



Financial Services Management

Alternative Consumer-Finance Data Standards

Cite

FRB, OCC, FDIC, CFPB, NCUA; Interagency Statement on the Use of Alternative Data in Credit Underwriting

Recommended Distribution:

Retail Finance, Risk Management, Corporate Planning, Corporate Policy, Innovation, Legal, Government Relations

Websites:

<https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20191203b1.pdf>

Impact Assessment

- Alternative-data use is actively encouraged, speeding adoption by banks and large nonbank lenders subject to the CFPB. Supervisory inquiries may now be more quickly and favorably addressed.
- However, no safe harbors or other clear process for obtaining supervisory certainty are created, perhaps leading to idiosyncratic decisions by different regulators or supervisory offices.
- Consumer reporting agencies may face new competition if lenders are willing to take regulatory risks and/or some agencies authorize alternative-data use.
- The extent to which consumer safeguards mandated for credit reports and scores apply to alternative data is uncertain even though the agencies appear to expect like-kind protections. Different consumer-protection and fair-lending regimes for different data, different lenders, and/or pursuant to different regulators could not only create competitive advantages, but also heighten consumer or small-business credit risk. However, alternative data with appropriate safeguards may improve not just financial inclusion, but also long-term economic equality.

Overview

In what is clearly a preliminary statement, the banking agencies and CFPB have for the first time addressed alternative consumer data, actively encouraging its use despite stipulating an array of general concerns and supervisory injunctions. The statement may well provide significant regulatory relief for cash-flow data and second-look programs, but is otherwise only general in its approach to alternative data. As a result, lenders subject to the statement will need additional supervisory assurances to limit compliance, legal, and reputational risk. This guidance may now be more likely to be both forthcoming and favorable, but regulatory exemptions appear unlikely. The banking agencies also reiterate safety-and-soundness

requirements, ending speculation that some standards (e.g., model validation) might be waived for alternative data.

Impact

As evidenced across an array of innovative financial-product offerings, retail and small-business financial institutions are increasingly using data well beyond traditional criteria for credit-underwriting, fraud-prevention, marketing, fee-setting, and other critical risk decisions. These alternative data are then often analyzed using artificial intelligence (AI) or other methodologies different not only in data sets, but also overall construct from the longstanding credit-report and credit-score approaches covered by the Fair Credit Reporting Act (FCRA) and by the existing construct of law and rule designed to prevent discrimination. The banking agencies are now also at pains to ensure that new data do not mean new risk. As a result, while a positive statement, alternative-data use may still vary by purpose, product, agency, analytical method, or provider.

Although the CFPB has created a process for preliminary review of fintech projects, including those using alternative data,¹ no such process has been finalized by the banking agencies. The OCC has sought comment on a pilot program that would allow its regulated entities to test and receive regulatory input on innovative products, services, and processes. The FDIC has announced that it will also propose a pilot program but has so far only sought comment on how it will process pilot proposals.² Banks may gain some legal certainty under the CFPB or these other procedures, but considerable legal and reputational risk remains. As a result, nonbank providers of financial services subject to CFPB oversight may have more latitude to innovate due to greater legal certainty.

One of all of the agencies' key concerns is the need to prevent overt, implicit, and disparate-impact discrimination by race, gender, age, or other protected bases. The discrimination question assumed immediate importance after the Department of Housing and Urban Development (HUD) proposed earlier this year to provide a generous safe harbor against disparate-impact assertions under the Fair Housing Act.³ No such special treatment is provided in this statement for mortgage finance, other forms of retail finance, internal pricing and marketing procedures, or for small-business lending, meaning that models using alternative data for credit underwriting and pricing or for the other purposes noted above will need carefully to monitor service delivery and ensure that any disparate impact is defensible on grounds of risk or an appropriate business strategy.

Alternative data may also challenge prohibitions against unfair, deceptive, and abusive practices (UDAP), and various requirements under the FCRA.⁴ The CFPB's authority over UDAP is in some cases shared with the Federal Trade Commission, which has not signed on to this statement. Although banks are generally subject only to the banking agencies and CFPB for UDAP compliance, companies subject to dual jurisdiction will need to be mindful that this statement not only warns them to take care, but also does not protect them from the FTC.

FCRA issues are at least as complicated due to shared jurisdiction and the uncertainties about when consumer information is or is not covered by the Act's protections. In general, any information a consumer shares with a lender is outside

¹ See **FINTECH27**, *Financial Services Management*, September 23, 2019.

² See **FINTECH28**, *Financial Services Management*, November 15, 2019.

³ See **FAIRLEND6**, *Financial Services Management*, September 3, 2019.

⁴ See Client Reports in the **FCRA** series.

the scope of FCRA as is information derived from sources other than a consumer reporting agency or resulting credit score. When FCRA regulation and related rights do not apply, consumers may not be able to remedy inaccurate data, prevent their data from being shared with third parties, or have confidence that confidential personal information is not subject to cyber-risk or identity theft. House Financial Services Committee Chairwoman Waters (D-CA) has objected to the asymmetry in consumer rights between traditional and non-traditional information, but a statutory fix does not seem imminent.⁵

Despite all these concerns, the statement provides comfort with regard to certain new data sources (e.g., cash-flow analysis) that are said to improve underwriting and better protect consumer data and ensure fair lending and credit-process rights despite the FCRA uncertainties. “Second-look” programs are said also to be beneficial due to financial-inclusion and consumer-protection rights.

What’s Next

This statement was issued on December 3 and is effective immediately. The agencies readily acknowledge that it is preliminary and reserve the right to issue subsequent statements. Feedback on it is also invited, with no deadline provided for doing so. Companies are invited to seek greater clarity from their supervisors, but no process for doing so is set forth.

Analysis

The inter-agency statement applies to use of consumer data rather than to furnishing, compiling, or transferring such data. Alternative data are defined as information not typically found on a consumer’s credit files held by nationwide consumer reporting agencies that is customarily provided for credit applications.

In general, all lenders under this statement must address alternative-data risk by understanding and addressing consumer-protection risk. Banks are also told to undertake rigorous assessments of the quality and suitability of data to support prudent operations. They should also ensure compliance with principles in the agencies’ model-risk guidance.

⁵ See *Client Report FCRA28*, July 25, 2019.