

Market and Policy Challenges Are Slowing Use of Cash-Flow Data in U.S. Credit Underwriting

Resolving Data Transfer Issues Could Facilitate Use of Cash-Flow Data, with Particular Opportunity to Expand Access to Credit for Millions of Underserved Consumers and Small Businesses

WASHINGTON, D.C., February 26, 2020 – Today, FinRegLab published a new report, *The Use of Cash-Flow Data in Underwriting Credit: Policy Overview*, identifying critical market and policy actions needed to enable the use of cash-flow data in credit underwriting.

“Our research suggests that widescale adoption of cash-flow data in credit underwriting could produce substantial benefits for borrowers and lenders alike by expanding access to credit, improving risk prediction and lender efficiency, and enhancing competition and innovation,” said Melissa Koide, FinRegLab’s CEO. “It could be particularly helpful for the roughly 50 million people in the U.S. who lack traditional credit scores.”

The new report finds that competition, coordination, and compliance issues are limiting cash-flow adoption and its potential to improve borrowers’ access to credit. While industry efforts on some issues are already underway, deeper engagement by both private stakeholders and public policymakers is necessary for reaching scale.

The report can be found [here](#), and a longer version titled *The Use of Cash-Flow Data in Underwriting Credit: Market Context & Policy Analysis*, will be available [here](#). Key insights include:

- **Cash-flow data underwriting holds substantial promise.** While the data’s most obvious use in underwriting is to evaluate consumers and businesses that lack traditional credit history, the report suggests that the information adds meaningful predictive power for a substantially broader swath of applicants. The data could be particularly important for increasing access to credit for African American and Hispanic populations, though it is not likely to close all gaps in credit availability and use between demographic groups.
- **Yet, there are critical challenges to adoption.** Whether and when cash-flow underwriting can reach scale will depend largely on the extent to which: (1) lenders are able to secure reliable data access; and (2) banks and investors determine that the information is sufficiently useful to warrant changes to their business processes. Although market developments are reducing some operational hurdles, competitive dynamics and coordination challenges are affecting both issues. And open questions with regard to regulatory compliance and liability issues are creating substantial uncertainty in affected markets.
- **There are emerging risks that require attention.** While the increasing use of cash-flow data in credit underwriting is providing benefits for consumers and small businesses, it also raises privacy tradeoffs and potential concerns about fairness, accuracy, data security, and transparency. These issues are not limited to loan origination, but also can arise in connection with loan servicing and firms’ re-use of cash-flow data for other commercial purposes. Although some positive developments are occurring, uncertainty about the application of existing laws and inconsistency

among market actors could become an increasing source of risk as the market continues to expand and evolve.

- **Industry and policy action are warranted now to ensure cash-flow data is able to achieve its potential to foster a more inclusive, efficient, and competitive marketplace.** Constructive action by industry, regulators, and Congress may each be needed to improve outcomes with regard to both cash-flow underwriting and the broader data transfer system.

The report analyzes both current initiatives and future options for action, including accelerating the adoption of safer and more efficient data transfer technologies, developing data processes and tools to foster meaningful customer control over their information, clarifying and strengthening existing customer protections, and increasing supervision of non-bank actors.

“Balanced regulation is key to capture the upside of new approaches, so that providers have clear guidelines to innovate while consumers are protected,” said Tilman Ehrbeck, managing partner of Flourish, a supporter of FinRegLab. “The findings of this report can help provide a path to achieve that balance.”

In the near term, increased engagement by federal regulators through research, monitoring, and interpretive activities could be particularly useful, in part by providing sharper focus and greater certainty to initiatives by industry and Congress. Addressing market challenges and customer protection issues in the underlying data transfer system in the next few years could be particularly helpful by setting the stage for more rapid expansion of cash-flow underwriting in years to come. These issues are potentially important to helping beneficial practices reach scale and to reducing risks to both borrowers and firms.

The Market Context & Policy Analysis report is the third in a series on the use of cash-flow data in credit underwriting by FinRegLab. The first [Empirical Research Findings report](#) summarizes the results of an independent analysis by FinRegLab in conjunction with Charles River Associates of loan data from a range of non-bank financial services providers —Accion, Brigit, Kabbage, LendUp, Oportun, and Petal— that have begun using cash-flow variables and scores in an effort to provide unsecured credit to consumers and small businesses who may have difficulty obtaining loans from traditional sources. The analysis evaluated the data with regard to its general predictiveness, its ability to increase access to credit, and its potential fair lending effects.

The second [Small Business Spotlight](#) detailed the increasing use of electronic cash-flow data in small business credit markets, which has allowed lenders to engage in faster, more sophisticated, and more consistent analysis than relying on paper records. The report tracked how use of cash-flow data has spread among both traditional lenders and new entrants and noted issues that could affect its further expansion.

FinRegLab was established with support from Flourish. Flourish and the Milken Institute also provided support for FinRegLab’s evaluation of cash-flow data in consumer and small business credit underwriting.

For more information, please contact Kerrigan Molland at kerrigan.molland@finreglab.org