaired by the Foreclosure Crisis and Great Recession, Dec. 2013, at 9-11, available at www.nclc.org/images/pdf/credit_reports/report-credit-conundrum-2013.pdf (summarizing research).

²⁴ For example, Fannie Mae requires lenders to review 12 months of bank account statements to establish payment activity. Fannie Mae Selling Guide, B3-5.4-03: Documentation and Assessment of a Nontraditional Credit History, August 30, 2016, available at <https://www.fanniemae.com/content/guide/selling/b3/5.4/03.html>. Anecdotally, we have heard that some lenders only require 3 to 6 months of bank account statements.

own bank.²⁵ The use of a data aggregator for account information allows this access even when a consumer does not have a deposit account at a large bank that also issues credit cards.

However, a data aggregator may access information far longer than consumers expect or may use or share the data in ways that the consumer did not affirmatively agree to. Thus, we urge that a consumer's permission to share bank account data for the purpose of credit underwriting always be time limited.

Another concern is that bank account data could be misused. Lenders and debt collectors could use it to figure out the best time to collect debts by analyzing when income comes in and can be grabbed. Bank accounts include sensitive information such as debit card purchases showing where the consumer shops or even which political causes they support. There will need to be methods to protect the privacy of this information while being able to use account information for credit decisionmaking. This could lead to discriminatory pricing not based on the individual's credit risk. Given how much sensitive information is in a bank account history, sharing should be strictly limited and disparate impacts carefully monitored.

Thus, we urge adoption of the following principles for use of bank account transaction data:

Consumer control

- **Consent must be real, knowing and meaningful.** It should never be buried in fine print. It must always be in a separate stand-alone document.
- **Consent should not be used to permit uses that consumers do not expect or understand.**
- **Consent must be limited by purpose.** A consent to use bank account data for credit underwriting should be limited to that use alone and should not permit the use of the data for other purposes such as marketing, debt collection, or government licensing.
- **Consent must be limited by data element.** A consumer should be able to choose sharing just cashflow information (credits, debits, balances) versus sharing cashflow plus the identities of merchants from debit card transactions or the identity of payors who make electronic deposits.
- **Consent should be time-limited and self-expiring.** A consent for credit underwriting should be a single use permission. A consent for account review for an open-end account should expire after one year and require renewal.

Consumer choice

- **Consumers should always have true choice in whether to share their bank account data.** There is too great a risk that creditors will require use of bank account transaction

²⁵ Consumer Financial Protection Bureau, Data Point: Becoming Credit Visible, June 2017, https://files.consumerfinance.gov/f/documents/BecomingCreditVisible_Data_Point_Final.pdf, at 33 (noting that “about 65 percent [of consumers studied], appear to have transitioned out of credit invisibility by opening an account by themselves despite their lack of a credit history” and that “perhaps some commercial banks are willing to lend to credit invisible consumers with whom they have existing deposit account relationships.”)

data for all consumers, including those who could have received credit without it. A consumer who already has a “fat file” and a good credit score should be able to rely on that alone without being required to share bank account information. Expansion into bank account information may benefit those consumers who have insufficient credit history information or lower credit scores, but could hurt or risk the privacy of consumers who already qualify for mainstream credit.

- **Consumers should never be required to share bank account transaction data for non-credit purposes**, such as employment, insurance, or government licensing. Needs-based government programs should be entitled to only a snapshot of current balances.

Meaningful benefit for consumers

- In order to ensure bank account transaction data benefits consumers, lenders should be urged to actually use consumer bank account transaction information supplied by data aggregators in a meaningful manner.

D. How should alternative data be used

The manner in which alternative data is used is important. One of the most important factors is consumer choice. If the use of alternative data is truly voluntary – that is, consumers make knowing and voluntary decisions to allow the use of the data and the data is used only for that limited purpose and in ways that consumers would expect – then it is much more likely to be helpful. This is why we would support the discussion draft of the Credit Access and Inclusion Act put forth by Representative Gottheimer, because unlike prior versions, it would permit the reporting of utility and rental payment information only when the consumer has provided written authorization, *i.e.*, only with consumer choice. We have in the past, and would in the future, oppose any versions that do not include a requirement for written consumer authorization, because of the potential for consumer harm.²⁶

Using alternative data to create special scores for otherwise unscorable consumers is preferable to the wholesale addition of the same data to traditional credit reports, where it might damage consumers who already have credit scores. A “second chance” score can give credit invisible consumers another shot to be seen, without potentially hurting some of the nearly 200 million consumers who do have a scoreable credit history.

