

BUYING AND SELLING AUTO LOAN PORTFOLIOS: NEW OPTIONS HELP CREDIT UNIONS MITIGATE RISK

By Mike Sheridan

William Shakespeare probably didn't have the subprime mortgage crisis in mind when he penned the famous phrase "Neither a borrower nor a lender be," but his words come close to describing the current environment consumers face when seeking financing to buy a home or automobile.

One hundred percent or interest-only loans? History. Subprime borrowers? Out of luck. Need a new car but have a low credit score? Come back when it is closer to 800. The fact is, anxious banks worried about losses are hesitant to lend to even the most highly qualified prospects in the wake of dramatically slower home sales, tumbling values and a record numbers of foreclosures.

The picture is far more positive across the street at the local Credit Union. So far, Credit Unions have emerged unscathed from the subprime mortgage meltdown because most stuck to their underwriting standards when banks relaxed theirs. With a different regulatory and ownership structure than the large publicly traded banks, Credit Unions emphasized loan quality over quantity. That said, the resulting credit crunch means everyone faces a future where there will be far fewer highly qualified applicants for all types of credit and greater risk to those doing the lending.

That's why there is renewed interest in a time-tested tactic that increases liquidity for lenders, auto dealers and consumers – buying dealer-originated loan portfolios, selling the loans you originate, or acting as an investor if you don't directly or indirectly participate in automobile lending. It also is why a great deal of attention is being paid to new technologies and processes that help Credit Unions mitigate portfolio risk by, in essence, creating a virtual secondary market.

What makes buying and selling auto loans such a compelling proposition even as recession threatens and auto loan delinquencies reach their highest levels since the early 1990s?

First, there's still a huge market for auto loans. Some \$575 billion in loans for new and used cars are made annually, according to the National Automotive Finance Association.

Although Americans are worried about their wallets, cars are a necessity for most. In a sense, the nation's economy literally runs on cars. Further, Fair Isaac reports that the car note is becoming a higher priority than the mortgage as some families prioritize bills. Borrowers would rather give up their home than default on an auto loan and hand over the car keys.

Rather than forego a car purchase, more consumers are choosing a comparable pre-owned car from a "buy here, pay here" dealer who originates the loan. While these consumers might prefer to buy a new BMW, with tighter credit the same consumer might select an older BMW. That creates more demand at the used car lot and at Credit Union branches.

However, this heavier demand creates a challenge for dealers and Credit Unions: Converting asset-backed debt into cash they can use to purchase additional inventory and fund their operations.

Used or "note lot" dealers are an under-served population. Institutional lenders have focused on building relationships with high-volume new car dealers who had the resources to invest in expensive loan management systems. Today, as used car sales increase, technology enables many note lot dealers to implement the kind of enterprise business best practices and process improvements that helped their new-car dealer brethren improve cash flow, profitability and efficiency.

Technology also improves the ability of smaller lenders, including Credit Unions, to get in the game. It used to be that buying and selling auto loan paper was only for lenders with an iron constitution and enough manpower to fan out to the four corners of the earth to perform due diligence. The acquisition cost alone made purchasing small loan packages more trouble than they were worth and discouraged many Credit Unions from participating.

Today, the cumbersome and time-consuming processes involved with commercial paper transactions are being replaced with new, more efficient and cost-effective approaches that bring transparency to the marketplace. New fee-based Internet auto finance transaction management platforms offer dealers and lenders the ability to transact business online 24/7 with pre-qualified business partners around the country – much as buyers and sellers of antiques meet and transact business on eBay.

This technology allows Credit Unions and other lenders to pre-select and bid on the types of loans they want to buy from the kind of borrowers they want in their portfolio. Only interested in 2006 or newer loans with clean payment records? You can control which loans are sent for review. Worried that borrowers from states with high delinquency rates are too risky? You can specify which geographies to include or exclude, the APR you want, or choose to review loans that fit some 30 other specific criteria. You can even test portfolio pricing to determine what the current market will bear, just as you would with a secondary market.

The technology automatically initiates the due diligence process, automating every step from copying and delivering documents for secure online review and returning them to the dealer, all within 72 hours. It also tracks each step of the contracting and closing process and provides a venue for communication with the dealer throughout. There's even a facility for handling funding and title tasks. The benefit for both dealers and lenders is that all this can be done without leaving your desk. Over the long term it opens the door to greater availability of credit at a lower cost to consumers.

There's no question that America's credit markets face challenges unlike any we've seen in recent memory. Solutions that facilitate liquidity and streamline the auto loan process will help credit unions, dealers and consumers alike endure and survive tough times.

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