NOVA CREDIT

The State of **Alternative Data** in Lending

2024 Survey Report

A complete picture of market adoption, opportunities, challenges, and other trends in alternative credit data.

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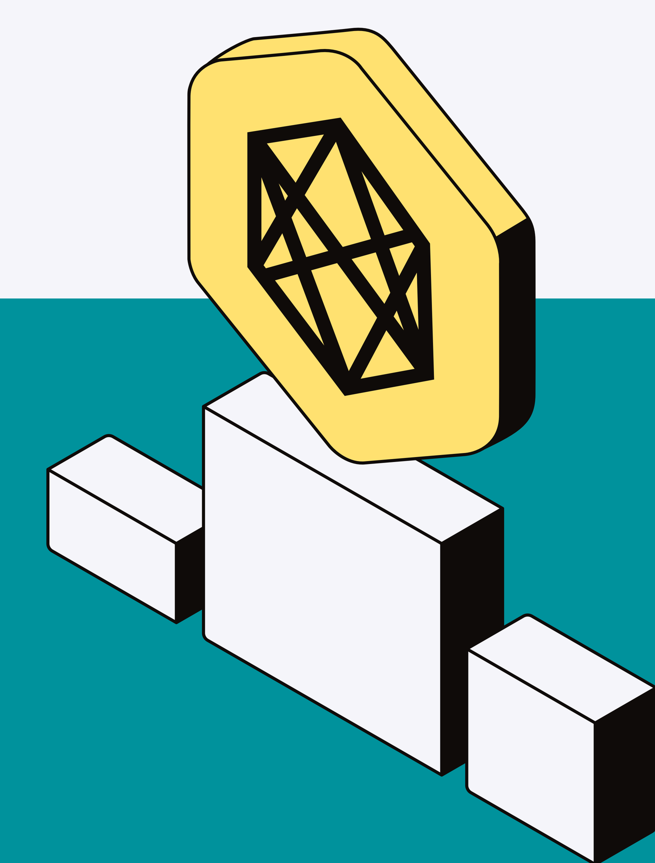
For two years running, lenders have spoken: incorporating alternative data into underwriting models continues to be an attractive proposition.

In our 2024 survey, **43%** of respondents confirmed that they are already using alternative data to improve their underwriting models, and **90%** agree it would help them approve more worthy borrowers.

At the same time, alternative data has yet to be leveraged by lenders to its full potential, despite the fact that lenders surveyed are prioritizing strategic initiatives that would greatly benefit from alternative data access.

As open banking in the US moves from trend to established practice, this report offers a comparative analysis of lenders' perspective on the adoption of alternative data sources in decisioning workflows plus key insights for a rapidly evolving industry.

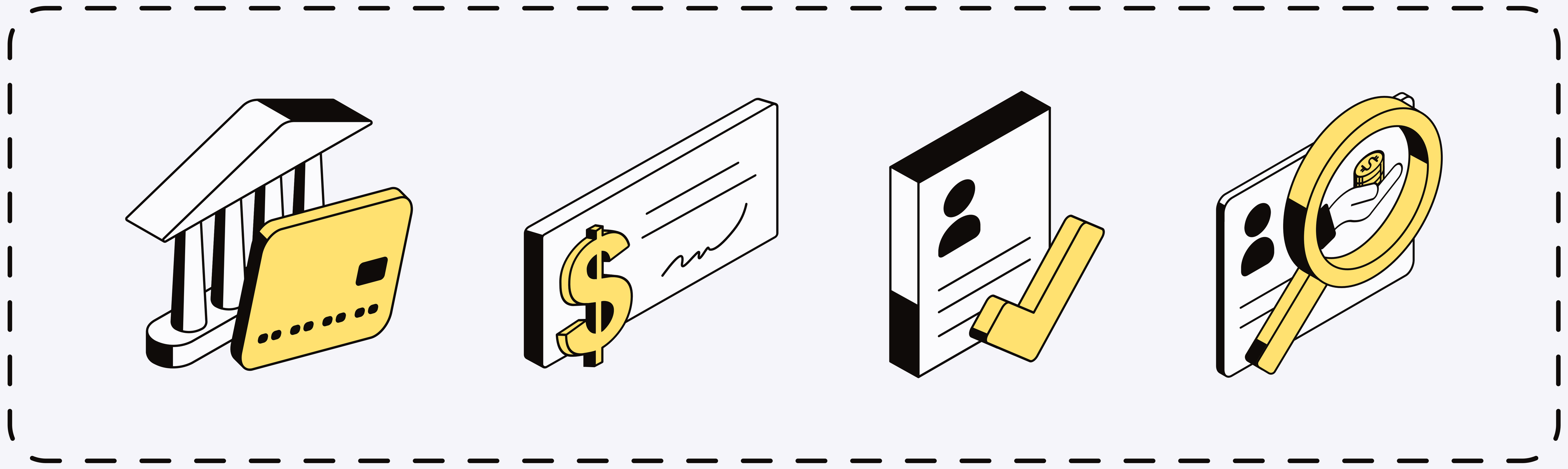


Introduction

When Nova Credit issued the first State of Alternative Data report in 2022, the consumer finance market was still reeling from the impact of COVID-19, the surge in alternative payment options like buy now, pay later (BNPL), and the threat of a looming recession.

Arguably, immediate fears of a recession have cooled, but the lending industry remains on edge. Today's lenders face rising delinquencies, elevated interest rates, and historically low demand—not to mention macroeconomic challenges posed by intensifying international conflicts and climate change—making their efforts to support their bottom line through market expansion and risk reduction even more pressing.

Meanwhile, many lenders are turning to **alternative data sources**, like bank data, income and employment records, and bill payment history, to supplement traditional credit reports in their underwriting processes. Combined, these sources offer a more comprehensive view of financial health, especially for thin file consumers (like younger generations and recent immigrants) who have had limited opportunities to build a formal credit history.



The effective use of alternative data in contemporary underwriting practices still presents challenges for lenders, impacting the extent of its adoption. We found that, while **90%** of the lenders we surveyed feel that access to more alternative data would help them approve more worthy borrowers, only **43%** currently supplement credit scores with alternative data in their risk assessments.

To learn more about the ways alternative data is shaping current underwriting practices—and the potential it holds for the future—Nova Credit surveyed 125 decision-makers at banks, credit unions, fintechs, and other lending institutions.