A number of alternative scoring products have recently been unveiled that hold promise but must also be monitored. UltraFICO is a voluntary opt-in product that will rely on bank account transaction information from Finicity, a data aggregator working in partnership with Experian.²⁷ UltraFICO will only be used to enhance a consumer’s credit scores to see whether a denied application can be approved or a lower rate can be offered. ExperianBoost considers utility

²⁶ The discussion draft also does not preempt state consumer protection laws protecting the privacy of utility customers and hindering states from regulating tenant screening agencies, unlike prior versions. Such preemption is another reason we have opposed prior versions.

²⁷ FICO, Introducing UltraFICO, <https://www.fico.com/ultrafico/> (viewed July 21, 2019).

payments, but does so by reviewing bank account transactions that do not get included in traditional credit reports and is also voluntary opt-in.²⁸ FICO XD similarly is a second chance score using mostly telecom data from the National Consumer Telecom and Utilities Exchange, which is not included in traditional credit reports.²⁹

A significant issue with promising alternative products may be to get lenders to accept them. Many lenders have not even adopted FICO 9 or VantageScore models that simply lessen the impact of medical debt. There may need to be efforts to encourage lenders to consider alternative data when it is more predictive or beneficial to consumers than traditional credit reporting. A provision of Regulation B, which implements the Equal Credit Opportunity Act and is discussed further in Section E.2, may be helpful in this regard.

E. Existing Regulation of Alternative Data

When data is used in the decision whether or not to grant credit, its use should be regulated by the Equal Credit Opportunity Act – period. If that data is not the result of direct, firsthand experience between the lender and the consumer, it is also covered by the Fair Credit Reporting Act. These statutes provide the regulatory framework that governs the use of all data for credit decisionmaking, including alternative data.

The key requirements for any data used for credit decisions are that it be accurate, predictive and transparent. The regulatory schemes for the FCRA and ECOA speak to each of these requirements.

1. Fair Credit Reporting Act (FCRA)

The FCRA was intended to have a very broad scope of coverage. Information is a consumer report if it is:

- Used or expected to be used or collected in whole or in part to serve as a factor in establishing eligibility for consumer credit or other FCRA-covered purposes;
- Pertains to any of seven characteristics, which cover an extremely far-reaching range of information – credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, and mode of living; and
- Issued by a third party that regularly assembles or evaluates such data for money or on a nonprofit cooperative basis.

Thus, almost all third-party data collected for credit decisionmaking purposes should be considered a “consumer report.” Unfortunately, several circuit courts have shown a reluctance to respect the plain language of the FCRA and its broad coverage.³⁰ We urge Congress to re-affirm

²⁸ Susan Henson, Experian, Introducing Experian Boost, a New Way to Instantly Improve Your Credit Scores, April 8, 2019, <https://www.experian.com/blogs/ask-experian/introducing-experian-boost/>.

²⁹ FICO, FICO Score XD, <https://www.fico.com/en/products/fico-score-xd> (viewed July 21, 2019).

³⁰ See *Kidd v. Thomson Reuters*, 925 F.3d 99 (2d Cir 2019)(CLEAR product was not a consumer report, despite state agency’s use for employment purposes, because Thomson Reuters had collected information

the broad scope of the FCRA and that it applies to any-third party data used for credit evaluation purposes.

FCRA protections are critical to protecting consumers when alternative data is used to evaluate them for credit. One of the key issues with alternative data is the level of accuracy of the data. As discussed above, our 2014 Big Data report revealed serious levels of inaccuracy in certain Big Data sources. The FCRA requires accuracy, in that Section 607(b) of the FCRA, 15 U.S.C. § 1681e(b), requires consumer reporting agencies (CRAs) to follow “reasonable procedures to ensure maximum possible accuracy.” Section 611(a) of the FCRA, 15 U.S.C. § 1681i(a), gives consumers the right to dispute any errors regarding information about them in a CRA’s files.

