

# Trust But Verify

## What Research Reveals About Subprime Vehicle Loan Performance when The Work Number® Data is Used



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“Trust but verify.” In case you are not old enough to remember, these were words that President Ronald Reagan often used during negotiations with the Soviet Union to limit a particular group of nuclear weapons.

You might wonder, “What exactly does that have to do with subprime loans and vehicle sales?”

**Subprime loans currently account for about 32% of auto originations being approved, the highest level since 2008.**

*Source: Equifax*

It turns out that “trust but verify” is also good advice for evaluating risk and determining rates for prospective customers. However, as the subprime vehicle market continues to grow most dealers and lenders still rely on traditional credit scores and customer-reported details to maintain stability of their loan portfolios. Unfortunately, these may not be the most accurate or comprehensive ways to assess borrowers’ qualifications:

- Credit scores reflect only a portion of the full picture that affects applicants’ credit-worthiness.
- Insufficient detail can result in the wrong terms and/or risk level being placed on deals, denying qualified applicants or inadvertently approving excessively high-risk borrowers.
- Applications frequently contain inflated or misrepresented information, providing a misleading view of associated risk.
- Verifiable insights into historical job tenure and disruptions, which can be highly predictive of ability to pay, are typically not included or inaccurate.
- Because underwriters and funders try to close deals quickly, manually verifying income and employment is inefficient and often fails to identify inaccurate data.

Stringent guidelines and strict regulatory enforcement by the Consumer Financial Protection Bureau also highlight the wisdom of “trust but verify.” The practice ensures both good relationships and business practices between dealers and lenders. But traditional verification procedures rarely provide completely reliable audit trails to demonstrate accountability and compliance.

Even in this era of information-on-demand, some of the top reasons contracts are returned to dealers are still:

- Lack of verification of stated income
- Missing or inaccurate documentation to meet stipulations
- Failure to meet approval terms and contracts that are out of policy

However, verifications supported by a database like The Work Number® can provide greater accountability, transparency and detailed insight into borrowers’ qualifications. Such verifications also provide operational improvements:

**Productivity and Customer Service**—Faster, more reliable verification results in more deals and happier customers.

**Authentication**—Independent validation uses data from an objective, well-established source.

**Consistent Reliability**—Automation eliminates inefficient and unsecured phone, fax and mail-based interactions and ensures centralized, replicable, streamlined processes.

This is accomplished by compiling and managing unique income and employment data that is updated with each pay period. Such timely data helps to reduce risk and mitigate fraud. It also enables lenders to refine risk level assignment, loan pricing and reduce stipulations to more accurately reflect applicants’ credit-worthiness.

Recent studies comparing The Work Number data to traditional verification demonstrates just how practical—and ultimately profitable—The Work Number results are. They enable dealers and lenders to make more informed decisions and to be more responsive to their business partners and customers.

## Studies illustrate the significance of verification and provides greater understanding of borrower behavior, loan performance

The studies looked at the impact of four specific attributes on borrower credit-worthiness:

- Income verification
- Employment tenure
- Pay frequency
- Employment disruptions

Each of these attributes helps create a more complete context in which to interpret credit ratings. They also enable lenders to develop a more dynamic understanding of each applicant’s individual circumstances.

The studies compared a random ten-percent sampling from The Work Number database to traditional credit bureau reporting and verification processes. Ninety-plus days past due (90+ DPD) performance for auto loans originated in 2011, 2012 and 2013 was examined from September 2012 to September 2013.

For comparison purposes, VantageScore 3.0 was used to quantify performance differences between The Work Number and traditional bureau data.

## Income Verification

*Specific levels predict specific loan performance*

The Work Number research revealed not only that higher wage earners are less likely to default, but that:

*The risk of delinquency is reduced approximately 50 basis points for every \$10,000 salary increase for individuals earning \$10,000-\$80,000 annually.*

In fact, borrowers earning \$10,000-\$20,000 annually are ten times more likely to go 90+ DPD than those earning \$100,000 or more.

What is most important in this finding is not that better qualified applicants earn more, but that income verification reduces the risk of delinquency. Being able to quantify the likelihood of default so specifically enables lenders to develop more accurate strategies to improve portfolio performance.

