Expanding Financial Inclusion in Automotive Lending

The only constant in the consumer credit industry during the past decade was disruption. The financial crisis and new regulations forced many banks to tighten lending standards, while fintech innovation and marketplace lending provided new channels and sources of credit. Consumer credit behavior evolved, along with the data and scoring systems that represented that behavior. As a result, there's a gap in the U.S. credit ecosystem that leaves many individuals without access to traditional financial services.

Traditional credit scores successfully predict whether known credit users are likely to default on their payments based on data typically taken from credit card, mortgage, student, and auto lending records. However, they lack information from key modern responsibilities that can provide additional predictive insights into a consumer's behavior. This incomplete perspective puts unscoreable consumers and those with poor scores at a disadvantage.

The Unscoreable Population: Thin-File and No-Hit Consumers

According to the Consumer Financial Protection Bureau, there are approximately 45 million U.S. consumers who either have no credit history or lack sufficient information to generate a bureau score. Without a score, these individuals are identified as unknown, or high risk, to an enterprise and largely denied access to credit. High-risk consumers who are granted credit can expect to pay significantly higher interest rates or receive other less desirable terms and conditions on their loans.

Alternative credit scores with insight into non-traditional loans and modern credit responsibilities often identify a significant portion of unscoreable applicants as meeting lenders' credit standards.

These results demonstrate a win-win situation for consumers and lenders—alternative credit scores provide unscoreable consumers with improved access to the credit they need, while allowing lenders to grow their portfolios without incurring additional risk.

The Scoreable Population: Marginal and Subprime Consumers

Out of the total number of U.S. consumers considered scoreable by the national consumer reporting agencies, 32% have a score that places them in a poor or bad credit class.

For purposes of this study, subprime consumers were classified as those with a traditional credit score below 640. However, bureaus can miss the complete picture when it comes to understanding the creditworthiness of these applicants. Traditional scores offer only a partial view of consumer behavior and its associated risk, making it difficult for credit issuers to recognize recovering customers within the subprime population.

Marginal consumers who fall on the threshold of financial inclusion—defined commonly as the near-prime population—can be the most difficult to assess. The lenders in this study identified marginal applicants as those falling in a traditional score band of 640-660. This narrow score band often makes it difficult to separate risk. Additional insight from alternative data sources can provide a more accurate assessment of consumers on the margin, and help reveal the underestimated applicants in this population.

A Better Assessment of Marginal Consumers

ID Analytics looked at over a year's worth of data and more than a million records from a major auto lender to demonstrate how an alternative credit score could increase consumer inclusion for marginal applicants. These applicants fell within a custom bureau-based score band of 640-660.

Traditional bureau scores struggle to separate risk within such a narrow score band while alternative scores can help identify the percent of the population that is underestimated and safe to engage. This analysis revealed 60% of the population is below the auto lender's marginal incidence rate and considered credit eligible (figure 1).

The additional separation of risk using an alternative credit score allows lenders to identify marginal consumers whose ability and willingness to pay aren't wholly understood by traditional data and scores.

Major U.S. Auto Lender: Applicants w/640-660 Bureau Score		
Percent of Population	**Bureau/ Traditional Score**	**Alternative Score**
Decile	Bad Rate	Bad Rate
Least Risky	6.3%	3.8%
2	7.2%	4.8%
3	7.3%	5.1%
4	7.1%	5.9%
5	7.8%	6.4%
6	8.9%	6.9%
7	8.2%	7.5%
8	8.5%	9.0%
9	7.7%	10.9%
Riskiest Decile	9.1%	17.3%
Overall	7.7%	7.7%

Figure 1: *The application of alternative scores to separate risk among the auto lender's marginal population.*

Recognizing Recovering Subprime Consumers

Many applicants categorized as subprime have suffered negative life events or financial struggles, but are now recovering from past credit problems. As a result, they can also be underestimated by traditional scoring models, which are blind to many of the typical steps these consumers take to re-establish responsible credit management.

ID Analytics looked at the portfolios of auto lenders to determine the percentage of applicants who were considered subprime based on traditional credit bureau scoring methods. Subprime applicants were classified as those with a traditional bureau score below 640. Depending on the lender, the research identified as high as 50% of the enterprises' applicants as subprime. Credit Optics FS was able to classify over 20% of this subprime population as credit eligible.

Conclusion: Alternative Credit Scores Promote Financial Inclusion

Our research clearly shows there's an information gap in traditional credit scoring models that prevents a significant percentage of U.S. consumers from achieving financial inclusion and that alternative data scores are an essential component in improving the current state of our credit ecosystem.

Alternative credit information and scores capture many of the critical consumer behaviors that bureaus miss, allowing enterprises to see people who are on the path to credit recovery, and offer improve credit options for underestimated applicants.

Based on our results, better credit decisioning can be achieved using a combination of traditional and alternative credit data. This allows enterprises to be more inclusive with their lending strategies without increasing risk exposure. Financial inclusion for consumers will rely heavily on alternative data scores to identify individuals completely missing from the credit conversation and better serve those on the margin.

To learn more about how alternative data can help improve consumer access to credit, visit us at www.idanalytics.com for our full study *Alternative Credit Scores: The Key to Financial Inclusion for Consumers* coming out next month.

About ID Analytics LLC

ID Analytics is a leader in consumer risk management with patented analytics, proven expertise and real-time insight into consumer behavior. By combining proprietary data from the ID Network®—one of the nation's largest networks of cross-industry consumer behavioral data—with advanced science, ID Analytics provides in-depth visibility into identity risk and creditworthiness. Every day, many of the largest US companies and critical government agencies rely on ID Analytics to make risk-based decisions that enhance revenue, reduce fraud, drive cost savings and protect consumers. ID Analytics LLC is a Symantec company. Please visit us at www.idanalytics.com

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