

Current state of the auto finance industry



NZ survey statistics:

*7 individual participants
out of 206 global responses*

*All of the biggest lenders
covering **the majority** of
the new retail loan market
participated in the survey*

*Portfolio size range: \$5
million to \$950 million*



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Overview

About our 2016 International Automotive Lending & Leasing Survey:

PwC surveyed executives from 12 countries, using a structured questionnaire. There were 206 participants, including 22 C-level executives, 46 presidents/directors, and 63 vice presidents/managers, among other leaders within IT, accounting, finance, legal and marketing.

PwC's 2016 International Automotive Lending & Leasing Survey is a global initiative that engages leaders across the industry and provides relevant insight to lenders, manufacturers and dealers. This is the first year in which the survey has been held, and we would like to thank all who participated for your responses.

PwC gathered information on current and future industry trends in business and technology to provide participants with useful market intelligence on both a national and global scale. To that end, we created business and technology focused versions of the survey and administered them to targeted groups of senior executives in 12 countries.

We then evaluated the responses and compiled the results into a comprehensive point of view that includes key findings, trends, top-of-mind concerns, and initiatives

that will likely shape the automotive finance industry over the next three to five years.

Our analysis spans priority initiatives and findings within credit, servicing, and product strategy; concerns across technology and compliance; and key initiatives that survey participants are taking in response to the push to go digital.

Lenders in most countries are generally positive, in particular in NZ where all participants indicated recent performance met or exceeded expectations. This is a great platform and opportunity for future growth, albeit participants clearly acknowledge challenges ahead.



Overview of NZ market sentiment

Industry performance: Positive current sentiment despite no expectations of growth

Overall, survey results indicate current period success for auto-lenders, with all of our participants indicating a positive view of market performance at or above expectations. This bears out in individual financial results, with all but one respondent reporting results at or ahead of expectations.

However, looking forward, most participants expect no growth over the next 12 months with 25% indicating the auto-lending market may even shrink. This reflects a stable and mature market with opportunity but also challenges.

“Most participants expect no growth over the next 12 months”

“Electric vehicles are an untapped part of the market.”

Overview of NZ market sentiment

Opportunities for growth:

Survey participants expressed a range of opportunities, but with several key themes coming through:

- Flexible mobility solutions are seen as an opportunity, alongside traditional vehicle leasing.
- Technology is an enabler, one that can provide better information to reduce fleet sizes and vehicle costs and support new product initiatives such as car sharing solutions.
- Several participants highlighted electric vehicles as an untapped part of the market, with Government support needed to promote broader uptake of that technology and associated benefits.



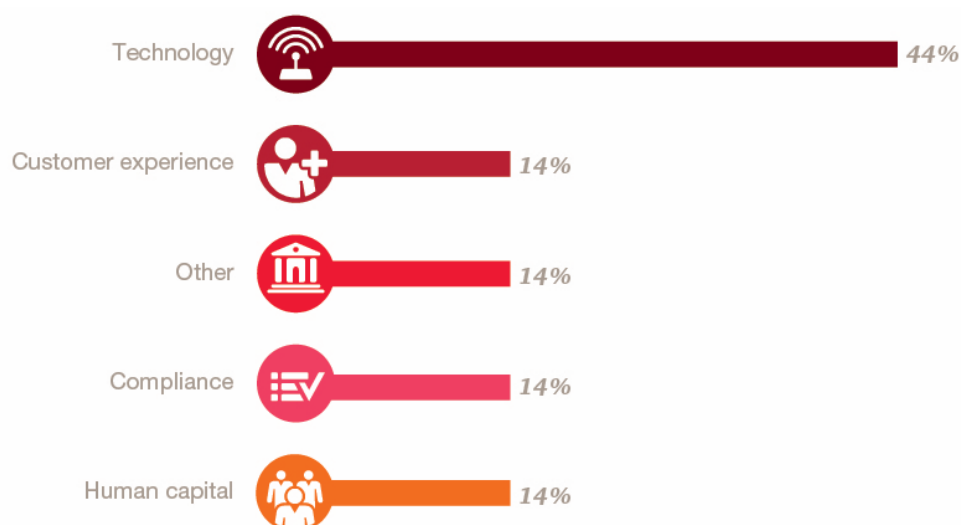
Overview of NZ market sentiment

Challenges to profitability

We asked survey participants to identify and rank the greatest challenges they're facing now (See Figure 1).

