RISK IN AN OPEN-DATA WORLD

How and where lenders can enhance affordability through open data and analytics

May 2020

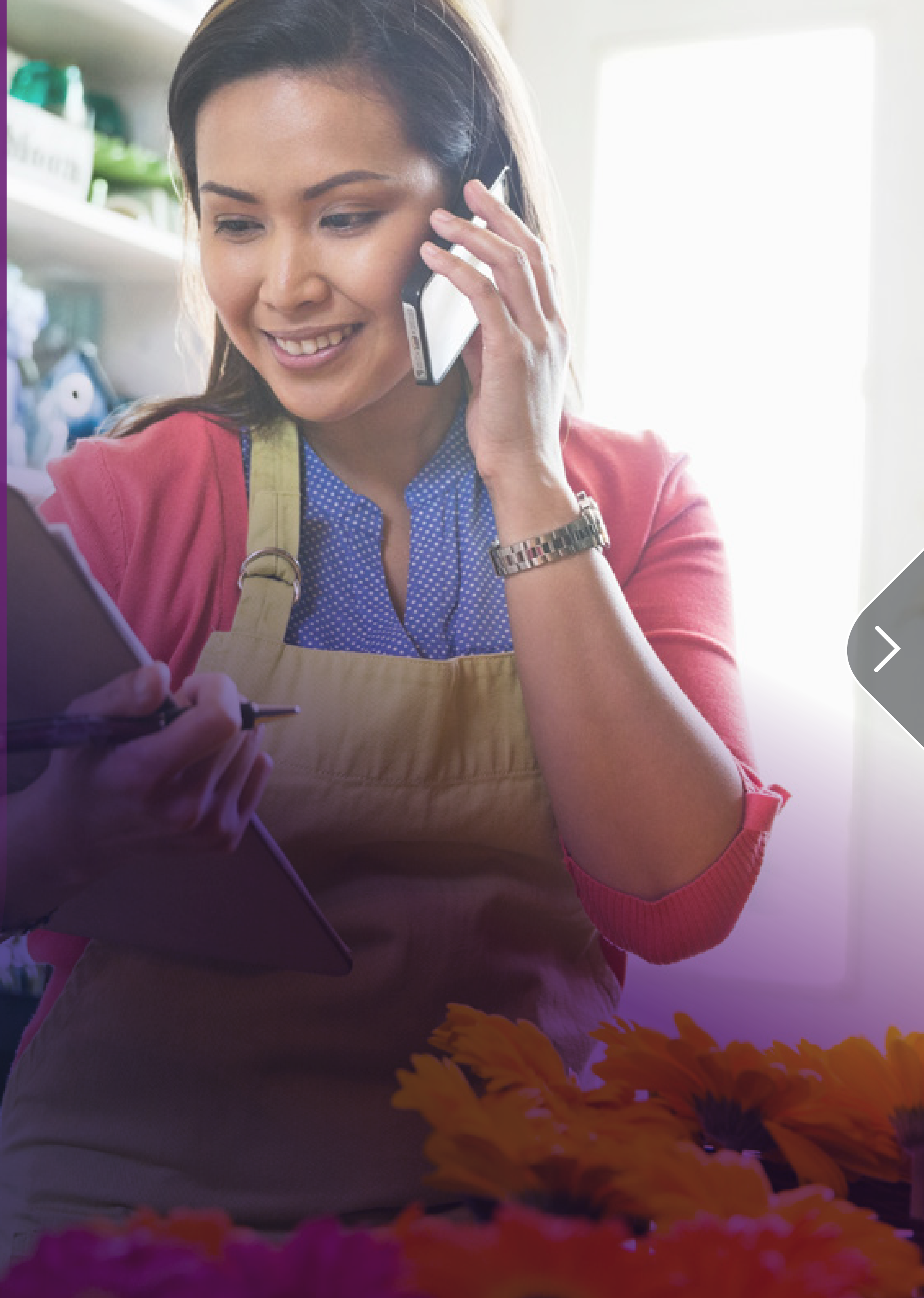
EXECUTIVE SUMMARY

In our last Paper: Rethinking affordability, we explored the increasing role of affordability in lending.

At Experian assessing and exploring the increase role of affordability in lending, has been a firm focus of ours. We welcome the FCA's distinction between credit risk and affordability[1]. While a customer may have the means to make repayments, doing so may place a strain on their finances and negatively impact on other commitments further down the line. As an industry, there is an opportunity to get a better understanding of that while also remaining competitive, meeting regulation and enabling the best customer outcomes.

In this paper we will look at credit risk in today's open data world.

Read our whitepaper:
Rethinking affordability



1. FCA Consultation Paper CP17/27 Assessing Creditworthiness in Consumer Credit

CONTENTS

INTRODUCTION

The FCA is striving for balance. Their aim is to minimise the risk of predictable financial distress, while at the same time avoiding restricting access or increasing costs of borrowing.

In an ideal world, customers would be granted credit only if they can afford to repay in a sustainable manner and without harming their overall financial situation.

In practice this can never be guaranteed and during an economic downturn like no other, it is even harder to achieve this. Assessing affordability isn't an exact science. Credit may be affordable for one, but unaffordable for another in a similar situation, purely because of how different people manage their finances. In addition, circumstances can change due to unpredictable life events, such as the sudden loss of a job, serious illness or loss of a partner.

Today, both businesses and regulators are striving for a sustainable future. There is also a unique opportunity to make this happen for everyone. Advances in analytics can equip you to become experts on your customers.

The need to consider the impact of each decision

In theory, a decision means deciding on far more than whether a person can go on a holiday or buy a house. It is contributing towards designing that path for them; designing the path for their future and helping people to achieve their life goals.

Today, a decision means the difference between someone being able to pay their bills or not.

It is undoubtedly unprecedented times - and lenders have an even more complex sum to do in regards to assessing risk and affordability. There is a need now to assess if a customer is high-risk because of the pandemic, or would have been anyway. If they are a risk - is it a short or long term risk.

