

Credit Invisibility and Alternative Data: Promises and Perils

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What is “Credit Invisibility?”

Consumers are “credit invisible” if they don’t have any credit history with the Big Three credit bureaus (Equifax, Experian, and TransUnion) or 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.¹ 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.

For young consumers or those who are new to the United States, credit invisibility may be a temporary status. Some people 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. And in some areas, such as employment and insurance, no credit history is better than a bad one. A negative credit report or low score could harm job prospects or increase rates, whereas no credit history could be considered neutral. 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.

“Alternative data” is often promoted as a 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 the Big Three credit bureaus (Equifax, Experian, and TransUnion).

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

What is Alternative Data?

Alternative data is information not included in traditional credit reports from Equifax, Experian, and TransUnion. It can include everything from monthly payment obligations, like rent and cell phone bills, to social media data.

Choices and Second Chances

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 the limited purpose and in ways that consumers would expect – then it is much more likely to be helpful.

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.

Ensuring That the Cure is Better than the Disease

Not all alternative data used to create a potential credit score is created equal. Each type has unique characteristics that can benefit or burden consumers.

- **Bank account transaction/cashflow data** - Recent efforts to use bank account transaction data have shown potential to help some thin file consumers. Because it includes both income and expense information, bank account data can reveal whether a consumer has sufficient available funds to afford to take on a loan. It could also 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 this information. However, 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.

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, which could lead to discriminatory pricing not based on the individual’s credit risk. There must be appropriate guardrails for sharing bank account data. Most importantly, given how much sensitive information is in a bank account history, sharing should be strictly limited and disparate impacts carefully monitored.

- **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 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.
- **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. 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, voluntary efforts to include utility data, for example by collecting the data from bank account transactions with consumer permission, could be useful, and also shows there is no need for no-choice full file utility credit reporting.

- **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 the consumer is current. High-cost credit is often designed to lead to a cycle of debt, and even merely using a subprime form of credit can negatively affect a credit score. Efforts to add payday loan data to address credit invisibility may not be necessary, since the vast majority of payday borrowers already have credit histories sufficient to be scorable.
- **Telecommunications data** – There have been efforts to use data from cell phone and cable providers to generate alternative scores. Unlike regulated electric and gas service, telecomm industries have fewer consumer protections that could be undermined by monthly reporting. But there are still questions such as the level of accuracy of the data and the impact on consumers who dispute over issues such as cramming and questionable surcharges. Consumers may also not be aware that their cell phone and cable payment histories are being supplied to traditional or alternative reporting agencies.
- **“Big Data”** – “Big Data” encompasses many types of information that are not as financially based, such as social media profiles to web browsing history. There are many unanswered questions about the predictiveness and accuracy of these data sources.² “Big Data” used for credit, employment, insurance, or other purposes is likely covered by the Fair Credit Reporting Act, and providers must comply with that Act. If Big Data is used for credit, the Equal Credit Opportunity Act applies. As discussed below, lenders must ensure that the use of Big Data does not create a disparate impact for protected groups.

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. The explanation for these disparities lies in the after-effects of historical inequalities and the racial wealth gap, as discussed more fully in another policy brief.³ If alternative data is based on financial information, it will likely also exhibit racial disparities, for the same reasons.

Alternative data may also result in disparate impacts when it is linked to geography, reflecting the continuing impacts of segregation and lower home values in communities of color, or to the communities to which consumers belong. These impacts are unrelated to the individual's credit worthiness.

Algorithms developed using data that exhibits racial disparities will themselves reproduce those disparities. The critical questions are (1) whether the use of a particular type of alternative data or modeling algorithm lessens or increases racial disparities; and (2) whether the data or model is more predictive than traditional data or models. These two questions are tied closely to the test for “disparate impact” under the Equal Credit Opportunity Act. If the alternative data is less predictive, then there is less of a “business justification” under the ECOA’s disparate impact test to use it. On the other hand, if the alternative data creates less of a racial disparity, its use may be more justifiable as a “less discriminatory alternative” than traditional scoring.

For more information, contact National Consumer Law Center Attorney Chi Chi Wu (cwu@nclc.org), (617) 542-8010.

Endnotes

1. Consumer Financial Protection Bureau, *Data Points: Credit Invisibles*, May 2015.
2. See Persis Yu, National Consumer Law Center, *Big Data: A Big Disappointment for Scoring Consumer Credit Risk*, March 2014.
3. National Consumer Law Center, Racial Justice and Equal Economic Opportunity Project, *Past Imperfect: How Credit Scores and Other Analytics “Bake In” Past Discrimination and Perpetuate It*, May 2016. See also [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.



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