Income verification is also important in determining appropriate rates, terms and deal structures. The research found that while approximately 80% of lower income applicants inflate their reported income, roughly 75% of applicants earning \$50,000 or more under-report. The result:

*A significant portion of highly desirable applicants probably qualify for more refined terms over the life of their loans. This improves customer satisfaction and increases the likelihood of nurturing a long-term customer.*

**Verifications from The Work Number identified more than twice the number of applicants overstating income compared to internal verification.**



## What makes The Work Number Work better?

The Work Number, compliant with the Fair Credit Reporting Act (FCRA) and enabled through consumer consent, provides unique employment data direct from the source. It also helps lenders and dealers reduce risk, mitigate fraud and efficiently approve more profitable and comprehensively verified vehicle loans than ever before. This is made possible through:

- 59 million records that come directly from employers
- Records that are updated every pay period
- Strong credibility with partners made possible through the timeliness of the database and automated verification
- Comprehensive database includes millennial employees who may not have established desirable credit histories but are an important segment of a profitable future customer base

The Work Number's automation and transparency adds to the arsenal of tools necessary for dealers and lenders to meet compliance standards established by the Consumer Financial Protection Bureau and other regulators. This enables dealers and lenders to confidently deliver more vehicles and write more loans even in environments with high volume indirect lending.

## Employment Tenure

*Over-reporting is high*

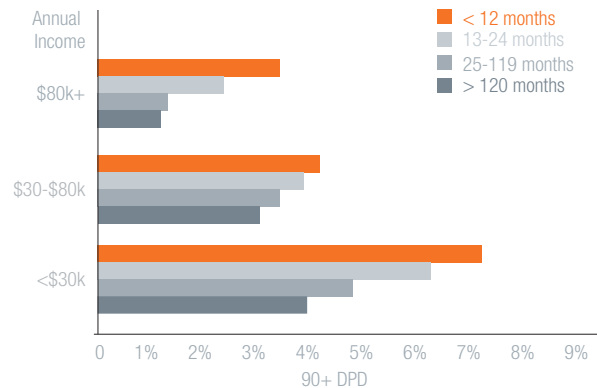
The length of time an applicant has held his or her job is highly predictive of loan delinquency. While it seems obvious that longer tenure indicates greater stability and more positive loan performance, The Work Number studies found that:

- The number of applicants with less than one year of tenure is under-reported by more than 150%.
- In the subprime population, borrowers with less than one year of tenure and loans of less than \$15,000 are nearly twice as likely to become delinquent than those with 10+ years.
- Borrowers in the general population with less than one year of tenure are three times more likely to go 90+ DPD than employees with 10+ years.

Combining employment history with the array of additional data available from The Work Number and credit scores is critical for obtaining a complete picture of prospective borrowers' circumstances. For example, shorter tenure (a negative indicator if viewed in isolation) might be mitigated by a salary increase with a new employer.

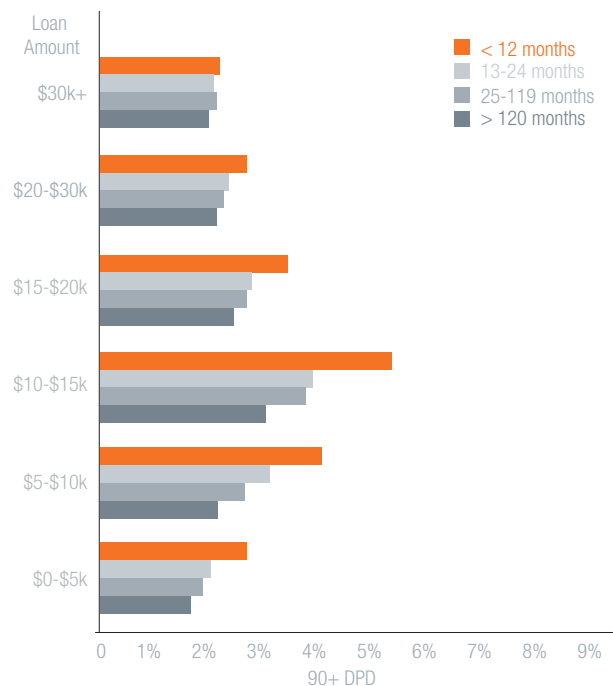
Credit scores do not include job tenure data, but The Work Number can add such insight across all income levels. This level of analysis provides valuable tools for identifying increased risk and writing profitable deals that might otherwise be missed.

## Auto 90+ DPD by job tenure and income (subprime population)



Job tenure provides exceptional detail about risk for a wide range of incomes in the subprime population.

## Auto 90+ DPD by auto loan amount and job tenure (subprime population)



Verified tenure can help avoid poor performance associated with smaller loan amounts and short employment periods.

