Visa Consulting & Analytics (VCA)

Sourcing new data for richer credit-risk decisions

Managing credit portfolio performance is a balancing act between credit risk exposure and growth objectives.

Financial institutions (FIs) need to look beyond traditional underwriting data and principles to serve new segments and grow their business. New and emerging data sources present the opportunity to re-imagine traditional credit risk management processes, enabling FIs to optimize the risk-reward balance. Using rich insights from new data sources, credit offers can become more transparent and more attractive to the customer, while letting FIs stay in control of their risk-tolerance levels.

Keeping pace with evolving economic conditions, FIs that develop a more holistic picture of risk profiles can improve relationships with existing customers and better target new ones—while also balancing risk exposure in areas like credit-line optimization or short-term credit offerings like Buy Now Pay Later or even targeting customers with thin bureau profiles.

When we talk about alternative (or third-party) data, we mean non-traditional data, which falls outside of traditional credit bureau data or an FIs internal data. Alternative data may include one's online activity, mobile-phone usage, spending data, and data from wearable devices, offering insights into one's habits, lifestyle, and financial behaviors and propensities.

Card issuers and lenders worldwide are increasingly using alternative data in credit assessment to improve decision making and extend credit to underserved segments. Similarly, small business lending is shifting towards dynamic cashflow data from third-party partnerships.

To better leverage opportunities around alternative data, FIs must navigate significant data management and security challenges. In this paper, Visa Consulting & Analytics (VCA) looks at how credit risk assessment evolved with the availability of data, scopes the global alternative data opportunity landscape and identifies key challenges for FIs to navigate.

How has credit risk assessment evolved with the availability of data?

In the past, lenders collected application data manually to guide their lending decisions and, over time, the process became more automated and enriched with internal performance and cross-product data. The advent of credit bureaus revolutionized lending. The COVID-19 pandemic further accelerated financial inclusion, increasing the reach of digital payments and expanding formal financial services globally. This has fast-tracked the evolution of the underbanked or unbanked segments, including Gen-Z consumers with little-or-no credit history, and the underserved, who may only have access to basic banking services. These individuals often resort to high-interest, non-banking financing options to meet their credit needs.

For lenders, "thin files" (consumers with limited data) and "no hits" (those with no data) present an appealing but risky customer acquisition opportunity. To profitably serve this untapped customer population, credit eligibility must be carefully analyzed and balanced with "ability to pay" and "verification." If properly analyzed and managed, this segment could yield significant benefits in acquiring new customers, maintaining acceptable levels of risk, and achieving high retention rates – provided the customer experience is well executed.

It is also an opportunity of significant scale. Even some of the most advanced markets have a large proportion of consumers with marginal-to-no records to assess creditworthiness. For example, in the U.K., one in seven, or 7.1 million, people struggle to access affordable credit. In the U.S., 26 million people are classed as "credit invisible" or having no credit history.[1,2]

Digitalization, however, has generated substantial data relating to these segments that can be stored and processed quickly. At the same time, big data and artificial intelligence (AI) techniques have improved credit risk assessment, enabling better understanding of risk profiles and customer expectations. To assess credit risk in this way, FIs need new capabilities.

Also, real-time access to data is crucial in credit risk management, as it enables accurate and fast lending decisions. FIs can leverage this to approve credit cards in real time at the point of sale and validate data from alternative channels, enabling them to make live decisions.

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1. LexisNexis, Financial Inclusion in the UK, 2021: https://risk.lexisnexis.co.uk/insights-resources/article/financial-exclusion-in-the-uk
2. Consumer Financial Protection Bureau, Who are the Credit Invisible?, 2016: https://www.consumerfinance.gov/about-us/blog/who-are-credit-invisible/

Scoping the alternative data opportunity landscape

As the potential of alternative data becomes better understood, data providers are emerging to cater to specific regional needs. And we see significant developments globally:

Asia Pacific

Across much of the Asia Pacific region, the substantial underbanked population brings a strong rationale for the use of alternative credit data, and FIs see this as a potential growth opportunity – especially in the current competitive landscape, as it is challenging to expand customer bases and retain clients.

Providers of alternative data are developing predictive models, which, they say, can instantly assess a borrower's creditworthiness using only their phone numbers.[3] These providers claim that this approach facilitates lending to underbanked consumers, allows for real-time underwriting, minimizes credit and fraud risks, and enables personalized product offerings.

Similarly, FIs are collaborating with organizations to utilize their alternative data, such as income and address verification, in the underwriting process. They are using advanced technology to provide a seamless, real-time digital onboarding experience through smartphones.