Tradition should not be forgotten

We should continue to capitalise on the advances in analytics that have powered risk based scoring models and other techniques for the last 30 years. However, today there is also an opportunity to maximise the greater potential of big data.

New data brings new opportunity

2018 saw bank account transaction data come to market through the PSD2 and open banking.

We continue to see many new data sources enter too, offering equally huge potential. If we are to maximise the transformative potential these new assets contain, we'll need to be able to qualify, manage and connect these data sources.

The requisite power of analytics and technology

Today's analytics can consume various data feeds, including those that are complementary to traditional data, then understand it in a simple way and deploy it to automate fast and accurate lending decisions. This is done by bringing together various trended points of data, including historic recorded data (such as bureau data), historic behavioural data (through bank account transaction data) and through forward-looking data (such as economic data and affordability risk variables). This can be powerful, and equip businesses with a single process to inform the right decision.

The challenge for many is where to start

In this paper we explore the most effective roadmap, alongside the biggest opportunities. Affordability, this far, is treated as a second stage of decisioning. First, an assessment on whether the applicant is creditworthy, then a view of if the applicant can afford the lending or not. By resequencing this journey you can help empower customers with control by giving them knowledge of what's realistic, or not; or affordable, or not, upfront.

We will also explore the areas for consideration as you re-tune your risk policies and manage the pace and scale of change across your customers and portfolios.

Today, current account turnover data (CATO) is used to check income during an application, and this is still an effective method for most straightforward cases. Open banking brings in bank account data through the PSD2, which offers another, more granular view of credit risk. Here, with consent, lenders can access a person's entire bank account transaction history.

When this data is categorised, it can further validate a person's financial circumstance by giving an understanding of their actual behaviours, including income and expenditure. This is particularly helpful in cases where a person's credit history is limited or non-existent, or in cases where a score refers the application for further review.

CONSIDER ATTITUDES AND IMPACT

There are many considerations required when conducting an assessment on whether lending is affordable.

The FCA state that: "Most firms have a strong commercial incentive to assess credit risk, including the probability of default, but may have less incentive to assess the risk that the credit will impact negatively on the customer's wider financial situation where these customers will still be profitable for the firm". As such they want to protect consumers from the harm that can arise when they are granted credit that is predictably unaffordable at the point it is taken out. To do this there is a need to understand not just financial performance, but financial health and stability with a keen eye on the future horizon too.

People themselves are unclear of what's affordable

Our recent research shows that customers themselves often overestimate how much they can afford to pay. Our calculations revealed that the amount people believe they can afford to repay on a mortgage each month is around 40% less than their actual mortgage payments are likely to be. In addition, we can see how most people have little if any accessible savings, or long-term savings in the form of a pension.

Willingness versus capacity to pay

When making a decision, regulation now requires businesses to look at credit risk (or willingness to pay) as well as affordability (or capacity to pay). Willingness is about track record – what's known about an individual's past behaviour. Previous good performance shows there is a good chance that an individual will honour credit commitments going forward, for example.

Understand, and consider future impact

It is important to understand both actual and future trends, behaviours and attitudes, in the entire lending criteria. By understanding this – something that's now possible through data analytics – you can then produce appropriate models that are reflective of the audience you want to engage with.

31%
of people will ask a family member to borrow money if an item is unaffordable

41%
are over their mobile phone contract at the end of the month, and a further 19% exceed their agreed utility bill

52%
of people are unable to accurately provide a view of their income and outgoings, half under estimating and half over estimating

For more detailed analysis into peoples financial behavours, view our insight report here

