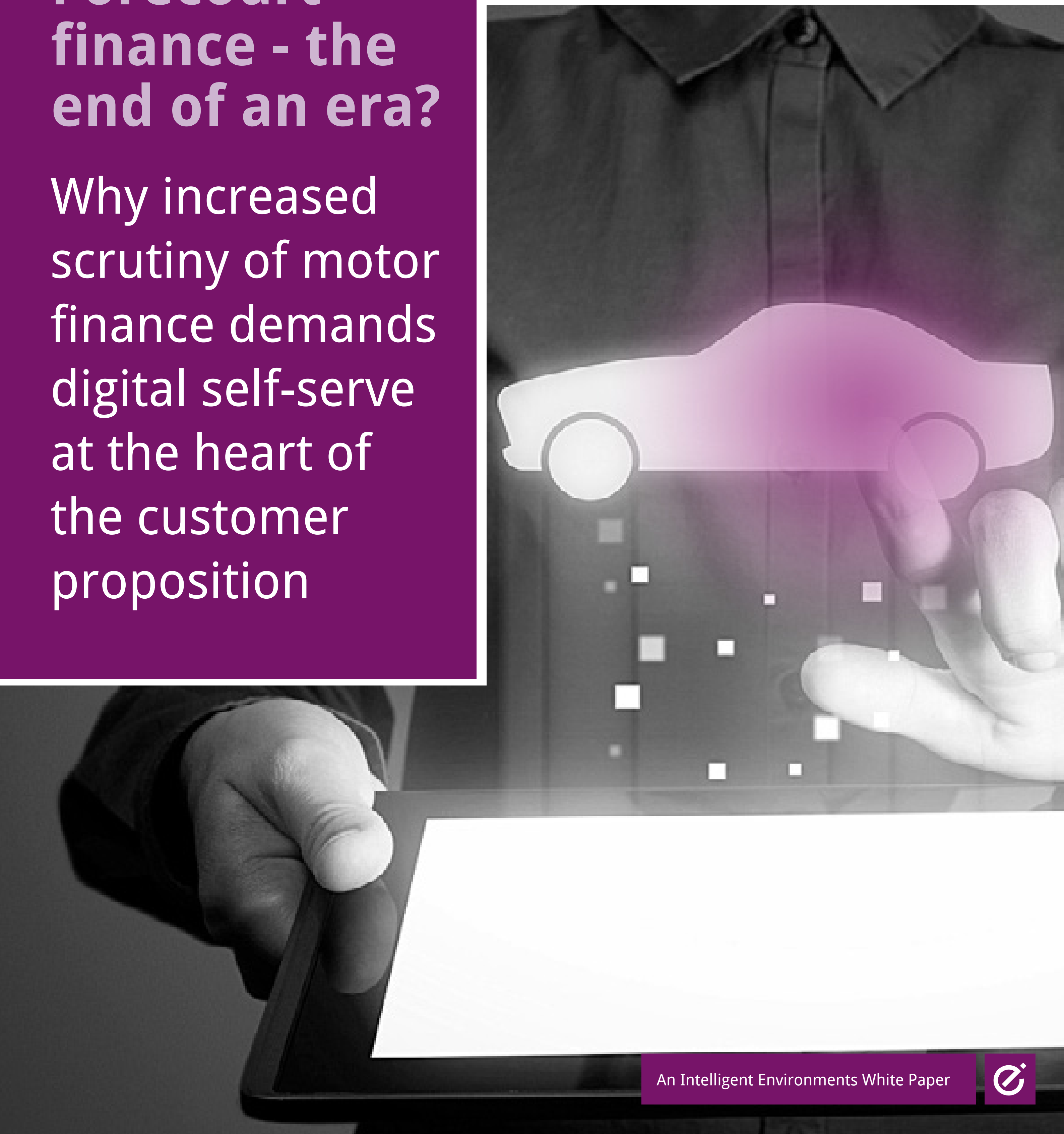
intelligent environments
Digital Financial Solutions

Forecourt finance - the end of an era?

