ISSN: 2755-0214

Journal of Economics & Management Research

Review Article

Open Access

Need for Alternatives to Traditional Credit Scores

Goutham Sabbani

Business Analyst, Media Systems Integration, UK

ABSTRACT
As of 2021, more than half of the adult Indian population remained unserved. Only 21.99% of the adult population could be counted as credit served. When we look at the top five Indian banks by total assets, we see that only one bank was utilising more than 60% of its total assets for loans and advances. If banks were able to expand their operations within the unserved population, they could operate at higher leverages. This would mean that the banks would have the ability to operate at lower net interest margins in times of credit crunch and reap higher profits during periods of normalcy. To reach the yet credit unserved, it is essential to gauge their credit worthiness in a manner that does not require credit histories. Hence, in this paper, we will look at some alternatives to traditional credit scoring methods.

***Corresponding author**
Goutham Sabbani, Business Analyst, Media Systems Integration, UK.

Received: June 07, 2023; **Accepted:** June 14, 2023; **Published:** June 21, 2023

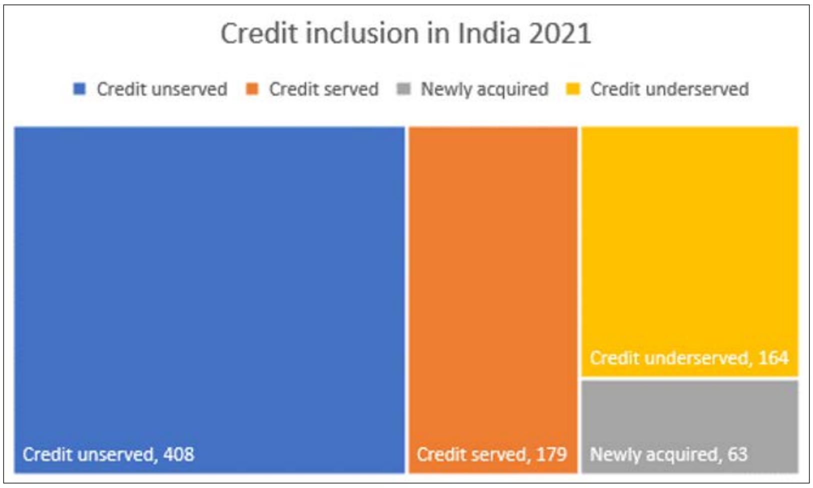
Keywords: Alternative Credit Score, Lookalike Credit Scoring, Creditvision New-to-Credit (Ntc) Score, Credit Inclusion

If you think from the perspective of an individual, credit opens the doors to homeownership, higher education, and vehicle ownership. In some cases, individuals might need to raise money through loans to pay for emergencies like medical expenses. However, a large portion of the population remains unserved in India. This could seriously impede improvements in standards of living for a large portion of the population.

Now, try to think from the perspective of banks and financial institutions. Since a large portion of the population is credit unserved, there are vast expansion opportunities. If a bank can lend more, it could operate at a lower net interest margin for the same profit levels or operate at higher profit levels by maintaining its net interest margins.

However, to make this a reality, it is necessary to effectively assess the creditworthiness of borrowers without credit histories.

Dearth of Individuals with Credit Scores
According to TransUnion CIBIL, in 2021, out of the 814 million Indians who are credit-eligible, 408 million were credit-unserved. Additionally, 160 million Indians were considered underserved. Only 179 million Indians were counted as credit served [1].



Note: All figures are in millions | Source: TransUnion CIBIL [1]

To put things into perspective, in developed countries like the United States of America, and Canada only 3% and 7% of the adult population were unserved. In Hong Kong, another developed country, 16% of the adult population was unserved [1].

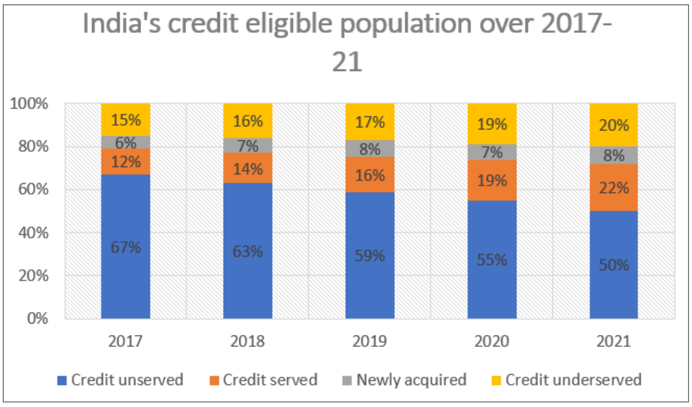
Credit Inclusion in Developed versus Developing Countries