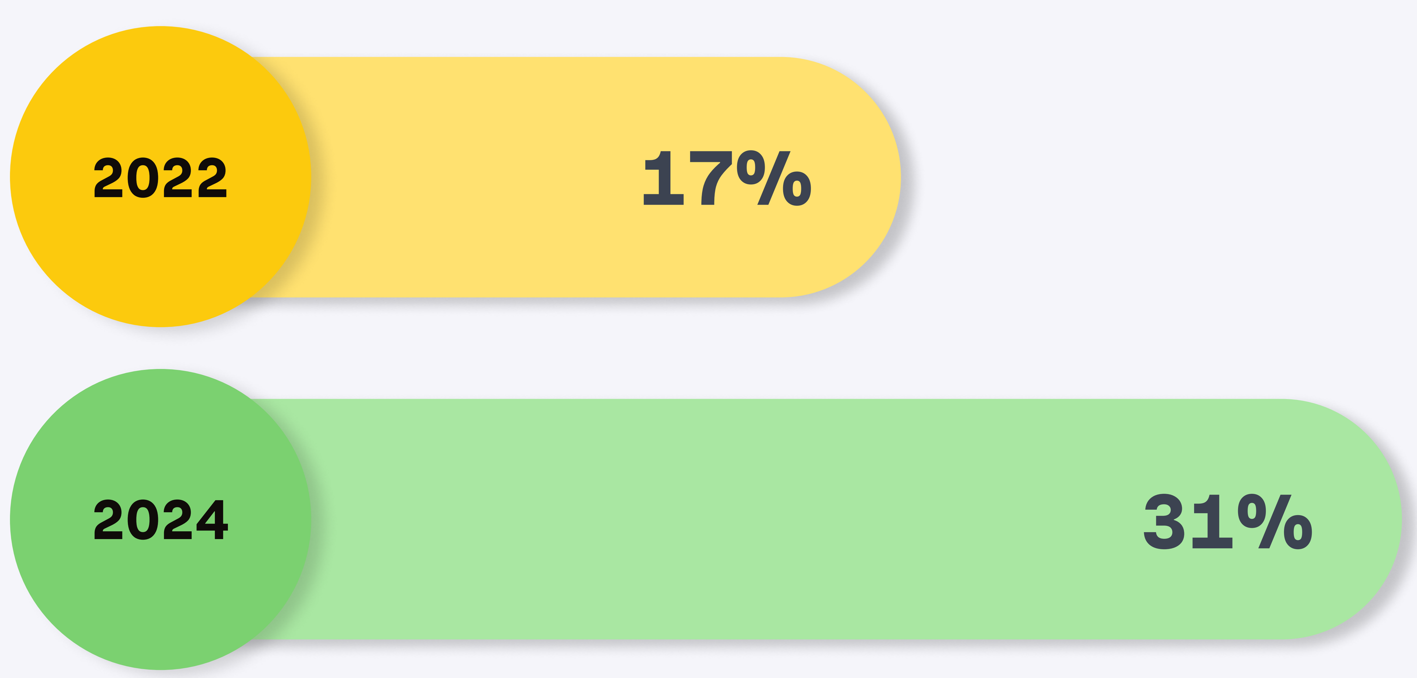
This report examines what they had to say about the benefits and challenges of using alternative data, key barriers to adoption, the role third-party data providers can play, and how proposed regulatory shifts are poised to transform data-sharing models for lenders and borrowers alike.

Where Lenders Get Their Data

Most lenders still rely on traditional, credit data-based underwriting practices as their main form of risk assessment, despite a commonly held belief that credit scores have considerable limitations.

Our survey found that a substantial number of lenders feel that credit scores do not accurately represent creditworthiness in today's financial landscape. This number is up from two years ago, when significantly fewer surveyed lenders expressed concerns about the completeness of credit scores.

Percentage of lenders who report that credit scores do not accurately represent creditworthiness



Inarguably, credit scores tell just one part of a consumer's story. That's because credit scores are only representative of information that's reported to credit bureaus, which is generally limited to how a consumer handles their outstanding debt and lines of credit. Credit scores don't take into account all of the activity that comprises a consumer's financial life.

Credit scores are also partly calculated on lagging data, as some events—adverse or otherwise—don't show up in a credit report for 30 days or more. That makes credit scores themselves a snapshot of a consumer's past rather than a trustworthy representation of their present. And credit reports themselves are prone to errors that can undermine their usefulness.

As a result, credit scores can mask critical information about consumers' creditworthiness. In fact, it's not uncommon to find that consumers with average and even above average credit are actually in a precarious financial situation.

A 2023 survey from PYMNTS and LendingClub found that **49%** of consumers living paycheck to paycheck who have no issues paying their monthly bills and **22%** of paycheck-to-paycheck consumers who do have issues paying their bills report having super-prime credit scores. In other words, there are a significant number of super-prime consumers who may be one hardship away from defaulting on a loan.

On the flip side, consumers with low or no credit scores can be good credit risks. That's because around 62 million U.S. consumers today (or almost a quarter of the adult population) are considered to be thin files.[1]

Thin file consumers are likely to include:

- **Young people**, who have not had much time nor reason to open financial accounts, apply for credit, and take on debt.
- **Recent immigrants**, who may have well-established credit histories in other countries that are not reflected in their U.S. reports.
- **Low-income workers**, who face greater obstacles applying for and obtaining credit.

In practice, this means that, even if a thin file applicant is securely employed, earns a steady income, and consistently pays traditionally unreported bills like utilities and rent, a lender relying primarily on credit data will deem their creditworthiness too difficult to evaluate.

The result is a lose-lose situation: The lender misses out on promising opportunities to grow their portfolio, while the applicant is denied potentially life-changing access to financial services.

78%

of lenders still use traditional credit data-based underwriting as their main form of risk assessment.

31%

of lenders feel that traditional credit reports don't paint a complete picture of a consumer's finances.

To address this financial knowledge gap, many lenders are turning to alternative data sources to bolster their underwriting models.

