NOVA CREDIT

THE STATE OF ALTERNATIVE DATA IN LENDING

Survey Report 2022

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In the U.S. alone, more than 50 million consumers are considered "credit excluded" because they don't use credit often or in conventional ways. Additionally, lending to mainstream consumers has become threatened by economic instability from a looming recession, disruption from Buy Now, Pay Later (BNPL) products, and COVID-19's impact on consumers' financial health. While traditional credit reports have been the primary data source used to measure credit risk for decades, these reports leave sizable gaps when evaluating a consumer's holistic financial situation and creditworthiness; they also limit opportunities for lenders to underwrite and offer services to large portions of the population.

Over the past few years, lenders have increasingly turned to alternative data sources — such as income verification, payday loans, bank transaction data, and cash flow underwriting — in order to gain a clearer picture of a consumer's true creditworthiness beyond credit reports.

In fact, Nova Credit found that 50% of lenders are ready to adopt alternative consumer data into their credit risk assessments and 39% are in the early stages of adoption.

As this trend of tapping alternative data sources has continued to grow, Nova Credit, the world's leading consumer-permissioned credit bureau, commissioned a survey with independent research firm Researchscape to uncover the state of alternative data in lending by polling 185 decision makers in the lending industry.

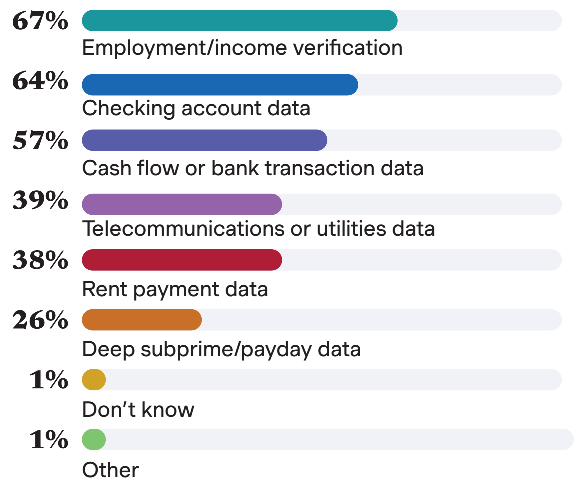
This report provides an inside look into how lenders are evaluating and using alternative data, the market's perception of this data source, and its untapped potential to improve underwriting decisions.

Current Use of Alternative Data in Underwriting

The data currently used in underwriting processes is insufficient, with almost **75% of lenders believing that traditional credit data and scores don't deliver the complete picture of a consumer's creditworthiness.**

As a result, 59% have turned to using forms of alternative data in their underwriting process — specifically employment/income verification (67%), non-transaction checking account data (64%), and cash flow/bank transaction data (57%).

WHAT FORMS OF ALTERNATIVE DATA DO YOU USE FOR UNDERWRITING?



Base: 109 (59% of respondents)
Note: Respondents could select multiple options.

Adoption of alternative data is prevalent across lending organizations of all sizes. However, far more midsized lenders — those with 500-1,000 employees — reported using it than larger organizations with 1,000+ employees (80% vs. 39%), suggesting midsized organizations are both open to change and innovation, as well as poised for growth and expansion.

Of those that use cash flow/ bank transaction data, 46% of lenders only started looking into it 1-2 years ago.

8%	<1 year ago
46%	1-2 years ago
31%	3-5 years ago
15%	6+ years ago

The data also indicates that lenders are using alternative data sources to get more transparency and create more opportunities for data-driven decisions.

50%

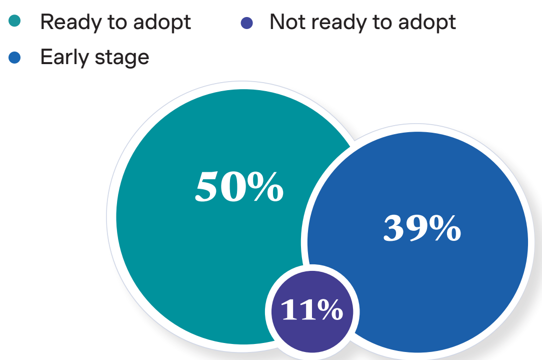
of lenders were motivated to adopt alternative data to improve predictability in their underwriting process.

