White Paper

Ensuring Consumer Access to Banking by Embracing Better Data

Executive Summary

One-in-four Americans are classified as underbanked or unbanked, meaning they have little, if any, interaction with established financial institutions (FIs). As a result, many in this segment conduct their fiscal affairs in an alternative financial services universe made up of check cashers, payday lenders, auto title lenders, rent-to-own outlets and pawnshops.

Financial industry regulators find these facts troubling and are asking FIs to expand their reach into this demographic. "Alternative financial services, such as check cashing and money orders, are often less convenient, more costly and have fewer consumer protections," said Richard Cordray, director of the Consumer Financial Protection Bureau (CFPB).[1]

In reality, FIs have actually been serving this segment for some time, and in recent years, numerous emerging FinTech companies have been wooing this segment as well. The difference is that often these newer companies cannot provide the same level of consumer protection that established FIs can deliver.

However, when it comes to onboarding new customers, many established FIs rely on legacy screening tools fueled by out-of-date, inaccurate or incomplete data. One possible outcome of this practice is prospective customers being unfairly turned away due to incorrect data, further reinforcing their underserved status.

FIs remain in the best position to serve *all* consumer segments – especially the underserved. What's more, research shows a significant portion of this segment is eager to work with conventional FIs. To effectively facilitate their transition from "unbanked" to "banked," FIs need to adopt screening tools that employ more accurate, comprehensive and timely data. Better data translates into customers who are approved faster and more quickly aligned to the appropriate products. In the age of Big Data, there is no reason to settle for out-of-date or incomplete information.

[1] Opening Remarks, CFPB Forum on Access to Checking Accounts, October 8, 2014.

"Alternative financial services, such as check cashing and money orders, are often less convenient, more costly, and have fewer consumer protections."

The Challenge: Effectively Serving the Underserved

The Federal Deposit Insurance Corporation (FDIC) classifies 70 million adults as either "unbanked" or "underbanked;"[2] Javelin Strategy & Research estimates that "just over one-in-four Americans" fall into these categories.[3]

Regulatory bodies such as the FDIC and the CFPB have made their expectations clear: They want more of these consumers given access to traditional financial services.

As noted earlier, most FIs have been soliciting this segment for some time. "Second chance" accounts – which enable consumers with limited or blemished financial histories to build (or rebuild) relationships with FIs – are now fairly commonplace. Moreover, a wide variety of FIs across the country voluntarily participate in Bank On, a nationwide initiative started in 2006 connecting nonprofits, government agencies and FIs to match underserved consumers to conventional financial products and services.

Nearly every FI's account-opening process hinges on screening new customers, and this process typically includes requesting specialized credit reports to determine – on a case-by-case basis – which products best meet individual consumer needs. The reports also help identify potential fraudsters in order to reduce risks to the financial system.

But, increasingly, regulators are expressing apprehension about some of the screening processes. In a recent, well-publicized case, New York Attorney General Eric Schneiderman pressured three banks in his state to "scale back" on the use of one screening tool because his office concluded data used in the screening resulted in a disproportionate number of low-income consumers being rejected as bank customers.[4]

Schneiderman's concerns mirror those voiced at the federal level. In October 2014, Corey Stone, director of the office of deposits, liquidity lending and reporting markets for the CFPB, testified his agency often found "screening practices present a major obstacle to consumers who are seeking a second chance to enter the financial mainstream."[5]

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[2] "*2013 FDIC National Survey of Unbanked and Underbanked Households*," FDIC, 2014.
[3] "*Empowering Underbanked Consumers in the Mobile Era*," Javelin, 2014.
[4] *American Banker*, April 27, 2015.
[5] CFPB Forum on Access to Checking Accounts Testimony, October 8, 2014, page 5.

"Underbanked consumers increasingly represent a group of younger consumers who are shifting to alternative financial providers and are opting out of mainstream financial services."