## Pay Frequency

*Hourly workers are riskier regardless of income*

Even highly paid hourly employees are less likely to stay current with loan payments than those who are salaried.

Because The Work Number data is updated with each pay period for reporting employers and does not rely on information provided by borrowers, it offers the most timely and reliable information on pay frequency. This means deals can be structured to reflect the most realistic circumstances. In other words, terms can be tailored to the most probable estimates to ensure a borrower's likelihood of keeping payments up to date.

## Job Disruption

*Immediate identification is key*

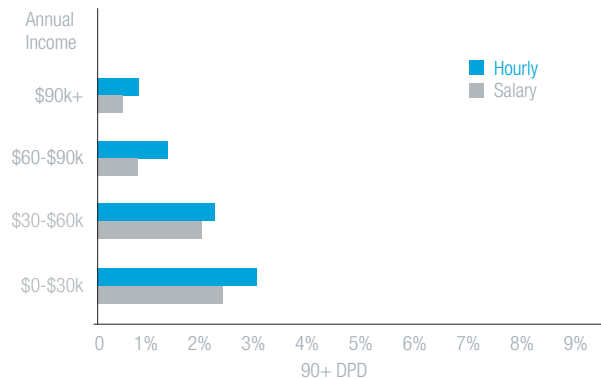
It is no surprise that loan applicants and current customers who have recently lost their jobs present greater risk than if they were still employed. The Work Number database presents a unique opportunity to:

- a) Identify recent disruptions that have not been reported accurately, and
- b) Leverage early signs that a new disruption has occurred.

Because The Work Number data is updated each time reporting employers process payroll, job disruption can be detected almost immediately. Relying on credit reporting alone only indicates the consequences of lost income well after employment has actually ended.

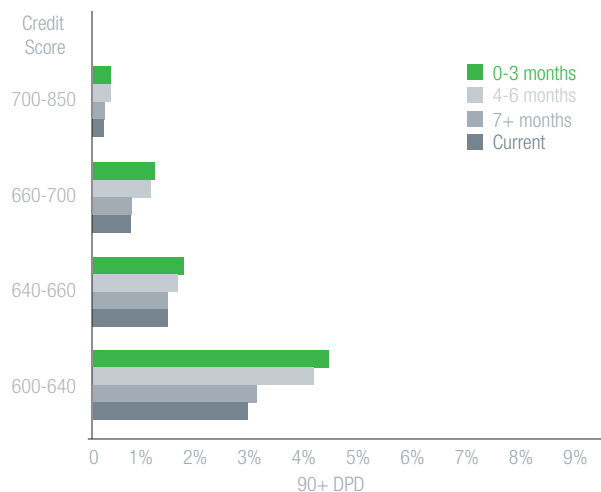
In fact, early detection creates opportunities for lenders and dealers to respond quickly, proactively and productively:

## Auto 90+ DPD by projected income



Research found that even highly paid hourly employees are less likely to stay current with loan payments than those who are salaried.

## Auto 90+ DPD by months since job disruption



According to the findings, the more recent the job disruption, the higher the risk of delinquency.

- Protect margins by intervening with borrowers before payments become delinquent and issues with other creditors arise.
- Avoid unnecessary expense by finding the right alternatives to keep the customer in the vehicle with a clear understanding of what the customer can afford.
- Work in partnership with customers to avoid default and improve the customer relationship instead of creating an adversarial environment.

## Increased Approval Rates

*Clearly identify and accommodate the most desirable customers*

As with any type of analysis, the more specifications that are available, the more detailed and customized the results can be. The multiple data elements offered from The Work Number provide much greater insight into loan performance and the characteristics that identify the most desirable borrowers.

For example, understanding the risks posed by a wide range of income levels means deals can be more appropriately structured to mitigate those risks. Incorporating that data with traditional credit scores allows deals to be customized further to give a more holistic view of the borrower.