Why increased scrutiny of motor finance demands digital self-serve at the heart of the customer proposition

2017



An Intelligent Environments White Paper

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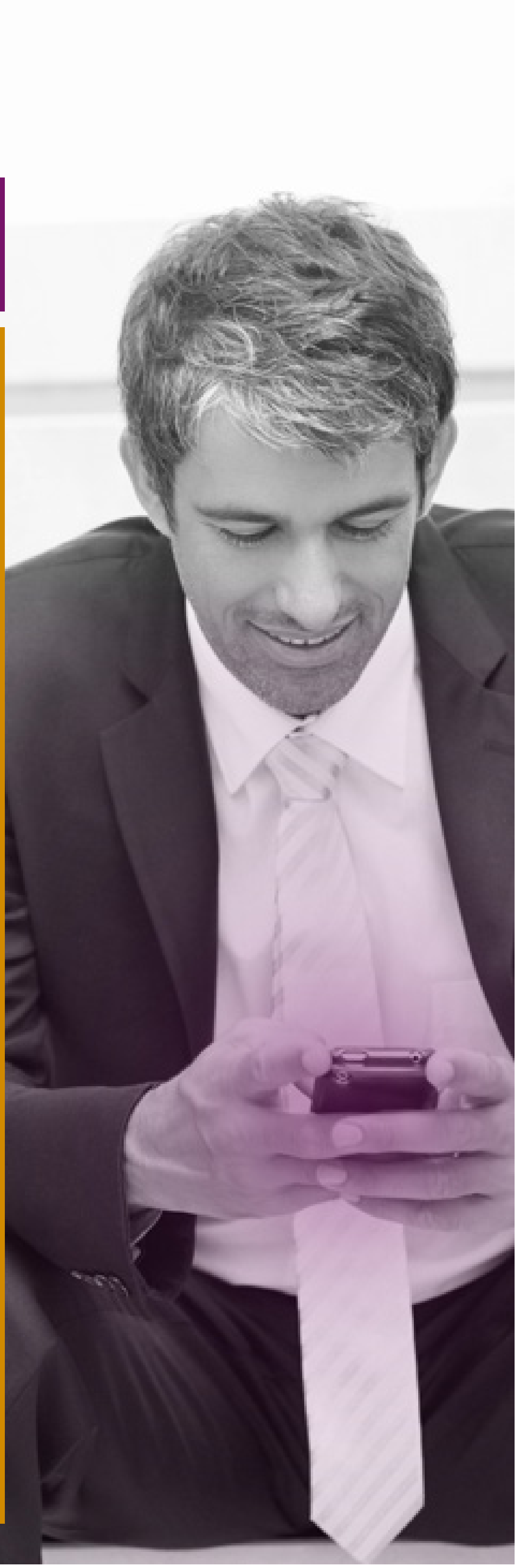


The outlook for UK automotive finance has changed markedly over the last year. Twelve months ago, the biggest question on lenders' minds was that of growth, and how to win an advantage over competitors in a market undergoing an unprecedented boom.

Now, however, while there is little material evidence of deterioration in the market, there is an unmistakable note of caution in the air. A lot of this, admittedly, is down to a 'Catch-22' situation - the sheer success of motor finance over the last decade has led to an anxiety, largely media-driven, that it must all somehow be too good to be true.

And whatever the foundations of these concerns, there is no avoiding the truth: they have made their way into the consciousness of both the UK's public and its regulator, and so motor finance products - and the way they are sold - are now under considerable and increasing scrutiny.

It isn't within the scope of this paper to examine what basis there is for worries over systemic fragility in motor finance. While specific debates over issues such as the sustainability of PCP are perfectly valid discussions to have, any attempt to summarise and advance them in a piece of this length would be thin at best, and misleading at worst.

