Lenders Protection
Reserving

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Agenda

• Lenders Protection (LP) basics
• Default drivers for auto loans
• Risks
• Reserving considerations
  – The a priori loss ratio
  – The a posteriori analysis

Basics

• Coverage
  – The coverage pays the difference between the loan balance and the “value” of the vehicle if the lender repossesses and sells the vehicle

• Premium
  – Lender pays premium for each loan, single premium for the life of the loan
  – Lender (typically) recovers the cost by charging the borrower a higher interest rate on the loan
Default Drivers for Auto Loans

- FICO score
- Credit history or lack thereof
- High Payment-To-Income (PTI) and Loan-To-Value (LTV) ratios
- Term of loan
- Payment and loan amount
Risks

- Frequency greater than expected
  - Unemployment rates

- Severity greater than expected
  - Vehicle depreciation

Reserving Considerations:
Setting an A Priori Loss Ratio

- Frequency factors
  - Unemployment or change in unemployment
  - Loan characteristics
  - Broad indicators of the overall economy
  - Auto-industry specific indicators

- Severity factors
  - Time until default (loan life)
  - Wholesale used-vehicle values
  - New vehicle sales (related to above)
  - Availability of credit

Reserving Considerations:
Chain Ladder Challenges

- Severity reverts to the mean over time
- The link ratios can vary substantially
- Economic distortions on the triangles
- Loan modifications
  - Re-default accident month
  - Severity effect
- Unadjusted chain ladder method results