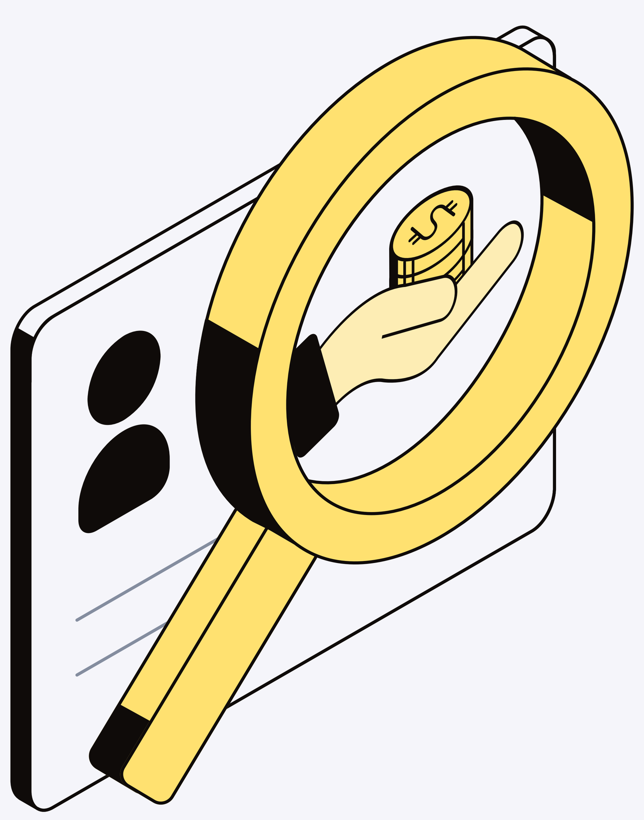
This alternative data is often direct-source and consumer-permissioned, meaning consumers give their informed consent for lenders to access it straight from the system of record—like their bank account, employment platform, or payroll provider.

[1] The term thin file is used to describe consumers who have fewer than five accounts listed in their credit report.

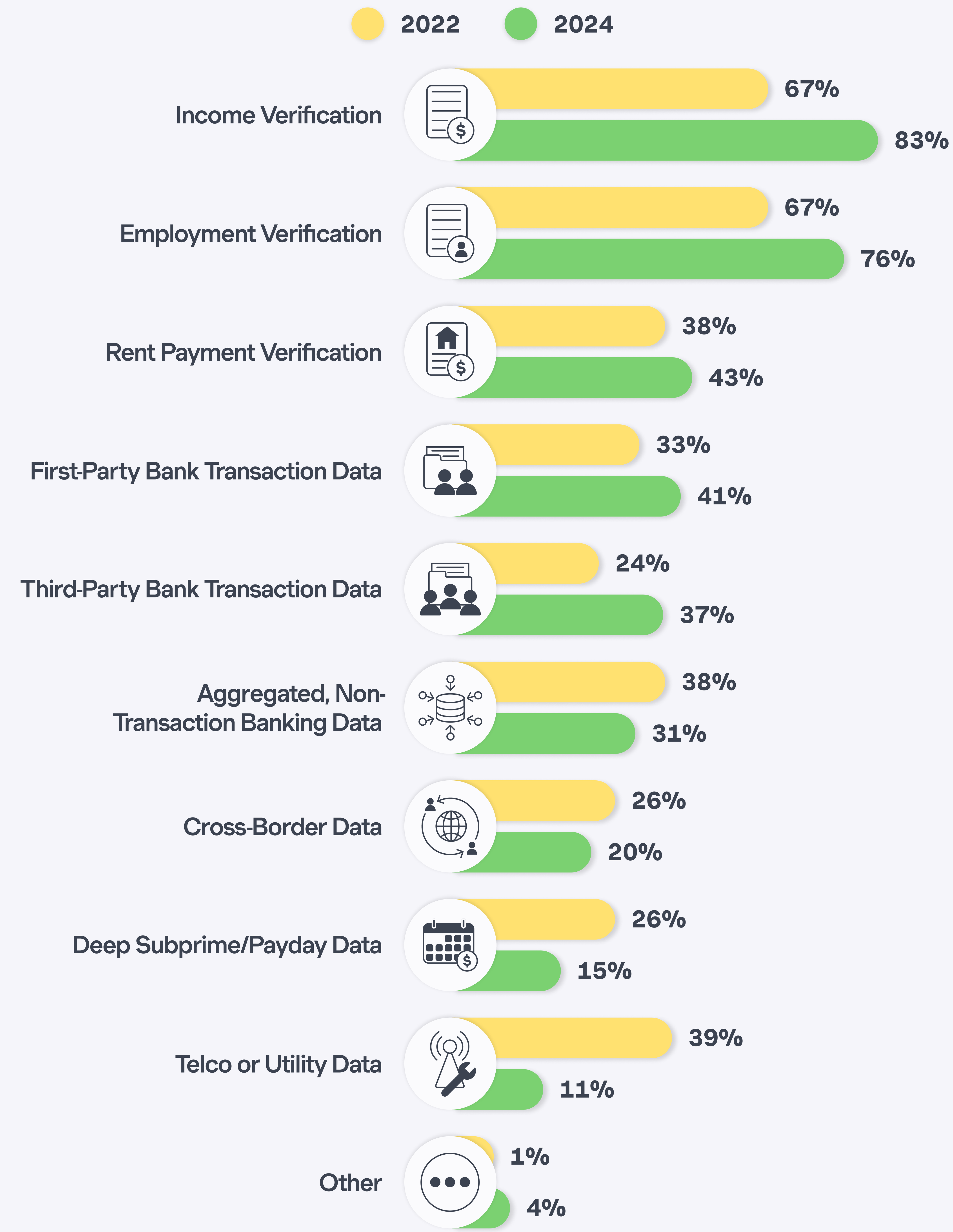
We found that **43%** of lenders are currently using alternative data to gain a deeper understanding of consumer finances—including more than half **(52%)** of surveyed fintechs.

This alternative data largely comes from income verifications (83%), employment verifications (76%), rent payments (43%), and bank transactions through first-party (41%) and third-party (37%) sources.

They're data points that don't lag like credit reports. Instead, they indicate how consumers are actively managing their cash flow in real time. If a consumer regularly honors their day-to-day financial obligations and has enough earnings and financial resources to take on additional debt, alternative data can show that. In turn, it offers a more complete view of a consumer's creditworthiness.



What forms of nontraditional/alternative credit data do you use?



The Benefits of Alternative Data

Surveyed lenders generally agreed that the more data they can leverage in their decision-making, the better. Among those currently using alternative data, the most commonly cited motivation was gaining a more holistic view of applicants' financial health in order to make more confident and profitable lending decisions, particularly when evaluating nontraditional consumers.

"Using alternative data has resulted in higher approval rates, higher initial credit lines, and increased utilization timelines."
- Anonymous Survey respondent

93% Nearly all lenders who have adopted alternative underwriting data feel it has had a positive impact on intended KPIs.

