

OPTIMIZING SUBPRIME AUTO FINANCE COLLECTIONS

New Strategies and Technologies for CFOs

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OPTIMIZING SUBPRIME AUTO FINANCE COLLECTIONS New Strategies and Technologies for CFOs

The auto industry has never been more important to the economy than in 2009. The issue? A huge percentage of potential car consumers have lower credit scores than ever before and there are more of them. The economy needs exactly these consumers if it is going to get back on its feet.

Auto finance companies serving the subprime market have therefore become crucial to the economy. They help consumers buy cars and provide them with the opportunity to improve their credit ratings and ultimately purchase other items.

For the banks, special financing companies and other lenders, the ability to provide credit to consumers presents several challenges. Capital markets are tight and liquidity is scarce. Consumers are reticent to buy cars and those that want to have much riskier profiles. Compound this with the equally daunting reality that on average, close to 30% of subprime loans require collection activities; of which half of these are repossessed; and 3% result in skips¹ and it's clear to see that CFOs have their work cut out for them.¹

To survive, CFOs of auto financing companies have to make cash management and collection effectiveness a priority. An Aberdeen Group study found that top priorities amongst CFOs are cost

30% of subprime loans require collection activities - a significant area for profit improvement for auto finance companies.

containment (73%), cash management (70%), and risk mitigation (43%).² Collection activities have become exceedingly important part of this equation. Fortunately, a small number of auto financing companies have begun to successfully identify mechanisms improve their collection activities and better manage their cash. The secret lies in being strategic, not just tactical. Car loan companies are

learning they need to change their relationship with consumers during the collection process and assist consumers in modifying their own payment behavior.

New Collection Strategies

To modify consumer behavior, strategies must address the people, processes and tools that are part of the collection activity, with the goal to reduce the emotion associated with collection activities and increase customer satisfaction. According to PriceWaterhouseCoopers "timely collection depends a great deal on customer satisfaction, turning it into an effective gauge of the importance A/R practices places on customer service."³

An emphasis on customer satisfaction

The people in the collection activity are the collectors – as well as the consumers. First-rate collection agents need to be trained on what to say to late payers and how to say it, while at the same time keeping the customer feeling positively inclined to make payment. Collectors are provided with realistic objectives and incentives so as to keep them motivated and to minimize staff turnover.

¹ NIADA 2008 Used Car Industry Report

² Andrew Bartolini, Christopher J. Dwyer, "The CFO View of Accounts Payable: Cash is King", Aberdeen Group, February 2009.

³ Global Best Practices "Financial effectiveness - Best practices for accounts receivable, credit, and collections management." PriceWaterhouseCoopers <http://globalbestpractices.pwc.com/Home/>

Processes are also important. Collectors are trained in processes and collection techniques - the time frames for contacting consumers, detection of warning signs of financial distress, and renegotiation of payment options and plans.

Add technology to the mix and efficiency increases further. Technology like automated dialers, now long available, helps increase collection calls. GPS over the last number of years has further increased productivity by helping to locate vehicles. Starter Interrupter Devices (SID and commonly referred to as “egg timers”) have also been used to warn consumers of nearing payments, and disable vehicles upon missed payment. More recently, a newer kind of payment protection system has been introduced to the market. Devices, combining the technology of GPS, mobile radio and a device that can provide a much broader number of commands and disabling features to a vehicle than any other system. Only a few car loan companies in the US have begun to use these payment protection devices, but those that have can attest to a real return on their investment.

Payment protection technology

Payment protection technology typically consists of a small electronic device installed in the car (the loan collateral) and a network connection back to the collection operation. When the driver whose payments are due turns the ignition, a series of beeps warns of the necessity to pay. If the consumer fails to make a payment or fails to contact the collections department, the collector can send a disable command to immobilize the vehicle once the key is removed from the ignition.

Payment protection technology is a collection tool auto financing companies can ill afford to overlook. Unlike SIDs, with these devices the collector is provided with a powerful set of alert indicators. Alerts

Payment becomes as essential as gas. The emotional quotient between the consumer, the vehicle and the collection agent is removed.

include signals that the device is being tampered; that the vehicle is operating at low power, or that the vehicle is moving without power, indicating that it is being towed. Compact devices can be discretely hidden in the vehicle to remind consumers without being conspicuous. Devices should include a GPS chipset and sensory input/output with a high degree of geographical accuracy to pinpoint the car’s location and maximize opportunity for repossession if required. The device should

also operate using ultra low power so as to preserve the life of the car battery.