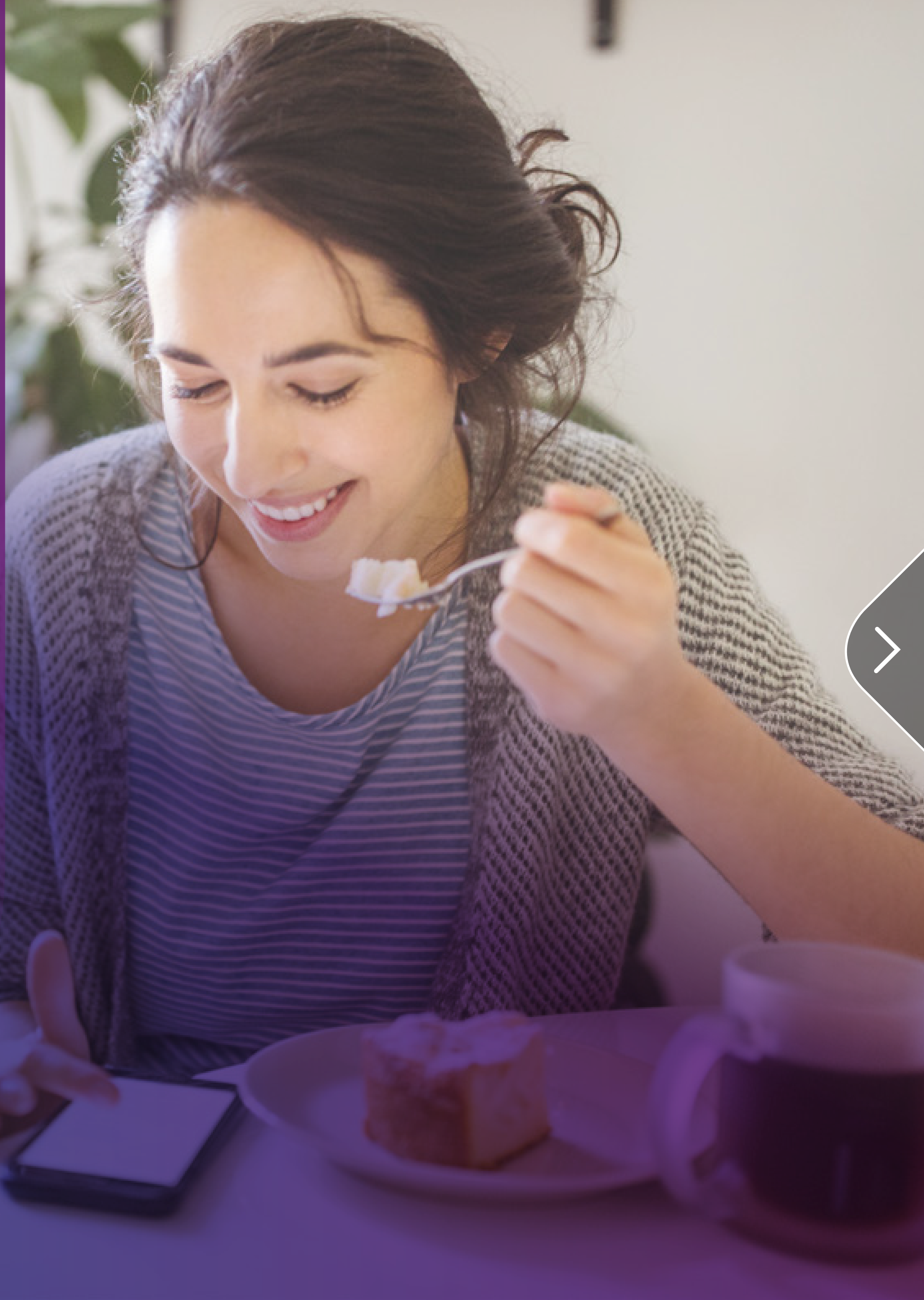
EMPOWER YOUR CUSTOMER MANAGEMENT WITH CONTROL AND INSIGHT

Reducing friction can engender loyalty

In today's fiercely competitive market having the slickest journey is imperative to compete and grow. However, to this point research shows how this is more often at the expense of certain checks; with fraud and affordability checks being forgone in a bid to relieve and reduce friction. Customers want, and at large need, financial stability, personalisation and command value.

By giving your customers an ability to self review if the lending is affordable pre-application you can help people only apply for what's affordable. You can guide them through the journey through the provision of value-add tools like a personal finance management (PFM), or help them manage their credit score by offering them knowledge on how to boost it.

Innovation at Experian is a critical part of our business. Recent developments in the design of Personal Finance Management (PFM) tools and other apps are helping solve problems and bring new-found value. Experian boost, our latest initiative offers a self-management tool that can help consumers understand and see where there is value through the introduction of new data, to boosting their credit score.



CONSIDERING MORE VARIABLES IN YOUR ASSESSMENT CAN ONLY BE A GOOD THING

Different lenders will have different appetites for risk, offering different prices and a different cut- off points in the decision process.

These factors are commonly based on the risk profile of the customers you want to attract through your marketing and product strategies. The challenge for many businesses is to align departments so that marketing is talking to the 'right' people. To do that, you need to know the risk appetite of your business, understand your ideal customers and find the best ways to reach them, ensuring your data and capabilities are relevant to those identified groups.

The economy must be taken into consideration

Levels of personal debt are currently higher than they were a decade ago and have continually risen over a period due to more consumer personal debt. People are borrowing more, for longer periods of time. Just before the pandemic hit we were seeing a risk in demand for loan values between £20-£40k. But also, worryingly, we were seeing early arrears in these loans.

It's vital that the credit-risk implications of this are understood, both from your own and your customers' perspective, and that you can improve your decision making accordingly.

As the economic crisis unfolds we are seeing a change in traditional behaviours. Both on a demand perspective, but also performance.

It's estimated that 40% of UK consumers are currently experiencing income shock. For the credit providers that serve them, moving forward means understanding how that impacts the tools they use to make critical business decisions.

Todays economic circumstances are not like anything we have seen before - and therefore modeling against previous crisis' would give an inaccurate assessment.

Across the credit industry, applications are tumbling, applicant quality is deteriorating and even once-reliable customers are facing tough financial futures. To confidently rise to these challenges, providers will need to be able to accurately assess affordability, credit score and risk, not just at the onboarding stage, but throughout the entire lending lifecycle.

Customer segmentation and scorecards are a vital part of that picture, providing for and protecting your customers, as well as your portfolio. However, as the world navigates these unprecedented circumstances, the tools you trusted even just a few weeks ago may no longer offer the relevancy or accuracy you need.

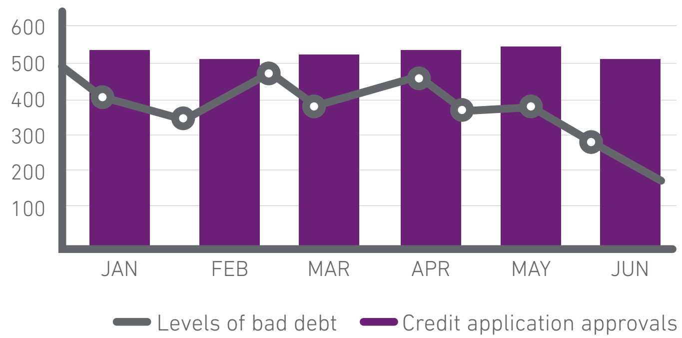
This is where integrating economic forecasts and foresight – the credit economy – into your decision making will have a huge impact. Used alongside bank account data, it will help you understand the full impact on that person. You can also foresee the likely impact to a customer future by looking at how they've prioritised before.

Ensuring your baseline is fit for purpose

Scoring and using scorecards can be hugely beneficial for a large proportion of people where a credit decision is straightforward. But only if the scoring model is reflective of the right data and relevant economic climate.

Scorecards are based on information obtained at a set period, which can become problematic as time passes. Here at Experian, we've been rigorously scrutinising our own industry-leading scorecard system, Delphi. Developed to meet logical as well as statistical validity checks, it's designed to continue performing, however extreme the economic conditions. As a result, it continues to discriminate strongly between good and bad risk applicants, even in our much-changed world.

Robust, recalibrated scorecard systems have the power to reveal a great deal about the consumer landscape, and are an incredibly powerful tool in putting together strategies for reducing risk while fostering much-needed new growth.



