



# F&I TRENDS REPORT



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# Overview

Automotive dealerships have continued to experience bright spots throughout 2019, coupled with new challenges that have been both market- and economy-driven. On the positive front, new-car sales at the midway mark in 2019 were still holding a seasonally adjusted annual rate (SAAR) of approximately 16.7 million<sup>1</sup>. This represents an automotive market that continues to produce solid sales results as well as strong support from fleet sales, despite this number being down from the 17.3 million<sup>2</sup> units that were sold in 2018.

On the used-vehicle front, industry experts believe used auto sales will reach their highest level since the recession. Industry observers believe 41 million used cars will be sold in 2019<sup>3</sup>, slightly up from 40.2 million sales the previous year. Factors contributing to the continued increase of used sales include rising new-vehicle sticker prices and interest rates, as well as falling incentives on new leases at the dealership.

Various other disruptive forces such as consumers changing views on mobility, vehicle ownership, demands for a simpler, faster and increasingly digital retail experience, coupled with industry disrupters like Tesla and Carvana, among others, have continued to escalate changes in the auto industry. As one looks to the future of auto retailing and dealerships, the speed of change will only increase.

A number of economic, policy and auto industry challenges have evolved since the industry's peak just a few short years ago. However, F&I has been a bright spot for many dealers, adding significant profit potential to their bottom line. According to the NADA 2019 mid-year report<sup>4</sup>, dealerships' total service and parts sales year-to-date in June represented \$64.6 billion. The income development of F&I programs is further impacted by the type of dealer participation program owners utilize. Dealers offering an F&I program aligned with the needs of their customers, their respective markets and their financial objectives have an important foundation for future success. Each of these are key areas impacting a dealership's business today and will continue to have an impact for the foreseeable future.

**This report is designed to specifically address the current landscape of F&I products in the marketplace, and to provide an overall view of how these products are performing for dealers across the U.S. The report will also address specific market challenges and opportunities, feedback from dealers across the U.S., F&I product growth opportunities as well as the outlook for various dealer participation program structures.**



# Industry Trends

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Conflicting market forces continue to add an element of turbulence to the market, as strong consumer confidence and employment markets have propped up demand for both new and used vehicles. However, despite this strength, affordability remains a growing issue throughout the industry.

These macro trends have made it even more important for dealers to maximize their opportunities to elevate profit potential and margins through F&I. This increased focus on F&I opportunities also carries important spillover effects since customers exercising their protection plans typically have their cars serviced at the dealership, resulting in increased service drive business and greater customer retention opportunities.

Several other trends have shaped dealership business activity throughout the course of 2019. The overall American economy has continued to be healthy and stable. GDP in 2018 saw full-year growth near 3%, and while this number has slipped in 2019, overall consumer confidence has remained relatively stable while unemployment levels have remained low.

Even though the price of new cars keeps rising, financing costs have come down since 2018. One of the most negative factors impacting consumer demand in 2018 was the rise in interest rates that translated into a rise in the average payment for a vehicle. However, as recently as July of 2019, the average interest rate for a new vehicle loan fell to its lowest level since the beginning of the year.

## REGULATION OF FOREIGN TRADE

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Tariffs could significantly impact the price of a vehicle for consumers. In 2018, tariffs increased the price of new vehicles by roughly 2%. Luxury cars and crossover vehicles are heavily impacted by imports and are especially sensitive to tariff legislation. The added expense and uncertainty of additional tariffs will continue to be closely monitored throughout 2019 and into 2020 as the Presidential election nears.





## MERGERS & ACQUISITIONS

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Dealerships are also continuing to analyze merger and acquisition opportunities. Analysts reported earlier in 2019<sup>5</sup> that the auto dealership buy/sell market started the year with a strong boost in the first quarter with 54 completed transactions, representing a 38.5% increase year-over-year. In fact, analysts said that the first-quarter pace illustrates that 2019 should see a sixth straight year of 200-plus dealership transactions.

## SHIFT TO PRE-OWNED

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The early part of 2019 reflected a shift in focus toward used vehicles, increased F&I and service and parts. This shift to higher margin profit centers, especially for used-vehicle gross margin, is three times larger

than new vehicles, and F&I products sold per new vehicle has risen 60% since 2010. The opportunities with used vehicles will only grow larger. By 2023, IHS Markit<sup>6</sup> predicts there will be about 84 million vehicles on the road that are at least 16 years old, reflecting a 240% increase from 35 million in 2002.

