Using Alternative Data: Top Three Challenges Addressed

83% of lenders using alternative data say they are seeing benefits, and 56% said that it's opening new markets, according to *The State of Alternative Data*, a recent survey of 317 lenders.[1]

While there are many benefits of using information not captured in a traditional credit report, only 34% of the lenders surveyed currently use alternative data.

Are you among them? If not, perhaps you're facing the top challenges cited in *The State of Alternative Data* survey: navigating credit laws and regulations, developing and testing new risk models, and understanding the true value of alternative data. The suggested solutions in this brief can help overcome these barriers to using and benefitting from alternative data.

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[1] The State of Alternative Data Report, TransUnion and Versta Research, 2015

CHALLENGE 1

Complying with credit laws and regulations

More than half of lenders surveyed (55%) said their biggest barriers to using alternative data are legal and regulatory concerns. However, among lenders actually using alternative data, only 47% say that complying with credit laws and regulations is difficult.

SOLUTION

Challenges with compliance and new regulations could be traced to an organizational resource issue. Do you have an internal model governance team or compliance staff with the expertise to perform the necessary requirements? Such a resource could, for example, conduct disparate impact analysis and fair lending reviews to ensure equal treatment across protected and non-protected groups.

If it's not cost effective to hire additional internal compliance staff, leveraging external resources may be the best option. A third-party partner can provide alternative data expertise in credit laws and regulations along with insight into how others perform compliance testing.

64% of lenders surveyed not using alternative data cite developing and testing new risk models as a barrier to entry.

CHALLENGE 2

Developing risk models

Nearly two-thirds of lenders surveyed who are not currently using alternative data cite developing and testing risk models as a barrier. For those using alternative data, this percentage decreases to 40%, indicating that lenders already using alternative data find that developing and testing risk models is less of a challenge.

SOLUTION

Traditionally, an accurate portfolio risk assessment requires appending alternative data to two years of booked loan performance information on a minimum of 1,000 non-performing loans. You also need to understand the performance of the previously non-booked accounts.

But what if you don't have a large enough volume of loans in your portfolio to perform a statistically accurate impact analysis of alternative data? Accessing pooled loan performance data from lenders of a similar size that offer similar lending products can be a solution. Working with a partner that can supply this pooled data on a national scale with verified account performance across the entire record pool can help you perform an effective risk assessment—even if you are a very small lender.

Consider selecting a provider that has developed alternative data models currently in-market and has a proven track record of success. In addition, an alternative data provider should be flexible in providing access to the underlying data for further segmentation and/or analytical purposes.

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CHALLENGE 3

Understanding the value of alternative data

Almost half of lenders surveyed (49%) acknowledge they do not understand the value of alternative data in helping lenders or consumers. And 40% say they do not understand how alternative data is different from traditional credit data.

SOLUTION

More than 90% of applicants who would be returned as no-hit or thin-file by traditional models can be scored using alternative data.[2] Alternative data provides you with insights beyond what traditional credit data reveals and adds depth to consumer files.

For example, data points from lending channels such as payday loans and club or magazine subscriptions provide additional payment history. Alternative data payment activity also can come from credit and debit account management, property, tax and deed records. These could reveal assets and equity in a loan to ascertain if potential borrowers have collateral they can leverage if needed. Keep in mind that length and time of residency also suggests address stability.

A partner that understands how alternative data impacts risk and compliance can provide the relevant information and education needed to help you become more comfortable with using alternative data.

THE PAYOFF FOR OVERCOMING CHALLENGES

Alternative data enables a more competitive approach during the current post-recession economy to meet the needs of evolving consumers and make better lending decisions. The return on investment can be sizable. Your peers have reported that 5 to 10 times their annual investment is recognized within the first year.[3] An experienced alternative data partner can assist you with recommendations to achieve maximum results.

If you're still unsure of how to use alternative data and how to stay abreast of an evolving regulatory and consumer environment, we recommend that you look for a partner that can provide the following:

- → Alternative data expertise in credit laws and regulations and a commitment to stay up-to-date on related regulatory changes.
- → Access to pooled loan performance data from similarly sized peers who offer comparable lending products.
- → Educational and informational tools that help lenders of any size become more comfortable with using alternative data.
- → Proven track record in developing alternative data solutions.

LEARN MORE

To see how TransUnion can help your business use alternative data, contact Mike Mondelli, senior vice president of TransUnion's alternative data services, at **mmondel@transunion.com** or **404-601-6319.**

[2] Based on multiple customer validation results using CreditVision® Link℠
[3] When using TransUnion's solution, CreditVision® Link℠

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