Network range and connectivity are also important. Financial officers should look for providers that not only manufacture their own device but also manage a wireless network. Multiple network management ensures that the auto financing company has a direct and seamless connection to their embedded collateral without a point of failure.

To ensure greatest control over their asset, auto financing companies should also consider payment protection technology accompanied by web based tools so as to enable collection agents to send vehicle commands, receive alerts, and search and manipulate vehicles. With web-based tools, collectors can access scheduling features which helps reduce amount of time spent programming and manipulating devices and vehicle behavior.

With the payment protection device installed, the potential increases for the relationship between the consumer and the collection agent to improve dramatically. For the low credit scoring consumer, payment all of a sudden becomes as essential to the vehicle as gas. The emotional quotient between the consumer, the vehicle and the collection agent is removed. When the beeping sound goes off – much like the fuel indicator – the consumer pays the creditor, just as he/she would for fuel. Today our cars are intelligent enough to remind us to put on our seatbelt, or fill up and we act accordingly. With the proper intelligent payment protection system there is much less potential to “duck and dodge” payment. The better payers subprime consumers become, the greater their opportunity to build credit.

Benefits to improved collection methods and technology

The benefits of improved collection methods and technology bear out in the numbers – in the statistics on the subprime market and the balance sheets of car loan companies that have implemented them.

Currently, only 17% of subprime car loan companies use payment protection technology to accompany their collection processes. Part of the reason for this narrow adoption rate is a lack of education in the marketplace on the range of features of newer systems. The 17% that have adopted the new technology however have seen a significant improvement in consumer payments and collection efficiency. A recent report by NIADA on the Used Car Industry indicated that of the car loan lending firms surveyed, 27.21% of subprime loans are delinquent. Overlay the industry average with the statistics based on the deployment of 72,000 devices with a midsized subprime lender over a 44 month period the areas of profit improvement are significant as shown in Table 1.

Table 1: Key Areas of Collection Improvement

Collection Areas	Without devices	With devices	% Improvement
Current Accounts	72.7 %	78.6 %.	+8.0 %
Delinquent Accounts	27.2 %	21.3 %	-21.0 %
Late payment	9.2%	6.2 %	-33.0 %
Repossession	15.0 %	12.0 %	-13.0 %
Skips	3.0 %	2.0 %	-33.0 %
Seizure costs	\$450/vehicle	\$150/vehicle	-66.0 %
Agent to Accounts Ratio	1:300	1:235	+8.0%

Increase in on time payments

The mid-sized lender experienced an 8% improvement in on time payments to improve current accounts, 13% reduction in repossessions and an astonishing 33% in skips.

Like their response to the ding of the low fuel indicator, many consumers respond positively to the warning beep from the payment protection device and would call their collection agent to arrange payment.

Using the sample date in Table 2, when we apply an 8% increase in on time payments to a typical car loan company, the numbers become even more interesting.

Let’s say a car loan company has an average of 10,000 loans and average monthly payments of \$271. With a payment protection device and an 8% improvement in on time payments, the lender could increase their monthly cash flow by \$157,000.

Reduced number of skips

Lenders also stand to benefit by reducing their costs associated with skips (finding hard-to-locate debtors i.e., accounts submitted with invalid addresses and/or telephone numbers).

With GPS based devices, lenders can increase the number of vehicles located and increase the potential to salvage this asset.

Most skips often occur within the first ninety days of the loan. With a GPS tracker, and disabler, it is possible to receive a warning from the vehicle when it enters into suspicious areas or exceeds certain perimeters. The vehicle can be disabled and located as necessary.

By reducing skips from the industry average of 3% to 2% the exposure to this risk is reduced by \$712,800 per year on our 10,000 loan portfolio.

Reduction of loan defaults

Good collection practices coupled with payment protection devices also help reduce costs associated with loan defaults and repossessions. Consider the expenses involved in a repossession – bailiff and legal, towing, storage, and the selling fees to auction to name a few. By using a payment protection technology the vehicle is easier to locate – reducing manpower and time. Smart lenders even have recovery specialists include the removal and return of the device as part of the services performed, salvaging the technology for use on another vehicle.