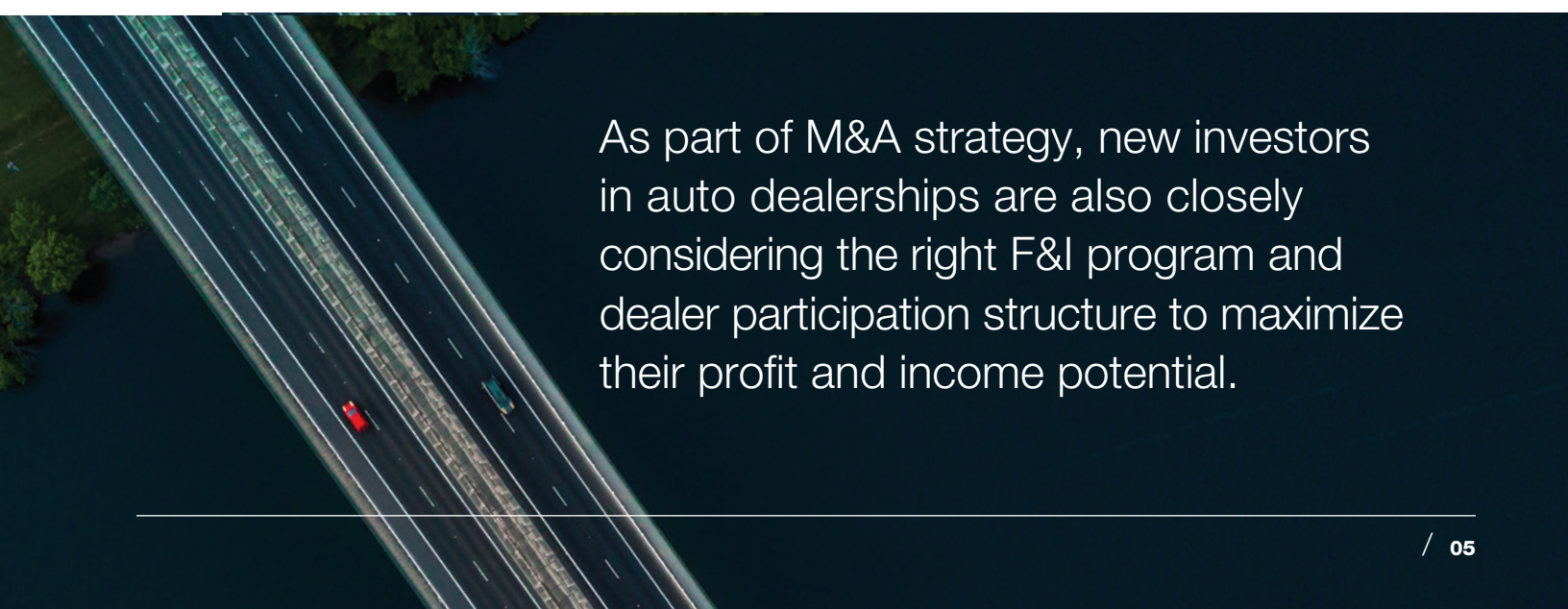
## TAX LAWS

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Lastly, changing tax laws continue to impact dealer's income from participation programs. The Federal Tax Cuts and Jobs Act (TCJA) was signed into law in December 2017 and took effect for the 2018 tax year. While the legislation was designed to reduce income tax rates for individuals and corporations, this tax reform affects the selection and profitability of participation programs for many dealers. This is noteworthy since dealer income can be greatly

influenced by the type of participation program dealers select for their eligible F&I programs.

Under the new tax law, auto dealers will need to make a determination of whether participation in a non-controlled foreign corporation (NCFC) will negatively impact the tax deferral affect of NCFC participation. Numerous dealership groups participate in NCFCs to focus on underwriting results. As a result of the TCJA, dealers have reason to look closely at the NCFC option. At this time there remains a fair amount of uncertainty around how the government will treat NCFCs under the tax law.



As part of M&A strategy, new investors in auto dealerships are also closely considering the right F&I program and dealer participation structure to maximize their profit and income potential.