Instead, this paper will focus on the fact that products and sales processes are now in the spotlight, and concentrate on what needs to be done to assure they are ironclad going forwards. Taking the broader view of the sector's regulatory challenges, it will outline the role we feel digital finance technologies can play in meeting them.

In short, we foresee the possibility of fundamental change to models of intermediation and distribution in motor finance, to the extent where the traditional dealer finance model will be transformed or replaced entirely - and we believe direct digital links to consumers will lie at the heart of what comes next.

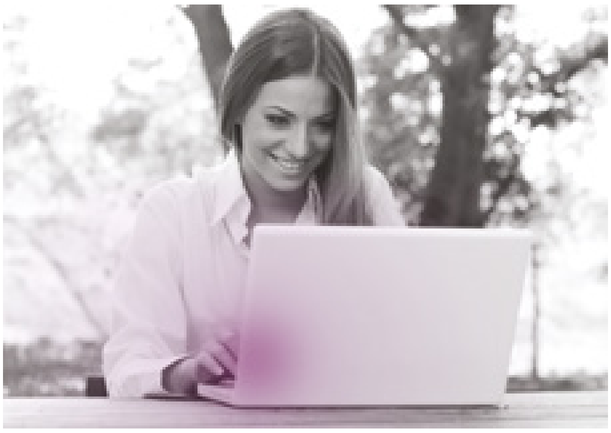
"But despite this boom, automotive credit still represents a fairly small proportion of household debt."

The Challenge

Under the Spotlight

As stated, much negative media analysis of motor finance has been spurred by the proportional growth of the sector - in particular, the increase of finance penetration into new car sales from around 50 percent ten years ago to 86 percent at present. But despite this boom, automotive credit still represents a fairly small proportion of household debt. It seems strange indeed to pin fears of a 'credit bubble' on motor finance growth, when more than three quarters of consumer debt remains locked up in mortgage lending.

Indeed, if one were looking for fears of a credit bubble, one might first look to the world of student loans, where the most recent figures show outstanding debt jumped 16.6 percent year on year to reach £100.5bn - twice what it was in 2012, and a full third of the UK's non-mortgage consumer debt. Credit card borrowing has also told a worrying story in recent years - but since it has not seen the same increase in prominence as PCP-driven motor finance, it has remained relatively uninteresting to the media.



Mortgages - a roadmap for change?

Nevertheless, as stated in the introduction, what's done is done - and if motor finance is being held up as the UK's biggest debt bracket after property, then it seems reasonable to look to the mortgage market to predict not just the future of regulation in the sector, but also the structural changes the industry is likely to undergo in reaction to that regulation.

Looking at the systemic changes that have taken place in property lending over the last decade, the most pronounced evolution has taken place with regard to distribution models. With the advent of more onerous compliance requirements around the sales process, providers went one of two ways - either building sizeable internal teams to sell directly, or leaving the distribution environment altogether and relying on large, highly professional brokers to pick up the slack.

Between these evolutions, no room was left for half measures: gone are the days of large, nebulous networks of remote offices, offering a highly variable quality of sale under the brand of a single lender. While intermediation remains strong in the mortgage market, customers introduced to a lender via a broker have absolutely no doubt as to where one brand ends and another begins - and who to blame for a poor sales process.

Keeping things clear

Can the same honestly be said of motor finance? While the dealer finance model is seen as irreplaceably central to the industry, there's no denying that distribution networks are enormous, highly fragmented, and represent a huge challenge in terms of ensuring a consistent (and consistently compliant) quality of sale.

The issue of consistency and intermediary risk is particularly pronounced in the new car market, where the majority of credit is provided by manufacturer-owned finance houses. Where a consumer has gone into a franchised dealer to purchase a vehicle on finance, there is arguably little to make explicit the fact that the dealer is serving as an introducer to a lender. The customer sees the manufacturer's marque above the dealership door, on the vehicle they choose, and on the finance agreement - the natural assumption to make is that retailer, OEM and finance house are all one and the same.

