This article first appeared in the January 13, 2006 issue of:

Auto Remarketing Newsmagazine

Non-Prime Lenders Promote Efficiency

James Flammang, Staff Writer

CHICAGO - Technology, efficiency and dealer-lender cooperation were among the top themes at the 7th Annual Non-Prime Auto Lending Conference held June 18-20 here.

Financial-institution representatives made up the majority of the 278 attendees, accompanied by a scattering of auto dealers with 34 exhibitors.

Quarterly workshops, introduced late in 2002, are becoming a crucial function of the National Automotive Finance Association, which deals strictly with the non-prime world. These events are an "attempt to bring the dealer community together with the lending community," said NAF Executive Director Jack Tracey.

On the afternoon before the conference officially opened, a "Crossfire" panel debated a dealer's true status when a finance manager makes a deal.

"Legally, the dealership is a creditor," said Brent West, vice-president of Triad Financial Corp. "We are purchasing contracts from the dealership itself."

West noted that many "contracts fly through clean as a whistle." For others, it's like "guerilla warfare trying to get a copy of the driver's license" or other stipulations. Before accepting the contract, lenders are obligated to ask, "Is there anything unique to this particular customer that we need?"

Dealer and lender goals for being in business are almost at opposite ends of the pole, West believes. Dealers simply want sales and volume.

"Lenders want volume," he explained, "but they're also a gatekeeper to quality."

"It can't be the dealer or the lender," said John Bening, president of Bening Automotive Group. "We're partners...as long as the communications channels are open."

Keith Wiesman, vice-president of Dealer Diversified LLC, added that the goal is to get dealers and lenders to share the same agenda.

But dealers need more margin per car than lenders tend to believe.

If a customer is looking for "too much car" for his situation, any dealership will try to find a way to sell it to him, said Bening, who has been in subprime for 10 years.

"That's human nature," he said. "If we averaged $800 or $1,000 a car, we'd go broke."

Eric Pointer, sales director for Credit Union Services, said he hates sending deals back to dealers. Worse yet is sending a termination letter to a dealer whose contracts are regularly troublesome.

Pointer noted that while only a small percentage of contracts may ultimately be unacceptable, the majority have a problem that must be dealt with.

How many secondary lenders should a deal work with? Bening is signed up with 15 or more, but uses only four prime and subprime. Snider believes a dozen might be appropriate, if each one will buy 12 different types of paper.

Sales Forecast

In the first regular session, David McKay, senior director of automotive finance for Power Information Network, an affiliate of J.D. Power & Associates, gave a rundown on the economic outlook for auto sales. Motivators for a positive outlook include low interest rates, lack of inflation, tax cuts, productivity gains, increased disposable income and relatively high consumer confidence.

McKay foresees sales of 16.4 million new vehicles in 2003, with modest growth next year to 16.6 million. New-vehicle sales, though, could be threatened by reduced effectiveness of incentives and by labor troubles. Ability to buy is strong, McKay said, and "vehicles are more affordable now than they have been in the history of the industry."

The pace of vehicle redesign and new entrants is increasing, but domestics are forecast to trail the Japanese.

"As new vehicles prices firm, used vehicle prices firm," said McKay, adding that they have stabilized in recent months after a substantial decline. New-car incentives, though, have immediate short-term impact on used-vehicle values.

Tom Webb, chief economist for Manheim Auctions, based his presentation on the latest Manheim Used Vehicle Value Index. After peaking in 2000-01, values suffered a steep decline through 2002. Prices stabilized by April-May 2003, Webb said, but at a "new, lower level." The year-over-year decline was 10.2 percent.

New-vehicle incentives are the main reason for the decline, according to Webb, coupled with supply-and-demand forces. Frequently, dealers are "selling a vehicle because they can attach a loan to it."

Labor market and credit conditions affect Webb's economic outlook.

"I don't think there's any doubt that the economy is in a recovery phase" he said.

Since October 2001, however, there's been a "pattern of one false recovery after another," Webb added. Vehicles three- to seven-years-old will peak in 2006, in Webb's view.

Online Connections

Dealers who haven't been following the development of Web-based aggregators are likely to be using them soon. A web-based aggregator more efficiently "connects lenders with dealers," said Rich McLeer, vice-president of Dealer Track, one of the emerging firms in this field.

Years ago, said Kelly Mankin, chief operating officer of Route One and an aggregator panelist, dealers simply phoned or faxed in credit applications. Responses took time, especially when several lenders had to be contacted.

For lenders, it's about efficiency, Mankin explained. For dealers, it's speed. Turnaround time can be reduced to minutes, according to moderator Steve Hall, president of Eastern Automotive Group and also NAF president.

Participants decried the notion that aggregators are "shotgunning" systems, which blast credit applications off to countless lending institutions.

"The dealer only sees the lenders on the platform that he does business with," said McLeer.

Legalities

Legal issues took up two separate sessions. Office of Foreign Assets Control is interested in cash sales of vehicles. Every business that can be defined as a financial institution will be required to carefully identify its customers.

Furthermore, they must check them against a list of some 6,000 alleged terrorists and other "bad guys" on the U.S. Department of Justice Web site, said attorney Tom Hudson, chairman and senior partner at Hudson Cook LLP.

These regulations are so broad, they're hard to enforce, said Hudson. However, the penalties are enormous with the prospect of a $5 million fine and 30 years in jail.