The FCRA also has specific notice requirements, which are intended to ensure transparency when information from a CRA is used. Mostly importantly, Section 615(a) and (h) of the Act, 15 U.S.C. § 1681m(a) and (h), require users of consumer reports to provide adverse action and risk-based pricing notices when information from a CRA has been used to deny them credit or charge them a higher price. This ensures that consumers are aware of the sources and types of information that are used against them in credit (and other) decisions, so that they are not left in the dark as to the reasons for decisions that may have critical consequences for their lives.

Furthermore, even if third party information is somehow not considered a consumer report, the FCRA includes a little-known provision that requires transparency in its usage. Section 615(b), 15 U.S.C. § 1681m(b), requires that lenders provide a specific notice if information that fits any of the seven characteristics listed in the definition of “consumer report” is obtained from a person other than a CRA and used to deny credit or charge more for it. This notice must inform the consumers of the right to make a written request for the reasons for the adverse action. Upon such a request, the user must disclose the nature of such information. Section 615(b) should apply to alternative data used for credit decisionmaking even if it somehow escapes the definition of a consumer report.

2. Equal Credit Opportunity Act (ECOA)

If alternative data is used for credit, there will be implications under the ECOA. Like the FCRA, the ECOA is a statute with a broad scope. It prohibits discrimination “with respect to any aspect of a credit transaction” on the basis of, *inter alia*, race, color, religion, national origin, sex or marital status, or age. 15 U.S.C. § 1691(a). “Credit” is broadly defined, as is the concept of

and intended it to be used only for non-FCRA purposes, expressly prohibited its sale or use for FCRA-related purposes, required users to make non-FCRA use certifications, and actively monitored compliance; entity must have a specific intent to furnish a “consumer report,”); *Zabriskie v. Fed. Nat'l Mortg. Ass'n*, 912 F.3d 1192 (9th Cir. 2019) (in a 2-1 decision, holding that Fannie Mae’s Desktop Underwriter program is not a CRA because its role is limited to providing software that allows lenders to assemble or evaluate information; majority ignored fact that it is DU itself which actually obtains information from various sources including nationwide CRAs and that DU itself issues a recommendation); *Fuges v. Southwest Title*, 707 F.3d 241 (3d Cir. 2012) (objectively reasonable for company that prepared reports on current owners of properties to interpret the reports as outside the FCRA because they allegedly pertained to the property and not to the consumer -- despite the fact the reports included information on judgments personally against the consumer).

“creditor,” which is not limited to banks or traditional lenders. 15 U.S.C. § 1691a(d) and (e). Finally, the ECOA is not limited to consumer credit but applies to certain types of business credit as well.

Most importantly for our purposes, Regulation B, which implements the ECOA, expressly notes that “legislative history of the Act indicates that the Congress intended an “effects test” concept ... be applicable to a creditor's determination of creditworthiness.” 12 C.F.R. § 1002.6(a). The effects test is another name for the disparate impact test, and the Official Staff Interpretations explain that the test:

may prohibit a creditor practice that is discriminatory in effect because it has a disproportionately negative impact on a prohibited basis, even though the creditor has no intent to discriminate and the practice appears neutral on its face, unless the creditor practice meets a legitimate business need that cannot reasonably be achieved as well by means that are less disparate in their impact.

Official Interpretations of Reg. B, 12 C.F.R. pt. 1002, supp. I, § 1002.6(a)-2.

As discussed in both Section B above and in Section G below, much of the data used for credit decisionmaking will have a disparate impact on protected classes. Thus, lenders must be extremely cautious in using alternative data given the effects test. This test has a three-step analysis which, teasing out the Official Staff Interpretations quoted above, consists of:

1. Does the practice have a disproportionately negative impact on a protected class even if it appears neutral on its face?
2. If so, does the practice meet a legitimate business need?
3. Can the same need be reasonably achieved using a less discriminatory alternative?