*Source: Office for National Statistics **Source: UK Debt Statistics from Credit Action based on Q1 2013

Data and insight has been provided by Experian and is subject to change. Correct at the time of creation – December 2013

Consumption is also changing criteria

How people consume credit has also changed – no longer do people prioritise a visit to a branch, but expect instant access via the internet or on a device. Consumption of credit has also changed. Therefore, the weightings of different pieces of information used in historic scoring models may no longer be as good as they could be.

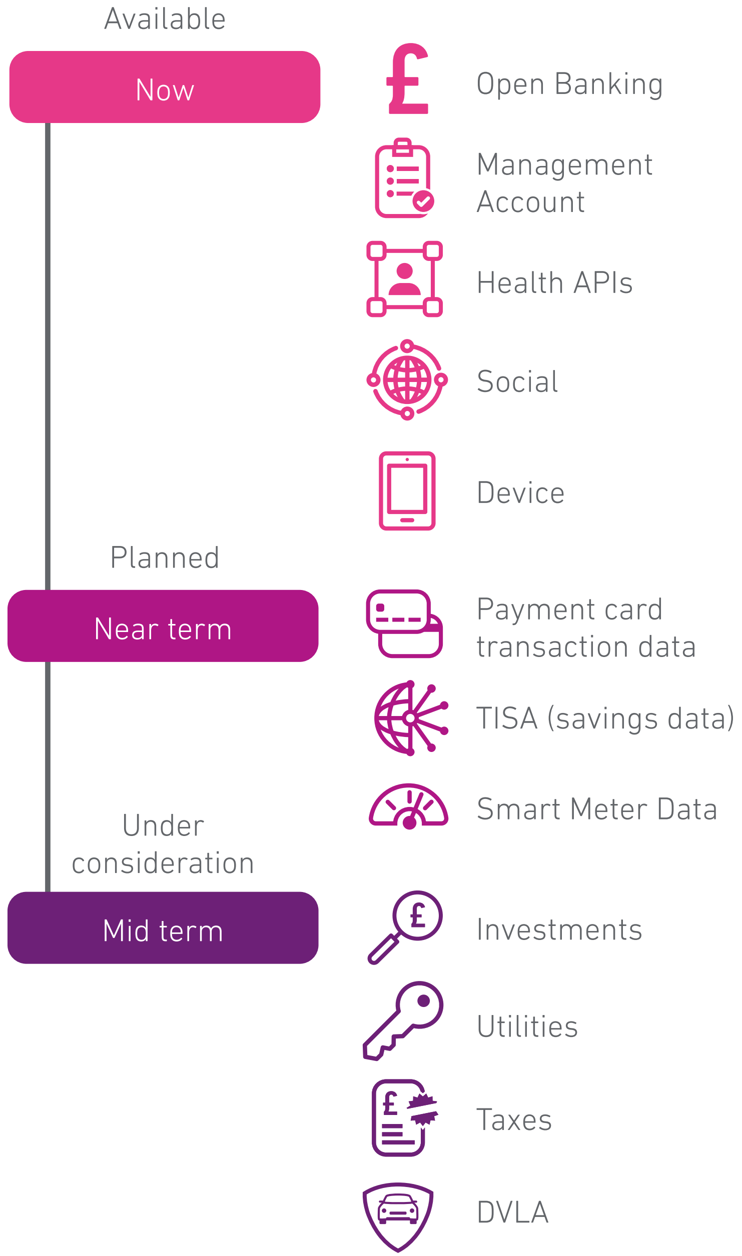
NON-TRADITIONAL DATA

More data can help you to perform a detailed assessment of a person's creditworthiness. As well as bank account data, potential new complementary data sources include government data and rental data.

Rent is a serious financial obligation and a large proportion of a tenant's outgoings. According to ONS, rent is around 27% of an average salary. Our analysis shows that factoring rental payment history data into affordability assessments can help give a more accurate representation of a person in terms of payment performance. This is important as "the cost of servicing a mortgage has fallen since the financial crisis, the cost of renting in some parts of the country has risen sharply", as reported by ONS.

In addition, new forms of analysis, ranging from psychometric questioning to advanced machine learning and artificial intelligence techniques, are also improving assessments by uncovering person-specific insights that have been traditionally overlooked. Today machine learning is identifying problems in data that were not obvious before, as opposed to solving problems it is asked to. How? By being able to ingest and understand large and disparate data sets that can bring a better base for understanding such problems.

