ALSO IN THIS SECTION:

Where now for subprime?

Dr Roger Gewolb analyses recent press coverage of the subprime world and the Cattles debacle

No doubt well-intentioned but woefully misguided souls have recently attempted to write about the future of the non sub-prime world and link their conclusions to essentially unrelated factors, such as the horrendous events now slowly unfolding at Cattles. I hope to cover both of these matters in this brief article.

Why should the events at Cattles delineate the future of UK sub prime car lending, I ask myself? The 22 March *Sunday Telegraph* has referred to "an alleged accounting fraud" at the group and a magazine article says "it seems that its internal governance procedures were woefully inadequate, and the assumptions in its business model were wrong. So much so that its results have been misreported for at least the last two years."

At this stage, it is unclear to me from the press whether it is a case of inadequate governance and control procedures or outright fraud, or for that matter whether there was anything done improperly at all, but what bearing does any of that have on non-prime lending generally? If they are present, fraud, poor controls or bad models can wreck any business, from the most toffee-nosed private banks to the local minicab outfit.

And, if collections and provisioning are not done accurately in any finance company, once you start to mess up or play around with your arrears and bad debt numbers, you not only misrepresent to or deceive your management and staff (those not involved themselves, that is), shareholders, lenders and others, but you also put yourself in a position where you do not even know where you actually are (how can a finance company keep two sets of collection records? – think about it) and your collections and arrears management go out the window.

Thus, in the case of Cattles, £700 million of new provisions, as has been announced, could very easily arise, once outside experts are called in to try to rewrite the past, if indeed provisions have had to be accelerated due to any inattention to business from not knowing what to actually work and when.

It is very simple – for any lender, if a case is inadvertently or improperly shown as current or almost current when it is not, how can any collectors work that case as it should be worked? How can they repossess a car when the account is shown as less adverse than it really is? How can they sue when required?

Next, what about the collections team? How do you tell someone to start doing it completely differently? In my experience, taking on my first ailing business, I had to use a new broom to sweep out some managers and then build up the junior collection staff; most of them became highly effective, and we collected much more than was projected – it can be done.

Obviously, with the Cattles situation, any "toxic" loans that may be found will first have to be ring-fenced and worked in a different manner, but even they can be collected to a significant degree if the right experienced, professional team is in place managing things.

Further, and also peculiarly to Cattles, another common sense fundamental seems to me to be out of sync here – how can they possibly close every one of their Welcome Car Finance (WCF) sites as recently announced? Are their repos now going only to auction? Did they never use WCF to retail their repos?

If the answer to either or both of the last two questions is "yes", I should think it is very much a Cattles business model issue, rather than a sub-prime lending model issue. By sending all repos to auction for auction value instead of the 90 percent or more of trade value others can still get from a retail site, they could in effect be throwing away one-third or more of their possible recoveries for no earthly reason I can think of. I wonder if the 20-odd banks to which Cattles owes some £2.5 billion are aware of this?

Access to credit

So how can this Cattles situation have direct relevance to the growing band of economically challenged people who cannot readily get car (or other) finance today? The government has long been concerned with the exclusion of these citizens from the world of credit and wants something done about it. With the rapidly increasing number of these people as a result of the present recession, I can only see this desire and this need accelerating.

There are good lenders and less good. Even Cattles can be made into a good lender again, given the right ingredients. Now is the time. My view, shared by almost everyone I know in our industry, is that there has never been such an opportunity to do sub-prime business on one's own (risk-controlled and highly profitable) terms.

I also believe that, once the current situation has passed, things will go back to pretty much the way they were, even if the terminology alters. In my view, this has always been more a crisis of confidence and trust than anything else.

There will be securitisation on a massive scale again, albeit in somewhat different form; there will be rating agencies and the rest. Mortgage lending will be limited on the loan-to-value ratio so as to avoid a repeat of the most obvious and egregious malpractices of the past years. But I will go out on a limb and say that motor finance in the UK will be relatively unaffected when it returns.

Even sub-prime will return, undoubtedly also with lower more sensible LTVs than some lenders used. It can be one of the most successful sectors in British financial services if it is developed correctly this next time.

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