Like the FCRA, the ECOA also has specific notice requirements. It requires creditors to notify consumers of the action on an application. 15 U.S.C. § 1691(d)(1). If the creditor takes an adverse action, it must provide either a statement of reasons for the action or written notification of the right to such a statement. 15 U.S.C. § 1691(d)(2). This notice must be specific, and must meet the requirements of Regulation B and its corresponding Official Staff Interpretations.³¹

The notices required by the FCRA and ECOA raise one of the key issues with regards to the use of alternative models that rely on artificial intelligence or machine learning – transparency. Consumers are entitled to know not only *what* information is being used to assess them, but *how* that information is being used. Users of alternative modeling techniques will need to provide ECOA and FCRA adverse action notices, and to make sure the notices contain sufficient information to satisfy the ECOA standard that the notice disclose the specific reasons for the action taken.

³¹ Reg. B, 12 C.F.R. § 1002.9(b)(2); Official Interpretations of Reg. B, 12 C.F.R. pt. 1002, supp. I, § 1002.9(b)(2). *See generally* National Consumer Law Center, Credit Discrimination § 10.5.4.2 (6th ed. 2013), *updated at* www.nclc.org/library.

Having “black boxes” that evaluate creditworthiness should be a thing of the past, as a matter of both fairness and ensuring that consumers are fully educated about financial issues. Consumers should always be able know, access, and understand both what is the information being used in credit decisions and how it is used. They should be able to review the information for inaccuracies so they can dispute errors.

Finally, there is a seldom-used provision of Regulation B that requires lenders to consider creditworthiness information that is not part of a credit report, if requested by a consumer.³² This could be useful in encouraging lenders to consider alternative data. However, it is only a first step in that they are not required to treat such information with the same weight and in the same manner as credit report history information.

F. Alternative Data as Competition for the Credit Bureaus?

One of the biggest problems in credit reporting has been the lack of competition in that industry. The Big Three credit bureaus constitute an oligopoly that controls financial information vital for consumers’ economic lives. What’s worse, consumers aren’t even the customers – our data is the credit bureaus’ commodity – and we have no choice but to deal with these three companies.

Alternative data has the potential to provide competition to the credit bureaus by supplying new types of information that both lenders and consumers can choose to use instead of a credit report or score. But the credit bureaus have been on a buying spree, purchasing companies that gather alternative data. For example, Experian purchased Clarity while TransUnion purchased FactorTrust, both of which are consumer reporting agencies focused on subprime credit. In some cases, the credit bureaus form partnerships with alternative data providers to access their data. Equifax manages NCTUE, while Experian has a deal with Finicity, a bank account data aggregator. These trends could eliminate the possibility of real competition.

G. Algorithms as a Reflection on Society’s Inequities

Communities of color are not just more likely to be credit invisible - study after study has found that when minorities do have a credit score, as a group those scores are significantly lower than those of whites. A list of these studies is available in our policy brief, *Past Imperfect: How credit scores and other analytics “bake in” past discrimination and perpetuate it.*³³

³² 12 C.F.R. § 1002.6(b)(6)(ii)(creditor must consider any information the applicant presents to indicate credit history being considered does not accurately reflect applicant’s creditworthiness); Official Interpretations of Reg. B, 12 C.F.R. pt. 1002, supp. I, § 1002.6(b)(6)-1 (“On the applicant’s request, however, a creditor must consider credit information not reported through a credit bureau when the information relates to the same types of credit references and history that the creditor would consider if reported through a credit bureau.”)

³³ Chi Chi Wu, NCLC *Past Imperfect: How Credit Scores and Other Analytics “Bake In” and Perpetuate Past Discrimination*, May 2016, available at https://www.nclc.org/images/pdf/credit_discrimination/Past_Imperfect050616.pdf.

As discussed more in one of this our Policy Brief, the explanation for these disparities lies in the aftereffects of historical inequalities and the racial wealth gap. African American families own less than seven cents for every dollar in wealth owned by white families, while Latino households own less than eight cents for every dollar of white wealth. With fewer assets to draw on, people of color – and the friends and family to whom they might turn – are far less able to cushion the blows of financial catastrophes, such as job losses, income reductions, sickness, or unplanned expenses.

Despite the fact that credit scoring has a disparate impact, it is also predictive on an aggregate level. That is why it is legal under the ECOA – there is a legitimate business need for credit scoring given its predictiveness.