Of course, this continuity of branding allows for a smooth, seamless customer experience. Unfortunately, it also bears significant regulatory risk for finance providers. Because so long as the dealer and the OEM appear the same to the customer, any incidents of real or perceived mis-selling will quickly pierce the veil and affect finance provider and retailer alike. Once again, this is not a paper aiming to put PCP on trial. But whether the product has an inherent vulnerability to mis-selling or not, even the possibility that it may should be enough to prompt lenders to have an answer in place.

Pressure cooker environment

It seems fair to say that the risk factors that drive intermediary mis-selling are on the up. This summer saw car sales drop significantly for the first time in years, with analysts blaming consumer spending anxiety in advance of Britain's departure from the EU, and the linked impetus to put money aside 'for a rainy day'. Despite this, finance volumes remain fairly static - the numbers clearly show finance being used increasingly as a lever to mitigate the decline in unit sales.

Over the last decade, finance has become by far the best tool dealers have for keeping vehicles moving off the forecourt - but we are in danger of a situation where it is facilitating the impossible. To pluck an example published recently in the Independent:

> Emmalyne Holgate spent a year travelling and returned home less than a year ago. She's 22, she had £1000 in the bank, no job and was living with her grandmother. She went to a car dealership and they ran some checks. She drove away in a brand new [vehicle], a bit over £14,000. She had to put her entire savings, that £1000, down to secure the deal but the salesman knocked £1500 off the price. Nobody asked her about her income.

Yes, the papers make too much fuss over isolated examples like this, and they are often frustratingly bereft of details or context. Some of the stories concern deposits and affordability, while others focus on excess mileage charge surprises, or term-end equity situations.

But let's face it - all these variants are becoming increasingly common. And while affordability issues in particular aren't currently causing a problem, as arrears remain at historic low levels, this is no cause for complacency. If the consumer purse is in for a shock, historical affordability checks will be held up to intense scrutiny, and lenders will be on the hook for decisions made on the forecourt.

This is also an area where media hype does play a role, as it creates a self-fulfilling prophecy. Even if current point of sale practice is fully reasonable, so many consumers are being repeatedly told that motor finance "could be the next PPI" that the public reaction to an arrears crisis could be an attempt to make it just that.

So, the challenge is twofold: first, what can be done to safeguard against potential corner-cutting, particularly with regards to affordability, in the finance sales process. Then secondly, what can be done to armour lenders against a potential spate of mis-selling claims on sales where the intermediary has acted by the book?

"...the easiest way to achieve this is via some element of self-serve capability - a digital relationship with the lender that is established during the sales process."

The Solution

Isolate to mitigate

From a technological point of view, the first clear need is for finance companies, especially those owned by manufacturers, to insulate themselves as much as possible from conduct risk at the point of sale. This means differentiating their identity from those of the dealerships selling their products, and making consumers fully aware that they are entering a finance agreement with a third party.

Practically, the easiest way to achieve this is via some element of self-serve capability - a digital relationship with the lender that is established during the sales process. How dealers would introduce customers to such a channel, however, and how it would affect the perennial industry friction over who ‘owns’ the customer, is a whole other discussion.