- **Technology** captured the No. 1 spot as the greatest concern, which could be read together with the challenge of maintaining or enhancing **customer experience**. This is consistent with our international findings.
- Viewing technology as touching more and more of the lending process, lenders believe the drive for improvement in other areas is often related to or based on technology investments.
- Further, as lenders grapple with identifying new and evolving trends in technology, they increasingly see innovation in other industries as driving customer expectations. This will continue to be a key challenge as lenders strive not only to compete with other lenders but to meet evolving customer demands that arise from interactions with other industries outside of lending.
- It is not a surprise therefore that **86%** of participants view technology and customer experience as a strategic imperative to profitable growth, and are focused on transformational initiatives.
- No other single challenge featured as prominently. However, **compliance** with ongoing regulatory requirements continue to be a concern, and will impact some auto-lenders in the NZ market more than others because of ownership, structure and lending strategies.
- Interestingly, **human capital** was also cited by our participants as a challenge, in contrast to international results. This may signal the supply of skilled workers remains a risk in a country with an increasingly mobile workforce and despite increasing automated solutions.

Figure 1: Greatest challenges to growth and profitability



Source: PwC's 2016 International Automotive Lending & Leasing Survey, New Zealand respondents

Credit-quality trends

*Today's lenders:
Largely OK with
current underwriting
standards*

*Plans for
underwriting and
credit quality trends*

85%

No change

15%

Plan to loosen and
increase availability of
credit

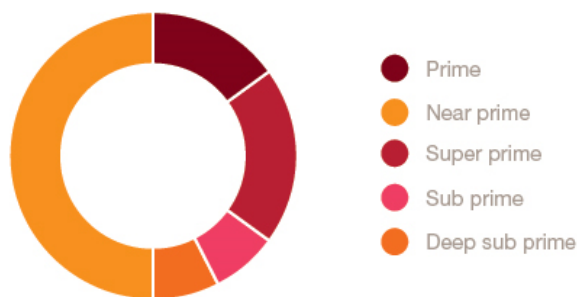
Our survey participants identified credit quality as one of the major drivers for underwriting efficiency. Higher quality also enables faster decisions and fewer rehashes with dealers.

Even though underwriting and credit-quality standards are critical components of the lending process, lenders appear to be largely content with the status quo. Most lenders do not see a need to go after market share by increasing risk, as evidenced by the fact that **85%** of participants do not expect to make any changes to their underwriting and credit-quality standards.

The quality of credit decisions to date is supported by low delinquency rates. For the next 12 months, participants forecast the percentage of loans and leases over 30 days due being only 0.1 to 2%.

This is consistent with most participants categorizing their loan portfolios as near prime to super prime. The distribution across these categories varied significantly between lenders. Responses indicate at least 50% - 60% lending is near prime, with approx. 30% -35% prime or super prime, and about 5% of subprime or below.

Figure 2: Credit quality of Lending Portfolio



Approximate distribution of lending

Source: PwC's 2016
International Automotive
Lending & Leasing Survey, New
Zealand participants

Servicing performance

Technology trends: The impact on customer service

Our participants highlighted the continued impact of changing technology on servicing, including areas that have already been adopted or are mid-flight. Primary areas show increasing use of digital contracting in originations, web portals, interactive voice response (IVR) and self-service for the customer. We observe that relative to counterparts globally, NZ lenders are not as advanced in their application of these new servicing platforms.

Below is an overview of our findings and observations in each of these key areas, describing current technology and anticipated enhancements going forward.

