

Tipping the SCALE:

Will Alternative Data Promote or Impede Fair Lending Goals?

ABSTRACT - Full Paper by Vanessa G. Perry and Ann B. Schnare

April 2021

Homeownership rates for Black and Latino Americans have lagged those of White Americans for decades. As access to mortgage credit is a key factor toward achieving homeownership, reviewing existing tools and identifying new credit valuation processes could unlock new opportunities to close that gap.

Current credit bureau data exclude many common household expenditures, providing only a partial view of a household's credit performance. This has a direct—and profound—effect on segments of the population with non-existent or thin credit scores, particularly in the Black community.

Specifically, credit history accounted for some 30 percent of mortgage application rejections for Black Americans, compared to just 23 percent for White applicants, 21 percent for Latinx, and 13 percent for Asian applicants.

Addressing this complex and deep-rooted problem becomes even more critical, given that 46.4 percent of Black households owned their homes in 2020, compared to 75.8 percent of non-Latinx whites.

This research paper reviews three major types of alternative data that could be used to evaluate a consumer's creditworthiness: credit proxies, banking data, and, non-financial personal data.

ALTERNATIVE DATA EVALUATION SCALE

Each form of alternative data is evaluated using a newly devised five-factor "SCALE" framework that incorporates important considerations in the data's predictive power:

Societal Values = Does it respect social and ethical norms like right to privacy?

Contextual Integrity = Regardless of predictive value, is it relevant to mortgages?

Accuracy = Does the data accurately reflect the household's financial situation?

Legality = Would the use of the data have a disparate impact on protected classes?

Expanded Opportunity = Would the use of the data increase the number of qualified borrowers?

RESULTS

Credit Proxies (recurring financial obligations not reported to credit bureaus) score high on the five SCALE criteria. Rent and utility payments especially make sense in the context of mortgage lending. Though there are limits on voluntary participation for small landlords and utility companies, these proxies have proven an effective way to expand credit.

Banking Data (savings, checking, and money market account data) also does well under SCALE, although with caveats. While banking data has long been used to verify funds required for down payment, the emergence of Fintechs and large-scale financial data aggregators have greatly expanded its potential use for credit scoring. However, policymakers might wish to limit the use of banking data to broad measures that reflect the consumer's overall financial well-being—for example, average balances, inflows, and outflows. The use of more granular data on expenditure patterns or sources of income could raise privacy concerns and pose challenges under the FAIR Housing Act.

Non-Financial Data (personal data harvested from a consumer's digital footprint) does poorly under SCALE. While it has been shown to be related to credit risk, some correlations may be spurious or based on the average behavior of groups with similar activities, and it's not clear that large scale data aggregators understand the issues involved or the legal requirements for the use of their data

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