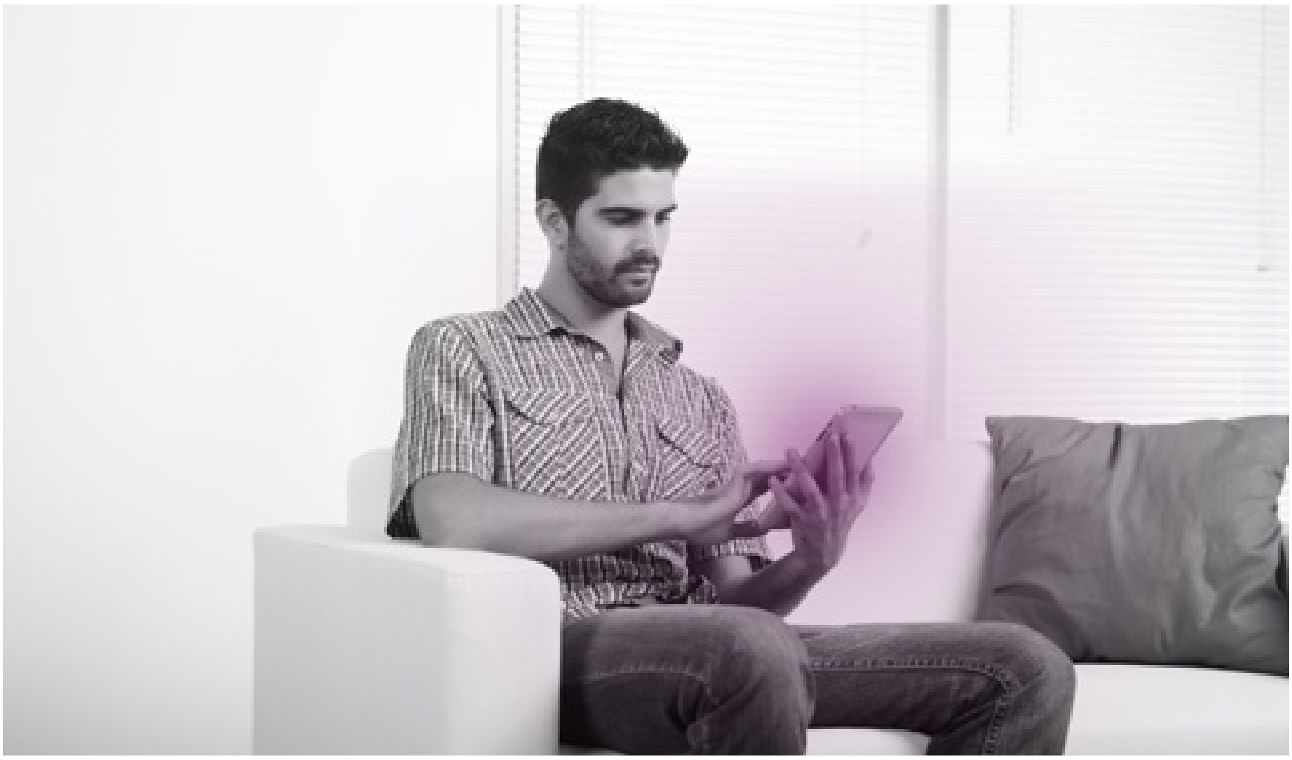
The next priority is to either ensure that the correct affordability checks are being carried out at the point of sale. Bluntly, the easiest way to do this is to move the process into that online, self-serve space controlled by the lender. There is no reason to say it can’t still be initiated by the dealer at the dealership - but it makes equal sense for it to occur away from the forecourt altogether, in the customer’s own time and space as a digital customer journey.

Thinking the unthinkable

It has traditionally been anathema to suggest moving finance origination away from physical retail sites, but the market is now long past the point where lenders have begun openly experimenting with direct to consumer, ‘finance first’ strategies. In the world of retail banking, of course, there is a well-established precedent for complex products being sold through the digital channel. In comparison with branch sales, it simply offers more consistency in the disciplines of disclosure, data capture and decisioning.

Annual mileage allowances and deposit levels in PCP agreements, for example - the most common bugbears cited by media reports - simply become lower-risk issues when tackled via a digital origination process. In the dealership, with the pressure on salespeople to move metal off the forecourt, the focus may naturally drift to reducing monthly payments to incentivise the sale, leaving these deal elements overlooked.

Even if dealership sales conduct is impeccable, moving this process online still protects the lender from later accusations of poor conduct. With the audit trail provided by self-serve interactions, there is simply no recourse for customers to claim they have experienced pressure from a salesperson.



Man versus machine

All of this leads to a question which is surprisingly difficult to answer: is a computer more equipped to sell motor finance compliantly than a human being? Of course, it's a question that can't be fully assessed without a hard definition of what a compliant customer outcome is - and that's something that's arguably impossible to define in the current regulatory climate.

