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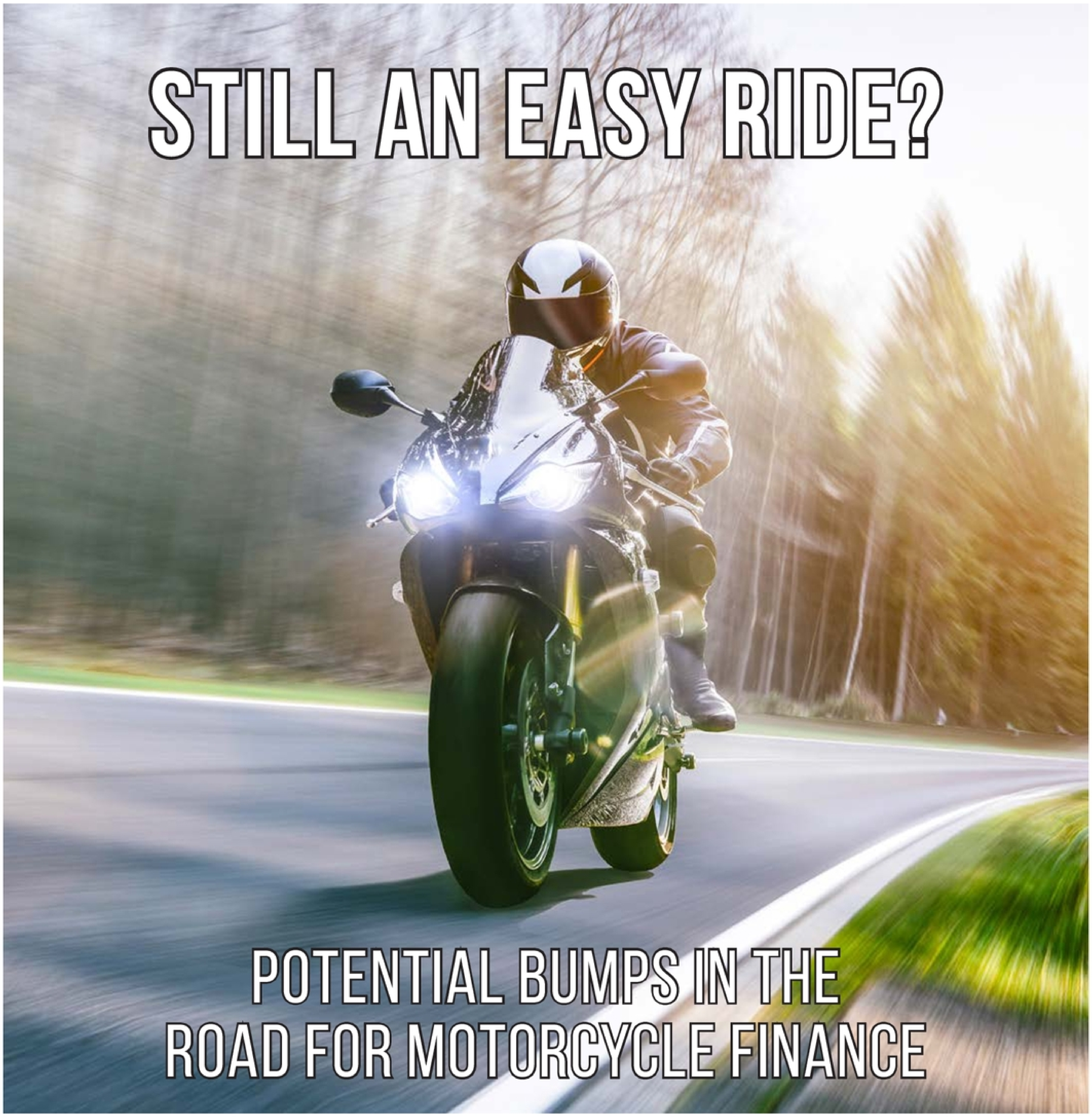
ISSUE 167 / OCTOBER 2018

THE JOURNAL FOR THE CAR FINANCE INDUSTRY

Motor Finance



STILL AN EASY RIDE?