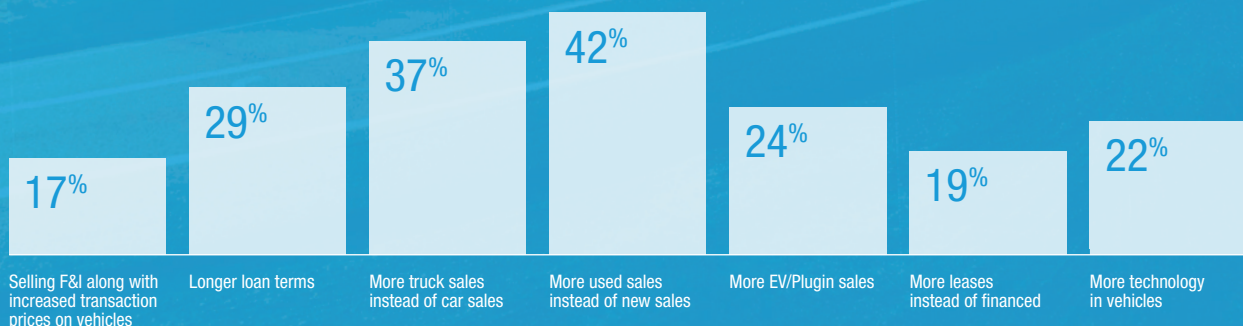
# Dealer F&I Product Programs in 2019

In 2018 and 2019, Vehicle Service Contracts (VSCs) and maintenance programs continued to become more popular. With cars now representing just 30% of overall vehicle sales, many consumers must rely on vehicle protection products and maintenance programs to protect themselves against the costs associated with their higher-priced trucks and SUVs.

This demand for F&I products has the potential for further growth in the coming years, especially as more consumers turn to pre-owned vehicles to combat affordability of new vehicles. What's more, the continued trend of off-lease volume will place additional focus on used vehicles, where vehicle protection products and maintenance programs will significantly help ensure consumers keep their vehicles on the road, looking nice and running. One trend that appears to be growing is the dealer-owned warranty company, which allows dealers to own their own warranty company, providing for greater control and dealership-branded F&I products designed to meet the needs of their markets.

Given all of this, dealers have a great opportunity to continue growing their F&I sales during the vehicle transaction process. In a recent survey of approximately 500 dealership executives across the U.S.<sup>7</sup>, 41.7% said more sales of used vehicles represents the greatest opportunity, followed by more truck sales (36.6%), longer loan terms (28.9%), and more EV/plugin sales (23.7%).

## BIGGEST OPPORTUNITIES IN SELLING F&I PRODUCTS TODAY VERSUS 5 YEARS AGO.





# GAP and VSC Claims Trends in 2019 & 2020

In 2019, dealers report slightly shifting trends in the type of F&I products they are increasingly offering to customers. Some of this is due to a rise in the type of technology found in vehicles, while other drivers include rising interest in alternate fuel and a shift toward more pre-owned purchases.

Guaranteed Asset Protection (GAP) coverage increased over the last several years. The average GAP claim payout has risen 19.5% between 2014 and 2018 for new vehicles, and a 95% increase over the same time for used vehicles. New vehicles have averaged a 4.7% increase each year during that time, and an 18.5% per year increase for used vehicles.

There are several factors that have led to this increase in GAP claims

payouts over the last few years: increase in claims due to more accidents with more cars on the road; insurance companies are more likely to total vehicles due to the rising complexity and cost of replacement parts, in conjunction with falling residual values (particularly for cars over SUVs/crossovers and trucks); and more impactful weather events driving up claims payouts in recent years.



Data Source: 2019 Protective Asset Protection Dealer Survey<sup>7</sup>

## AVERAGE VSC CLAIMS

↑ 21%

between 2014 and 2018 for new vehicles, and a **3.7% increase for used vehicles.**

## NEW VEHICLES AVERAGE

↑ 5%

each year during that time, with a smaller **0.9% increase for used vehicles.**

The average GAP claim payout has risen **19.5% between 2014 and 2018 for new vehicles, and a 95% increase over the same time for used vehicles.**

New vehicles have averaged a **4.7% increase each year during that time, and an 18.5% per year increase for used vehicles.**

