Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Economic Letter Series

# An Overview of the Irish PCP Market (Revised Data)[1]

Martina Sherman, Tiernan Heffernan and Bryan Cullen

Vol 2018, No.2

**Abstract**

This Letter presents descriptive statistics of the car finance market in Ireland, focusing in particular, on personal contract plans (PCPs). We provide some stylised facts and an overview of the Irish PCP market, drawing on both qualitative and quantitative surveys. At the end of 2017, €1.4 billion, or 76,582 contracts, were outstanding in PCP-related finance advanced by financial insitutions, and owed by Irish resident households. We find that PCPs are the current driver of the growth in bank-related lending to Irish households for non-mortgage purposes, and have become the most prevalent source of car finance in the Irish market since July 2017. Our analysis indicates that non-banks account for 1 in 6 outstanding PCP loans, with most PCPs being advanced by Irish resident banks.[2]

## 1 Introduction

Personal contract plans (PCPs) have become a feature of the car finance market in Ireland in recent years. As the prevalence of these contracts has grown, they have received significant attention due to potential risks to consumers and financial stability. As reliable data on Irish PCP agreements is lacking, developing an informed understanding of the market has been difficult. As a result, the Statistics Division of the Central Bank of Ireland initiated a survey of the Irish car finance market with the aim of establishing comprehensive and consistent data on the PCP market for the first time. The statistical collection from all bank and non-bank PCP financiers consisted of a quantitative data collection covering the period from 2012 to 2017, and a follow-up qualitative questionnaire.

[1]This economic letter was updated on 13 September 2018 to reflect the receipt of revised data from a small number of reporting agents. While the revision impacted a number of categories, there were large downward revisions to the number of outstanding PCP contracts from one reporting agent. The changes primarily impact section 3.
Corresponding authors: martina.sherman@centralbank.ie and tiernan.heffernan@centralbank.ie. The views expressed in this Letter are those of the authors only and do not necessarily reflect the views of the Central Bank of Ireland. We would like to thank Joe McNeill, Rory McElligott and Aisling Menton for useful discussions and helpful comments. All remaining errors and omissions are our own.

[2]Non-bank entities refer to financial institutions that are not licensed as credit institutions in Ireland.

The note is structured as follows; Section 2 provides background information on PCP products and how they operate. Market-based products and a stylised example are discussed in the context of the Irish market. Section 3 presents descriptive statistics and results from the car-finance survey of banks and non-banks. Section 4 briefly outlines the wider issues that require further consideration. Section 5 summarises and concludes.

# 2. Personal Contract Plans

## What is a PCP and how do they work?

A PCP, or personal contract plan, is a type of hire purchase (HP) financing agreement used for the purchase of vehicles. In a PCP contract, the consumer pays a deposit and continues to make regular payments over the life of the agreement, typically three years. It differs from traditional HP agreements in that there is a large final payment at the end of the contract, as opposed to equal monthly repayments as per a standard HP agreement. Additionally, at the end of the PCP contract, the consumer can decide to return the car to the seller, enter into a new PCP arrangement on another vehicle or, as with HP agreements, purchase the vehicle with a final payment. The consumer is not the owner of the vehicle until the final payment is made, as the lending institution is the owner of the vehicle, as per a traditional HP agreement. In the meantime, the consumer must abide by certain contractual restrictions on usage and maintenance, such as maximum mileage limits and servicing obligations. These conditions can vary across institutions.

The final balloon payment is an amount set at the origination of the contract, referred to as the Guaranteed Minimum Future Value (GMFV), the final bullet payment, or optional final payment. The GMFV is set at the beginning of the contract by the financing entity, sometimes in conjunction with the manufacturer. It is the agreed minimum value of the car, based upon and set lower than an estimate of the vehicle's expected residual value at the point in time when the contract is due to expire. The GMFV is set such that the deposit and the monthly repayments cover the car's depreciation in value, alongside other costs such as the interest expense.

Expected residual values are modelled using historic market databases and applying a haircut to protect against market fluctuations. The model results, alongside proposed GMFVs by the car manufacturers, decide the final GMFV, which in all cases, the lender has final say over. During the survey, lenders indicated their belief that GMFVs are set conservatively, citing possible pricing risks such as the transition to electric vehicles, Brexit and diesel restrictions. The lending institution aims to set the GMFV somewhat lower but relatively close to the estimated value of the car at the end of the agreement, allowing a build-up of equity to part-finance another PCP. Setting a lower GMFV increases the consumer's monthly repayments.

PCPs have existed in the UK for over a decade, and now account for the majority of UK car sales, with Bank of England analysts putting the percentage of new cars purchased using PCPs at 80 per cent.[3] PCPs have become popular in Ireland in recent years, however no reliable data previously existed detailing the size of the Irish market.

## The Irish PCP landscape

The structure of a PCP product differs depending on the vehicle model, manufacturer and finance provider, with variations of the deposit, monthly payments and cost of credit. PCP deposits generally range between 10 and 40 per cent of the car value, with typical deposits advertised at around 30 per cent. Table 1 details a sample of current arrangements available for typical PCP contracts on a range of vehicles, with variations evident across the various offerings.

[3] See Bank of England (2017).

