

Comments on “Fintech Lending: Financial Inclusion, Risk Pricing, and Alternative Information” by Julapa Jagtiani and Catharine LeMieux

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At Fintech: The Impact on Consumers, Banking, and Regulatory Policy

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Summary Comments

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- A very interesting paper with good insights into the role and capabilities of fintech lenders.
- Affirms an important point: a market for credit to financially constrained households exists in which pricing reflects risks, but not necessarily large economic rents to lenders.
- Provides some compelling evidence on the risk-price relationship in one form of lending, at least through the long recovery cycle.
- I identify two areas where additional context would be helpful

The Authors Investigate Three Features of Fintech Lending

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- Credit Access—the authors offer good evidence that fintech lending reaches households that likely do not meet traditional banking standards
- The Price of Credit—they provide compelling evidence that a fintech can grade and price credit to match risk of delinquency, at least through the long economic recovery.
- The Use of Alternative Data Sources in Making Credit Judgments and Determining Pricing—the authors infer its importance in the fintech's lending decision and could continue to strengthen this section.

What the Authors Do

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- Use loan level data from LendingClub, a fintech lender, and from large banks' Y-14M submissions on consumer credit, as well as other sources.
- Investigate the nature of the fintech's borrowing customers and lending markets. Provide very interesting insights (e.g., borrowers are less likely to be homeowners).
- Identify striking changes in the fintech's borrower characteristics and concentrations of lending over time, along with significant growth and geographic penetration.
- Develop evidence on the three main issues.
- As noted, provide compelling evidence of how pricing is aligned with risk rating and how effectively the risk rating maps into delinquencies through 2016.

Risk and Pricing

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- The most compelling results of the paper concern the relationship between risk, pricing, and delinquency at the fintech.
- The comparison of a specific line of fintech lending (payoff of credit card balances and consolidation of debt) to general consumer credit card originations by large banks is less convincing, since the pricing and use of credit cards reflects very diverse consumer behaviors.
- The authors could more fully describe the fintech digital business model--we have good insight from the paper into credit underwriting, what about other features important to success (servicing, customer care).

The Role of Alternative Information

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- The authors look at use of alternative information in lending decisions and pricing.
- The authors infer that the fintech lender is relying more heavily on alternative information based on growing divergences over time with FICO scores.
- One unanswered question is whether traditional banks purchase (or possess) similar alternative information and use that in their credit decision models, and if not, why not. What creates the competitive advantage for the fintech?
- And the authors could note more of the potential legal and regulatory issues around personal information based on what they observed here.
 - The information apparently available for purchase is alarming (e.g., medical payments).
 - The question of ownership rights and obligations for personal information seems to be an area requiring more legal (and regulatory) clarity.

Principal Context Issue

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- Financial services is undergoing a technological transformation toward more electronics. The pace of industry adoption is often slow. How much have large banks matched the online loan product offered by the fintech (e.g., rapid decisioning)?
- The electronic transformation is particularly important for the role of branches.
- The issue is not just cost. Consumer preferences matter. Branches require foot traffic.
- Risk for the authors is that they overinterpret the decline in branches as a withdrawal from or reduction of service to certain geographic markets. We see that in the authors' results when they cover credit access.

Principal Context Issue (continued)

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- The context of transformation in traditional banking offers alternative hypotheses that might better explain change over time in the fintech's business.
- The authors note that average FICO scores of the fintech's customers in the middle part of the sample were more similar to customer FICOs in the Equifax Consumer Credit Panel, but the fintech average FICOs have declined noticeably over 2012-2016 (while the ECCP panel distribution has ticked up).
- Was the fintech an early entrant with new technology, and did the later entrants push the fintech to more of a niche? Or did the fintech identify where the greater potential profitability resided, after exploring the risk-price space?
- Finally, on financial inclusion, is it possible that electronic rather than in-branch applications present a lower hurdle to low-income and other underserved customers than traditional loan applications?

Secondary Context Issue

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- Another set of important competitors in the consumer credit market are community banks and credit unions.
- Credit evaluation is often hailed as one of the strengths of community banks.
- How do the authors see the competitive role of community banks and credit unions?
- Is it an important gap in your analysis to omit those institutions, especially if you continue the comparison of fintech lending to large bank consumer lending?
- Any hope for the microdata you would need?