Finding the Right Balance Between Risk and Opportunity Can Translate into Big Business for Auto Lenders

After being described as the “industry hardest hit by the economic downturn,” the automotive industry is reveling in a long-awaited upswing. Analysts are reporting that 2012 was a record year for U.S. auto sales, reaching $14.5 million for the year-end total and marking the industry’s strongest performance since 2007’s pre-recession sales.

Even better news is that automotive sales should continue to drive the country’s economic recovery. The Polk research firm reports that 2013 auto sales are expected to rise nearly seven percent over 2012’s total, which would translate into $15.3 million in new vehicle registrations—a sure sign of health for the automotive industry.

As auto sales continue to rise and lenders experience higher rates of return on their investments, now is an optimal time for those looking to re-enter or expand into the indirect lending market. As additional opportunities emerge, lenders find themselves in an excellent position to grow their loan portfolios and increase revenue—if they can efficiently manage more originations while still mitigating risk.
“Wait and See” for the Auto Industry

With the auto market rebounding, lenders are feeling pressure to get more business through the door more efficiently. However, as lenders work to manage significantly greater volumes than they’ve seen in years, the risk of non-compliance also increases.

While today’s indirect lending environment is still plagued with a complex regulatory environment, the focus has shifted from the constant onslaught of new regulations to stricter scrutiny over a lender’s ability to adhere to laws that are already in place, particularly at the state level.

That is not to imply that big changes are not on the horizon. At more than 2,300 pages long, the Dodd-Frank Act and the Consumer Financial Protection Bureau (CFPB) are expected to add significant regulatory burdens to lenders in the next few years. Right now, the CFPB is completing foundation-building work. Once that is finished, the CFPB will begin proposing new regulations or revising existing ones that affect the consumer auto finance industry.

As lenders “wait and see” what regulators have in store for them, it is an ideal time to review existing compliance documentation and optimize processes to ensure they are satisfying all current requirements at both the state and federal level.

Best Practices for Lenders to Optimize Opportunity

Effectively managing larger loan volumes while still remaining compliant is comparable to walking on a tightrope. Everything must be in place to make the indirect lending process run smoothly and efficiently or things will slowly begin to topple over—resulting in rework or other potentially damaging consequences for the lender.

Therefore, it is important to find the right balance so lenders can quickly respond when opportunity knocks. Here are some best practices to help you achieve greater operational efficiency and put effective risk management processes in place.
Pick the Right Partners
Today, lenders need to be more diligent than ever. With lenders and dealers now sharing responsibility for each other’s actions when a credit sale is originated, partners must be carefully selected. To ensure that you are working with reputable dealers only, there are outsourcing providers that will connect you to a pre-certified dealer network. As part of the pre-certification process, the outsourcing provider performs a comprehensive background check before underwriting the dealership. Lenders benefit from this arrangement because it gives them access to a much larger dealer network—allowing them to grow their sales with minimal risk.

Build a Compliant Document Portfolio
Ensuring lending contracts and ancillary documents are compliant can be a difficult task, especially with more than 2,700 legal paragraphs that could potentially be incorporated into the documents based on the type of transaction, vehicle and state where the sale takes place. Therefore, it is important that lenders create and maintain a document portfolio containing only fully compliant retail installment contracts and ancillary documents either drafted by their legal team or a trusted documentation provider. In addition, lenders should only consider partnering with dealers who are also committed to providing complete, accurate and compliant loan documentation. Since smaller lenders often lack the legal and compliance resources they need to manage risk effectively, finding a reputable provider that offers a compliance warranty is their best option.

Maintain Strict Version Control
One of the single most important ways to ensure lenders operate efficiently while meeting regulatory guidelines is to maintain strict version control of the contract documents. Lenders should pay close attention to the revision dates on the contracts they fund and only accept the most recent versions. It is a good practice for lenders to frequently cull through their forms to determine which contract versions are acceptable and remove anything that is out-of-date or obsolete. Also, don’t forget to check for the most current revision dates on all of the ancillary forms that often accompany the contract.
Eliminate or Reword Extraneous Data Fields
Lenders should evaluate the number of data fields on their documentation and look for opportunities to reword or reduce them. The concern is that the number of data fields required to complete a contract is often directly correlated to the number of mistakes found on a lending contract. In other words, too much dealer data entry leads to errors and process exceptions within the lender’s back office. It is important to find a documentation provider that offers streamlined lending documentation with a limited number of completion fields, while still ensuring that the contract is enforceable and compliant. Making sure your lending contracts are completed correctly the first time will eliminate any re-work down the road.

Don’t Be Afraid to Ask for Help
For many lenders, the ability to effectively and efficiently grow their business can prove to be challenging and cost-prohibitive. One way to achieve operational efficiency may be to outsource the parts of the lending process that are overly resource and/or time intensive. Lenders spend a tremendous amount of time verifying customer information, such as proof of insurance, income and residence, before they fund a loan. Consider partnering with an outsourcing provider to take over these responsibilities so financial institution resources can be applied toward other more revenue-generating aspects of the business.

Summing It Up
With the auto financing industry one of the few areas of the economy that is doing well, lenders are once again finding auto loans to be an attractive option. But, as we learned during the financial crisis, there is no such thing as easy money. As states focus on clarifying and enforcing existing requirements, and federal regulators continue to lay the groundwork for the next wave of new regulations, lenders need to prepare for what lies ahead. And, the best way to do this is to implement processes and best practices that help you find the right balance between efficiently managing more originations and mitigating your business and compliance risk.
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