Alternative data has also set a new trend in small business lending. Instead of relying solely on balance sheets and past financials, which are often inadequate for the small business segment, issuers are now considering forward-looking and dynamic cash flow information.[4]

3. Trusting Social, Trust Scores (accessed January 2024): https://trustingsocial.com/products/trust-scores
4. Underwriting with alternative and cash flow data, Fintech futures, Aug. 22, 2023, https://www.fintechfutures.com/2022/08/underwriting-with-alternative-and-cash-flow-data/

CEMEA

In the CEMEA region, the use of alternative data is pioneered by emerging fintech innovators and telcos, like in other markets. Most fintech credit offerings are targeting underserved and now increasingly unbanked customers with quick, digital loans of limited size and tenure. The underwriting decisions are based on alternative data with modelling leveraging artificial intelligence and machine learning. Typical sources of alternative data include telco and mobile money data for retail clients, extended to cashflow data from ecommerce for small and medium-sized businesses. Telcos, especially in Africa, have used this opportunity to cash-in on their proprietary data access and large proprietary client bases. As open banking becomes more prevalent across the region, it is expected to become another key source of alternative data. Overall, these developments resulted in a significant credit acceleration in some countries, Nigeria being a prime example.

Moreover, in the Middle East, some Buy Now Pay Later (BNPL) operators, who typically have access to limited traditional data on their customers but have data on their customer's payment credentials (e.g. card numbers), are exploring partnerships with payment networks to incorporate transaction data insights into their credit assessments.

However, most traditional lenders in CEMEA have been slow to adopt alternative data in credit risk decisioning mainly due to limited digital lending capabilities and sometimes conservative approach to credit risk. Interest in new alternative data initiatives can therefore be tempered by perceived operational and data integration challenges as most lack the required data partnerships.

An interesting development is the increasing interest among credit fintechs to collaborate with traditional lenders. Although these partnerships are still not widespread, they signal a potential transformation in the credit sector. The integration of fintech's innovative use of alternative data and the substantial resources and customer bases of traditional banks could significantly evolve the credit landscape in the CEMEA region, making it more inclusive and dynamic.

Europe

Alternative data, particularly through open banking, has shown significant potential in improving credit decisions in Europe. It provides a more holistic view of a customer's financial health, especially for those with limited or no credit history and the underbanked. FIs are testing risk insights based on income and spending behavior for potential integration with existing credit strategies.[5]

Third-party open banking providers are widely used by FIs for real-time income verification to enable seamless lending, crucial for individuals who are credit invisible / have no credit file.[6]

In the small business sector, fintechs are using alternative data like cashflow-based variables, social media presence, and digital footprint to tap into firms that are underserved by traditional FIs.[7] By analyzing business-focused alternative data, platforms can quickly underwrite small business loans and adjust credit lines based on real-time business performance data.

However, as a limiting factor, the use of alternative data must comply with the General Data Protection Regulation (GDPR), which requires explicit consent from individuals and transparency about the data's use.

5. Sambla Group partners with Tink to strengthen lending verification process, Sambla Group partners with Tink to strengthen, https://tink.com/press/sambla-partnership-tink/
6. Bank Norwegian: automated and simplified, Tink, https://tink.com/customers/bank-norwegian/
7. YouLend Data Science: Leveraging Alternative Data to Drive Financial Inclusion, YouLend, March 28, 2022, YouLend Data Science: Leveraging Alternative Data to Drive Financial Inclusion, https://youlend.com/blog/alternative-data-in-embedded-finance

Latin America and the Caribbean

Key players across the Latin America and Caribbean region are making strides to not only reach previously untapped segments, but also to strengthen the existing capabilities while making decisions that help serve their customers in every stage of the credit lifecycle. Here are a few regional examples:

Mexico

Fintech firms are rapidly expanding, collecting diverse and meaningful data through customer interactions via apps. Firms focusing on food delivery or transportation have amassed data that helps anticipate customer needs and predict creditworthiness. Their unconventional business approach has enabled them to establish connections with customers without previous credit experience, positioning themselves competitively to offer credit opportunities.

Meanwhile, issuers and merchants are adopting credit scores based on telco behavior and attributes. This approach, with its strong market penetration, provides valuable insights on the unbanked population, enabling tailored financial products based on willingness and ability to repay.

Central America

In the post-pandemic recovery, some issuers are seeking new customers outside the reach of credit bureaus, driven by the search for new opportunities and the need to cope with the impact of amnesties and special COVID programs. Alternative data is playing a key role in providing additional elements to confirm the creditworthiness of customers and supplement credit strategies. For instance, several large FIs are testing transactional scoring algorithms on a regional level. These aim to generate ratings linked to the likelihood of delinquency, considering transactional elements like consumption patterns, magnitude, and declined transactions.

Brazil

Major banking players are testing elements captured through mobile device interaction. The aim is to evaluate the additional insights provided by metadata, and to integrate them with current rules and standards. This approach claims to enable FIs to leverage their existing capabilities and identify pockets of incremental opportunity, such as reconsidering customers with limited or no credit information for approval.