If alternative data is based on financial information, it will likely also exhibit racial disparities, for the same reasons.³⁴ In general, systems replicate themselves, and systemic racism keeps perpetuating itself whether or not individual animus-driven bias exists. This impacts the very foundations and institutions of our society – education, income, employment, housing, and criminal justice. This is why all the indicators discussed above – education, employment, income, and assets – exhibit such racial disparities.

Moreover, algorithms developed using data that exhibits racial disparities will themselves reproduce those disparities. There is an assumption that algorithms are automatically unbiased or judgment free, but recent research indicates otherwise.³⁵

Thus, because any economically based data is likely to show racial disparities, the Regulation B test for disparate impact will require a “legitimate business need” to use it for credit decisionmaking purposes. At a minimum, this means the data must be accurate and predictive.³⁶ But it should be more than just predictive – it should be more predictive than traditional data or should provide more access to credit (not less) to credit invisible or credit impaired consumers, and such credit should be affordably priced.

³⁴ See Carol Evans, Federal Reserve Board - Division of Consumer and Community Affairs, *Keeping Fintech Fair: Thinking about Fair Lending and UDAP Risks*, Consumer Compliance Outlook - Second Issue 2017 (2017), <https://consumercomplianceoutlook.org/2017/second-issue/keeping-fintech-fair-thinking-about-fair-lending-and-udap-risks/> (“[F]intech may raise the same types of fair lending risks present in traditional banking, including underwriting discrimination, pricing discrimination, redlining, and steering. Although some fintech trends may decrease certain fair lending risks, other trends could amplify old problems or create new risks.”) [hereinafter “Evans, *Keeping FinTech Fair*”]

³⁵ See Robert P. Bartlett, et al., *Consumer Lending Discrimination in the FinTech Era*, UC Berkeley Public Law Research Paper, December 7, 2017, <https://faculty.haas.berkeley.edu/morse/research/papers/discrim.pdf> (finding that fintech lenders discriminate, albeit 40% less than face-to-face lenders). See also, Evans, *Keeping FinTech Fair* (“while statistical models have the potential to increase consistency in decision-making and to ensure that results are empirically sound, depending on the data analyzed and underlying assumptions, models also may reflect and perpetuate existing social inequalities. Thus, big data should not be viewed as monolithically good or bad, and the fact that an algorithm is data driven does not ensure that it is fair or objective.”).

³⁶ *Id.* (“Generally, the more speculative the nexus with creditworthiness, the higher the fair lending risk”).

Also, even if predictive, there is certain data that is troubling because it entrenches and perpetuates inequality in such an obvious and stark way. One obvious example is educational attainment level, which as discussed in Section B.2 is highly correlated with parents' income and education. Another type of data would be the consumer's geographic neighborhood, given the obvious racial and economic segregation in housing in this country. Using these factors would only worsen the already herculean barriers that disadvantaged children face in making economic progress. And beyond race, we know that income and wealth inequality are already increasingly stark; using factors like educational level or neighborhood would just make it worse.

The danger of gathering massive amounts of data and using algorithms to analyze them is that they reinforce and entrench existing inequality, whether it be racial or economic. The American dream has always been that the child of a factory worker could be the CEO of a corporation, a Senator, or even President. That dream is already dying a slow death in this country. Using massive amounts of data, chopped up and analyzed, may be the nail in the coffin of that dream.

We know that credit reports and scores can reinforce existing inequality. The question is whether we treat new sources of data, *i.e.*, alternative data, in the same way or whether we develop algorithms and policies that allow the American dream to flourish once again. Data models, whether traditional or alternative, could be programmed to reduce racial and economic disparities while maintaining – and hopefully, improving -- predictiveness. This could address the third prong of the disparate impact test - “a less discriminatory alternative.”³⁷

We have a chance with new data sources and models to do better. The question is whether we will do so or whether we will contribute to the gaping inequality in our society.

* * * * *

Thank you again for the opportunity to provide my views to the Task Force today. I look forward to your questions.

³⁷ For example, one modification proposed by researchers would require including minority status as a “control variable” during the development of a credit scoring model. Michael LaCour-Little and Elaine Fortowsky, *Credit Scoring and the Fair Lending Issue of Disparate Impact* in *Credit Scoring for Risk Managers: The Handbook for Lenders* (Elizabeth Mays ed. South-Western Educational Pub. 2003).