POTENTIAL BUMPS IN THE ROAD FOR MOTORCYCLE FINANCE

ANALYSIS

Lenders and brokers tap into AI and chatbots for underwriting and support

FEATURE

Car finance: has it now made the unsecured personal loan redundant?

COMMENT

Cazana's Rupert Pontin on why August's exceptional activity is not all it seems

THIS MONTH

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Financial News Publishing, 2012. Registered in the UK No 6931627. ISSN 0956-5558

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NEWS

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OCTOBER 2018

EDITOR'S LETTER
POS FINANCE A MORE ATTRACTIVE OPTION

Brian Cantwell, Editor

A busier month for new car sales in August, as the WLTP restrictions drove deals at dealerships and got cars onto the road.

But Cazana is reporting a knock-on negative effect on used-car sales, meaning there was no total increase in customer numbers. The other thing to mention is that it skews the results – September often reveals greater new car sales.

It is hard to say whether we have seen a change in motor finance penetration rates because of Brexit, but rises in the Bank of England base rate are likely to affect the rates of motor finance penetration for the better, says software provider Sword Apak.

It said rising Bank of England rates – which have been notched up twice since November and now stand at 0.75% – would push up costs for forms of financing such as unsecured personal loans. This, in turn, would make point-of-sale car finance a more attractive option for prospective buyers.

"The recent increase in the UK base rate will impact motor retailing with its inevitable knock-on effect on loan rates, underwriting and the cost of wholesale stocking," said Sword Apak executive vice-president James Powell.

"A potential 'silver lining' to this is that tighter underwriting is more likely to impact personal loans than secured loans, which could make dealer finance a more attractive option for consumers."

In May, a Moody's note said car finance and associated financial instruments – such as asset-backed securities – would be shielded from a rate rise, thanks to the prevalence of fixed-rate agreements. And with the plate change, there may well be a push on numbers going into dealerships looking for finance.

FCA staff change

According to chatter from the market, the FCA's office move from Canary Wharf to Stratford has caused some disquiet amongst the regulator's personnel.

Overall, the move has not gone down too well with its staff, causing some to leave the FCA.

The regulator declined to comment on this directly. However according to its annual results for 2017/18, its current staff turnover is 11.7%, with roughly 400 people leaving a year.

Whether or not this has affected its ability to deliver the motor finance review on time is unclear. ■

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CAR LOANS:
IS FINANCE THE FUTURE?

It is an industry adage in asset finance that leasing's biggest competitor is a loan from one's own bank. Is that still the case, or has car finance made the unsecured personal loan redundant? *Lorenzo Migliorato* assesses the state of play

As the price range for cars has expanded over the decades – making progressively fewer customers likely to have enough cash in their account to pay up front – carmakers and specialist finance houses have been working to claw customer shares from personal loan providers.

A loan from one's own bank is probably the first thing that comes to the minds of people looking for a way to finance a car purchase – at least until they are offered other options at the point of sale – and arguably remains the most straightforward route, thanks to the troves of data that a home bank will hold on an existing customer.

"There is clearly little difference between hire purchase and a personal loans, in practical terms, from a customer's perspective," says Scott Cargill, chief executive of Admiral Financial Services, the one-year-old lending division of the Cardiff-based insurer. "Ultimately they are fixed-repayment loans, and by the end of the loan you own the car."

A car loan – effectively a form of personal loan – offers a lower entry point for lenders, to the point that pretty much every high-street lender offers them, with peer-to-peer platforms like Zuto, Zopa and RateSetter also entering the space.

However, car finance does not necessarily make the personal loan offer redundant: Hitachi Capital and Santander Consumer Finance offer both.

Admiral's choice to include both types of product was made with a specific business rationale at work, explains Cargill. "The security that is offered in a hire purchase gives us more confidence to offer it to people that have less-strong credit scores, or are less experienced, where there are really top-grade ownership customers."

Car finance packages, of course, allow for a more sophisticated offering than basic loans, and Cargill says Admiral is looking into car-related services and packages to bolt onto PCP and HP products.

> "
> PERSONAL LOANS GIVE US AN OPPORTUNITY TO SERVE THE PRIME CUSTOMER BASE

Still, personal loans serve their purpose, especially within the prime customer base, and although PCP may be more attractive than a loan to customers looking for flexibility, Cargill says car finance has not been cannibalising loan products.