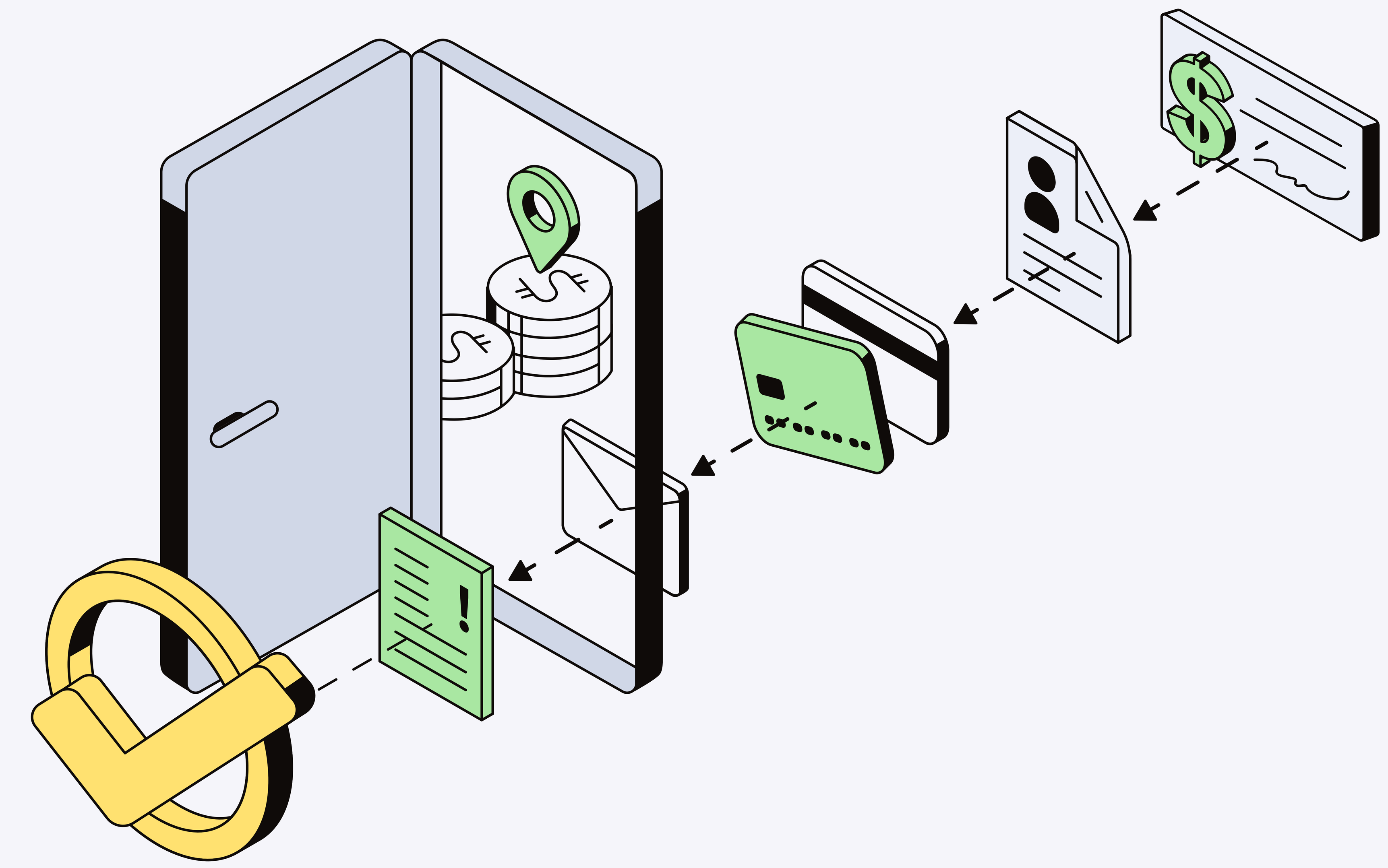
Lenders who use alternative data note stronger portfolio performance across the board, including higher approval rates and initial credit lines, increased borrower engagement and retention, more accurate risk assessments, reduced losses, faster application and funding timelines, and expanded market share.

The benefits of using alternative data should be a clarion call for lenders, many of whom are focused on shoring up their bottom line in light of an uncertain economy. Protecting their profits by reducing fraud **(22%)** and loss **(12%)** as well as growing their business among their current customer base **(17%)** and across new market segments **(16%)** are among their highest priority initiatives.