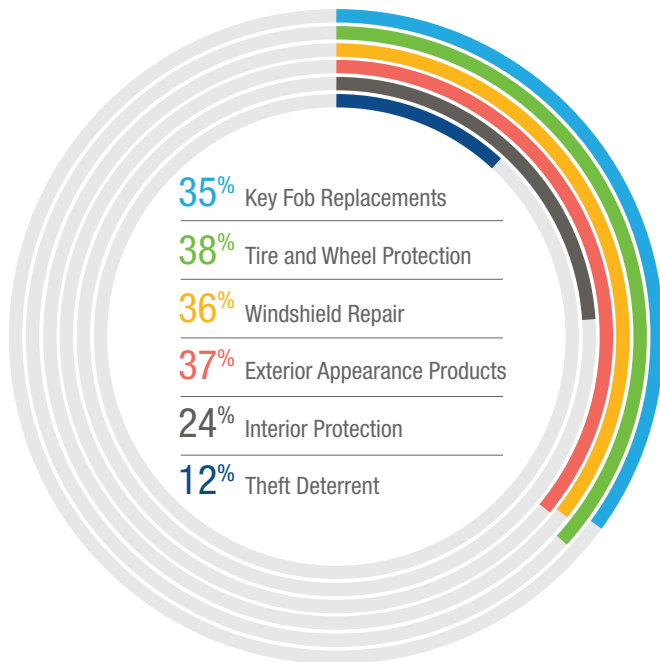
# Dealers Report Increased Ancillary Product Sales



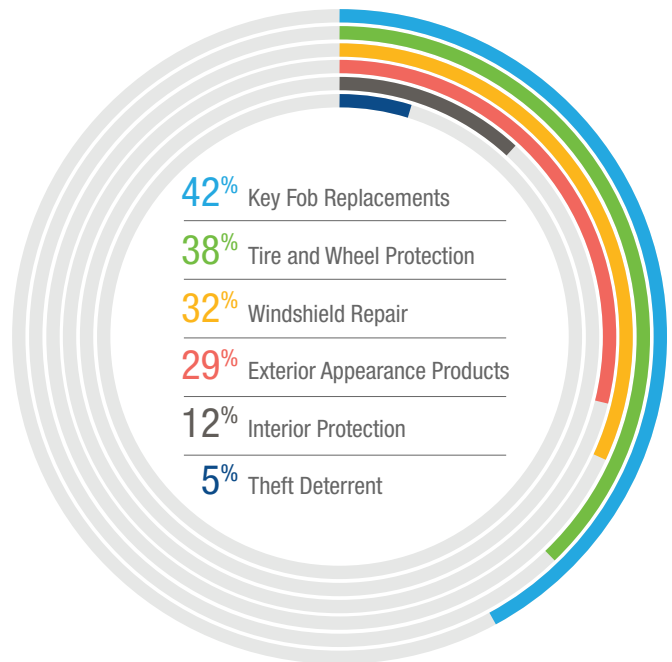
Five years ago, dealers reported most car shoppers purchasing F&I products such as tire and wheel protection (37.9%), exterior appearance products (37%), windshield repair (35.6%) and key fob replacement (34.8%).

Today, ancillary products such as key fob replacement has grown for dealers, with 41.7% saying it's a product offering in demand for customers.

## F&I PRODUCTS BEING SOLD THE MOST 5 YEARS AGO



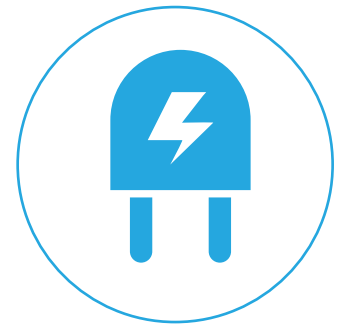
## F&I PRODUCTS BEING SOLD THE MOST TODAY







# The Impact of EVs and Hybrid Technology on Dealer F&I Programs



Current estimates put roughly one million electric vehicles on the road in the U.S. today, according to media reports<sup>8</sup>. Proponents of the technology agree that this is a small number, compared to the more than 270 million cars and trucks<sup>9</sup> in the U.S., but it continues to grow and has a bright future for those focused on lowering their carbon footprint.

EV cars and trucks are obviously built with different technology throughout – particularly in the engine components – which means servicing these vehicles can be different from traditional gas-powered cars and trucks. As a result, it can be more difficult for dealers to recommend the right F&I products for EVs. These inherent differences make it important for

dealers to understand how to effectively communicate with their customers, as well as understanding the different types of F&I products that best serve these vehicles.