"The cost of security on hire purchase and PCP, because of things like voluntary termination and manufacturer court disputes, can never get to a point where you can offer 3% APR," he says, adding: "Personal loans give us an opportunity to serve the prime customer base."

CREDIT DIFFERENCES

Many brokers and intermediaries will offer loans and car finance side by side: Auto Trader, for instance, was referring customers to Zuto long before it allowed dealers to advertise finance on classifieds last year.

Car Finance Plus is a broker that has been working with providers from the full spectrum of products: its panel lineup includes PCF Bank, Shawbrook, Advantage and Moneybarn, as well as Shawbrook Bank, Progressive Loans and online lenders RateSetter and Lendable. Unlike Admiral, it focuses on bad loan credit.

"In the prime [segment], it is actually very hard for brokers to compete," says director Roman Danaev.

"If you are a prime customer with excellent credit, you go to a high-street bank, or your own bank, and get a personal loan. You have lots of brokers and a lot of lenders operating in subprime, because the APR is high."

That said, there is only so much personal loans can do. "The problem with personal loans is that unsecured loans are capped at £25,000," says Danaev.

That works for the subprime segment: Danaev says the average amount it brokers is £10,000, with HP accounting for 80% of contracts, personal loans for 5% and guarantor loans for 15%.

Scott Cargill, Admiral

Roman Danaev, Car Finance Plus

In the prime space, however, £25,000 is a tight jacket. Danaev explains: "If you've got excellent credit and earn a lot, you would need something more expensive than £25,000," he says.

"With the loans, it is a very thin layer of customers that has good credit and is not looking for an expensive car."

That was partly the market rationale that led the industry to introduce PCP – so dealers could give the experience of driving a high-end car at a total cost equivalent to a personal loan on the same vehicle. However, Danaev says many customers often misunderstand how PCP works, thinking they are simply getting an extremely good-value HP.

"People don't understand that, at the end of the term, they have to pay up if they want to retain the car," he says.

"When the term ends, they start looking for loans to finance the balloon payment. It happens quite a lot – I would say daily; and not even a few – a lot of them, actually."

MARKET CORRECTIONS

Given that high employment and cheap credit greatly benefited the penetration of PCP in the post-recession era, it is worth pondering whether the car finance and loan markets would weather more stressful economic conditions equally well.

Admiral's Cargill sees underwriting as a more crucial determinant of how a portfolio would fare than product type, noting: "It very much depends on your customer appetite and your underwriting criteria. As long as you are making the right risk decisions, and understanding the customers well from an affordability perspective, there is not much difference [between loans and finance]."

Still, lenders are well aware of the security element that car finance offers. Despite growing concerns over the country's household debt bubble, Bank of England (BoE) governor Mark Carney said at the start of this year that he was "comfortable" with lenders' exposure to motor finance.

"If you [conduct a stress test] and, say, we have a recession and the value of the car is worth 20% less than the residual value that was in the contract, it works out to about six basis points," he told the UK parliament's Economic Affairs Committee.

Consumer credit, meanwhile, despite accounting for around 8% of banks' debt exposure, would hit lenders' balance sheets with a 40% impairment rate in the BoE scenarios, which by Carney's own admission are quite "brutal".

For Danaev, a correction in the market – not necessarily one as brutal as in the BoE stress test scenarios – would lead to a rebalancing of product mix, at least on the car finance side of the market.

> " THE MARKET WILL ONE DAY REALISE THAT YOU DO NOT NEED BROKERS, BECAUSE THE LENDERS AND THE DEALERS CAN WORK DIRECTLY

"If something goes down, people will stop purchasing new, expensive, luxury cars. The upper-middle class, people who earn anything from £40,000 upwards – I would say these customers will stop using PCPs."

WHAT PLACE FOR BROKERS?

While loan providers still have plenty of opportunity for business next to car finance, brokers like Car Finance Plus might need to do some adjustments as disintermediation puts their role at risk.

Danaev says: "With personal loans, the way the market is going – and it's going towards automation – it is actually harder to be a broker [for the product]."