Countries	Number of Unserved Consumers (in Millions)	Percentage of Adult Population that is Unserved	Number of Underserved Consumers (in Millions)	Percentage of Adult Population that is Underserved
Developed Countries				
United States of America	8.1	3%	37	14%
Canada	2.1	7%	7.5	24%
Hong Kong	1	16%	1.8	28%
Developing Countries				
India	408	50%	164	20%
South Africa	20.6	51%	5.96	15%
Colombia	16.3	44%	7.1	19%

Source: TransUnion CIBIL [1]

In India, 70% of the population was under-served or unserved, while in the US, this figure was only 17%. Even among developing countries like South Africa and Colombia, India had the highest percentage of population that is under-served or unserved [1].

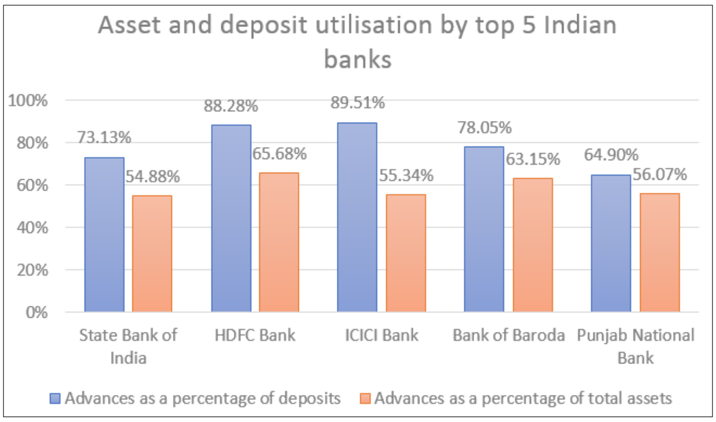
From December 2017 to December 2021, there was a significant improvement in credit inclusion in India. In December 2017, 67% of the adult population was unserved which dropped to 50% in 2021. Despite the significant improvements in credit inclusion, the way ahead seems long [1].



Source: TransUnion CIBIL [1]

Balance Sheets of Top Listed Banks in India

In India, the five biggest banks by total assets were the State Bank of India (SBI), HDFC Bank, ICICI Bank, Bank of Baroda (BoB), and Punjab National Bank (PNB) in June 2023, according to S&P Global. These five banks had combined total assets of $1,772.31 billion[2]. Let us look at how much of their deposits went to advances



Source: BSE [3-7]

We can observe that a large portion of the banks' total assets is not being utilised for advances. While, this could be because of rising interest rates in the past couple of years, knowing that only 21.99% of retail borrowers are credit served suggests a different story [1,8].

The obvious benefit from serving a larger number of customers is the increase in profits. Another benefit could be that, in times of credit crunch, banks could operate on a lower net interest margin with a smaller compromise on profits.

Remedies
If the banking and financial services industry can come up with a way to measure the creditworthiness of first-time borrowers, benefits can be reaped by borrowers as well as lenders. Due to a lack of significant lending history, calculating creditworthiness requires some ingenuity.

CreditVision New-to-Credit (NTC) Score
TransUnion CIBIL, a major credit information company, came up with CreditVision New-to-Credit (NTC) Score. To make up for a lack of credit history, these scores are calculated based on a lookalike model. This model would start by identifying key characteristics of the new borrower and then observing trends in the credit behaviour of similar borrowers for whom the data is available [9].

Some of the factors considered in finding the closest match to the borrower are age, gender, geography, and bank. Factors considered in calculating the score are actual payment amount, payment patterns over 36 months, and enquiry patterns [9].

Unlike credit scores that range from 300 to 900, CreditVision NTC Scores range from 101 to 200 [9,12]. Higher values indicate a lower risk of default. TransUnion CIBIL provides these scores only to credit institutions and banks.

The CreditVision NTC Score is calculated by applying a machine learning model to monitor behavioural trends of similar data subjects [11].

In its report, TransUnion CIBIL presented its observations on movements in credit scores of different types of consumers who were provided credit in January 2019. The key highlights of which were

Type of Consumer	Percentage that had a Credit Score of 700+ in January 2020
New-to-credit	72.30%
Existing credit consumers with credit scores of 300-699	47.29%
Existing credit consumers with credit scores of 700+	85.90%

Source: TransUnion CIBIL [11]

Alternative Credit Scoring
Alternative credit scoring involves understanding the creditworthiness of a borrower by looking at factors other than their credit history. Unlike lookalike models that study behavioural patterns of similar individuals, alternative scoring considers the behaviour and financial strength of the borrower.