Open banking as a stepping stone to open data



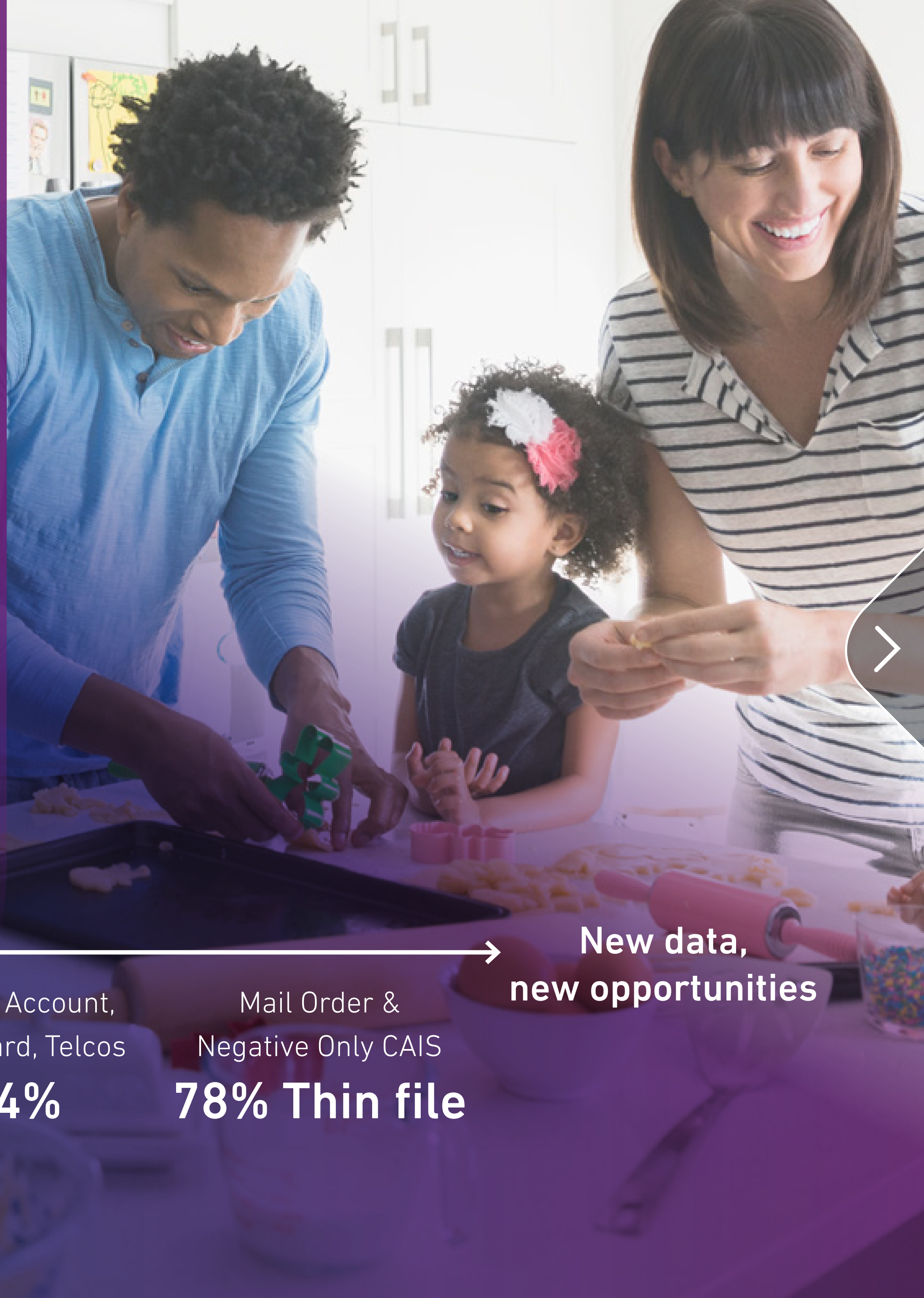
The evolving credit bureau

Credit bureaux have changed over the last decade. We know more about people than we did 10 years ago and some new pieces of data have entered the equation. The recent addition of bank account transaction data, for example, gives the opportunity to improve your ability to assess willingness and capacity to repay.

In addition, new alternative data now contained within the bureau, such as rental data, utility data and more, offers extra insight that can be valuable too when making a decision and increase the performance of your scoring.

There are many types of new data available across both commercial and consumer lending which is a significant asset in such turbulent times. Thanks to such advances in data - but also the requisite power of analytics to understand it and technology to act on it, there is the opportunity to reduce economic impact.

With our deep understanding of data, we are in a unique consulting position. The road ahead may be rocky, and there will undoubtedly be new developments to navigate. However, by working together, and bringing you powerful data (and the tools to process it), we believe we can help you and your customers come back from this crisis strong, secure and ready for a brighter future.

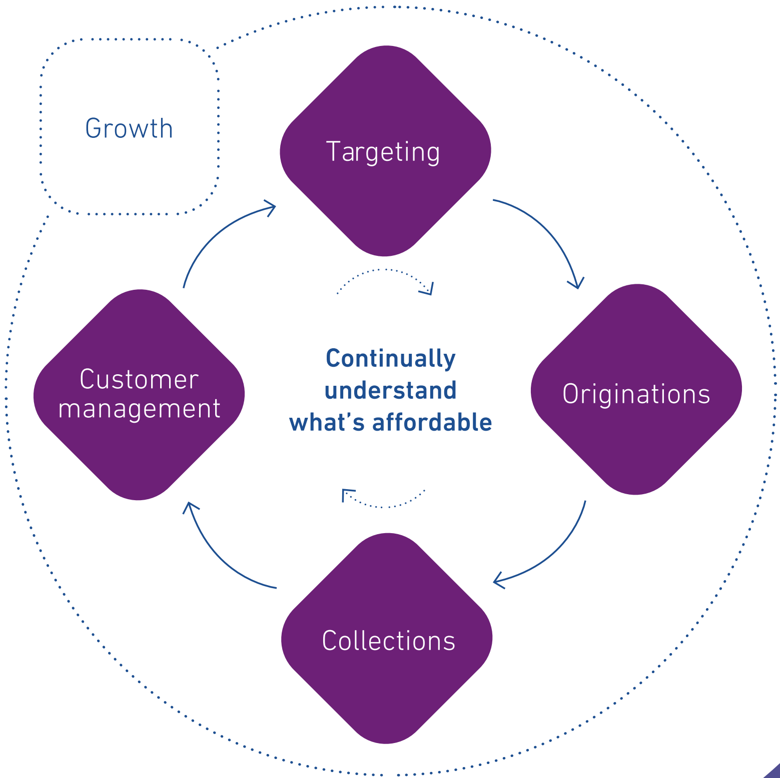


New data, new opportunities

Open Banking	Council Tax, Private Rental	Utilities, Social Rental	Current Account, Credit Card, Telcos	Mail Order & Negative Only CAIS
2.3%	**2.7%**	**7.3%**	**8.4%**	**78% Thin file**

Integrating affordability from start to end

With the right software, data and analytics, you can perform checks across the credit lifecycle to see what a person can afford at different points in time. These checks could include re-verifying their income using CATO and/or bank account data. Income estimations based on trended data can help determine a person's ongoing ability to repay. Debt-to-income ratios can allow you to understand a person's debt profile in relation to their income, while knowing their monthly disposable income can help you to assess and automate a decision on whether they can repay.



Having confidence in your calculations

In addition to traditional scoring models, there is an opportunity today to be able to connect new data and tailor metrics during an assessment. As we've covered, where you're confident a customer is giving accurate information, credit scoring and affordability software are still helpful. Introducing prequalification into the mix will also help enhance the customer journey.