Lenders are adopting alternative data at different rates with only 39% looking at telecommunications or utility data, 38% at rent payment data, and 26% at deep subprime/payday data. All of these sources provide valuable insight into a consumer's trustworthiness in paying important expenses — like electricity bills and rent payments — on time and can be a solid indicator of their risk, or lack thereof, for other lenders.

Market Perception of Alternative Data

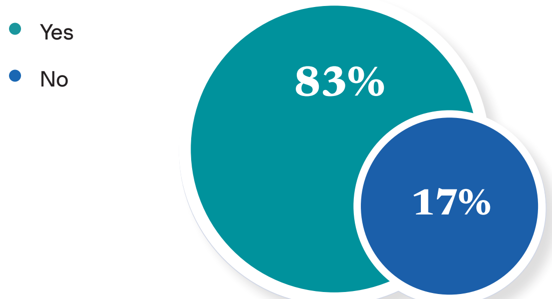
When asked about their perception of where the industry is today in regards to adopting alternative data into risk assessments, 50% of lenders say the industry is ready to adopt, with 39% saying they are already in the early stages of adoption. These findings mirror the responses throughout the survey, which show that there is a willingness to adopt but a lack of knowledge of how to best generate the most benefit from the data.

WHICH OF THE FOLLOWING BEST DESCRIBES WHERE THE MAJORITY OF THE INDUSTRY IS WITH ADOPTING ALTERNATIVE CONSUMER DATA INTO CREDIT RISK ASSESSMENTS?



Base: 168 (91% of respondents)

WOULD YOU FEEL DIFFERENTLY ABOUT THE INDUSTRY'S READINESS TO ADOPT ALTERNATIVE CONSUMER DATA IF THE INDUSTRY COULD BETTER VALIDATE ITS IMPACT?

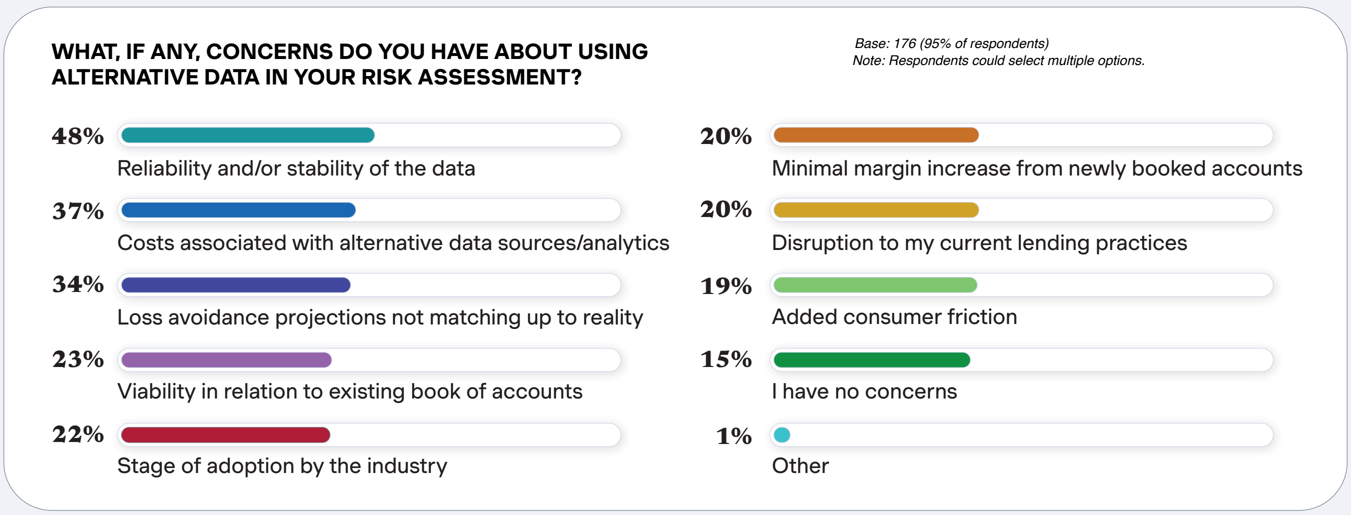


Base: 18 (10% of respondents)