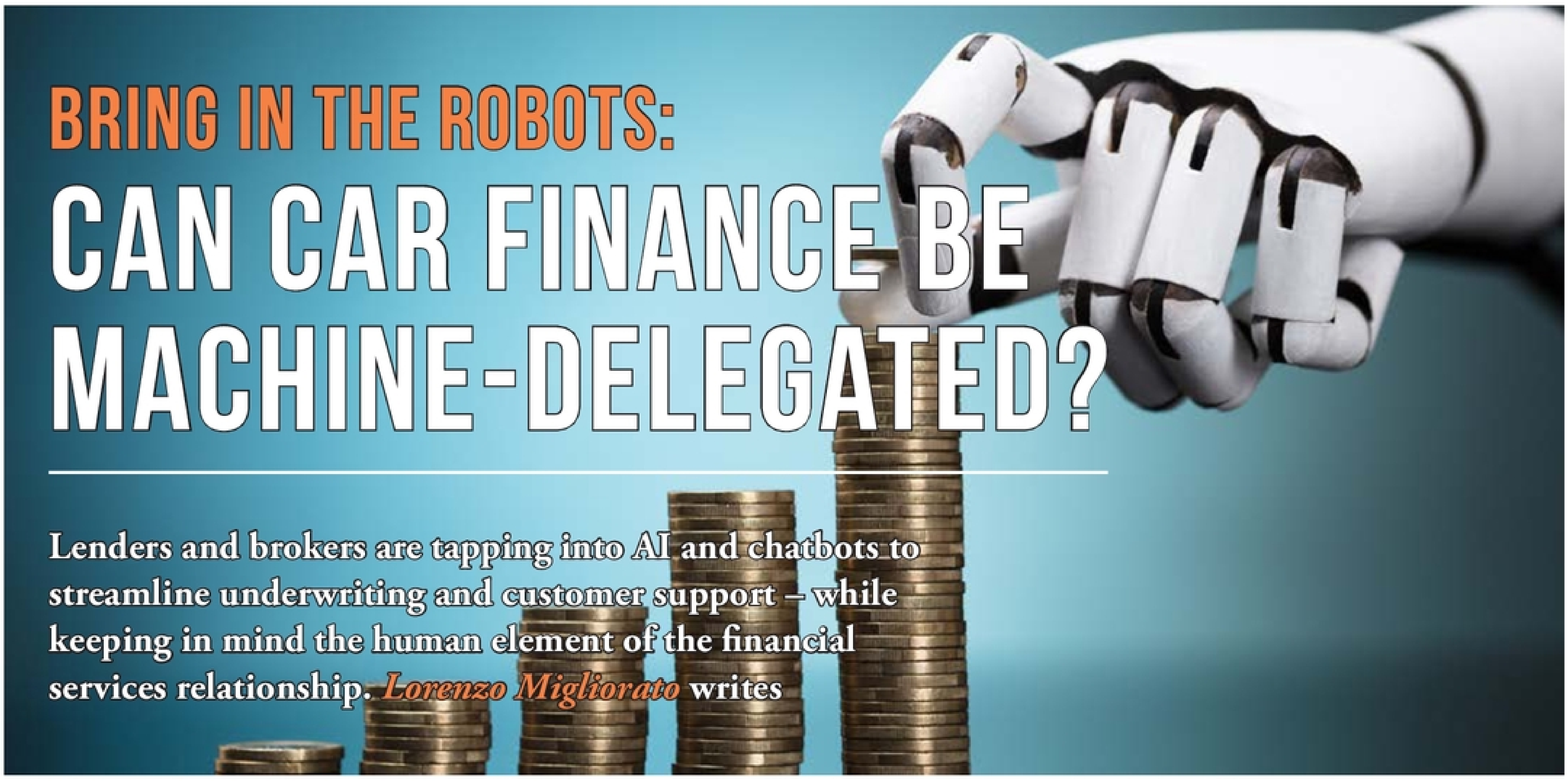
Not only is the cost of acquisition drastically lowered by the internet, underwriting is also being made progressively redundant.

"Everything is automated, and they would hardly ask you for any proof, because the credit searches, the cross-checks with bank details, it can all be validated pretty much instantly. And if you apply with your home bank, they know you as a customer. You hardly have to do anything to be a broker in the personal loans space."