One line of thought in alternative scoring considers recurring obligations like utilities and rent. Rent would be priced lower than home loan EMIs as they do not lead to ownership, however, the values are seldom far apart. Utility bills, on the other hand, have much smaller values but are recurring bills nonetheless. The idea is to understand prospective borrower's trustworthiness by analysing trends in paying off recurring obligations.

Another alternative credit scoring approach involves analysing records of alternative loans such as paycheck advances and Buy Now Pay Later (BNPL) loans. This approach is probably the closest one can get to traditional credit scoring among all alternative credit scoring approaches.

Another alternative credit scoring approach is to look at accumulated assets. This is a more straightforward approach. Typically, if an individual owns more valuable assets, they would have higher repayment ability. Another factor considered in this approach would be how easily the assets can be liquidated. Naturally, if a larger portion of the assets are easy to liquidate, then the prospective borrower will have a higher score.

Conclusion
Widening the spread of credit to previously underserved segments of society has the potential to improve standards of living and improve the profitability of banks. It could also make it easier for banks to operate at lower net interest margins. This could further benefit borrowers and depositors while making it easier for banks to survive credit crunches.

However, as obvious as it may seem, banks need to be cautious not to excessively increase non-performing assets. Those of us who had firsthand experience of the subprime mortgage crisis of the late 2000s know the destructiveness of excessive greed and negligence.

Therefore, practices like No-Income-No-Jobs-Or-Assets (NINJA) or No-Income-No-Assets (NINA) loans are out of the question.

Instead, ingenuity must be directed towards finding new metrics to understand creditworthiness that can be as effective as credit scores. Some promising alternatives are lookalike models and alternative credit scoring models.

References
1. More than 160 million Indians are Credit Underserved. https://newsroom.transunioncibil.com/more-than-160-million-indians-are-credit-underserved/.
2. State Bank of India, HDFC Bank keep top slots in ranking as total assets grow. https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/state-bank-of-india-hdfc-bank-keep-top-slots-in-ranking-as-total-assets-grow-76132188.
3. State Bank of India – Annual Report for FY 2022-23. https://www.bseindia.com/xml-data/corpfiling/AttachHis//22d33d1d-af2a-4d2d-98c0-eff16cd73cb5.pdf.
4. HDFC Bank (2022-23) Annual Report for FY 2022-23. https://www.bseindia.com/xml-data/corpfiling/AttachHis//0fb0e6bd-7110-44c3-a750-76933ddf105c.pdf.
5. ICICI Bank (2022-23) Annual Report for FY 2022-23. https://www.bseindia.com/xml-data/corpfiling/AttachHis//f68c72c9-9c03-42e9-a5e6-413cb88728a4.pdf.
6. Bank if Baroda (2022-23) Annual Report for FY 2022-23. https://www.bseindia.com/xml-data/corpfiling/

AttachHis//5e7191ef-8de8-4aa3-8118-93fd1fa83426.pdf.
7. Punjab National Bank (2022-23) Annual Report for FY 2022-23. https://www.bseindia.com/xml-data/corpfiling/AttachHis//01b4a055-de00-4725-acb2-3925a86b10f0.pdf.
8. Major monetary policy rates and reserve requirements - Bank Rate, LAF (repo, reverse repo, SDF and MSF) rates, CRR & SLR. https://dbie.rbi.org.in/BOE/OpenDocument/2311211739/OpenDocument/opendoc/openDocument.jsp?logonSuccessful=true&shareId=2.
9. CreditVision NTC Asset sheet. https://www.transunioncibil.com/content/dam/transunion-cibil/documents/asset-sheets/creditvision-ntc-asset-sheet-web.pdf.
10. CreditVision New-to-Credit Score. https://www.transunioncibil.com/product/creditvision-new-to-credit-score.
11. TransUnion CIBIL Helps Expand Access for New-to-Credit Consumers and Drive Profitable Growth for Lenders. https://newsroom.transunioncibil.com/transunion-cibil-helps-expand-access-for-new-to-credit-consumers-and-drive-profitable-growth-for-lenders/.
12. Learn Everything You Need to Know About the New CIBIL Score. https://www.cibil.com/faq/new-cibil-score.