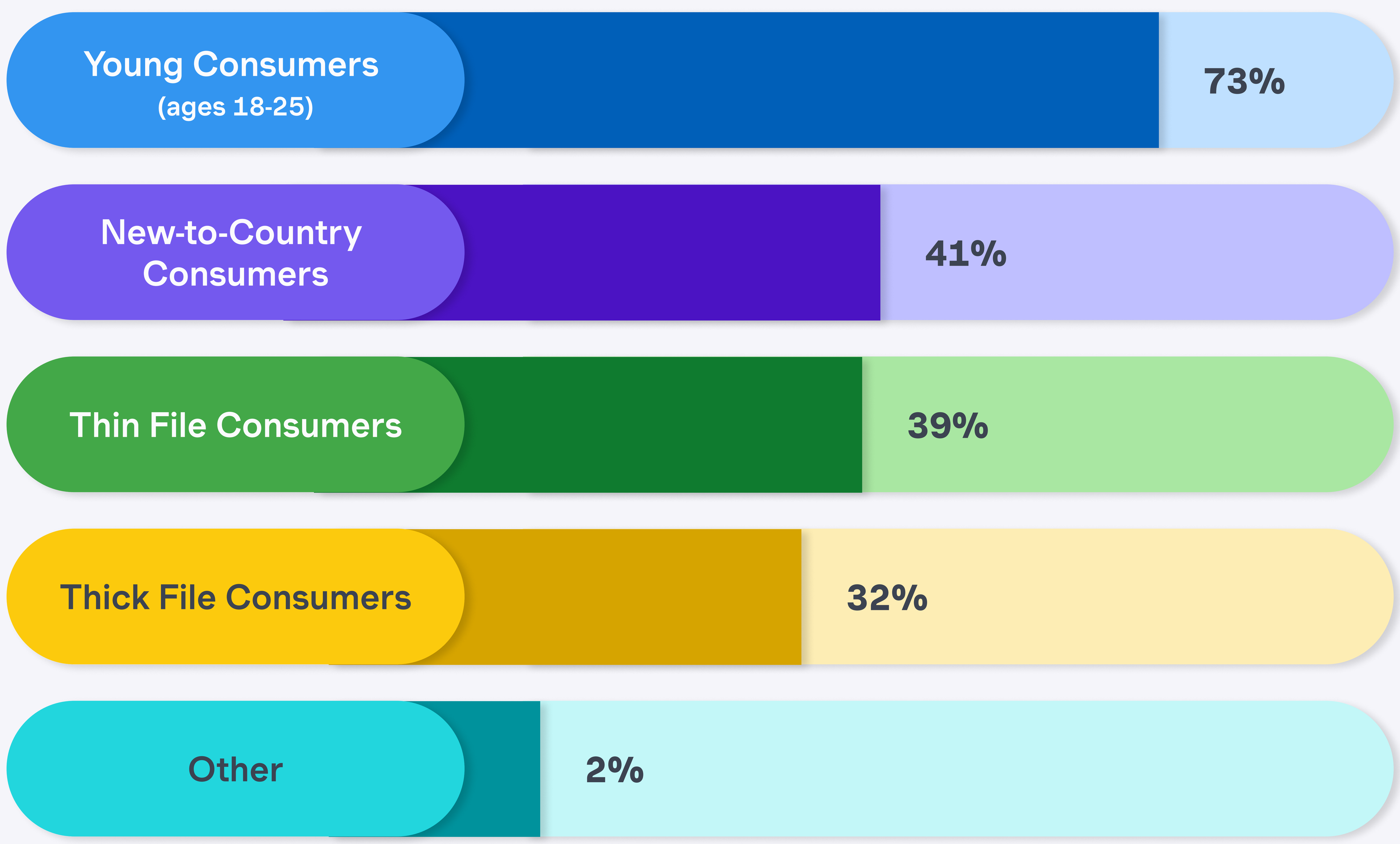
Which of the following do you view as the greatest strategic initiative for your organization?

These goals surpassed initiatives that have historically been front-of-mind for financial institutions, including building a digital/online presence **(9%)**, expanding to new geographic markets **(8%)**, and diversifying their products and services **(6%)**—which were all among the top priorities for lenders in our 2022 survey.

Lenders' new areas of focus are those most directly supported by the use of alternative data, which can be particularly powerful when it comes to approving a greater volume and range of borrowers without taking on additional risk.

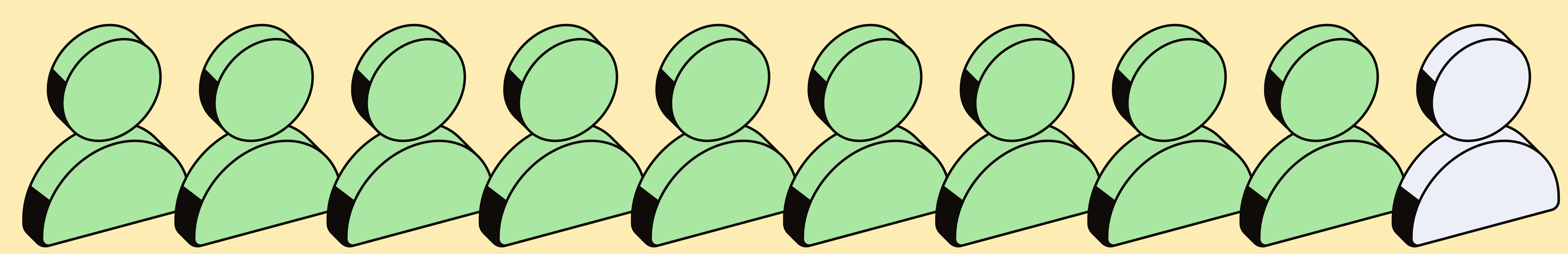


Which customer segments do you view as having the greatest opportunities for growth for your organization?



Lenders are aware of the potential alternative data holds in this regard. In fact, a vast majority of survey respondents **(90%)** believe that greater access to alternative data would help them tap into new markets of interest. So, why aren't more lenders putting alternative data to use?

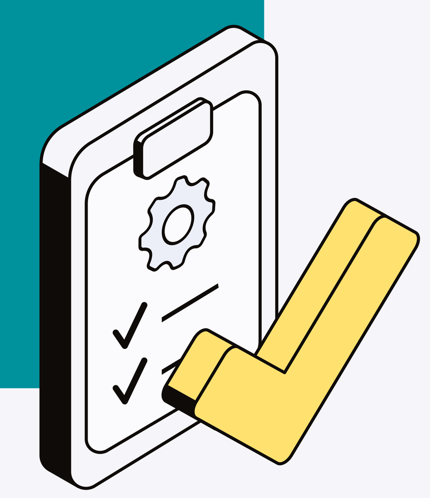
90% of lenders believe greater access to alternative data would help them confidently approve more borrowers.