Car Finance Plus may currently operate as a broker, but Danaev is not afraid to push the company to reinvent itself so as not to be pushed out of the market.

"As a broker, the market will one day realise that you do not need [brokers], because the lenders and the dealers can work directly. What brokers do for the lenders is just that: they provide high volumes of customers," he notes, adding that for the company, "automation-proofing" will also involve beefing up its existing – but currently small – own-book loan business.

"You have to look to the future," Danaev says. "Having a portfolio of loans is something we are looking to do [more] in the future, because being a broker means you are always dependent on the lender – you never know what way the market will go." ■



BRING IN THE ROBOTS: CAN CAR FINANCE BE MACHINE-DELEGATED?

Lenders and brokers are tapping into AI and chatbots to streamline underwriting and customer support – while keeping in mind the human element of the financial services relationship. *Lorenzo Migliorato* writes

The technological promise of a financial services quasi-utopia, where the entire borrowing process is automated and algorithm-assessed – what the Financial Conduct Authority (FCA) termed the "algogracy" – may neither be realistic nor desirable.

That is not stopping players in the consumer credit space from tapping into technologies such as robotic advisors and machine learning, and experimenting with how far automation can go within the limits of fair treatment and compliance.

While the wealth of transactional data at the disposal of retail banks make simple products such as personal loans the area most ripe for automation, more specialised, non-bank-backed actors have not been sitting idle.

In car finance, brokers and lenders are looking into how to tailor technologies such as artificial intelligence (AI) to their customer base – and they are not automating for automation's sake. "The driver isn't so much the technology," says Adrian Dally, motor finance head at the Finance and Leasing Association. "The driver is the accuracy of the information you have about customers."

The UK is one of the most fertile grounds for AI research globally, and lenders have been approaching leaner and younger companies to tap into the technology. In the UK, Toyota Financial Services partnered with startup Aire to manage delinquencies, and Hitachi Capital brought on board Jaywing's AI software, Archetype, to improve credit assessment.

Some companies decided to take another route and build their own in-house systems. That is the case for brokerage Autorama, parent of brokerage businesses Vanarama and Motorama, which is exploring how technology can help in the initial ontake of customers and funnel more business to the underwriters.

"We wanted to have full control over what the software does exactly. We did not use an off-the-shelf product or rely on third parties who did not understand the full end-to-end journey," says Jamie Buchanan, chief technology officer at Vanarama. The broker's website sports a live price engine and soft-search credit quotes.

AUTOMATED JOURNEY

It is perfectly possible for a Vanarama customer to go through an entirely automated buying journey – which means the business is not restricted to working hours.

"Some customers are very comfortable with the self-service journey. They are very sure of what vehicle they want, of the finance deal that they want," says Buchanan. "Those customers – that's where our platform really works well. It can be 10 o'clock on a Sunday night – if they know what they want they can go ahead and order the vehicle."

The spearhead of customer engagement on Vanarama's website are its two 24/7 chatbots, aptly named iVan and iCarli. It is another tool that Vanarama uses to keep engaging with customers in after-work hours – the time of the day when, as Buchanan points out, most people will be able to actually sit down and research their purchase online.

Chatbot systems are one area where Vanarama is looking to implement AI and machine-learning technology. That said, delegating customer-facing functions to a machine – something that may raise some eyebrows at the FCA at a time when the watchdog has repeatedly emphasised the importance of clearly explaining contract terms – is not a way of doing more with less.

"One of the great things about the chatbot is that it's a conversational interface, and that it can be designed to include any information that we want or that is required by the FCA," says Buchanan. "It forces you to break down quite complex information into plain English," he adds, potentially giving the broker a chance to assess the adequacy of its customer approach.

He adds that the chatbots also give Vanarama an insight into the kind of question customers are likely to ask. In any case, for all automated processes – from online applications to chatbots – there is always a human fallback to pick up the process when algorithms cannot go any further.

Not only has Vanarama kept the phone call route for customer enquiries – the chat's interface was designed to make it clear that the customer is talking to a bot, not a human underwriter.

"Some customers want the ease and speed of using something like a chatbot. But obviously, it has to be compliant and it has to be fair," says Buchanan.

"The FCA is very clear on what the requirements are, and all the technology we build is built with that in mind." ■

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