Striking a Balance and Outpacing Competition

Despite apprehensions, the CFPB recognizes the need for screening tools because FIs must also manage risk. This means FIs have to strike a balance between serving consumers while protecting the financial system.

FIs must also consider the growing competition coming from emerging financial services firms.

In recent years a number of non-traditional financial services start-ups – or FinTech companies – have made significant headway in this market. In 2013 the Center for Financial Services Innovation profiled 29 FinTech firms that were successfully "reinventing the marketplace of financial services for underserved customers."[6] The companies were lauded for "improving access to effective, high-quality products for underserved consumers while developing technology with broad applications beyond the underbanked market."[7]

These financial services upstarts – many of which are classified as "neobanks" – have admittedly put only a small dent in the vast underserved segment. But, as *American Banker* noted last year, "it would be a mistake to outright ignore them. Their market share may be miniscule, but they have gained some traction with millennials and the underbanked, two demographics that mainstream banks covet. They are connecting with customers in ways most banks can only dream about, turning users into genuine fans."[8]

A recent Javelin study helps clarify why the underserved are emerging as a coveted demographic: "Underbanked consumers increasingly represent a group of younger consumers who are shifting to alternative financial providers and are opting out of mainstream financial services," said their report.[9] Among Javelin's other findings: 41 percent of the underbanked are age 35 or younger; 47 percent are employed full-time and, although a majority of this group has an affinity for mobile banking, 41 percent *prefer* face-to-face banking. Add to these two more findings, courtesy of the FDIC: 90 percent of underbanked adults own a mobile phone (compared to 83 percent of *all* adults) and 31 percent of underbanked mobile phone owners say they would likely use mobile banking (versus 24 percent of the "fully banked").[10]

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[6] "Financial Technology Trends in the Underbanked Market," CFSI, 2013.
[7] Ibid.
[8] "*Five Reasons You Can't Ignore the Neobanks*," *American Banker*, May 20, 2015.
[9] "*Empowering Underbanked Consumers in the Mobile Era,*" Javelin, 2014.
[10] "*Assessing the Economic Inclusion Potential of Mobile Financial Services*," FDIC, 2014.

"On several occasions, the CFPB has called for the use of more 'nuanced' data in account decisioning."

The takeaway: A substantial portion of the underserved are younger, upwardly-mobile, tech-savvy consumers interested in mobile banking, but *craving* in-person interaction from traditional FIs.

Against the backdrop of today's regulatory pressure, emerging competition and enthusiastic consumers, FIs have little choice but to adopt screening tools that draw on more accurate and comprehensive data to help promote inclusiveness.

The Answer: Screening Tools Powered by Better Data

"We are especially interested to learn more about how the screening system could be used to help institutions better meet the needs of these consumers, rather than simply excluding them from the banking system altogether."

Richard Cordray[11]

Established FIs remain in the best position to serve the underserved. They offer the widest array of products and services – and those products and services come with regulatory oversight and protections. They also offer sophisticated mobile and online banking solutions created with consumer demand in mind. But in order to effectively match new customers to appropriate products, (while screening out potential fraud and curtailing disproportionate results), FIs must adopt onboarding tools that rely on more accurate data.

The CFPB does not oppose the use of screening tools. Rather, as Cordray clarified last year, his agency is simply asking the industry to use resources that "result in better and more informed screening decisions that are fair to consumers." [12]

At the time he identified the three questions his agency has with regard to screening processes: How accurate is the data used in these tools? Are remedies in place enabling consumers to dispute inaccurate data? And how are the findings used?[13]

With these questions in mind, selecting up-to-date screening methodologies should be straightforward. The tools must rely on up-to-date, comprehensive and accurate data, ensure consumers can challenge and correct inaccurate data, and, lastly, offer transparency in how the reports are used.

[11] CFPB Forum on Access to Checking Accounts Testimony, October 8, 2014, page 2.
[12] Ibid, page 2.
[13] Ibid, page 3.