Key Barriers to Adoption

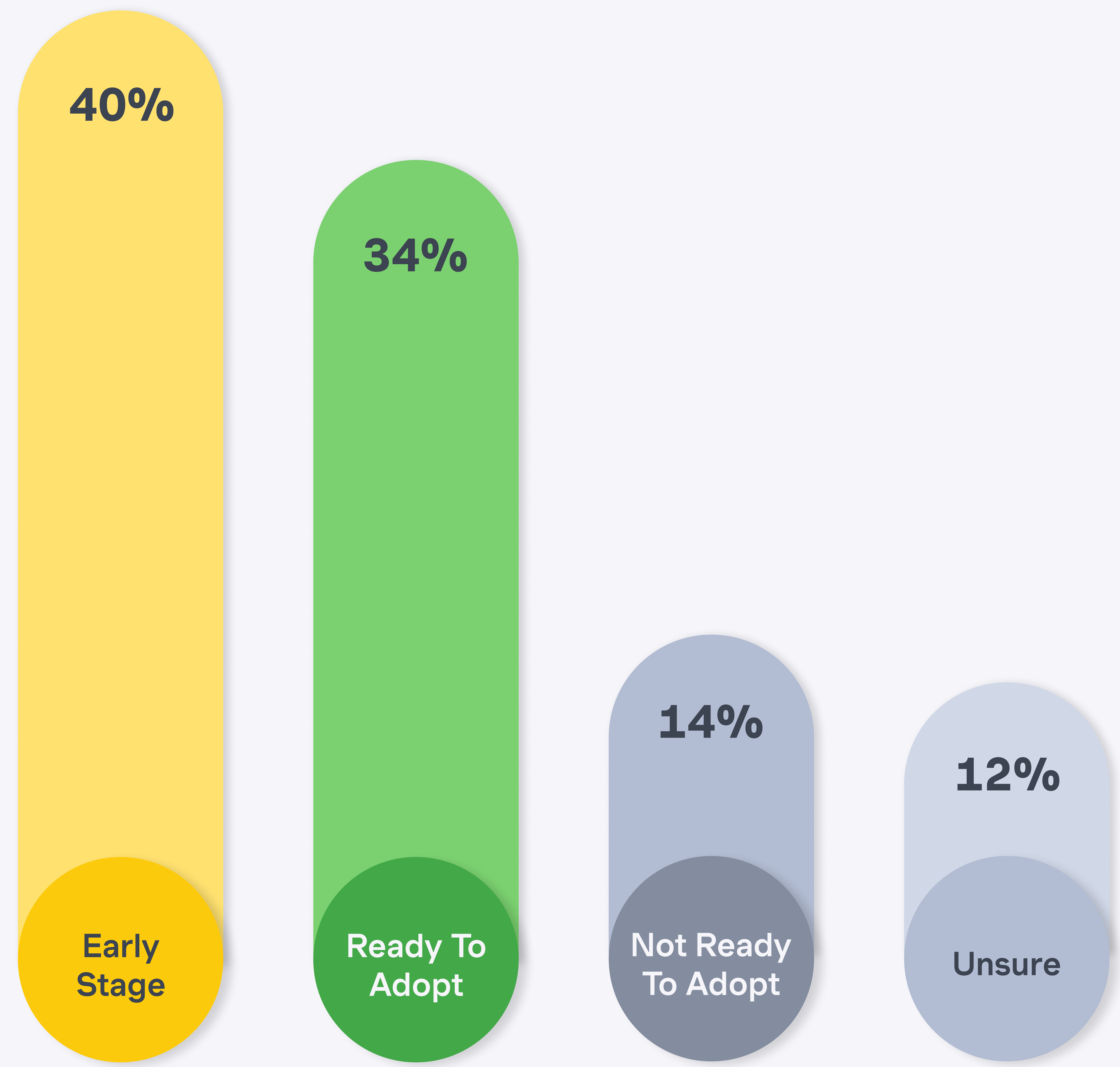
Despite high expectations and promising results, not all lenders feel that their organization is ready to leverage alternative data as part of its underwriting process.

Digital-native fintechs **(83%)** and banks **(78%)** feel the most prepared to implement consumer-permissioned alternative data sources today, while only **57%** of credit unions are confident about their current capabilities.



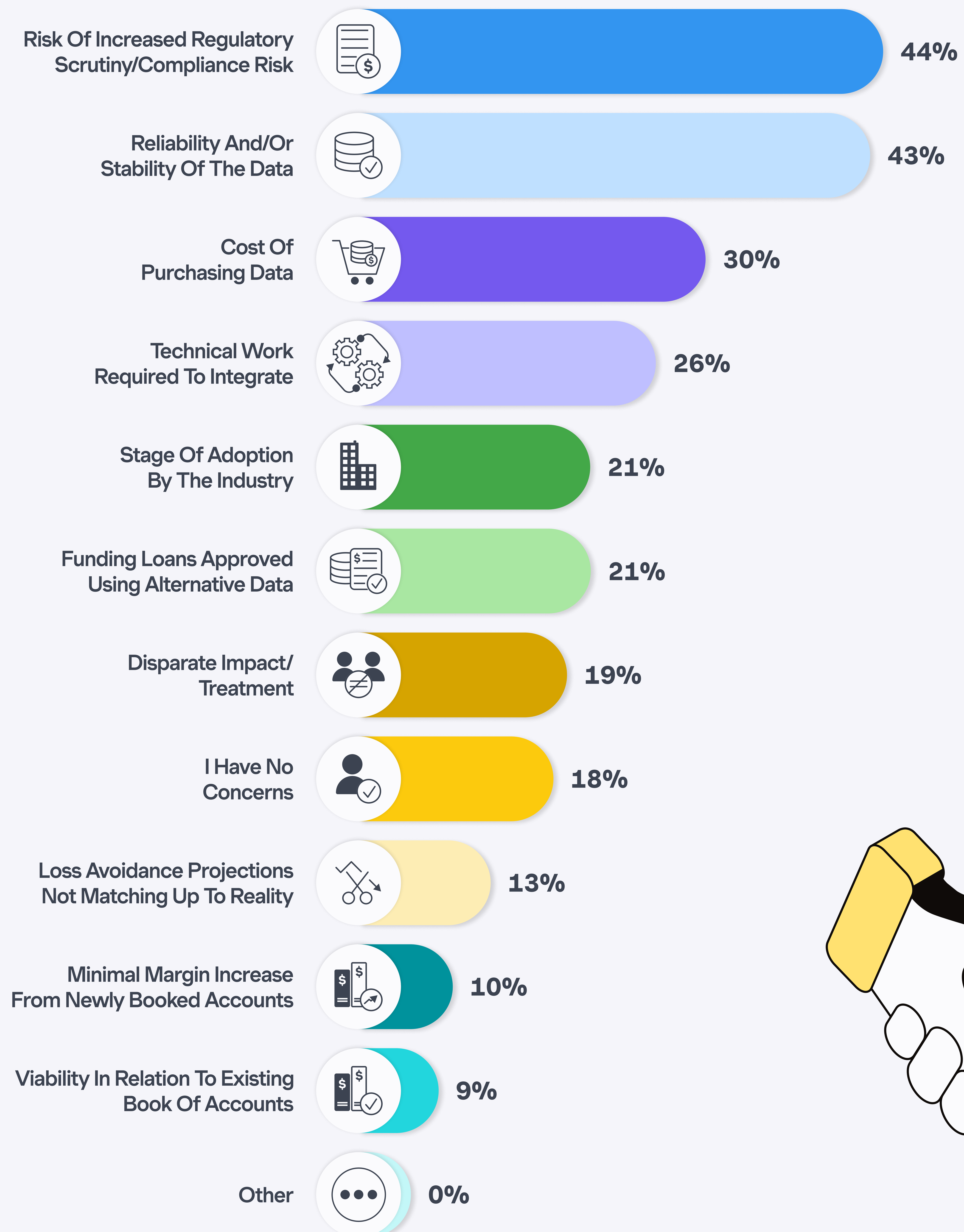
Respondents also believe that most of their fellow lending institutions are in the early stages of adopting **(40%)** or just becoming ready to adopt **(34%)** alternative data models into their credit risk assessments. And more than a quarter **(26%)** either feel that the industry is not yet ready to handle new data sources or are unsure about its current level of preparedness.