Digital contracting

- **69%** of participants in the US have some form of e-contracting origination, with **23%** originating at least half of all loans digitally. By contrast, most NZ participants indicated **no** underwriting decisions were fully automated, and for those which do include some automation only about **20%** do not involve a review by an underwriter.
- E-contracting will continue to gain acceptance as a means of improving customer service and simplifying the dealer process for the end customer, at the same time reducing both errors and personnel devoted to paperwork for the dealer.

Web portals

- Most lenders surveyed provide some form of web portal for customer service. **30%** of participants reported up to **40%** of customers' requests are handled without human interaction.
- While web-portals are a basic provision, lenders are investing in a variety of additional web-based functions, such as end-of-term customer interactions.
- As demographics shift toward millennial auto buyers, and as older generations become more comfortable with technology, superior performance in the online arena is quickly becoming a differentiator.
- Overseas experience suggests customers often prefer the instant resolution and confirmation of web- or IVR-based interactions that do not involve waiting time and can be completed on a computer or smartphone.

Cost of service

- **30%** of lenders felt servicing costs will remain steady, with **50%** indicating that such costs would increase over the next 12 months.

Servicing performance

Outsourcing trends: What's in and what's out?

We found the trend toward outsourcing back-office functions should remain consistent in 2016. In contrast, customer-facing service functions continue to be viewed as a strategic differentiator for lenders and are therefore less likely to be outsourced.

100% of participants keep core customer-service functions in-house, which ensures that customer-service quality and satisfaction standards are maintained. Pre-charge-off activities are also viewed as being essential components to maintaining brand and quality, with **83%** of participants maintaining these functions in-house.

In other markets, vehicle disposal activity is also largely retained in-house to maintain brand quality. By contrast, in NZ almost **50%** of participants largely outsource this activity.

In our view, the decision to outsource may involve a drive toward cost savings, economies of scale, and the desire to retain key customer-contact touchpoints while a customer is in the active-loan portfolio. No major movements in the existing outsourcing strategies employed by lenders are anticipated.

Which functions are lenders outsourcing?

According to our survey participants:

- **50%** outsource at least some post-charge-off collection activity and most vehicle disposal activity, indicating lenders may be less concerned with branding and customer loyalty post charge-off.
- **67%** outsource at least some bankruptcy processes.
- The approach to branded ancillary products is the least consistent, with **33%** completed in-house, **33%** completely outsourced, and the balance outsourced to some degree.

Product and dealer offerings

*An informative view:
What lenders and
dealers are offering
now, and what they
plan to offer down
the road*

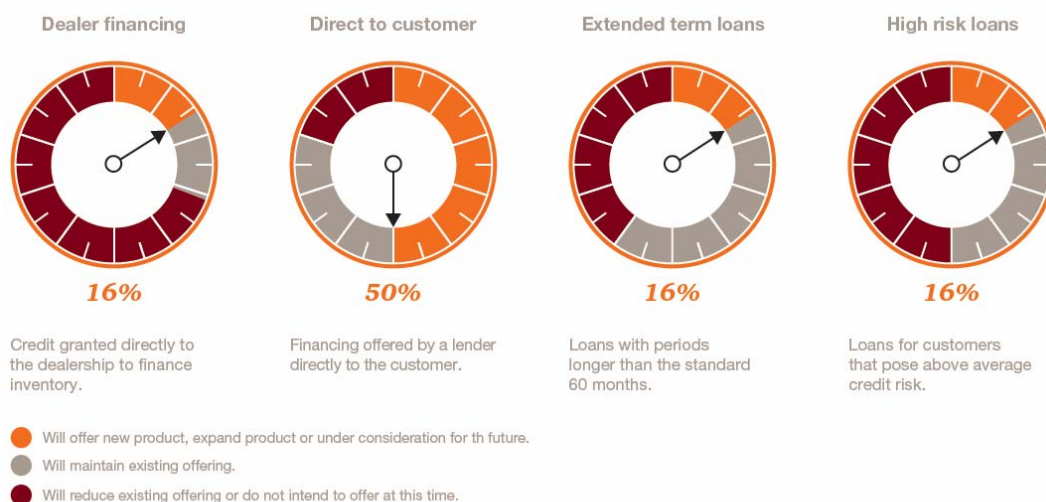
Product offerings

Dealers can play an important role in the auto-finance value chain, and they can be critical partners for lenders. However, this is less prevalent in the NZ market than, for example, in the US.