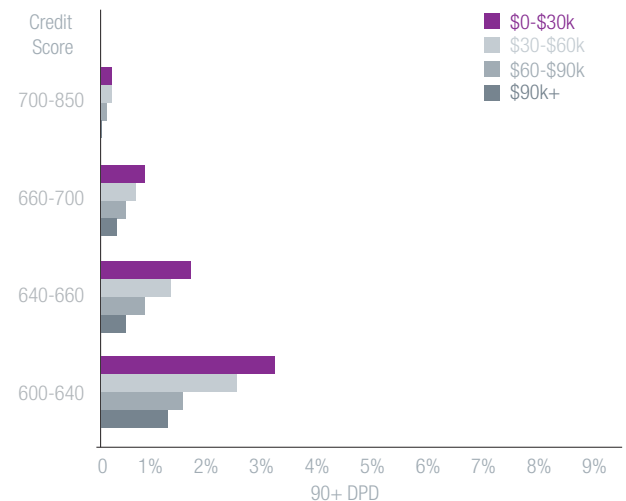
Combining additional segmented data on pay frequency, tenure and job disruption means gaining even further insight into the financial status of individual borrowers. And that introduces the possibility of eliminating stipulations, offering more refined terms and improving underwriting efficiency.

*Verified income data from The Work Number facilitates more deals while also mitigating risk.*

All of these benefits are made possible by the holistic view provided by The Work Number. By looking beyond credit scores, lenders and dealers have the power to:

- Make more informed, proactive decisions
- Customize more deals to the benefit of lender, dealer and customer
- Improve customer satisfaction
- Increase the number of approved deals

## Auto 90+ DPD by The Work Number income and VantageScore 3.0



# Conclusion

## Make better loan decisions with better data

This paper has addressed the risk of relying on applicant-provided information—either honest mistakes are made or intentional misrepresentation occurs. And waiting on applicants to provide information and documentation can cause delays in the process and potentially negatively impact the customer experience.

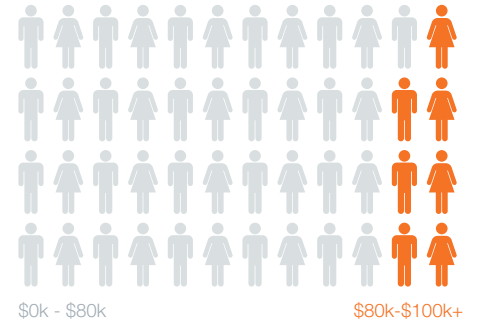
Leveraging verified information supported by a database like The Work Number can help provide greater accuracy, accountability, transparency and detailed insight into applicants' qualifications. This insight provides a competitive edge when evaluating applicant risk and opportunity.

*Note that results illustrated are specific to the data that was used for this example and will differ based on individual data and policies.*

### CREDIT SCORE 600-639 12% applicant lift

▶ Previously would have been turned down

- ▶ **The Work Number** identified applicants with an annual income of \$80k or more should be considered for approval



### CREDIT SCORE 640-659 reduce risk by 53%

▶ Previously would have been approved for a loan

- ▶ Applicants are at a higher risk for default and therefore should be declined, or given more conservative terms

- ▶ and 8% of applicants (whose annual income is over \$100k) **should be given more competitive loan terms**



### CREDIT SCORE 660-699 47% more refined terms

▶ Previously would have been given a preferred loan

- ▶ Applicants, as identified by **The Work Number**, are at a higher risk for default and therefore should be offered more conservative terms based on the policies used in this example



A more comprehensive picture of individual credit-worthiness means some previously approved applicants may be denied. But incorporating income data from The Work Number with traditional credit scores helps a significant number of applicants receive more refined loan terms to optimize risk level.

## About The Work Number®

The Work Number database is the largest central source of consolidated employment and income information. The database houses more than 59 million active employment records and more than 189 million historical records. These records are contributed by more than 4,000 employers nationwide – from Fortune 500 companies to small regional and local employers representing every major industry. Accessible 24/7, The Work Number database enables a streamlined verification process for both automotive dealers and lenders alike.

## About Equifax

Equifax (NYSE:EFX) is a global leader in consumer, commercial and workforce information solutions that provide businesses of all sizes and consumers with insight and information they can trust. Equifax organizes and assimilates data on more than 600 million consumers and 81 million businesses worldwide. The company's significant investments in differentiated data, its expertise in advanced analytics to explore and develop new multi-source data solutions, and its leading-edge proprietary technology enable it to create and deliver unparalleled customized insights that enrich both the performance of businesses and the lives of consumers.

Headquartered in Atlanta, Equifax operates or has investments in 18 countries and is a member of Standard & Poor's (S&P) 500® Index. Its common stock is traded on the New York Stock Exchange (NYSE) under the symbol EFX. In 2013, Equifax was named a Bloomberg BusinessWeek Top 50 company, was #3 in Fortune's Most Admired list in its category, and was named to InfoWeek 500 as well as the FinTech 100. For more information, please visit [www.equifax.com](http://www.equifax.com).



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