Looking broadly at the types of EVs, there are electric vehicles which are fully electric from a battery; hybrid vehicles which have a combination gas and electric-powered engine; and a plugin hybrid which allows a driver to plug in the vehicle for an additional charge of the battery. A fourth type of alternate engine that is becoming more common today is the mild hybrid, which is a gas-powered engine that has an automatic start-stop of the engine when the car is not in motion, such as sitting at a red light.

This education-first approach will help dealers increase F&I products for alternate fuel vehicles. The share of EV cars and trucks is expected to reach 7.6% of all new-unit sales by 2026.<sup>10</sup> This compares to just 1.2% of sales in 2018. What's more, 18 models were available in 2018 which is expected to grow to 133 by 2026.<sup>10</sup>

# New Versus Used Vehicle Sales

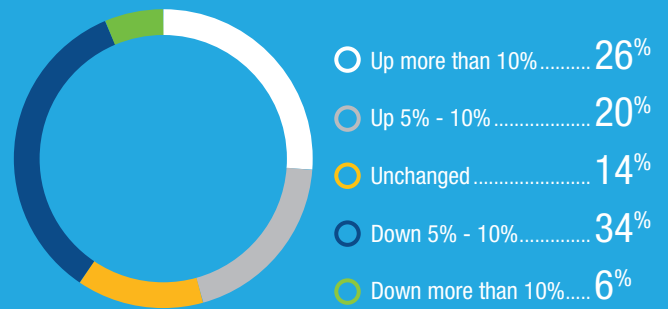
Among the largest reasons F&I product offering trends have shifted can be seen from the changing trends of sales over the last few years. 34% of dealers say their 2019 sales are trending down 5% - 10% for the year. Conversely, a quarter of dealers say their sales are actually up more than 10% for the year.

A large part of this can be seen in the type of vehicles that are being sold, and the type of vehicle now in demand from consumers. 56% of dealers say they are selling more used vehicles today, compared with 23% who say they're selling more new vehicles.

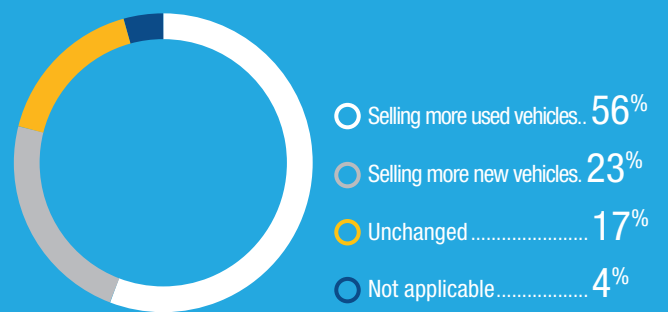
Furthermore, approximately 42% of dealers say their gross margins on used vehicles are up more than 10%, while this compares to just 25% of dealers reporting similar increase for new-vehicle sales.

