Value of Credit Data Reporting

An Equifax Study

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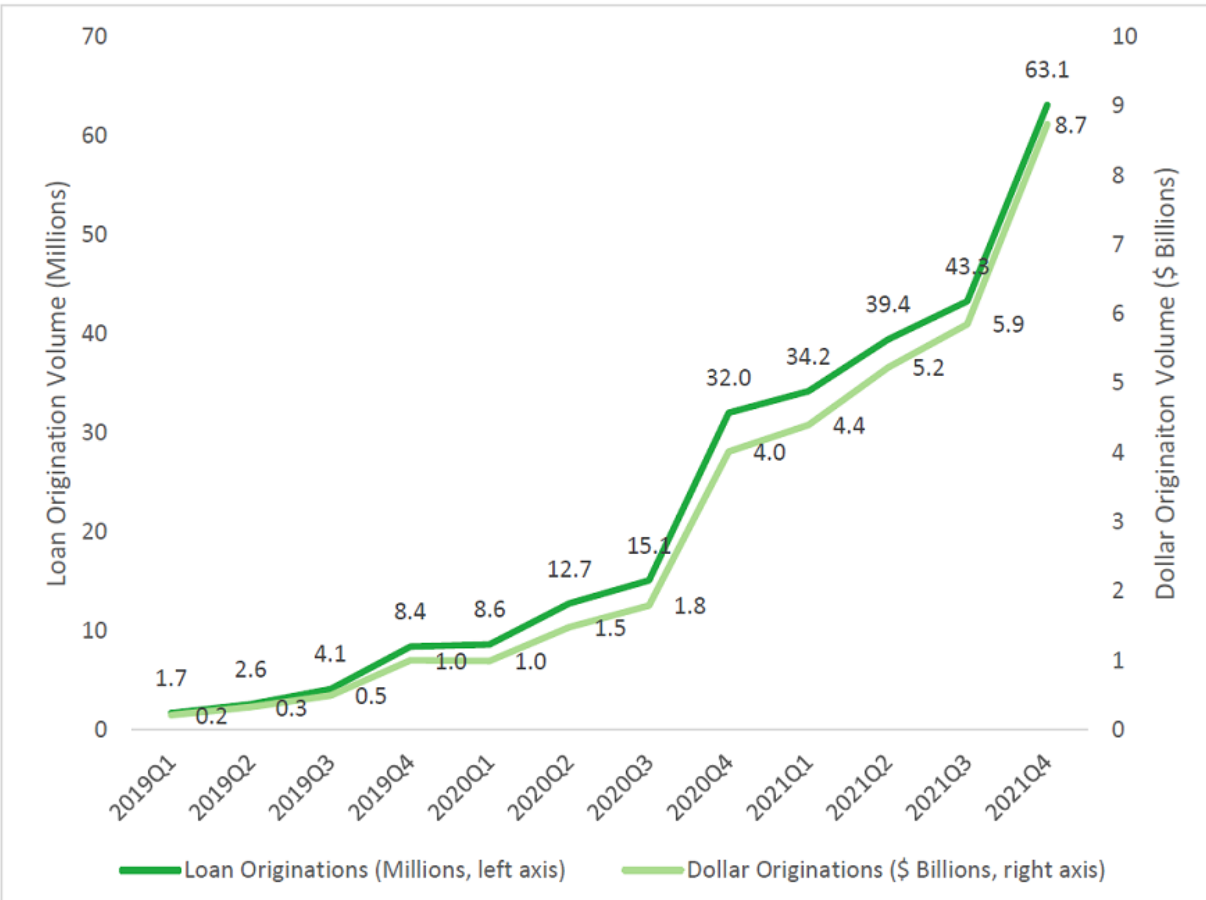
Introduction

The consumer lending market has gone through a radical change in the past 3-4 years. New market players (Fintechs) have exploded on the scene offering everything from traditional deposit accounts and credit cards to unsecured personal loans, credit rebuilder loans, Buy Now Pay Later (BNPL), and Speciality Financing options such as rent-to-own. Consumer use of these loans grew significantly during the COVID-19 pandemic and has continued to expand since. For example, the graphic below from the CFPB's report on BNPL market trends shows that the top 5 issuers of BNPL loans tripled their new loan balances from 2020 - 2021.