Where a decision is more complex, for example where an application needs further assessment or with a limited credit history, new data and analytics can be extremely powerful.

More frequent data updates will prove beneficial

The data infrastructure powering credit bureaux uses periodic batch updates of data about a customer. So, while credit decisions are made in real time, the information used to make that decision can be a snapshot of how each active credit account looked several weeks ago.

In today's digital-orientated economy, we believe more frequently updated data would bring better-informed decisions and greater efficiency. Particularly in high- cost, short-term lending, when loans can be applied for, received and paid back all within the monthly-statement cycle.

We've already developed a real-time CAIS capability to facilitate increased speed in data sharing and identify where a person may be overextending themselves by making multiple applications in quick succession. Now we are consulting with lenders to fully understand the benefits of this.

Listen to our podcast:
How data has changed over time

UNDERSTANDING THE SUPPLY CHAIN OF A DECISION

To be truly responsible, lenders should look beyond affordability to consider the impact or knock-on effect of any lending decision. For example, if someone can't afford to pay for insurance and loses their car, it will mean they can't get to work. If income is lost, they may struggle to pay their bills.

They need to connect people better to finance

There is an opportunity across financial services to help people in many ways. While today's economy is nervous, people's economic attitudes are somewhat indifferent. As we touched on earlier, people express concern about their future well-being yet their spending traits suggest no contingency is being developed.

The generation gap is closing: the need to intervene is now

For a long time now, we have seen a growing gap between generations. Young adults face high property prices and low wage growth, versus their elderly counterparts who are benefiting from periods of economic growth, final salary pensions and inheritance.

"If we can help introduce positive change to financial behaviours now, we can safeguard the future which is currently poised to suffer due to an increasing pensions and savings gap. It is important to act now."

Risk becomes an opportunity

We must realise the risks in this and see the opportunity to be more helpful. As we pass through generations the ability for inheritance is limited as people's financial freedom becomes tighter. The bank of mum and dad, who still helped a quarter (27%) of millennials buy a house last year (worth £81.7bn in gifts) will soon not be an option.

We will likely see the impact of this in the future, and therefore need to understand how we can create positive opportunities and choices now.

Helping people make the right life choices

People are becoming savvy to this changing climate. More than half (60%) of young people are considering buying a home with friends or family to be able to get on the property ladder. The main problem many face is the deposit – 59% of those 18-35 have savings of less than £1000 and 20% have settled to the fact they will never be able to afford to buy their own property, causing shifts in other financial traits and behaviours.

We are seeing:

- A decline in demand
- People becoming exposed through greater indebtedness
- Greater levels of persistent debt
- Mortgage applications declining
- An increase in fraud

HOW DO YOU CREATE THE OPPORTUNITY FOR BETTER RISK ASSESSMENT IN AN OPEN-DATA WORLD?

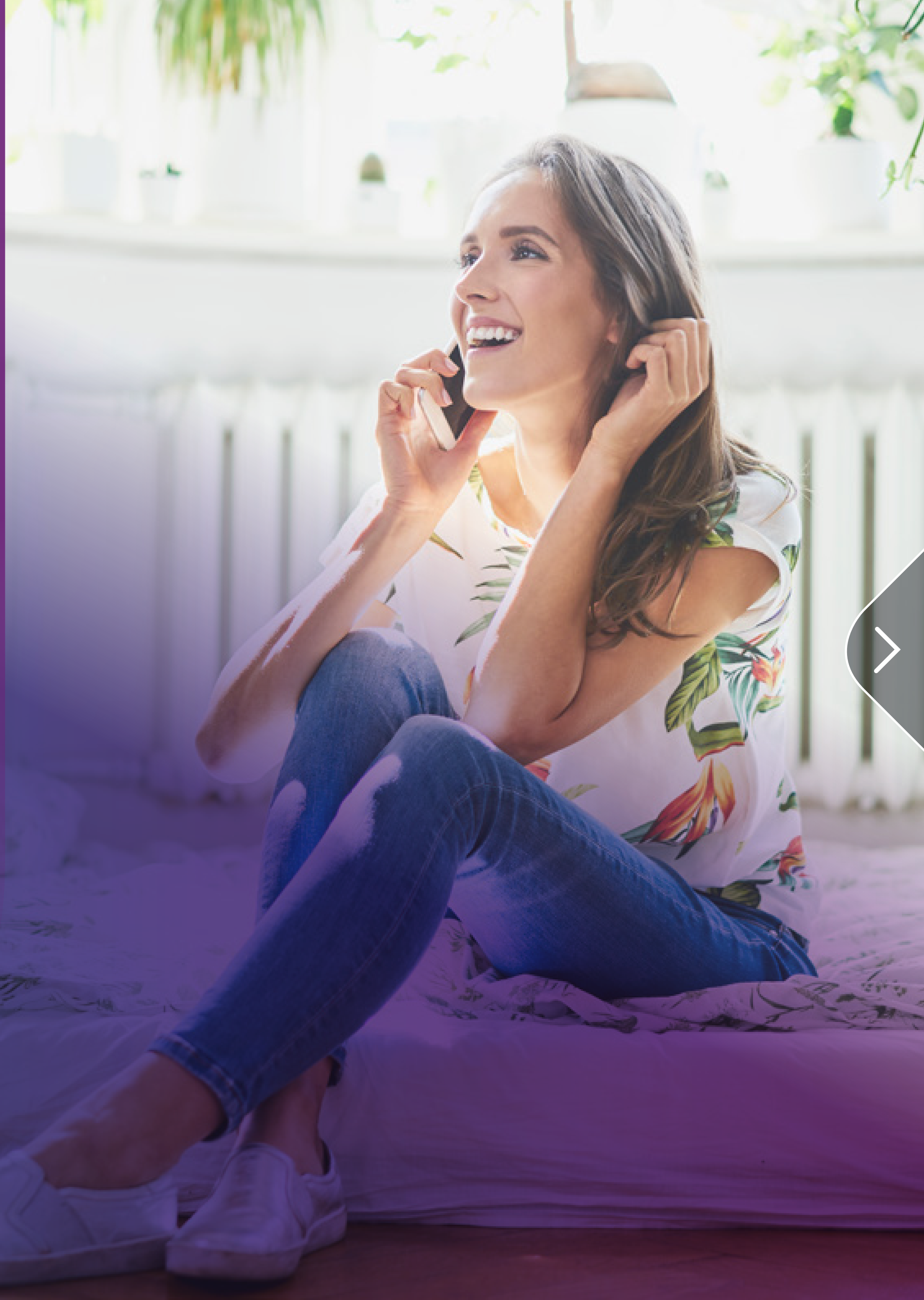
With the current hype around analytics, as well as a surge in regulation, you need to not become overwhelmed by change.