One thing we would state with utter certainty, however, is that - despite our clear favouring of digital sales and a digital customer journey - we would never advocate for the complete removal of the human element from the motor finance sales process. Cars are an emotive purchase, and the stripping of all personal contact from that purchase would be very much a case of throwing the baby out with the bathwater.

Indeed, it could be argued that digital very much has a place in the face-to-face sales process - for example through interactive explainer videos, where the consumer must show they have understood a section of product explanation before proceeding to the next stage of the process.

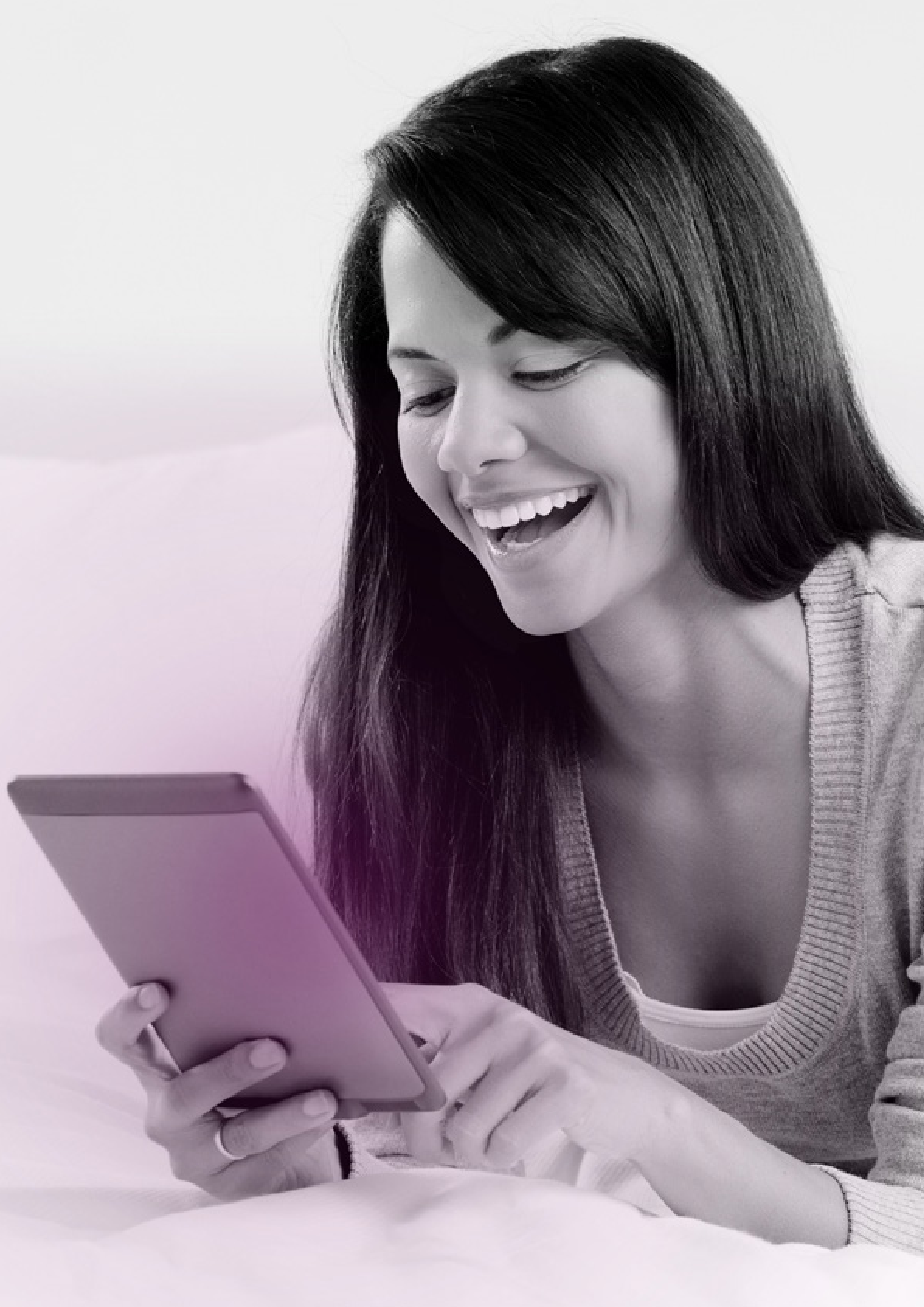
Nevertheless, there are aspects of the process which it seems utterly illogical not to automate. To draw a parallel with the property market again, for example, no mortgage lender would think it was a good idea to have a human recording income and expenditure details, when they could be captured in full online. And while dealers might argue that credit checking is of course already automated, it is affordability that is likely to be the industry's future battleground.