Source: CFPB, Buy Now, Pay Later: Market trends and consumer impacts report, September 15, 2022

In addition to Fintech lending, Specialty Finance lending continues to grow as well. Although there was a downturn in installment loans and payday loans resulting from government stimulus checks during the pandemic, there was a significant increase in lease-to-own borrowing. Consumer credit files managed by the three major national Consumer Reporting Agencies (CRA), including Equifax, remain the bedrock that is used for the vast majority of consumer lending. As such, reporting account information CRAs to be included in a consumer's credit file continues to be fundamental in helping consumers expand their lending options to help them more effectively live their financial best.

However, as the traditional consumer credit data becomes more homogenized, the use of alternative data such as specialty finance, utility, rental, consumer permissioned banking, and employment data has become more prevalent to help provide a more complete picture of a consumer's financial landscape. Given this incredible growth in lending alternatives, it is more important than ever that all types of lenders (Traditional, Fintech, and Specialty) report their loans into the traditional and specialty finance consumer credit files (such as DataX and Teletrack), some of which are owned and managed by the three major CRA's. In June 2022, the CFPB released a blog post stating in part that "few BNPL lenders furnished information about consumers to the nationwide consumer reporting companies (NCRCs).

This lack of furnishing could have downstream effects on consumers and the credit reporting system. It could be bad for BNPL borrowers who pay on time and may be seeking to build credit, since they may not benefit from the impact that timely payments may have on credit reports and credit scores. It may also impact both BNPL lenders and non-BNPL lenders seeking to understand how much debt a prospective borrower is carrying." (CFPB Blog, "Buy Now Pay Later and Credit Reporting"). Reporting account data to traditional and specialty CRAs provides benefits to all players in the system: Consumers, Fintechs, and Traditional Lenders. This paper examines the value for these three groups of reporting these new loans into the CRA's.

Consumer Benefits

Of the approximately 250 million credit-eligible adults in the U.S., Equifax data shows that roughly 91 million have little to no access to credit due to a lack of credit activity. Additionally, nearly 75% of those consumers have "thin" credit files, where the lack of data on their credit file significantly limits their lending options or causes them to pay much higher interest rates for the money they borrow. Reporting all loans to a traditional nationwide CRA like Equifax or a Specialty CRA means that previously credit invisible consumers (no-file, thin-file, and subprime) can establish tradelines on their credit file that could substantially improve their credit options.

Since this is one of the most important components of a consumer's credit score is the presence of on-time payments on lending obligations. Given that many consumers pay their financial obligations on time and completely, reporting BNPL loans could help increase consumers' credit scores as they demonstrate a responsible financial track record. An analysis conducted by Equifax on the effect of small-dollar, revolving lines of credit on consumer credit scores showed that consumers experienced a score increase of between 13-21 points when these types of loans were applied to their credit files.

The impact was even more pronounced for those with thin files who paid their loan on time. As borrowers and lenders are looking for more ways to responsibly expand financial inclusion and give responsible consumers the chance to participate in the “American Dream,” it is more important than ever to have all consumer obligations reported to the consumer credit files.

Finally, the importance of reporting all lending facilities to the consumer credit files becomes especially crucial in helping consumers practice sound financial discipline. Lenders do not want to provide a consumer with a loan that may overextend their reasonable ability to repay the loan; that is bad for the lender and the consumer. When all financial obligations of a consumer are not being reported to the credit file, lenders that rely on the credit report to evaluate the consumer’s creditworthiness and ability to repay may be missing critical information regarding that consumer's credit obligations. This could lead to a lender offering a consumer a loan that may overextend that consumer and put both the consumer and the lender at undue risk. The CFPB noted this concern in their findings regarding BNPL lending by saying, “Even if the credit extended by any single lender does not exceed a few hundred dollars, the ease with which an applicant could borrow that much from multiple BNPL lenders within a short time frame could quickly affect their financial health.”(CFPB, Buy Now, Pay Later: Market Trends and consumer impacts report, September 15, 2022).

