Inclusive lending strategies for banks:

a summary of findings and recommendations

⟶ A companion piece to **"Bridging the credit divide: income, risk and inclusion in consumer finance**

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Introduction

In this companion piece to "Bridging the credit divide: income, risk and inclusion in consumer finance," we present income and credit findings through a public-interest lens, illustrating why closing credit gaps is both a societal imperative and a strategic priority for banks. Lenders and organizations that recognize these trends can lead with inclusive strategies that expand opportunity while bolstering portfolio health.

Financial institutions can leverage the insights presented in the white paper to refine their models and practices, improving both business outcomes and social impact; below are key takeaways and recommendations.

Modernize credit risk models with inclusion in mind

Traditional credit scoring has served as a reliable workhorse, with factors like payment history and credit utilization remaining predictive. However, these traditional credit models alone don't reflect a comprehensive view, leaving lenders with an incomplete picture and consumers without access to the financial services they need. Lenders should explore leveraging greater risk models to unlock new growth opportunities to reduce portfolio risk through diversification while building trust with potential new borrowers.

Use dynamic model calibration

The influence of factors predicting risk can change over time. As such, lenders may use frequent revalidation — at least annually, but ideally leading lenders may reevaluate quarterly or monthly — to adjust scorecard weightings. Machine learning techniques can also be deployed to help detect economic interaction effects or shifts. Financial institutions can form cross-functional teams (risk, data science, compliance) to review model performance by segment to ensure that models are appropriately identifying and measuring shifts in risk structure as the population evolves.

Leverage alternative data carefully

Attributes like education level, occupation or rent/utilities payment history aren't currently used in underwriting, but they've been shown to have predictive power in credit outcomes. Some credit bureaus now offer employment data, and Experian Boost®Ø and Experian® RentBureau® incorporate utility, telecom, video streaming and rent payments. Using these can score people who were invisible and potentially raise their scores. Lenders may experiment with these data points in pilot programs or model refreshes (ensuring compliance). Any alternative data must demonstrably add predictive value and avoid proxying for protected classes. Regular bias audits are essential whenever new variables are introduced. The reward for doing this right is substantial: more inclusive lending without sacrificing risk management and possibly identifying overlooked good borrowers in the process.

Strengthen early delinquency intervention

Analysis from the white paper affirms that a missed payment is a red flag that should trigger swift action. Correlations between short-term delinquencies (30/60 days past due) and long-term default were very high and increasing with time.[1] If a borrower falls 30 days behind, there's a strong chance they'll fall 60 days behind absent intervention, according to the data analysis in the white paper. These numbers are worse as a borrower falls beyond 60 days late. To prevent minor hiccups from snowballing, banks can implement real-time delinquency alerts and outreach: Don't wait for a 60- or 90-day delinquency; contact customers leading up to a payment, and again in the event that a payment is missed. If a deep subprime borrower misses a payment, escalate the response — perhaps an immediate phone call by a specialist who can offer to restructure the loan or enroll them in a payment plan. The key is a tiered collections strategy: high-risk customers likely need faster and more hands-on intervention, whereas low-risk customers may just need a nudge.

Segment & target portfolio strategies for inclusion

As noted in the white paper, understanding the profiles of who's more prone to exclusion should inform both risk management and marketing. While lending decisions must be blind to protected characteristics, if data show, for example, that female borrowers in your portfolio have higher delinquency rates within certain markets, targeted financial coaching programs or an AI-driven budgeting app service for female customers could help. Some institutions have launched initiatives like credit counseling for single mothers, aligning with corporate social responsibility (CSR) goals.

Incentivize & support education & self-improvement

White paper analysis showed higher education correlating with better income and credit outcomes. While care must be taken so as not to inadvertently disadvantage those who couldn't afford higher education, rewarding credentials can be one form of inclusive design, especially if paired with programs to help others gain those credentials. For example, a bank could offer a "finish your degree" loan at a favorable rate for working adults, confident that helping them graduate will improve their lifetime earnings, thus their creditworthiness.

Offer small-dollar credit & credit-building tools

The racial and income disparities suggest a portion of the population either can't get mainstream credit or can only get it at very high rates. To prevent these customers from resorting to payday lenders or loan sharks, banks can offer safe small-dollar loans and secured credit cards. As noted earlier, credit-builder loans (where the loan amount is secured in a savings account until repaid) are a great way to help consumers establish credit. Secured cards with low limits can graduate to unsecured cards over time. These products won't be huge profit centers initially, but they serve as entry ramps for future loyal customers. Additionally, consider reporting nontraditional payments (with customer permission) to credit bureaus, such as on-time rent, utility or cellphone payments as a way to boost thin-file customers' credit scores. For example, Experian Boost allows consumers to add utility payments to their credit file; banks could similarly incorporate such data in underwriting to say "yes" to someone who has scant credit history but a solid record of paying bills.

Extend Community engagement

Build relationships with community organizations and not-for-profit organizations to pilot programs, and work with regulators and researchers. For example, a bank might collaborate with the CFPB on a no-action letter to try an alternative scoring method for disadvantaged applicants. Alternatively, lenders can work with researchers to implement and use financial education and curriculum as a tool to improve financial inclusion and consumer outcomes.

Financial institutions that recognize changing consumer demographics have the biggest opportunity of leading with inclusive strategies to expand growth and revenue opportunities.

Click here to learn more about Experian's financial inclusion offerings and roadmap to help you navigate shifting consumer trends.

1 Bridging the credit divide: income, risk and inclusion in consumer finance, 2019 Correlations across delinquency occurrences, Table 3a

Ø Results will vary. Not all payments are boost-eligible. Some users may not receive an improved score or approval odds. Not all lenders use Experian credit files, and not all lenders use scores impacted by Experian Boost®. Learn more.