Many perceive change to be a long and expensive process and often struggle to know where to start, or which areas will have the most impact and therefore are unable to secure investment due to a lack of visibility on the ROI.

Change can happen in many ways; it's just as impactful to solve many small problems as it is to tackle bigger challenges.

There are many ways you can take advantage of these new opportunities, without necessarily investing in an entirely new IT system. An affordability assessment of the future is beyond a single check, it spans your entire business processes and redesigns your entire processes from prospecting through to customer management.

With the right affordability check upfront, and within the customer lifetime, you can negate the need for collections to even be an issue. Your cam optimises each action in real-time and better manage your, and your customers risk.



1

Ensure you're accessing the most accurate information

Ensuring your scorecards are equipped with all the data that's available and taking the economic climate into consideration, will help ensure the cases that are straightforward receive the best decision, based on accurate data. In addition, accessing specific variables, such as disposable income, economic change, debt-to-income ratios and so on, will help ensure that you can measure affordability risk easily and accurately based on current and future scenarios.

2

Advanced analytics

Many businesses (78% according to our research) plan on investing in advanced analytics, but few have a clear roadmap of where and how and year on year analysis shows only 12% have managed to adopt in-year as they aspired to do. Advanced analytics can be complicated and require specialised teams to implement and manage. It needs continued development and investment and while we have seen some great results across the market, they are most often in specific isolated cases. The most effective way of accessing advanced analytics is by choosing solutions that integrate this capability, allowing the intelligence to be accessed in specific tasks.

3

Innovation through test and learn

Innovation is critical and needs constant investment. Test and learn is important for all organisations if we are to solve problems and innovate. The most effective way to do this is to access a data rich analytics sandbox which enables you to connect various data sources, for example your own and Experian data, and perform advanced analytics in a safe and secure testing environment. This type of access can allow you to test on a segment in parallel to your everyday business, letting you prove, and identify, the case before full implementation.

4

Digitisation

At present, we see many augmenting customer experiences. This is important, especially as people today expect to give the minimum of effort, but receive convenient, instant access. Digital means fast, accessible and easy. By using an appropriate decision management software, you can not only fully transform into a digital company, but can create an environment that underpins your entire business offering significant uplift in strategic outcomes and an ability to digitally transform.

Advanced and enriched scoring, through access to trended data.

Forward-looking credit risk modelling through machine learning based aggregation and categorisation.

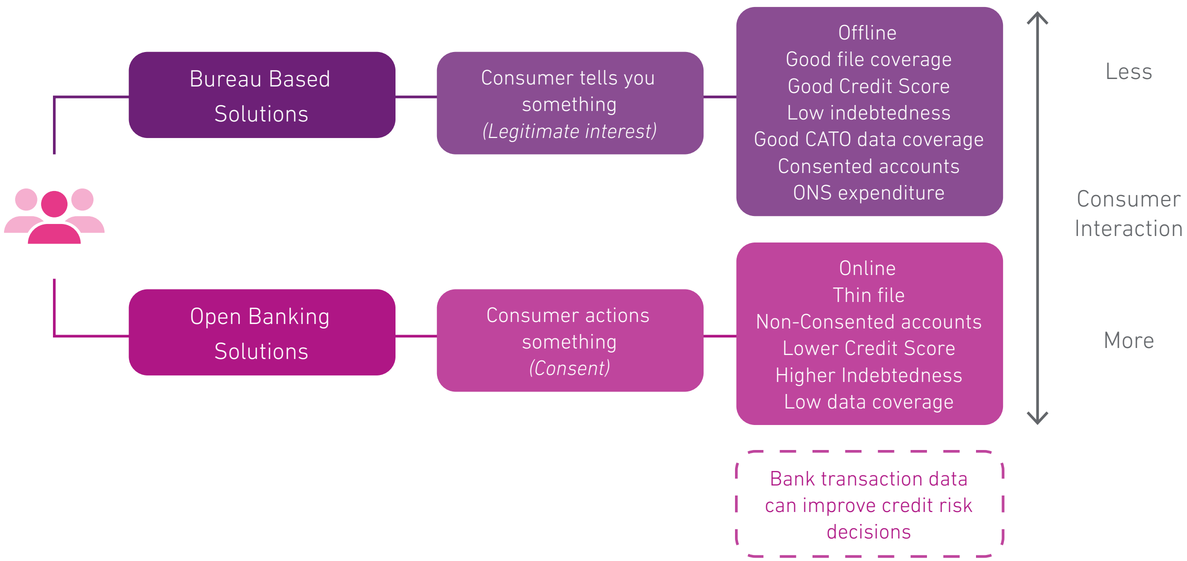
Real-time scenario planning and modelling through an analytical sandbox enriched with data.

Next generation decisioning, allowing connection of all processes that can act, from start to end.

