

INSURANCE SERVICES ASSET MANAGEMENT

Lenders Protection Reserving

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1

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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

2

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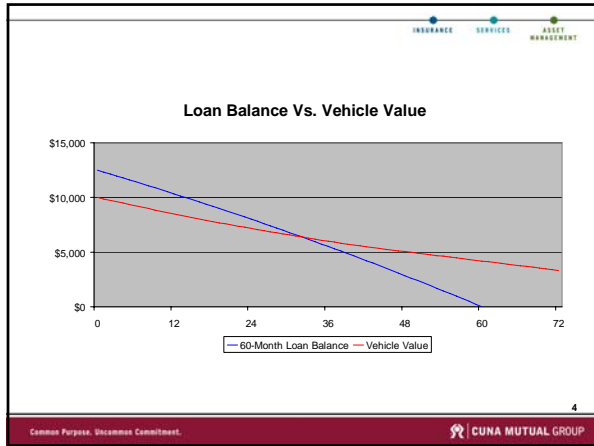
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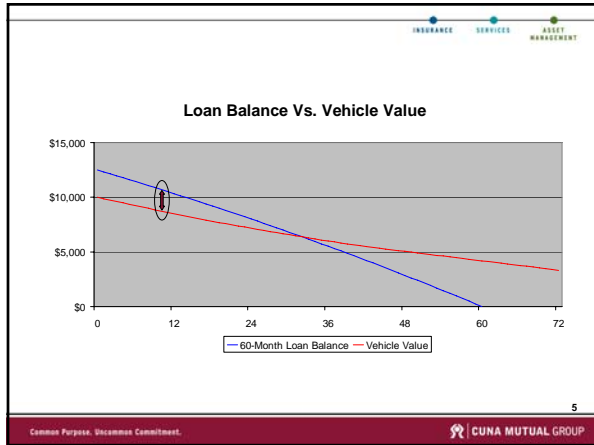
Basics

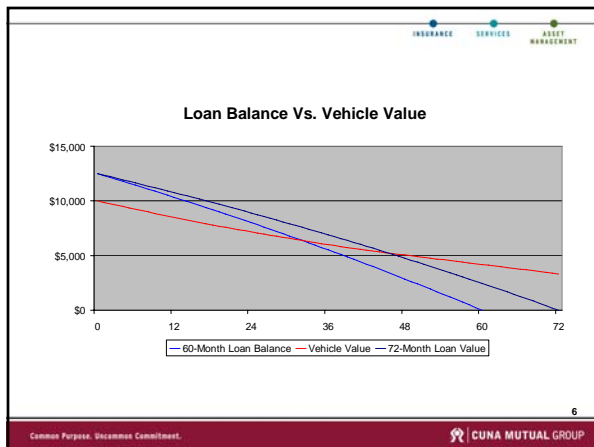
- Coverage
 - The coverage pays the difference between the loan balance and the "value" of the vehicle if the lender repossesses and sells the vehicle
- Premium
 - Lender pays premium for each loan, single premium for the life of the loan
 - Lender (typically) recovers the cost by charging the borrower a higher interest rate on the loan

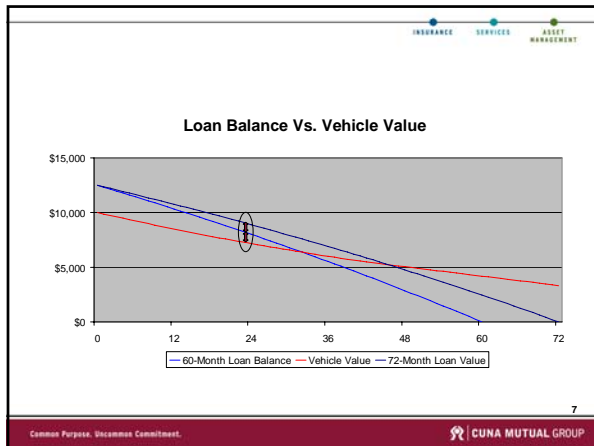
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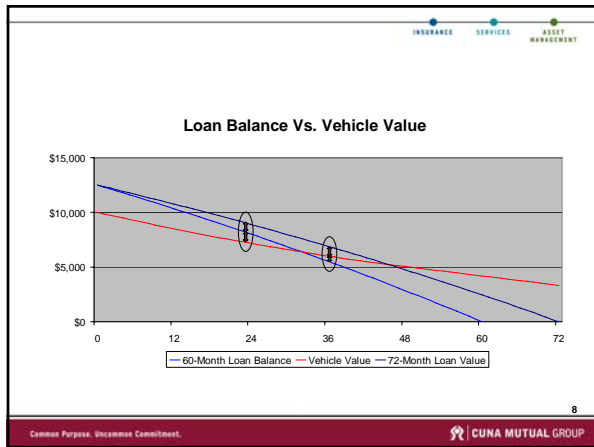
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- ### Default Drivers for Auto Loans
- FICO score
 - Credit history or lack thereof
 - High Payment-To-Income (PTI) and Loan-To-Value (LTV) ratios
 - Term of loan
 - Payment and loan amount
- 9
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Risks

- Frequency greater than expected
 - Unemployment rates
- Severity greater than expected
 - Vehicle depreciation

10

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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

11

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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

12

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