Credit Scoring and Financial Inclusion

Increasing financial inclusion and equity is a key area of focus in the financial services industry, particularly in the aftermath of the COVID-19 pandemic which exacerbated the economic gaps faced by many disadvantaged communities. Lenders are examining systems and processes to better serve those consumers who may be fully capable of borrowing and re-paying within their means but in the past have had limited or no access to mainstream credit because of outdated and unnecessarily restrictive credit scoring models, systems and processes. Fair lending enforcement is being highlighted as a priority for financial services regulators as well.

Since its inception in 2006, VantageScore Solutions, LLC (VantageScore) has developed models which generate the most accurate credit score for as large a percentage of consumers as possible, which in an increasingly automated industry is a critical step towards expanding consumers' access to credit. VantageScore has been able to accomplish this objective using the same credit data as conventional scoring models[1] but applying more modern, patented modeling methodologies that can more effectively use the available data for consumers who may have more limited activity reported in their credit files. Rigorous testing performed during model development and on an ongoing basis show that the scores provided for these newly scoreable consumers provide an accurate estimate of their likelihood of defaulting on a debt obligation.

More recently VantageScore 4.0, the company's latest model, allows lenders to accurately evaluate approximately 37 million more consumers than conventional models. This allows consumers who have been historically marginalized to now gain access to credit and creates a corresponding financial inclusion opportunity for lenders, all in a safe and sound way.

VANTAGESCORE SCORES MORE CONSUMERS

Conventional credit scoring models that have been used by financial institutions for decades have inherent limitations that leave millions of consumers without the ability to obtain a credit score. The scoring criteria used in these conventional models are based on credit use patterns and data quality from a different era and the criteria do not adequately reflect today's realities.

Based on the 2019 census data and a large, random sample of consumers from the National Credit Reporting Companies, nearly 47 million consumers are invisible to these legacy scoring models. The inability to obtain a credit score significantly limits access to mainstream credit products for these consumers, which in turn contributes to the persistent disparities in lending and wealth accumulation which exist for these historically disadvantaged groups and minorities.

VantageScore models leverage modern methodologies in order to provide a fair and accurate credit score for an additional 37 million consumers. This means VantageScore can **score 96% of all consumers in the United States who are 18 or older.**

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[1] In order to generate a score, conventional models require (1) at least one tradeline/account open and reported to the credit bureaus for six months or more; and (2) at least one tradeline/account that has been reported to a credit bureau within the past six months.

VantageScore
a higher level of confidence

This provides a significantly broader group of consumers with the opportunity to enter mainstream credit markets, gain a better understanding of their financial health and begin to establish their credit.

The newly scoreable consumers include consumers with Dormant or Inactive credit files, consumers who do not have accounts (tradelines) on their credit files but have other information, such as collections, inquiries and public records, and consumers with young credit files.

Category	Description	Consumers	Conventional Models	VantageScore Models
Dormant	Infrequent credit use; consumers who haven't had updates to their credit files in the past 6 months but have earlier updates	24 million	✗ Fall outside minimum scoring criteria	✔ Score generated
No Trades	Consumers who have no tradelines but are scored based on the external collections and public records on their file	11 million	✗ Fall outside minimum scoring criteria	✔ Score generated
Young File	Young to credit; consumers who have only tradelines that are less than 6 months in age	2 million	✗ Outside minimum scoring criteria	✔ Score generated

IMPACT ON UNDERSERVED GROUPS

The newly scoreable population includes nearly 14 million minority consumers who have been particularly adversely impacted by legacy processes, including 5.5 million African Americans and 5.2 million Hispanics. The ethnicity breakdown of the newly scoreable population is as follows:

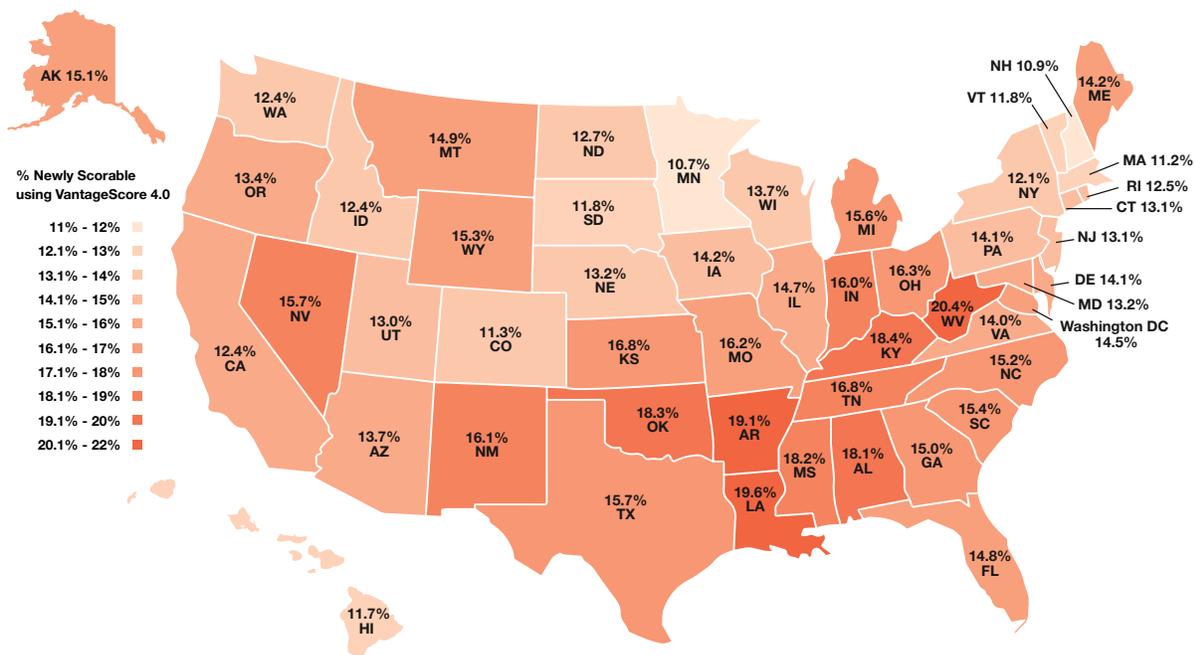| Ethnic Group	VantageScore Newly Scoreable Consumers	VantageScore Newly Scoreable Consumers with scores 620+
African American	5.5 Million	1.3 Million
Hispanic	5.2 Million	1.7 Million
White	24.2 Million	9.2 Million
Asian	1.4 Million	0.6 Million
Native American and Pacific Islander	350 Thousand	100 Thousand

Nearly 4 million of these newly scoreable consumers from minority groups, including 3.7 million African Americans and Hispanics, obtain scores that are 620 or higher using VantageScore 4.0.

VantageScore research shows that in addition to minorities, lower income populations have significantly higher percentages of consumers who are newly scoreable using VantageScore 4.0. Further, there is an increased percentage of newly scoreables in communities with low home ownership rates as well as in communities where access to brick-and-mortar banking services is limited. The impact of these factors is further explored in part two of this whitepaper series.

By providing a fair and accurate credit score to a broader population, VantageScore models create opportunities for lenders to extend credit safely and soundly to consumers who are historically underserved by legacy processes.

IMPACTS ACROSS GEOGRAPHIES

Approximately 14.5% of adults nationwide are newly scoreable, or put another way, are unscoreable when conventional models are used but can receive a score from VantageScore. The rates of newly scoreable consumers vary significantly across the country based on differences in socioeconomic factors. Southern states tend to have larger volumes of newly scoreable consumers compared to the rest of the country. The challenges of conventional models and the potential opportunities presented by the use of a more inclusive model like VantageScore 4.0 are particularly pronounced for lenders who may have a geographic footprint in areas with a greater number of newly scoreable consumers.

% Newly Scorable using VantageScore 4.0

- 11% - 12%
- 12.1% - 13%
- 13.1% - 14%
- 14.1% - 15%
- 15.1% - 16%
- 16.1% - 17%
- 17.1% - 18%
- 18.1% - 19%
- 19.1% - 20%
- 20.1% - 22%

AK 15.1%
WA 12.4%
OR 13.4%
ID 12.4%
MT 14.9%
ND 12.7%
MN 10.7%
WI 13.7%
MI 15.6%
NH 10.9%
VT 11.8%
ME 14.2%
NY 12.1%
MA 11.2%
RI 12.5%
CT 13.1%
NJ 13.1%
PA 14.1%
OH 16.3%
IN 16.0%
WV 20.4%
VA 14.0%
DE 14.1%
MD 13.2%
Washington DC 14.5%
NV 15.7%
UT 13.0%
WY 15.3%
SD 11.8%
NE 13.2%
IA 14.2%
IL 14.7%
KY 18.4%
NC 15.2%
CA 12.4%
CO 11.3%
KS 16.8%
MO 16.2%
TN 16.8%
SC 15.4%
AZ 13.7%
NM 16.1%
OK 18.3%
AR 19.1%
MS 18.2%
AL 18.1%
GA 15.0%
TX 15.7%
LA 19.6%
FL 14.8%
HI 11.7%

At a more granular level, there are greater differences across communities, even within the same state, in terms of the percentage of newly scoreable consumers. Significant differences in income levels, homeownership rates, racial make-up and access to banking, among other factors, lead to a large variation across newly scoreable rates. In certain disadvantaged urban areas, 1 in 3 adults are unable to obtain a credit score from conventional models. There are significantly larger percentages of consumers who are newly scoreable in these communities. Newly scoreable rates may be as high as 30% in many urban areas that are socioeconomically disadvantaged.