Survey results show that only 33% of participants intend to offer new *dealer finance* products or expand existing ones.

Adding to the product offering mix, lenders point to *high-risk loans* as a continuing product offering with 50% of participants either maintaining or considering their high-risk loan offerings.

Figure 3: Strategic areas of focus (growth and retreat)



Source: PwC's 2016 International Automotive Lending & Leasing Survey, New Zealand respondents

Product and dealer offerings

In addition, **66%** of lenders said they plan to continue with or increase *extended-term loans* and **83%** will maintain or expand *direct lending*.

Dealer offerings

Our survey shows that lenders continue to offer assurance products as a portion of their portfolio, although few lenders are looking to add entirely new products to their assurance/consumer-products offerings. Some thought is being given to expand and grow ancillary vehicle protection.

Of the lenders surveyed:

66%

plan to maintain current VSC offerings

50%

intend to maintain current gap insurance products

33%

will either offer new or expand existing ancillary vehicle protection products

33%

intend to grow existing liability or comprehensive insurance offerings

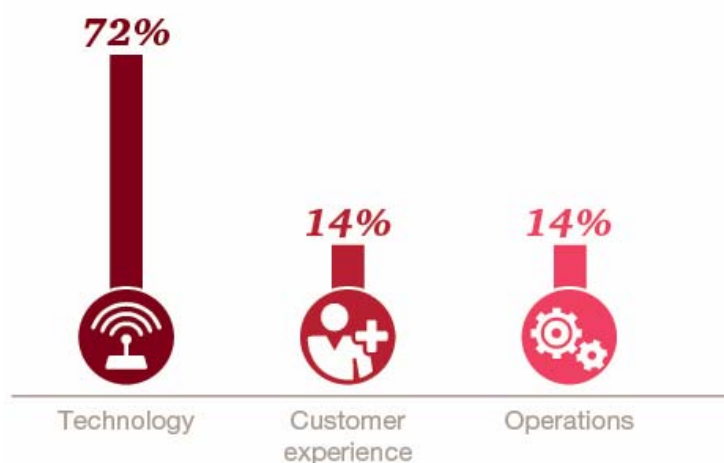
Trends on the horizon

*Focus for 2016:
Where are industry
leaders planning to
reinvest going
forward?*

When asked to look ahead and consider the biggest investment areas for their organizations over the next three to five years, survey participants cited technology followed by customer experience and operational efficiencies (See Figure 4).

Given that experiential initiatives (both for customers and dealers) are often based on foundational technologies (for example, creating new mobile capabilities for customers), technology may receive a larger share of funding than may be indicated.

Figure 4: Focus areas for the next 3-5 years



Source: PwC's 2016 International Automotive Lending & Leasing Survey, New Zealand respondents

Tech trends

The impact of technology on auto lending globally: Now and on the journey to the future

As part of this global initiative, PwC also surveyed technology and digital trends in the US and European markets.

Where we are now ...

With regard to technological transformation, the automotive finance industry continues to experience rapid changes. Most participants indicated that their organisations have gone through significant technological change over the last few years, with **67%** citing technology as the area with the largest number of transformational initiatives.

In general, our survey shows that technology remains fundamental to defining an organisation's strategy, with IT spend as a percentage of revenue running at a median of **13%**. In particular, participants highlighted foundational technology as the primary origin of their transformational change. The importance of keeping up with emerging technology is clear to today's lenders, and they view it as the single greatest challenge to building profitability.

Participants also cited other challenges to their IT functions. Threats to technology environments include escalating regulatory changes; business growth, as compared to slow implementation timelines; technology underinvestment; security challenges; and data-center space constraints.