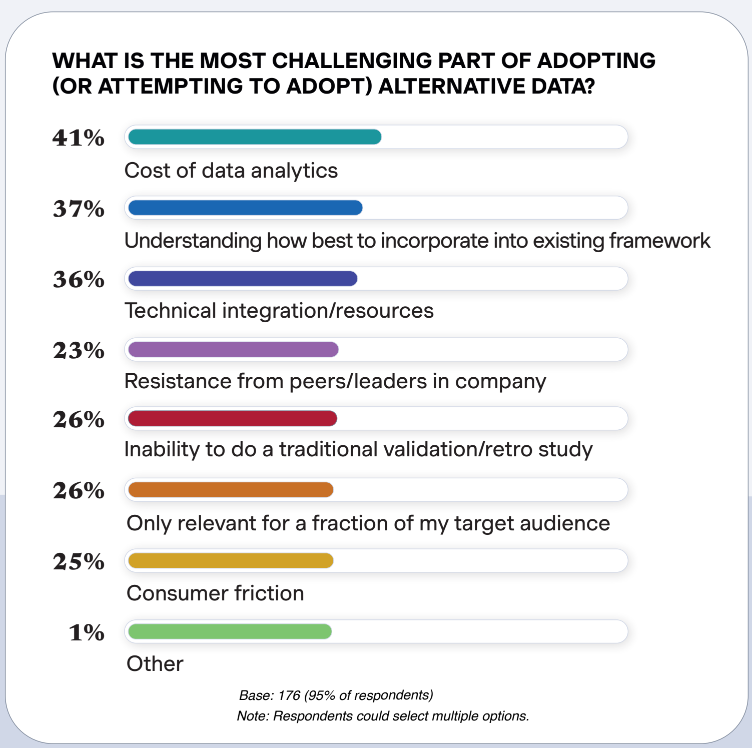
Among the small proportion of lenders who feel the industry is not ready to adopt (17%), a vast majority (83%) would feel differently about the industry's readiness if the industry could better validate its impact on predictability. Given the infancy of the practice and majority of lenders still relatively early in adoption, this concern is not surprising and one likely to shift as more organizations can report that such data proves effective.

Barriers to Alternative Data Adoption

As with any new process adoption, some are ready to embrace it, while others proceed with caution. Not surprisingly, the top two concerns about using alternative data for risk assessments are the reliability and/or stability of the data (48%) and the costs associated with such data sources and related analytics (37%). While those concerns are valid, taking into account other facets of a consumer's financial makeup can ensure lenders aren't missing out on viable growth opportunities as they can engage previously overlooked consumers or markets without introducing new risk.



For those already on the journey, the cost of data/analytics (41%) and understanding how to best incorporate within their existing underwriting framework (37%) have been the most challenging parts of incorporating alternative data into their processes. And while the upfront investment was perceived to be challenging, the benefits are immense, especially as 90% of lenders surveyed believe that alternative data has the potential to access new consumer segments or paint a more holistic view of consumer credit risk.



Even with a looming recession, a third of lenders will continue to adopt alternative data points into their underwriting over the next twelve months. These lenders are poised to grow as they will have more complete data to make smarter decisions and can take on more growth opportunities than the lenders who decide to wait out the recession to adopt.