Which of the following best describes where the majority of the industry is with adopting alternative credit data into credit risk assessments?



What's more, a majority of surveyed lenders **(82%)** expressed some hesitation around using alternative data in their own underwriting.

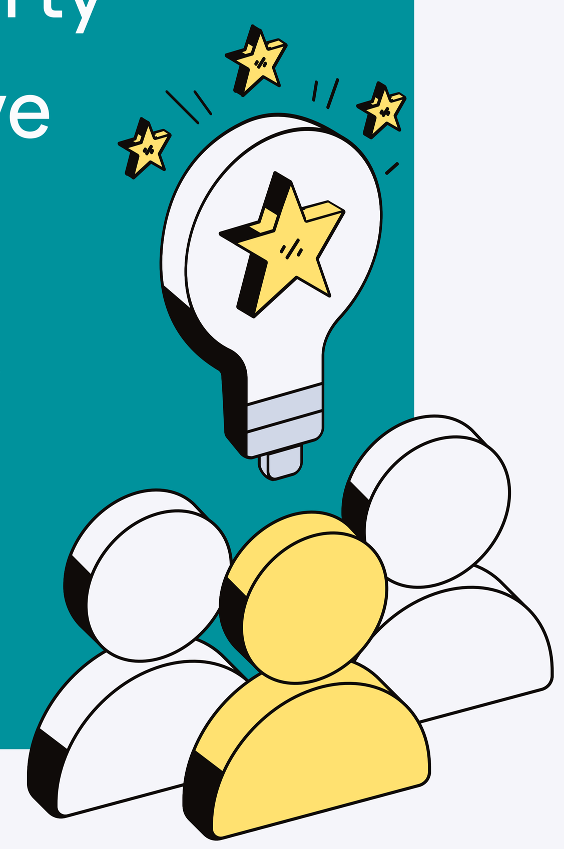
What, if any, concerns do you have about using alternative data in your risk assessments?



The most widely reported concerns have to do with the logistics of implementation, rather than any doubts about potential results. These include unease with the risk of increased regulatory scrutiny and compliance **(44%)**, the reliability and/or stability of the data itself **(43%)**, the cost of purchasing and accessing alternative data **(30%)**, and the technical work required to integrate with and maintain new data connections **(26%)**.

These barriers could all be solved by partnering with a specialized alternative data provider. Many specialized providers optimize for time, cost, and regulatory needs by using API technology to establish real-time connections with multiple original data sources. In turn, they help lenders get off-the-shelf infrastructure quickly to market, access pre-verified financial data directly from a range of sources, and avoid the time, cost, and hassle of manually collecting and orchestrating data.

That's why **71%** of surveyed lenders foresee an opportunity to collaborate with third-party vendors to help them implement alternative data practices like open banking, with one finance professional going so far as to say, "We would be dumb not to use their expertise and analysis."

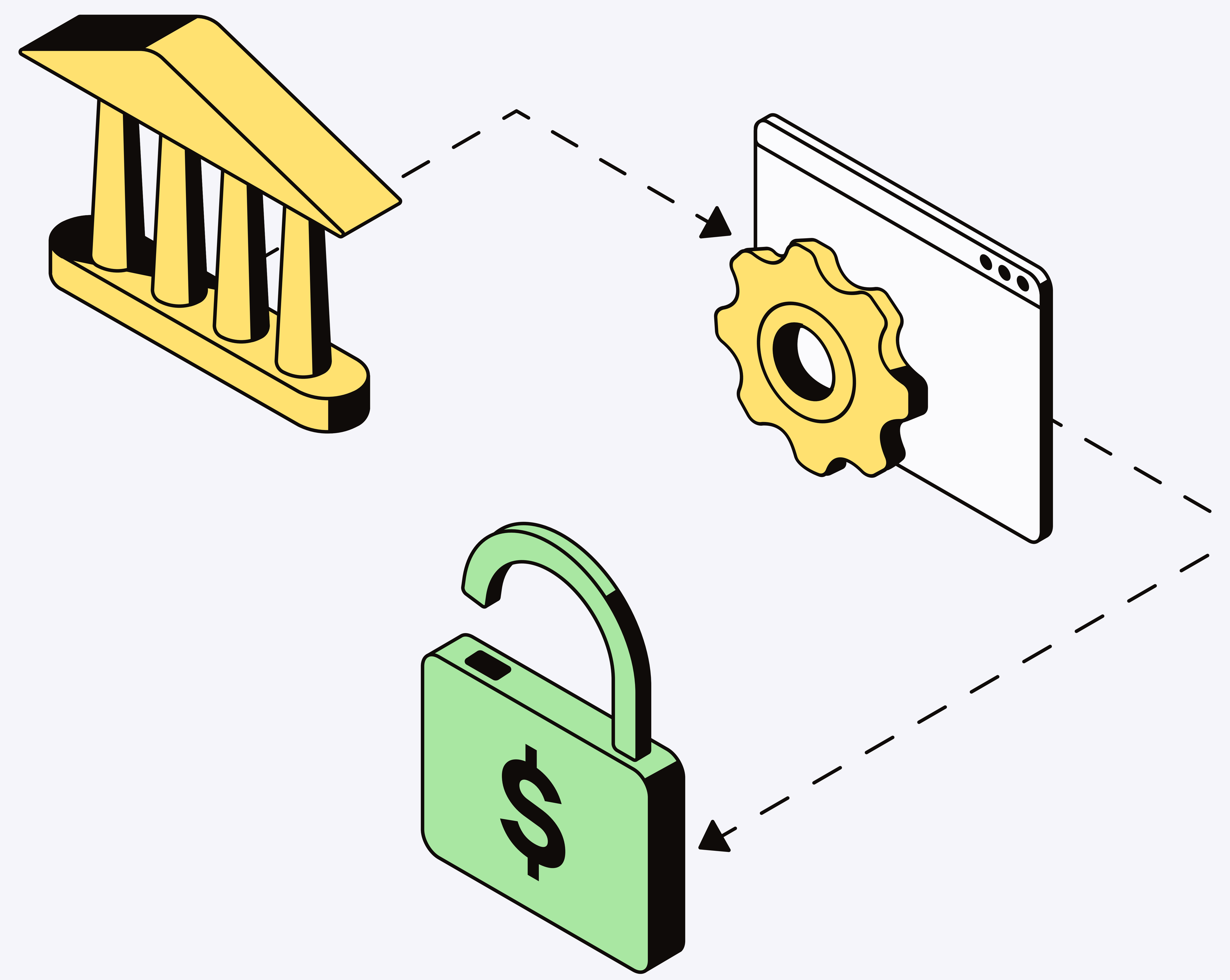


That said, most are still largely unfamiliar with top consumer-permissioned data providers on the market, indicating that more awareness is needed to drive the alternative data market forward.