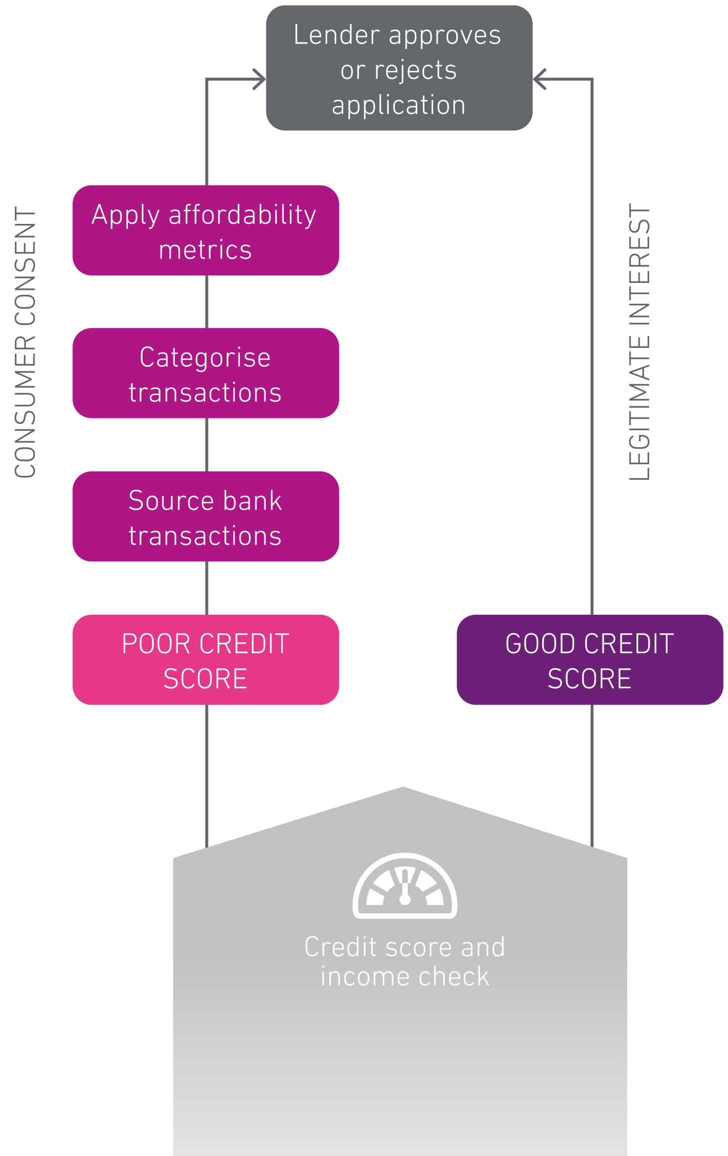
WHAT DOES RISK IN AN OPEN DATA WORLD LOOK LIKE?

By being able to automate data, add complimentary data and understand it, you can power new opportunities for fairer, more accurate and more inclusive lending, at scale and at speed. You can innovate and you can be better equipped.

Deciphering which assessment criteria is valuable



How will this change the way you engage with customers?



CONCLUSION

The theme running throughout this paper has been the need to focus on the customer by having the most appropriate tools to serve them. That same theme came out very strongly in our research where we saw businesses prioritising customer insight and customers frustrated by the lack of it evidenced in their interactions.

Keep pace with changing business models

Regulation aside, we believe the main reason for this is the speed at which business models are changing – or expected to change. In today's ultra-competitive climate, focusing on the customer is the only way businesses can succeed. The benefits are far bigger than simply market share. With the right tools, you can engage more people who were previously misunderstood and reap the benefits of better relationships through having a better knowledge.

AI can automate at speed, and scale with more accuracy

What we find particularly exciting is the potential of artificial intelligence and to make automated personalised recommendations at scale – something that could improve the financial futures of millions of people quickly.

From understanding credit risk, to understanding your customer

Get this right, and we move from understanding credit risk to understanding the risk to the actual customer. The process becomes more human and you can have a better dialogue. The industry has the chance to reconnect with customers, win their trust and help them manage their finances better.

Data can improve scores, assessments and much more

As the open-data climate becomes an everyday reality, we have a phenomenal opportunity to improve the quality of data, scorecards, affordability assessments, and understanding.

"In our trials we have seen significant uplift in GINI performance brought through new data and are able to identify where opportunities exist, in what scenario."

Consent requires value, value comes from trust

Obviously, this use of open-banking or personal data is only possible with consent. Our research, which explores the attitudes of people to share their data, has clear evidence that people will share their data if there is immediate value to them. And value in this sense is depicted in the role of easier access to finance. There is appetite but inevitably you will need to work on building, and in some instances rebuilding, their trust. To do this, you need to better understand them.

Creating a fair, inclusive financial economy

In a big-data, high-churn environment, being able to automate insight from data to inform decision- making will be critical. Categorisation and machine learning can be used to promote fair and responsible lending in the gambling industry, provide personalised credit limits for home shopping, and automate income and payment history checks for the rental market or the self- employed for example. This is all achievable by analysing open-banking data and serving it up in real time at the point of decision making.

Experian are the prime partner who can help you continue to innovate and adapt

Data and insight have become a valuable currency; businesses with the best insight on their customers will be the ones that thrive. By working with the right partner and accessing the tools that can help you better understand a person's credit risk, you can access information that gives you a clear advantage. Data analytics and technology all have a role to play and present a huge opportunity for all.

"Today, risk can be assessed quickly, accurately and fairly. It can also be more integrated into the customer journey creating better opportunity for growth which expands the opportunity far beyond a single decision."

Visit our website for more information on how we can help:
www.experian.co.uk/business

Or contact us:
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The insight contained within this report is prepared using research performed on both Experian data and external data sources, in addition to market research. All sources, unless referenced, are from Experian insight.

The information contained within this report is designed to help businesses manage the complexity brought by a national crisis - and is a summary of key areas and capabilities. To understand more about the breadth of market-leading capability Experian has, or to access further detail on the impact of Covid-19 on consumers, business and lending portfolios - please contact us.

Content methodology

The insight contained within this report is correct at the time of publishing – 4th May 2020. Insight is derived from Experian data sources, incuding analysis produced by our award-winning Economics team. Note that Experian owns the copyright in this document and the information that it contains is the confidential information of Experian. We are providing this to you because we believe it is in the public interest to do so at a time of national crisis. However, the confidentiality provisions of our contractual arrangements apply and you may not share this further.

We also wanted to let you know that Experian will shortly be adding a transparency information page to its website to let data subjects know how we are using data to help at this extraordinary time.

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