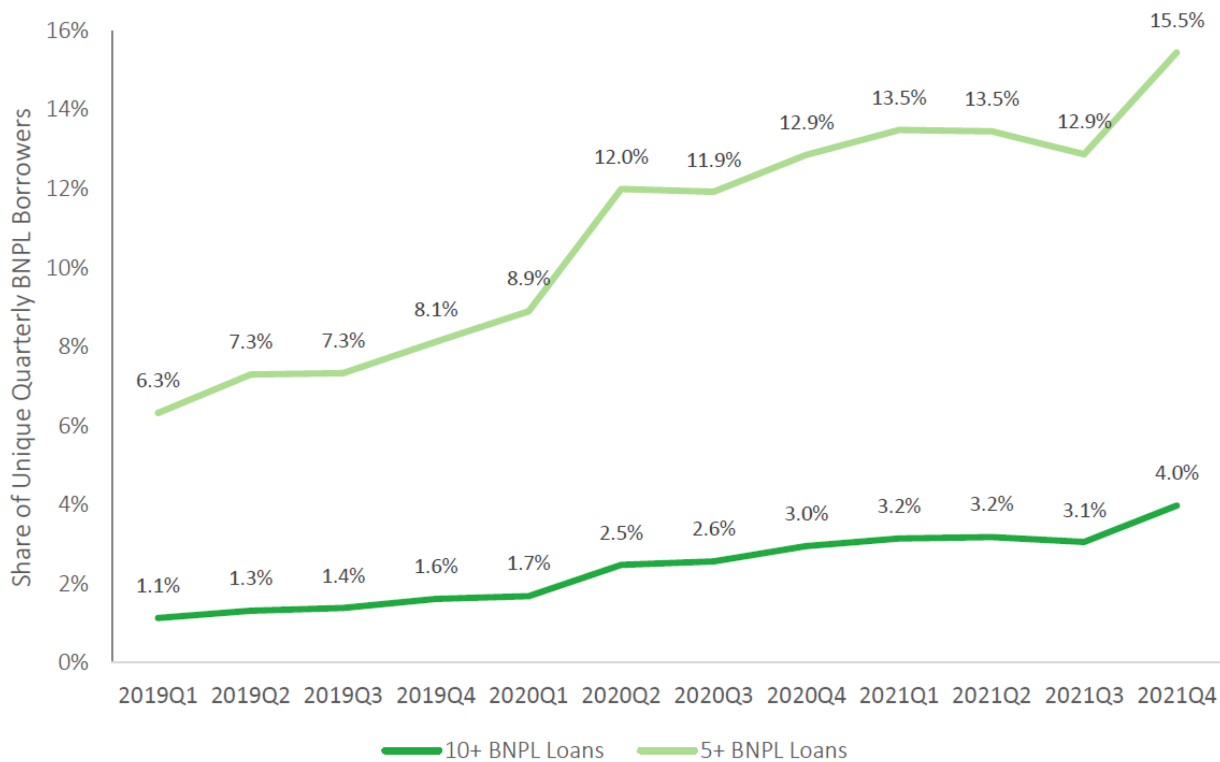
Non-Traditional Lender Benefits

While the benefits to consumers of widespread reporting are readily apparent, the benefits to Fintechs and Specialty Finance lenders are a bit more nuanced. Reporting loans to the CRAs requires a measure of investment on the lender's part. This comes in the form of time to properly establish reporting practices that conform to the CRAs requirements as well as providing customer support for consumers that may call in with questions regarding their loans being reported to the CRAs. These are not trivial investments, but the benefits of reporting significantly outweigh the costs.

The foremost benefit is that reporting loans to the CRAs can help incentivize stronger payment performance by consumers who are often aware of which loans get reported to CRAs and which do not. Consumers are more credit conscious than ever. Studies show that 42% of consumers check their credit file and score at least once per month, and 61% of consumers are actively trying to improve their credit scores. As such, consumers understand that their payment behavior on loans reported to the CRAs matters when it comes to their credit scores driving them to pay those loans on time compared to delaying or not paying those that are not being reported to their credit file.

Broad reporting of Specialty Finance and Fintech loans could also help build consumer loyalty with their brand by helping consumers establish or build credit. Moreover, it has the added benefit of providing the lender with a bigger picture of total payment history that could help lenders reward their customers with better access and terms.

Fintech lenders want to grow their portfolios responsibly, providing the most lending opportunity within an acceptable risk level. If Fintech lenders are not reporting their loans to the CRAs to be included in consumers' credit files, they are lending with "blinders on" because there is no way to know how many other loans a consumer may have with other Fintech(s). This can lead to consumers becoming over extended by opening multiple loans with a variety of Fintech lenders, especially during the holiday shopping season. In the CFPB's recent study (see chart below), they reported that in Q4 2021, 15.5% of consumers opened 5+ BNPL loans. These loans are often opened across multiple lenders, none of whom has exposure to the other loans being opened by their peers.