"Third-party data providers specialize in open banking technologies, data security measures, and compliance regulations. They can help organizations like ours navigate the complexities of implementing an open banking solution."

71%

of lenders are looking to third-party data providers to help them navigate the adoption of open banking practices.



Expected Shifts in the Market

There is wide consensus among finance leaders that the rising popularity of alternative data stands to shake up the lending market, particularly when it comes to regulatory compliance. In fact, **81%** of surveyed lenders believe that open banking practices in the U.S. will have a significant influence on the development of consumer data security protocols.

> *"Alternative data is one of the biggest opportunities for lenders. Over the next one to five years, regulation of open banking is going to do a lot to advance the availability of one of the richest data sources for underwriting: transaction-level account data. I think lenders that anticipate what's going to be coming out, and are ready for it, are going to be positioned to benefit from stronger growth and lower losses."*

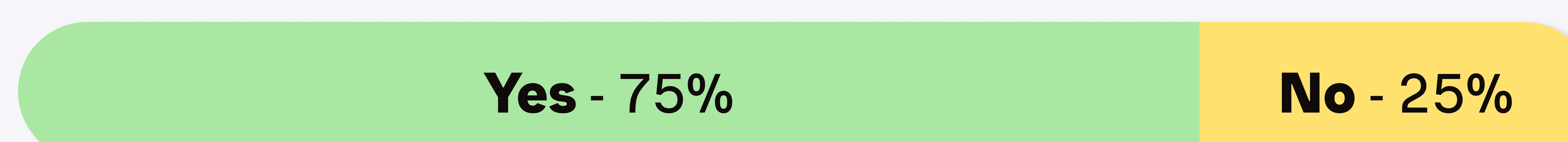
Brian Hughes
Former Chief Risk Officer
DISCOVER

Special attention is being paid to the 1033 "Personal Financial Data Right" rule proposed by the Consumer Financial Protection Bureau (CFPB). If approved, it would require financial institutions to provide consumers with shareable access to their own financial data, including information from bank accounts, credit cards, and digital wallets.

The idea is that this would not only hasten the shift to open banking, it would make it easier for consumers to shop for and switch to new financial service providers. This would ultimately drive competition and improve the accessibility and affordability of financial products and services.

The 1033 ruling has important implications for lenders, in particular. Among survey respondents, a large majority **(75%)** expect that, if passed, it will reduce obstacles as consumers seek to share information from a growing number of sources—streamlining the way lenders collect and consider alternative data points in their credit risk assessments.

Do you think CFPB's proposed rule will help reduce friction for consumers to provide lenders with permission to access their data?



Key Takeaways

The data reveals that a significant number of the lenders we surveyed **(31%)** feel that credit scores do not accurately represent creditworthiness in today's financial landscape, and **90%** feel that access to more alternative data would help them approve more worthy borrowers. However, while more lenders are steadily supplementing credit scores with alternative data in their risk assessments **(43%)**, industry adoption is not yet universal.

As lenders look to reduce risk **(22%)**, grow their customer base **(17%)**, and expand their addressable market **(16%)** amid lingering economic uncertainty, alternative data offers a promising path forward—and a more accurate and comprehensive way of evaluating consumers' creditworthiness than traditional credit reports.

The three market segments respondents most hope to engage in 2024—young consumers **(73%)**, recent immigrants **(41%)**, and other thin file applicants **(39%)**—are among those whose true creditworthiness is best determined by the more expansive visibility offered by alternative data.

Obstacles to more widespread adoption of alternative data among lenders surveyed include unease with the risk of increased regulatory scrutiny and compliance **(44%)**, the reliability and/or stability of the data itself **(43%)**, the cost of purchasing and accessing alternative data **(30%)**, and the technical work required to integrate with and maintain new data connections **(26%)**.

The emergence of specialized, third-party data providers is paving the way for lenders to incorporate alternative data sources into their existing underwriting processes. **71%** of surveyed lenders foresee an opportunity to collaborate with third-party vendors to help them implement alternative data practices.

Meanwhile, surveyed lenders believe proposed regulations, like the CFPB's 1033 Rule, offer great promise in terms of data accessibility **(75%)**, but also great disruption to current protocols for the security of consumer data **(81%)**. Some lenders speculated that it would increase their liabilities, creating the need for more infrastructure to remain compliant and relevant.

Together, these industry developments will transform the way lenders access and use consumer information and make alternative data the powerful, industry-shifting resource it was always intended to be.

About Nova Credit

Nova Credit is a credit infrastructure and analytics company that enables businesses to grow responsibly by harnessing alternative credit data. The company leverages its unique set of consumer-permissioned data sources, bank-grade infrastructure and compliance framework, and proprietary credit expertise to help lenders fill the gaps that exist in traditional credit analytics. Nova Credit serves as the bridge between data and credit excellence, providing a comprehensive suite of solutions designed to give lenders across various industries—including finance, fintech, property management, telecom, and automotive—a competitive edge in the era of open finance.

Its cross-border credit product, Credit Passport®, cash flow underwriting product, Cash Atlas™, and income verification product, Income Navigator, are used by leading organizations like American Express, Verizon, HSBC, SoFi, Scotiabank, and Yardi. Nova Credit is backed by investors including Canapi Ventures, Kleiner Perkins, General Catalyst, and Index Ventures as well as executives from Goldman Sachs, JP Morgan, and Citi. Learn more at www.novacredit.com or reach out to connect@novacredit.com.

Methodology

This survey was commissioned from independent research firm, Researchscape, which ran an online survey among 125 U.S.-based finance leaders from banks, credit unions, fintechs, and other lending institutions between January 23 and February 6, 2024.

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