All in all, technological change and transformation has been and remains a key priority, forcing those wishing to lead on the technology front to find innovative ways to deliver new technologies while managing related spend.



72% of New Zealand participants see technology as their largest transformational initiative

Tech trends

... and where we are headed

It comes as no surprise that our survey participants are undertaking technology projects as their largest current transformation initiative, and they project this trend to continue. Most participants said they anticipate initiating significant technological changes over the next three years—particularly with regard to floorplan, servicing, collections, and data warehouse technologies.

As lenders deal with challenges presented by their aging technology infrastructure and the corresponding inability to meet business needs, they should actively seek tech innovations that are both flexible and scalable. Scalability in particular is seen as a

means of delivering the agility that lenders need to be quick off the mark when fluctuating factors—business growth ahead of projections, rapid regulatory change, IT investments, and infrastructure and technology disruptors, for example—suddenly appear on the horizon.

As we see it, the industry will likely continue to see a push toward transitioning core systems, particularly when it comes to implementing strategies such as cloud-based management. Most participants reported having a cloud-based strategy within their organisation, which they plan to continue enhancing over the near term.



Digital outlook

*Technology disruptors:
A paradigm shift is clear*

In line with many industries, the auto lending market faces significant technological change. Technology-enabled disruptors—such as mobile apps, personalized digital marketing, peer-to-peer (P2P) lending platforms, direct auto lending, and shared economy platforms—are forcing lenders to change the way they operate. But rather than viewing these emerging trends as threats, many lenders see opportunities: that technology-enabled operations present a chance to increase their competitive edge. Survey results clearly show a paradigm shift toward enhanced technological advancements to meet the growing customer demands in this space.

Mobile applications

As auto-buyer demographics migrate toward a younger and more connected base, there is a greater need to expand mobile capabilities as a means of building customer loyalty. While some of the key industry players say they already offer various applications, they also see room for improvement—specifically citing new loan applications, mobile payments, customer self-service and multi-customer vehicle sharing as potential opportunities for new functionality that they are not currently offering.

Personalized digital marketing

Online, social media and mobile channels are becoming more prevalent in the auto purchasing process, driving a shift in traditional marketing channels that are not only becoming more digital but also more personalized. To create effective targeted content, campaigns, and offers for each channel and customer segment, dealers should require better access to lenders' digital marketing tools and customer data, and lenders will need to develop better tools to support dealer needs. To that end, captives and banks that fail to keep pace with this personalized digital marketing trend may ultimately lose touch with customers and cede more ground to competitors.

P2P lending platforms

P2P platforms also have seen an increase in popularity globally. Indeed, in the US PwC estimates, P2P origination growth has been **84%** per quarter since 2007.¹ Whilst not as prevalent in NZ, there is growth in P2P lending which has the potential to disrupt the local market. Key differentiators driving the growth of this disruptor include quick funding decisions, simplified application processes, and end-to-end loan processing via web portals.

¹ PwC, "Peer Pressure: How peer-to-peer lending platforms are transforming the consumer lending industry," February 2015, www.pwc.com/consumerfinance.

Shared economy platforms

The rise of car-sharing platforms has paved the way for consumers to employ their car as a revenue source. To make the most of this trend, some lenders are experimenting with developing and implementing their own shared-economy platforms. Although these platforms remain in their infancy and have not yet been proven to grow profitability, PwC in the US is now seeing programs being piloted in which lenders allow customers to share their vehicles via a dedicated car-sharing platform. In return, lenders can lower a participating customer's lease payment.



The bottom line

Opportunity for growth

In summary, our 2016 International Automotive Lending & Leasing Survey indicates positive sentiment across the industry, but disruptors driven by rapidly changing technology are expected to have an impact on strategies and operations.

Nevertheless, survey participants view these disruptors as not just challenges but also opportunities for growth and improvement for organisations across the industry.

Overall, the news is good:

Growing trends show a focus on enhanced customer experience and technological investment. The automotive finance industry shows opportunity for growth, provided that lenders are quick to adopt market driven changes.

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