HOW DOES VANTAGESCORE SCORE MORE CONSUMERS?

VantageScore models use the same credit data as conventional scoring models but apply more modern, patented modeling methodologies that can more effectively use the available data for consumers who may have more limited activity reported in their credit files. VantageScore 4.0 model developers also leveraged machine learning techniques to develop scorecards for those with limited credit histories to enhance predictive performance. Tens of thousands of combinations of data elements were analyzed as part of the data exploration and model development process. Applying VantageScore's domain expertise and model governance principles to the machine learning discoveries has resulted in compliant and explainable model attributes that enhanced predictive accuracy of the model for those with limited credit files.

ARE THE SCORES FOR NEWLY SCOREABLE CONSUMERS ACCURATE?

Rigorous testing performed during model development and on an ongoing basis show that the scores provided for these newly scoreable consumers provide an accurate estimate of their likelihood of defaulting on a debt obligation.

Overall, the scores assigned to consumers in these groups are accurate and reliable, as confirmed by our annually published model performance assessments. There is a nearly identical alignment of default rates between these newly scoreable consumers and other consumers who have similar scores. In other words, the meaning of the score, in terms of the level of risk it implies, is consistent regardless of which group a consumer belongs to.
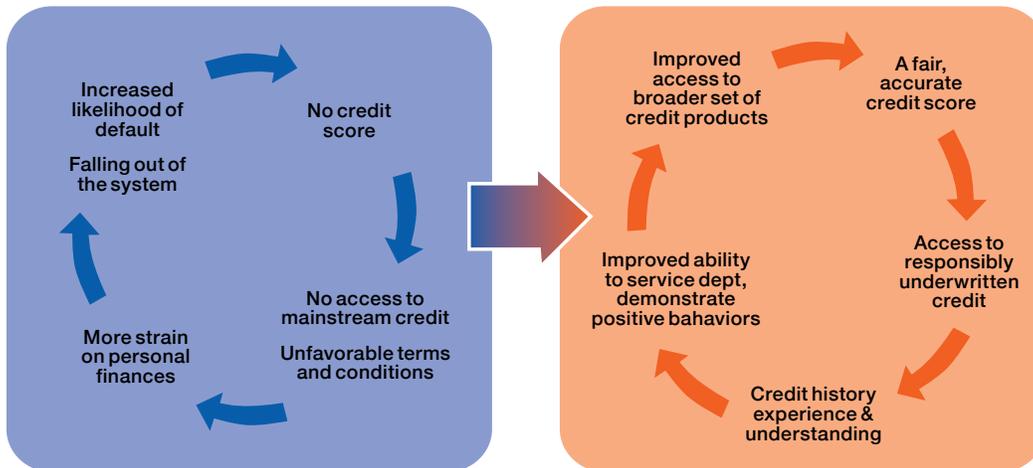
WHY IS SCORING MORE PEOPLE SO IMPORTANT?

Breaking the cycle:

With its ability to score more people, the VantageScore model plays a vital role in making the credit markets more accessible to creditworthy consumers - without lowering risk standards - while creating a corresponding opportunity for lenders.

The inability to obtain a credit score significantly hinders the availability of affordable credit products available to such consumers. With no access to mainstream credit products, these consumers are left with the choice of no credit at all or being forced to accept unfavorable product terms, such as high fees and high interest rates. This, in turn, puts additional burden on these consumers' financial situation; increasing the risk that they will fall behind on payment obligations and default, which pushes them farther away from the ability to access mainstream credit markets.

VantageScore, by providing a fair and accurate credit score to a broader population, affords a greater number of consumers the opportunity to enter mainstream credit markets and begin to establish their credit. While not all of these newly scoreable consumers may be ready to take on a credit obligation on day one, a significant portion will likely become eligible for a credit product. Consumers will have a chance to demonstrate positive credit behaviors, build their experience in managing their credit, and over time graduate to more significant credit responsibilities. Further, a credit score allows consumers to become more educated about their financial lives and to have a benchmark to compare their progress against.

Providing a fair and accurate assessment of credit risk to a broader population through a more inclusive credit score affords a great number of consumers the opportunity to enter mainstream credit markets and pursue financial growth.

CONCLUSION

The VantageScore 4.0 model can help lenders meet their business objectives and allow them to grow their portfolios in a safe and sound manner and without lowering credit standards, while also improving access to credit and supporting financial inclusion for millions of consumers who have been systematically marginalized by outdated legacy systems.