Conclusion

It remains to be seen to what extent the motor finance industry will follow the mortgage market in terms of disintermediation and centralisation of sales. While we certainly think that current scrutiny (or the fallout that may follow) will add fuel to the current disruption of the point of sale model, the motor retail sector has proved itself too resilient and adaptable in the past for the demise of dealer finance to seem likely now.

Nevertheless, independent finance houses have already been experimenting with direct-to-consumer online sales for some time, and this is now something the captive market is looking into. Manufacturer finance houses are more entwined with franchised networks than independent lenders are with their dealers, making this an even greater challenge - but that same symbiosis is a source of considerable intermediary risk.

In the end, origination models will evolve that sit somewhere between the current forecourt finance model, and the 'nightmare scenario' posited by many dealers in which they end up as little more than distribution centres for vehicles which have been sold online complete with finance. The synthesis which emerges will depend as much on the creativity of retailers, lenders and technology partners as it will on the future findings of the regulator.



About the Author

David Webber,

Board Advisor to Intelligent Environments and CEO of Whistlebrook Limited

David brings with him over 20 years hands on experience of the financial services software industry and a wealth of experience including delivering software solutions to the vehicle and asset finance sector.

David is a Board Advisor to Intelligent Environments and CEO of Whistlebrook Limited. At Whistlebrook his focus is developing industry partnerships and deepening their market penetration.

Prior to joining Whistlebrook as investor & CEO In July 2017 David was Managing Director of Intelligent Environments for five years, responsible for its diversification into the vehicle finance and debt collection verticals.

Prior to this David was CEO at Patsystems Group the provider of electronic trading, risk and exchange systems for six years. Before this he spent 8 years as the CEO and Managing Director of retail financial systems provider, AttentiV. The AttentiV business provided finance and collections software to the vehicle and asset finance industry as well as the UK mortgage market. The business was subsequently acquired by Sopra and now forms the Sopra Steria UK banking business.

About Intelligent Environments

Intelligent Environments is an international provider of innovative financial services technology. Our mission is to enable our clients to deliver a simple, secure and effortless digital customer experience.

We do this through Interact®, our digital financial services platform, which enables secure customer acquisition, onboarding, engagement, transactions and servicing across any digital channel and device. Today these are predominantly focused on smartphones, PCs and tablets. However Interact® will support other devices, if and when they become mainstream.

We provide a more viable option to internally developed technology, enabling our clients with a fast route to market whilst providing the expertise to manage the complexity of multiple channels, devices and operating systems. Interact® is a continuously evolving digital customer engagement platform that ensures our clients keep pace with the fast moving digital landscape.

We are immensely proud of our achievements, in relation to our innovation, our thought leadership, our industrywide recognition, our demonstrable product differentiation, the diversity of our client base, and the calibre of our partners.

For many years we have been the digital heart of a diverse range of financial services providers including Generali Wealth Management, HRG, Ikano Retail Finance, Lloyds Banking Group, MotoNovo Finance, Think Money Group and Toyota Financial Services.

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