Data Source: 2019 Protective Asset Protection Dealer Survey<sup>7</sup>

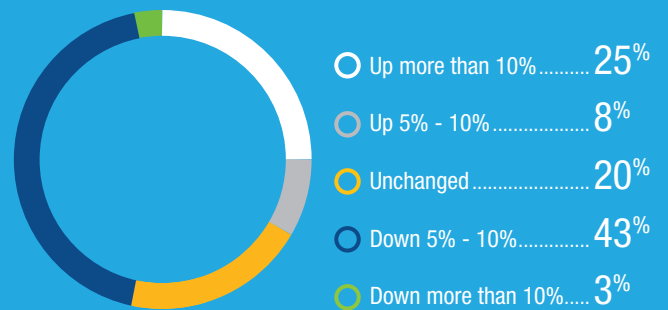
## 2019 SALES TRENDING COMPARED TO 2018



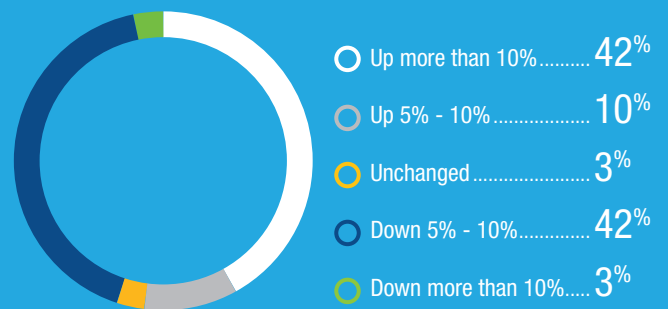
## CHANGE IN RETAIL SALES MIX



## 2019 NEW VEHICLE GROSS MARGINS COMPARED WITH 2018



## 2019 USED VEHICLE GROSS MARGINS COMPARED WITH 2018



## TAX IMPLICATIONS AND DEALER F&I PARTICIPATION PROGRAMS

The Federal Tax Cuts and Jobs Act (TCJA) was signed into law in December 2017 and went into effect for the 2018 tax year. This approved legislation, which reduces income tax rates for corporations, has the potential to impact profitability of participation programs for dealers. This is noteworthy since many dealership groups participate in non-controlled foreign corporations (NCFCs), which defer tax liability and allow participation in underwriting results. However, this structure may now impact profitability for dealers. As a result, dealers are considering other participation program options.

While NCFCs may have served dealership principals in the past, the changed law has forced dealers to rethink this structure moving forward.

There are several types of participation programs available to dealers – some more beneficial than others to a dealer’s financial goals.

Throughout 2019, dealers have taken a closer look at dealer-owned warranty company (DOWC) structures for their dealer group. A DOWC allows a dealer to own, market and sell their own branded F&I program by owning their own company. Besides greater profit potential on F&I sales, another advantage is that dealers can customize F&I offerings. For example, a dealer can build a portfolio of F&I products that cater to a variety of branded vehicles, not just one. These F&I products can range from service contracts to ancillary products.

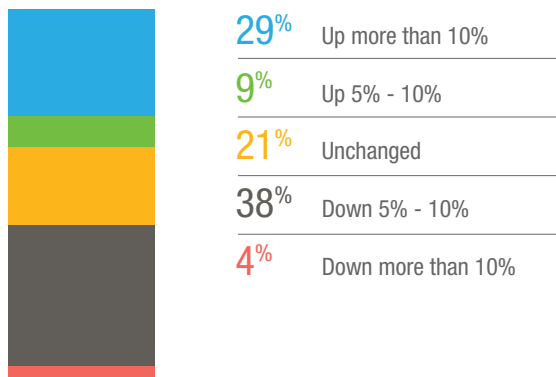
### Participation Program Analysis

Here are some common areas that dealer groups compare when analyzing their participation programs.

	RETRO	CFC	NCFC	DOWC
Product Flexibility and Control	Minimal	Minimal	Minimal	Maximum
Branding	Provider-driven	Provider-driven	Provider-driven	Dealer-driven
Dealer Goal Alignment	Simple Low cost Periodic payouts	More options Upfront costs Investment income	More options Upfront costs Investment income	C-corp Operating costs Investment income
Support and Training	Lower	Higher	Higher	Highest
Administration	Provider	Provider	Provider	Provider with dealer specifications and dealer override authority
Obligor	Administrator	Administrator	Administrator	The DOWC (not the dealership)



# Profitability Outlook for F&I Products

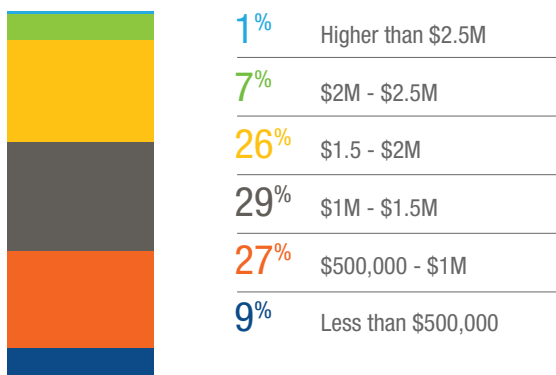
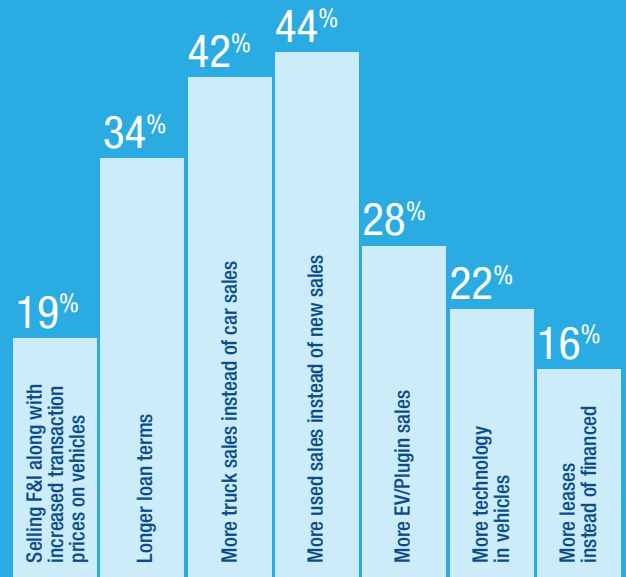


