Post-COVID Economic Trends in Auto Finance

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The COVID-19 pandemic and its economic consequences have dramatically affected the auto finance industry. The pandemic has presented challenges and opportunities for auto finance lenders that will require accommodation in terms of expectations, procedures and future planning. The pandemic has created a scenario in the auto finance industry with a heightened demand for personal vehicle ownership, a reduction in manufacturing and an increase in unemployment. The result is that auto finance companies must navigate a unique landscape as they seek to satisfy the increased demand for their services coupled with the need to protect and secure their investments in the face of an uncertain financial future.

The Macroeconomic View

The auto industry in North America has experienced a drastic decrease in manufacturing since April. Auto production had been around 1 million vehicles per month, but the business shutdowns enacted to slow the spread of COVID-19 caused this figure to drop to only about 5,000 vehicles per month. That number has started to rise — factories resumed production as restrictions eased — but shutdowns and slowdowns certainly could return as infections spike again across the country.

Another point to consider is that manufacturing is not the same as sales, which is also not the same as financing. During the COVID crisis, the industry experienced a drop in sales and leasing as many dealerships were closed. Reports indicate that vehicle sales have started to rebound due to pent-up demand and low cost of credit to help buyers finance their purchase.

For those customers with existing loans and leases, it has been difficult to accurately assess how COVID-19 has impacted borrower payment. The CARES Act regulates how lenders report information about borrowers in a way that may provide an overly positive view of repayment behavior. Coupled with expiring payment relief programs that were offered by many auto finance companies, the full impact of COVID-19 on borrower payment behavior is still unknown.

A Pivot to Digital

Many dealerships and auto finance companies expanded their digital sale and financing platforms prior to 2020. COVID has only accelerated this trend. In addition to required closure of dealerships, customers have been reluctant to visit dealerships because of health concerns, so dealerships and their financing partners have responded with expanded digital sale and financing options. Although in-person dealership sales continue to provide value to many customers, dealerships and finance companies have expanded their online marketing and contracting options to support remote sales.

Enabling this expansion of digital vehicle sales is states' ability to accept electronically signed odometer disclosure statements. Most vehicle title transfers were subject to a requirement that odometer disclosures be made in a hard copy format with wet ink signatures. That changed last year when the Department of Transportation's National Highway Traffic Safety Administration authorized states to decide at the local level whether to accept electronically signed odometer statements. Most states have issued regulations or agency guidance to accept electronically signed odometer statements, which has helped grow the digital sale process. Federal law provides auto finance companies with a strong and established legal framework for how to accept electronically signed documents, like credit agreements and title applications. States have almost uniformly adopted these standards for electronic signatures, yet a few state agencies have established additional requirements for how the signatures must be certified, or otherwise authenticated, in the digital environment. There have been some minor impediments and roadblocks in a couple of states, but in general, auto sales and finance is clearly trending toward a completely digital, paperless process.

Customer Behavior

The many personal and financial challenges brought about by the pandemic have caused changes in customer behavior. Auto sales have been impacted and finance companies are reacting by instituting creative efforts to help customers finance the purchase of vehicles.

Finance companies are increasingly offering incentives that allow borrowers to delay when their first payment is due, or incentives for returning customers to promote brand loyalty. Companies are also expending their advertising budgets to use strategies including direct marketing and digital advertisements that will coordinate with traditional holiday promotions.

It should be noted, however, that some of these efforts likely will draw attention from consumers and regulators as to whether the financial products are being advertised and sold in an accurate and transparent manner. Special care should be paid to ensure that customers meaningfully understand the terms, the conditions, and the true cost of the credit being offered.

Companies are also considering the use of online post-repossession auction sales as an alternative to the traditional in-person auction. While the case law around this practice is not well developed, it is certainly possible when companies are mindful of state law that regulates the reinstatement, redemption and disposition process. In fact, the comments to the Uniform Commercial Code (UCC) indicate that an online disposition is acceptable if it is completed in a commercially reasonable manner.

The Road Ahead

While consumer demand for vehicles and financing has grown since the start of the pandemic, finance companies will want to carefully monitor the market and customer behavior, as some reported data may paint an overly optimistic viewpoint. For example, since April there has been a 51% reduction in savings for lower income Americans, while credit reporting has shown an increase of on-time payments. It should give the finance community pause when considering that consumers are saving and earning less, but still making payments on time.

Government assistance is one explanation for these seemingly conflicting statistics, but so is the fact that many "on time" payments are being reported as assistance is added. This likely means that there are a significant number of customer accounts being reported as performing, despite the fact that this designation may be illusory. Consequently, the results that are being seen right now could change dramatically in three to six months as federal relief and finance company accommodations expire, without prospects for further relief in sight.

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