Source: CFPB, Buy Now, Pay Later: Market trends and consumer impacts report, September 15, 2022

Lack of insight into lending activity also may encourage unscrupulous practices such as fraudulent loan stacking practices, all of which increase the risk of loss to Fintech lenders. In the Specialty Finance space, it is common practice for lenders to check for other active loans before approving consumers to avoid loan stacking. Lenders who do not report are at higher risk of getting "stacked" when other lenders do not know about unreported loans.

Traditional Lender Benefits

Traditional lenders are very interested in having insights into the loans being extended by Fintechs and Speciality Finance lenders. While the volume of loans originated by Fintech and AltFi has increased significantly in the past several years, traditional lenders still extend the vast majority of credit to consumers, so having a complete picture of a consumer's debt picture is extremely important to ensure sound lending practices. With access to a consumer's full loan picture, traditional lenders can better assess risk and understand a consumer's ability to repay by seeing all credit obligations, including a consumer's Fintech and AltFi loans.

This allows lenders to better assess risk with the full picture of a consumer's financial position compared to. potentially underestimating debt levels. More robust lending data can also allow traditional lenders to 'say yes' to a larger pool of consumers who may qualify for additional loans, and/or receive better terms on loans, based on their payment history with Fintech and AltFi lenders. This could lead to a broader base of qualified consumers helping drive efforts toward greater financial inclusion.

General Industry Benefits and Equifax Support for Lenders

As evidenced in this paper, the entire lending ecosystem benefits from broad, accurate, and detailed credit reporting. While the CRAs continue to evolve their practices over time, they provide a valuable service in receiving, normalizing, and aggregating consumer lending data from millions of lenders which can then be used by all lenders to make prudent credit decisions that enhance the lives of hundreds of millions of consumers.

When it comes to lending the key is the breadth of data. The more data provided, the better it allows lenders to evaluate a consumer's application more thoroughly. This gives the consumer the broadest access to lending options based on their previous track record of managing those loan obligations. Consumers deserve to get credit for paying their loans on time, and the way they get that credit is by having those loans, with their full payment history, available for evaluation on the standard and specialty credit files. This way all lenders can have access to the data allowing consumers to benefit from their positive payment history, or avoid taking on additional debt because a lender does not have their full financial picture.

Equifax is fully supportive of credit reporting by Fintechs and Specialty Finance Lenders. We manage two Specialty Finance exchanges, DataX and Teletrack, where lenders report data on loans such as Lease to Own and other short-term financings. We are also accepting reporting from Fintechs into Equifax's traditional, core consumer credit file, ACRO. Fintech lenders can report all of their loan types including unsecured personal loans, BNPL (pay-in 4 loans), credit cards, secured cards, etc. Concerning BNPL (pay in 4 loans), Equifax understands the challenges this unique lending product may cause when included on the core consumer credit file.

The nature of these loans - very short-term duration, low dollar, zero interest - combined with the fact that many consumers open multiple BNPL loans within a year, means that these loans need to be managed carefully on the credit file. To that end, Equifax has implemented two measures to ensure that BNPL lenders can report these loans to the credit file without affecting consumers' credit scores. This will allow proper analysis of these loans by lenders and credit scoring companies to make sure that consumers are receiving the credit they deserve for on-time BNPL loan payments: First, Equifax has created a special code that will be applied to all BNPL loans that are reported to the Equifax credit file.

This will allow lenders and scoring providers to quickly identify these loans on the consumer's credit file. Second, Equifax will exclude BNPL trades from the calculation of credit attributes and models at Equifax for models developed by Equifax, as well as some third-party generally available models. This will ensure that consumers' credit scores will not be impacted by these loans until they can be properly analyzed and accounted for accordingly in new attributes and scores.

Conclusion

Accurate, detailed, and timely credit reporting is the foundation for consumer lending in the United States. Fintechs and Specialty Finance lenders have a critical role and responsibility to report their loans to the CRAs so that consumers receive full credit for all of their activity, not just those reported by more traditional lenders. All lenders benefit from the ability to see a complete picture of a potential borrower's history so that they can make accurate and responsible lending decisions. Equifax is ready to help lenders that would like to report their loans to the credit file but are not familiar with traditional credit guidelines. Our team of credit reporting experts will provide guidance and assistance to make the process as smooth as possible.