## CHANGE IN SALES OF F&I PRODUCTS COMPARED TO 2018

Given the slight decrease in overall total vehicle sales, 38% of dealers have said their F&I product sales have also been trending down in 2019 between 5% - 10%. However, as a bright spot, half of dealers said their 2019 F&I product sales are either up more than 10% or have remained unchanged from the prior year.

## BIGGEST CHALLENGES SELLING F&I PRODUCTS VERSUS 5 YEARS AGO

The shift to selling more used vehicles is being reported as the largest challenge (43.7%) in selling F&I products. As a result dealers are continually educating themselves on the right F&I products that benefit used car shoppers. Another 42.3% of dealers say their continued focus on selling trucks instead of cars also represents a challenge for finding the right F&I products for customers, followed by longer loan terms (34.2%).



## AVERAGE ANNUAL PREMIUMS OF F&I PRODUCTS SOLD

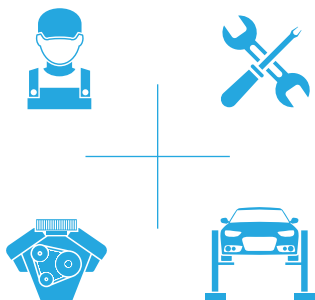
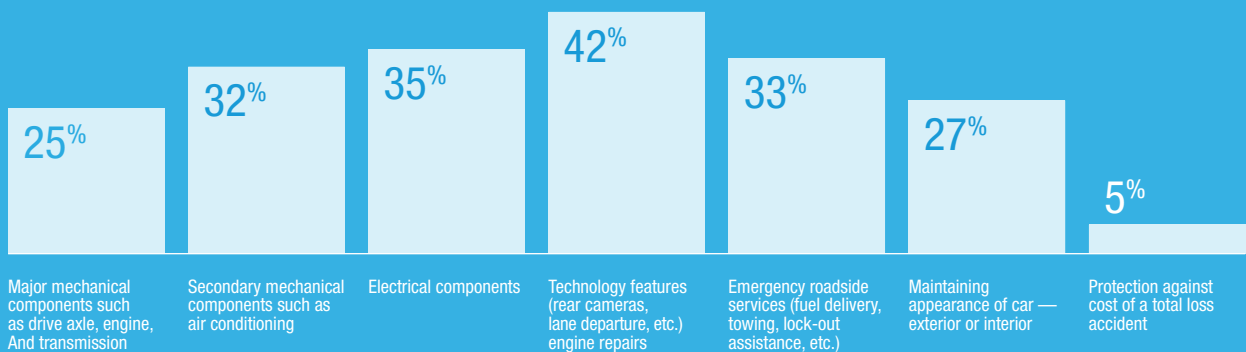
Roughly 29% of dealers report annual premiums of F&I products sold in the area of \$1 million - \$1.5 million. Another 27% list their premiums between \$500,000 - \$1 million.

## VEHICLE TECHNOLOGY

Many of the components driving F&I outlook for dealers is centered on the reasons why consumers are interested in F&I products for their cars and trucks. The largest reason (42.1%) is because of the new technology features now available in cars and trucks, such as rear cameras and lane departure systems. Consumers appreciate what these new technologies bring to their driving experience and are looking to ensure they operate effectively throughout the life of the vehicle. Consumers also cited electrical components (35.4%), emergency roadside services (33%), and mechanical components like a/c as reasons they're investing in F&I products.



### MOST FREQUENT REASONS CONSUMERS NOTE FOR SELECTING F&I PRODUCTS SUCH AS A VSC, APPEARANCE PACKAGE, GAP, ETC.



F&I products are poised to return larger profit potential in the years to come, especially as younger drivers pay a larger out-of-pocket sum for vehicle repairs. In fact, young adults especially could benefit from vehicle service contracts since this age group has been found to pay a larger amount out-of-pocket for repairs. Today's consumers ages 18 to 34 are paying nearly \$700 more than those drivers age 55 and older for maintenance and repairs<sup>11</sup>. The younger demographic is paying an average of \$2,334 on repairs, compared with \$1,654 for older age groups. Dealers have an opportunity to educate on the value found in vehicle service contracts for these customers.