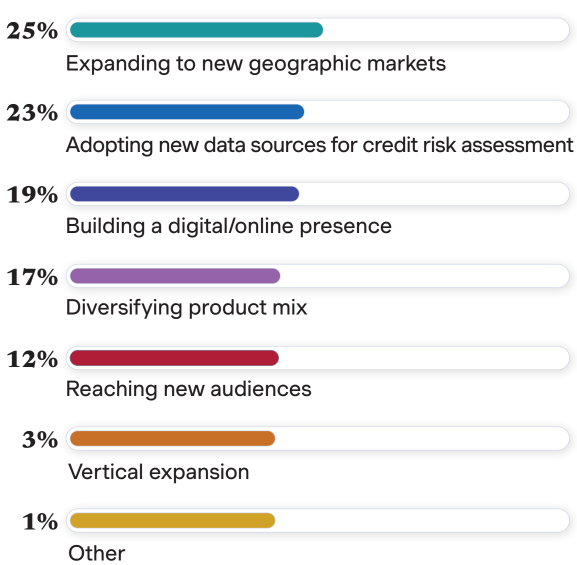
The Untapped Potential of Alternative Data

While 50% of lenders are using alternative data to improve predictability, not enough lenders are taking advantage of its ability to reach new audiences, with only 27% of lenders indicating this was the motivator behind adoption.

WHAT WAS THE MOTIVATION BEHIND ADOPTING ALTERNATIVE DATA INTO YOUR UNDERWRITING?

Base: 107 (58% of respondents)

WHICH OF THE FOLLOWING DO YOU VIEW AS THE GREATEST STRATEGIC INITIATIVE FOR YOUR ORGANIZATION?



Base: 181 (98% of respondents)

While improving predictability is important, the opportunity for growth was noted as a priority strategic initiative by 40% of lenders — specifically expanding to new geographic markets (25%), reaching new audiences (12%), and vertical expansion (3%). Knowing this, it will be important for lenders to align their motivators for adoption with their organizations' strategic initiatives in order to get the most out of alternative data within their underwriting processes.

However, lenders agree that there is untapped potential with reaching more customer segments, especially those considered credit invisible, who could benefit most from lenders having greater visibility into alternative financial data points.

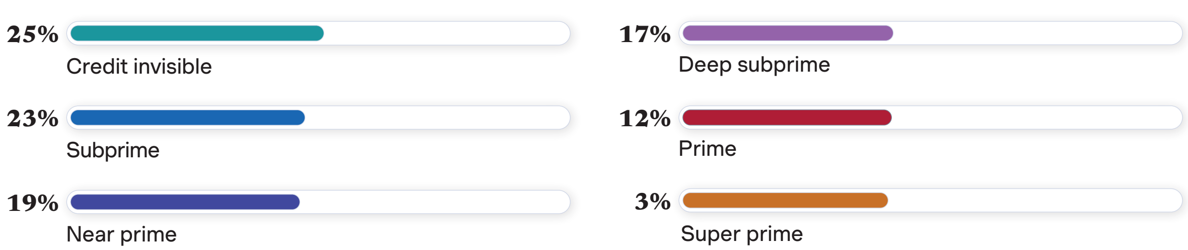
Key Takeaway

The movement toward alternative data in underwriting comes at a critical time as lenders navigate an uncertain economic landscape — 56% of lenders anticipate changes to their credit risk policies in the next twelve months in preparation for a possible recession.

Alternative data, such as cash flow underwriting, provides an enhanced toolkit to holistically manage credit risk for mainstream and credit-excluded consumers by clarifying whether the consumer has the capacity to afford a loan based on the financial health of their bank account and also whether the consumer is likely to repay the loan given the availability of funds. Incorporating alternative data into underwriting practices not only enhances the lender's capacity to accurately assess consumer credit risk, but has the potential to end the very idea of a credit-excluded population in the United States.

To learn more about integrating alternative data in your underwriting practices, contact Nova Credit at connect@novacredit.com to learn more about solutions like Cash Atlas™.

WHICH CUSTOMER SEGMENTS/MARKETS DO YOU VIEW AS HAVING THE GREATEST UNTAPPED OPPORTUNITIES FOR YOUR ORGANIZATION?



Base: 143 (77% of respondents)

Methodology

Nova Credit commissioned the survey with independent research firm Researchscape, which surveyed 185 decision makers in the lending industry in October 2022. They represented banks, credit unions, lending fintechs, and auto lenders in the U.S.