Average repossession costs per year for the car loan company before using the payment protection device were \$450. After the device was installed, they were just \$150. By reducing repossessions by the industry average of 15% to 13.2% loan companies realize a savings of \$477,000 per year.

More efficient collection personnel

Mention has already been made that pay protection technology changes the collector-consumer relationship, but it can reduce collection overhead too. The payment protection device turns around the collection process. Instead of the collection agent calling the consumer, the consumer calls the lender when the warning is triggered in the car or discovers it to be immobile from the disabler. This significantly reduces the collector’s work load enabling them to handle more accounts.

Additionally, with a higher number of on time accounts, the amount of default accounts is lower so collection agents have fewer accounts to collect and do a better job. A typical workload for a collection agent is 300 accounts – but if we consider an 8% improvement in on time payments that workload drops to 235 accounts per agent. With greater personnel efficiency, auto finance companies have the option of reducing personnel.

If average overhead per collection agent is \$24,000 per year and the number of agents can be reduced 21% from 9 to 7, that’s a \$46,500 reduction in personnel overhead.

Table 2: Sample Company Profile

Company Profile	
Portfolio Size	
Number of loan originations	10,000
Average Loan Conditions	
Rate	21 %
Loan advance amount	\$7,200
Term	36 Months
Time Balance	\$9,750
Average Monthly Payment	\$271

Impact on the lender's bottom line

Taken together, the savings derived from increased on-time payments, reduced repossessions and defaults, and greater collection agent productivity are significant for the subprime lender.

Consider some of the yearly savings associated with improved collection practices and technology identified in the preceding pages. Using the company profile model above, a 10,000 loan portfolio will generate significant savings. Given a sample portfolio of 100,000 loans, the potential improvement in profit for a subprime CFO could be in the range of \$2-3,000,000. If "cash is king", CFOs are hard pressed not to improve their collection strategies and use the right technology.

Conclusion

The importance of efficient collection activities and the need for an improved percentage of on time loan-paying consumers has reached a new level of urgency. CFOs have to look hard at the solutions to help consumers pay. Improved collection methods and payment protection technology are in the interest of both the finance company and the consumer. An improvement in payments made by consumers improves their credit ratings and ultimately the commercial well being of the loan company itself. With better collection strategies, loan companies will have more capital to loan out. Customers are more likely to borrow again if they had a satisfactory or respectful collection experience.

The key to efficient collection activity is a more strategic approach to collection – one that changes consumer behavior aided by new technologies. The return on an investment in improved collection strategies and new payment protection technologies bears out in the numbers. CFOs of auto financing companies would be wise to implement these strategies and new technology systems today.

About iMetrik

iMetrik is an innovator in embedded wireless tracking solutions (also known as machine-to-machine, or M2M) that enable companies to reduce cost and increase control of remote assets. We help subprime automotive finance companies improve profits by engaging them in best practice collection strategy consulting; provisioning them with connected, intelligent devices to manage client payment behavior; deploying a web-based collection management system to automate the control of high-risk clients and training agents on payment protection and collection management. Our team is dedicated to being global leaders in the (M2M) space. Founded in Montreal in 1995, we now have offices in Montreal, Berlin and Hong Kong.

Specific to M2M, we have developed the iMETRIK platform with the goal of being the industry standard for those seeking speed-to-market solutions with a proven partner. We have created off-the-shelf solutions for three different markets: iMetrik-COLLECT for auto finance companies and BHPH dealerships; iMetrik-COVER for the insurance market; and iMetrik-MONITOR for commercial fleet tracking. iMetrik also acts as a wireless carrier or mobile virtual network operator (MVNO), thereby providing complete end-to-end delivery.

Hundreds of thousands of vehicles, with an estimated value of \$1.3 billion, are currently tracked in our network, with another 10,000 added monthly. We have thousands of aftermarket customers in auto financiers, fleet operators like Avis and OEMs like Volkswagen. We continue to build on these successes in other mobile-asset and fixed-asset verticals.

Unlike our competitors, iMetrik better serves global markets via a unique delivery model: a single affordable compact car and truck tracking device with Open Standard programming for multiple applications and services. Our culture of innovation means we will continue to design and build ever better products and to create more powerful and value-driven applications. iMetrik designs and manufactures GPS tracking devices to offer significant processing power and fast wireless connectivity.

iMetrik is recognized as one of the top 100 (M2M) technology providers by M2M magazine.

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