To break it down further:

- **Data**: Screening tools should use accurate, timely and comprehensive data that generate findings beyond what regulators refer to as "binary" or simplified yes/no findings. Indeed, it was simplified yes/no findings that captured the attention of the New York Attorney General last spring and, on several occasions, the CFPB has called for the use of more "nuanced" data in account decisioning.[14] Similarly, regulators have called for reports that draw clearer distinctions between actual instances of fraud versus incidents where consumers have simply failed to manage their finances appropriately. Equally important: positive data should be reflected as well as negative data.

- **Disputes**: A fully Fair Credit Reporting Act (FCRA)-compliant and accessible dispute structure must be in place for consumers that need to challenge data in the screening reports. "If consumers cannot take steps to ensure that information about their account history is accurate, they will be unjustly hindered from re-entering or participating effectively in the banking system," Cordray said last year.[15]

- **Details:** Will detailed report data be used in any way beyond account opening decisions? If the information is used in any way to contribute to a "black list" of consumers non grata, or anything else that limits access to conventional financial services, then regulatory inquiries are likely to follow. The same holds true if data in the reports is used in marketing or sales follow-ups.

Conclusion:

In 2015, the CFPB's Corey Stone spoke at the *Early Warning Summit,* an annual conference of top banking executives. He shared the following:

"Screening to assess credit risk is important; in fact, it's part of your fiduciary responsibility. And screening also helps you assess a consumer's financial capability to handle particular product features such as overdraft that pose risk to the consumer of going negative and incurring fees. This process doesn't have to be used just to say "yes" or "no" to an applicant. You have a lot of different levers available to manage risk. Some of these are up front, and they can be used to identify which products best meet the needs and capabilities of the consumer. Some of these are back end based on transactions and behavior, and can be used to be manage

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[14] *American Banker*, April 27, 2015.
[15] CFPB Forum on Access to Checking Accounts Testimony, October 8, 2014, page 3.

overdraft eligibility and limits. The point is to manage risk to the institution and safety for the consumer so that the institution can be as inclusive as possible. Ideally this involves a full range of risk management tools and a range of account products."[16]

There is a wide variety of specialized credit reporting bureaus operating today. Stuart Pratt, head of the Consumer Data Industry Association, represents many of them (including Early Warning). In 2014 he told regulators: "Every company that I've spoken to within our membership is looking for positive data sets to add nuance to the negative data. … We think data can actually help banks develop new products… to get that different 'yes,' that creates a safe marketplace."[17]

When it comes to effectively serving the underserved, FIs face a myriad of challenges – challenges that include changing economic conditions, consumer demand for untested technologies and ubiquitous, non-FI "alternatives" already thriving in underserved communities. FIs have little control over those factors; however, FIs are positioned to address two key challenges head on: 1) outpacing emerging Fin-Tech companies seeking underserved clients and 2) adopting screening tools that employ more nuanced data.

The first challenge should be easy to overcome. The U.S. financial services industry has remained at the forefront of innovation for decades and has proven itself to be a trusted partner working on behalf of millions of consumers.

Addressing the second challenge should be just as easy. It simply requires FIs to embrace screening tools that, in the words of Richard Cordray, reflect "clear data standards, with better enforcement, [to] ensure greater consistency and quality in credit reports…"[18] By doing this, the financial services industry can deliver on Cordray's request for "better and more informed screening decisions that are fair to consumers."[19]

To learn more about Early Warning, visit EarlyWarning.com or contact an Early Warning Account Manager at 1-855-589-7541.

[16] Corey Stone, 2015 *Early Warning Summit.*
[17] CFPB Forum on Access to Checking Accounts Testimony, October 8, 2014, page 14.
[18] Ibid, page 2
[19] Ibid, page 2.

About Early Warning

Early Warning provides innovative risk management solutions to a diverse network of more than 2,100 financial institutions, government entities and payment companies, enabling businesses and consumers to transact with safety, speed, and convenience. Owned and governed by five of the largest banks in the United States, this unique business model facilitates a data exchange system based on collaborative intelligence and trusted exchange.