New York attorney Michael Cardello III, of Moritt Hock Hamroff & Horowitz LLP, targeted his remarks at collection issues. He explained that the line between delinquency and default can be hazy, adding that "a default judgment is not recognized by every state." Cardello suggests a three-step approach:

1. Conduct an asset search.

2. Send restraining notices out early, as other creditors might also have judgments against the debtor.

3. Serve subpoenas as needed.

Collectors must be aware of the legal climate they're working in, said Steve Levine, national counsel for the Regional Acceptance Corp. Many collectors don't know what a retail installment contract is, he added.

Mark Edelman, managing director of McGlinchey Stafford, warned against product packing and pricing packing, where buyers may be unaware that they're being charged for such extras as credit life insurance. Salespeople must avoid claiming that add-on products are required, not optional.

Courts, Edelman suggested, presume that "creditors are evil and consumers are stupid." To help comply with the law, "don't compensate your people based on the number of credit life policies they sell."

The question of "packing" also comes up when a dealer offers a certain APR to the customer, but then sells the contract to a lender for a different rate. If the dealer says "this is the best rate I can get," Edelman advised, that isn't necessarily packing. Attorney Hudson believes the dealer is free to do anything with the contract. Plaintiffs' attorneys, on the other hand, may emphasize the "real" interest rate.

In a second legal panel, Tara Murphy, vice-president, counsel and compliance officer at Fireside Thrift Co., looked further into customer-identification programs and money laundering measures as they affect dealers and lenders.

Financial firms must implement a written risk-based customer ID program, she advised, obtaining the person's name, date of birth, physical address and an identification number with photo. Records must be kept for five years, and names must be checked against the terrorist list. The final rule became effective June 9, 2003.

"This is the wave of the future," Murphy warned, affecting a broad variety of what are deemed financial institutions, including auto dealers.

"You really need to know your customer," said Doug Koktavy, president of Douglas D. Koktavy PC, if the Patriot Act becomes applicable. And someone in the company has to be designated as compliance officer.

Knowing the Buyer

Joe Lescota, chairman of automotive marketing at Northwood University, held a lively session on dealer-lender relations. The smaller dealer relies more and more on used cars, he said. Yet, dealers often insist they would sell more if they could get them financed.

In a 2002 survey of AutoTrader users, 80 percent said they would consider only a used vehicle (up from 72 percent), while 15 percent might buy either new or used. Looking more deeply, 32 percent planned to buy in one or two months; 21 percent in two to four weeks; 9 percent in a few days; and 17 percent in two weeks. Only 4 percent said they intended to buy today or tomorrow -- yet most auto advertising is spent on that tiny group.

Why are they taking longer? Lescota cites problems with financing, downsizing and layoffs and the growing number of vehicles to choose from.

"We confuse the devil out of people," he said.

About 40 percent of used-vehicle buyers need some sort of special financial assistance. Lescota said these are typically good people with bad credit usually at no fault of their own. These customers become extremely loyal and remember a dealer who took care of them" during a difficult period."

Lescota also recommends looking at teenagers, noting that 4.3 million will reach driving age by the end of 2003.

"We oftentimes ignore this market," he said. "We don't want to deal with kids on our lot. They've got money [and] we also find that they pay their bills."

Hispanics are another market worth considering.

"They simply have no credit," he said, not bad credit.

Paying attention to cultural differences is vital, Lescota added. Buying a car is traditionally a family decision for Hispanics and they usually shop for payment rather than price, he said.

Starter Devices

Another session explored starter-interrupt devices. Although they've been around since the 1990s, the legalities of their use have not all been clarified. Initially, the devices were installed mainly at buy-here, pay-here dealerships.

"I think the potential exists for these to move up the credit chain a bit," said attorney Tom Hudson.

If the customer does not make the required payment, the vehicle is disabled. The engine simply won't start until the customer pays up, and obtains another code to enter into the unit.

Delinquency and repossession rates have dropped sharply through use of the devices, according to a 2002 report from the National Independent Automobile Dealers Association. OnTime, one of the companies that produces these devices, calls it a method of "Changing Behavior Through Technology."

Use of starter-interrupt devices "probably constitutes a repossession," Hudson said. Best bet -- act as if a repossession really has occurred, and comply with the appropriate laws. Hudson recommends that dealers know the legal basics for their use in each state, visit the state regulator to explain how they work and get some assurance.

Stealing Identities

Special Agents Brad Beeler and Chris MacLeod, of the U.S. Secret Service, warned about identity theft.

Criminals involved in this practice, Beeler said, have been turning to cars simply because they bring a high return from a single transaction. Identity thieves working in organized rings can make $20,000 to $100,000 in one hour, he said, adding that "it's hard to track that car down." It's "like chasing a ghost."

Stealing someone's identity to purchase a vehicle is as lucrative as car jacking, Beeler said, but considerably safer for the criminal. The victim is unaware initially, the offender's identity is unknown, the crime is hard to prove and penalties are weak.

Identity thieves will often target certain types of salesmen and finance people within dealerships. Beeler said dealers need to be aware.

"You've got to take the blinders off," he warned.

To avoid falling for one of the identity-theft scams, Beeler recommends watching for customers who don't dicker or care about options, who have people waiting outside, who seem in a hurry, or who cannot answer simple credit/background questions. He also warns against mother/son teams, and people who have photocopies of identity documents rather than originals.

"You're looking for clusters of behavior," he said.