As with Central America, there is also significant interest in using transactional scoring to assess risk among new and existing customers – an attractive approach given its added value and its potential for seamless integration with existing strategies and internal models.

North America

In mature markets like the U.S., the adoption of alternative data is already advanced. Innovative users and providers are establishing processes for peer-to-peer (P2P) lending using alternative data for credit line determination, and some credit bureaus are even considering rental payments for credit scoring.[8] A Lexis Nexis survey revealed that 65 percent of FIs in the U.S. use alternative credit data for 50-100 percent of new applicants, with over half of them reporting revenue increases of more than 15 percent.[9]

8. Forbes Technology Council, Alternative Data: The Great Equalizer To Lending Inequalities?, 2019: https://www.forbes.com/sites/forbestechcouncil/2019/08/14/alternative-data-the-great-equalizer-to-lending-inequalities/?sh=2259478e2449
9. LexusNexis, New LexisNexis Risk Solutions Report Reveals Financial Inclusion is Accelerating the Adoption of Alternative Data Across Financial Institutions, 2021: https://risk.lexisnexis.com/about-us/press-room/press-release/20230215-alternative-data-across-financial-institutions

Key challenges for FIs to navigate

Different lenders will have different considerations. For example, a larger FI with a significant cache of internal data that works closely with credit bureaus will have different needs than a new lender that depends almost entirely on external data. Across all of them, however, the common denominator is the need to source accurate, validated, compliant and reliable data from the right external partner.

At Visa Consulting & Analytics (VCA), we break it down into two distinct components:

The challenge	The issue	The VCA recommendation
Data management	Alternative data, though detailed, can be complex to integrate due to varied sources and potential reliability issues. There can be low overlap with mainstream banking data, and understanding the additional information, limitations, potential biases, or errors in alternative data is crucial. Misunderstood data can lead to biased results and impact credit decisions negatively. Variability in data sourcing and collection can lead to inconsistent model results.	FIs should consider validating alternative data with internal and external sources, understand its relevance to their portfolio, and seek high match rates with reliable attributes. Strategies should be in place to mitigate data bias, especially from manipulable sources. Appropriate statistical techniques can handle inherent bias. Continuous monitoring and updating of credit scoring models built on alternative data is necessary for compliance and effectiveness. A robust model governance policy can help track model performance and data relevance over time.
Third-party management	Alternative data is often transferred from the source to various parties, and the FIs using it usually are not the collectors, so they do not control the collection, transfer, nor storage processes. The data collector may not follow required stringent data protocols, including validation, potentially compromising sensitive information. Disruptions at the data provider can affect decision engines and credit decisions.	Given that alternative data sharing involves personal data, strong security measures are needed to prevent breaches during the transfer, storage, or use of data outside an FI's control. A vendor-management policy can help align vendors with the FI's internal policies and processes. A solid business continuity plan should be in place considering the dependency on alternative data, which should be audited and reviewed regularly.

How Visa can help

Through its fintech relationships and programs, Visa can provide access to a range of pre-screened alternative data providers, while VCA's consultants and analytics experts can identify the best strategies for introducing and integrating alternative data sources. This can enable FIs to overcome some of the challenges entailed in using data that is known to be clean, validated, reliable and compliant.

VCA's alternative data framework and approach

VCA has successfully helped credit card issuers to implement alternative data and score through back testing and enhanced understanding of its effectiveness and applicability for credit decisioning.

VCA's analysis has helped FIs better understand the potential consequences of using the alternative data and score, which can result in an increase in the acquisition funnel due to higher approval rates. The analysis includes both the quantitative aspects of the data, such as matching, validation, and model lift, as well as qualitative aspects, like maintenance, and vendor management.

VCA's alternative data framework to back test and implementation of alternative data is developed to help the issuer to build credit models as well as to validate the credit risk and income estimation models created by the alternative data vendor. This provides detailed guidelines for both qualitative and quantitative model evaluations.

About Visa Consulting & Analytics

We are a global team of 1300+ payments consultants, digital marketing specialists, data scientists, and economists across six continents.

- Our consultants are experts in strategy, product, portfolio management, risk, digital, and more with decades of experience in the payments industry.
- Our data scientists are experts in statistics, advanced analytics, and machine learning, with exclusive access to insights from VisaNet, one of the largest payment networks in the world.
- Our economists understand economic conditions impacting consumer spending and provide unique and timely insights into global spending trends.

The combination of our deep payments consulting expertise, our economic intelligence, and our breadth of data allows us to identify actionable insights and recommendations that drive better business decisions.

For more information, please contact your Visa Account Executive, email Visa Consulting & Analytics at VCA@Visa.com or visit us at Visa.com/VCA

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