# F&I Product Opportunities and Digital Retailing

Consumers want a digital car shopping experience. In fact, according to recent reports<sup>12</sup>, more car shoppers are willing and likely to start the car buying process online. Approximately 83% of car shoppers indicated online buying technology would help them narrow down their vehicle choice and determine what is affordable.

However, consumers also feel added pressure and frustrations when considering additional products and features for their vehicles – including F&I products. 87%<sup>13</sup> of Americans dislike some aspect of car shopping at dealerships, with the majority saying they feel pressure to buy right away or to buy additional features.

This pressure and mindset can be lessened if car shoppers have information ahead of time on F&I product options so they can learn the benefits of these products in the comfort of their own home as opposed to the dealership where they don't have time to make proper considerations.



The biggest opportunity for dealers remains in the amount of time that it takes a consumer to get through the entire purchase process, especially online. A time-consuming F&I process can be stressful and is the primary source of customer dissatisfaction. Consumers want to complete parts of the vehicle buying process online prior to visiting the dealership and engage with digital technology while at the dealership so they are not sitting idle for hours waiting for the paperwork to be finalized. Addressing these opportunities provides significant benefits to dealerships. As more dealers incorporate F&I product options and education earlier in the process to car shoppers, the greater the chance to include F&I products in the final transaction through a less adversarial environment.

## GROWTH OF DIGITAL RETAILING TO IMPACT F&I

As consumers drive the need to address a digital retail experience, F&I needs to insert itself in this process by:



- Educating consumers on F&I product benefits earlier in the process



- Utilizing easily understood formats like video



- Presenting F&I products in the digital environment



- Incorporating F&I into the complete digital retail experience online



# In Summary

Despite global, economic and policy headwinds there continues to be a bright outlook for today's automotive dealerships. Seasonally adjusted new-car sales are holding steady heading into 2020, and used-car sales are increasing slightly, as consumers look for more affordable options of transportation. As a result, F&I product sales represent high-margin growth areas for dealers,

particularly since many used vehicles will benefit from service contracts and ancillary product programs. Even with a growth of alternative fuel vehicles, which will continue to be technology-intensive, many drivers will need service contract programs that are designed to protect their investments and keep them on the road. A key for dealers will be to leverage new digital retailing strategies, where they educate

and present these additional F&I products online for shoppers conducting their research before they step foot into the showroom for a possible transaction. This will enable a more educated customer on F&I in a less adversarial environment when it comes time to decide on what's best for their automotive experience, leading to stronger customer satisfaction and long-term success.



## Sources

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- 2: [https://www.marklines.com/en/statistics/flash\\_sales/salesfig\\_usa\\_2018](https://www.marklines.com/en/statistics/flash_sales/salesfig_usa_2018)
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## **ABOUT PROTECTIVE ASSET PROTECTION**

Protective Asset Protection has been providing F&I solutions for the automotive industry for over 55 years. We proudly serve thousands of dealerships throughout the U.S. and Puerto Rico, with innovative F&I products, training, dealer participation programs and technology. Our portfolio of vehicle protection plans, GAP coverage, limited warranties and ancillary products provide opportunities to generate revenue with products that help drive customer retention and satisfaction.

Protective Asset Protection is part of the financial services holding company, Protective Life Corporation.

## **ABOUT PROTECTIVE LIFE CORPORATION**

Protective Life Corporation provides financial services through the production, distribution and administration of insurance and investment products throughout the U.S. Protective traces its roots to its flagship company, Protective Life Insurance Company – founded in 1907. Throughout its more than 110-year history, Protective's growth and success can be largely attributed to its ongoing commitment to serving people and doing the right thing – for its employees, distributors, and most importantly, its customers. As of March 31, 2019, Protective had assets of approximately \$92 billion. Protective Life Corporation is a wholly owned subsidiary of Dai-ichi Life Holdings, Inc. (TSE:8750). For more information about Protective Asset Protection, please visit [www.ProtectiveAssetProtection.com](http://www.ProtectiveAssetProtection.com).