*Table 1: Sample of PCP Product Structures*

| Finance Provider | Model | Retail price | Cost of credit | Deposit % | APR % | Monthly payment | Term (mnths) | GMFV to Value % |
|---|---|---|---|---|---|---|---|---|
| Renault (RCI) | Renault Twingo | €13,990 | €662 | 34% | 3.0% | €115 | 36 | 40% |
| Renault (RCI) | Renault Kadjar | €25,490 | €1,096 | 34% | 3.0% | €199 | 36 | 41% |
| Volkswagen | VW Take Up | €12,495 | €734 | 30% | 3.9% | €159 | 36 | 29% |
| Volkswagen | VW Touareg | €71,995 | €4,483 | 30% | 3.9% | €820 | 36 | 35% |
| BoI | Peugeot 508 | €29,157 | €0 | 36% | 0.0% | €238 | 36 | 35% |
| BoI | Peugeot 5008 | €30,094 | €2,150 | 40% | 4.9% | €258 | 36 | 36% |
| BoI | Lexus RX Hybrid | €86,550 | €6,194 | 36% | 4.5% | €723 | 36 | 41% |
| AIB | Micra 1.2 SV | €16,395 | €1,038 | 30% | 3.9% | €162 | 36 | 40% |
| AIB | Tesla Model X | €115,482 | €16,018 | 25% | 5.9% | €1,036 | 48 | 46% |

Source: All figures sourced from manufacturer websites.
Notes: Typical hire purchase arrangement fees between €63.49 and €150 apply. Data correct as at end-January 2018.

Figure 1 presents a stylised example of the evolution of a PCP contract over a 36-month term. The payment schedule is shown as the blue line. The other two lines represent simplified scenarios of a car's market value at the end of the contract.

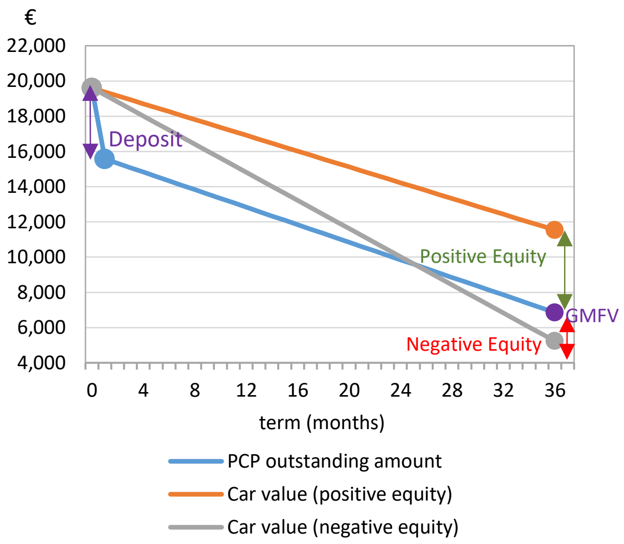
The orange line in Figure 1 illustrates a scenario in which the value of the car is greater than the GMFV at the end of the contract. This creates positive equity for the purchaser of the vehicle. The consumer may now do one of the following:

- Purchase the car outright through cash or by refinancing the final payment;
- Use this positive equity towards a deposit on a new car; or,
- Hand the car back with no further payment.

This scenario (i.e. where the market value is above the GMFV) is the typical situation in the market in recent years. Financial institutions indicated that consumers do not often choose to return the car. Typically they refinance the final payment due at the end of the PCP contract, through either a term loan or standard HP agreement, or enter a new PCP using the equity as a deposit.

The grey line shows the reverse scenario, in which the value of the car at the end of the contract is less than the GMFV. This creates a situation of 'negative equity', as shown by the red arrow. In this situation, the consumer has little incentive to make the final balloon payment, as the car could be returned at no extra cost (provided certain conditions are not exceeded), and a similar quality vehicle purchased at a lower price on the open market. There would also be little incentive to enter into a new PCP arrangement where no positive equity exists to put towards a deposit.

*Figure 1: Stylised PCP example over a 3 year term*




Financial institutions involved in PCP financing assume risk differently in a negative equity situation. Banks and non-bank underwriters of PCPs that are a subsidiary of a car manufacturer assume any loss, as opposed to the car dealership or the consumer. For PCPs underwritten by other retail banks and non-banks, the dealership guarantees the GMFV and therefore absorbs any loss where the resale value of the car is not enough to clear the GMFV. This agreement is enforced by a separate contract that the underwriting institution and garage enter into when a PCP is initiated.

## 3. Data on Irish car finance

The value of the Irish PCP market was €1.4 billion at the end of 2017, with 76,582 contracts outstanding (Table 2). Irish resident banks accounted for 79 per cent of the market in value terms, and 82 per cent in contract terms, with the remainder relating to PCPs advanced by non-bank entities.[4]

Table 2 shows significant growth in the PCP market since 2012, with outstanding contracts increasing from 500 to over 76,000 in five years. New contracts agreed per annum increased from approximately 400 per year to over 30,000 as prevalence of the product grew. New contract average values have decreased over the past number of years, from circa €30,000 to over €25,000. The market growth decreased somewhat in 2017, with outstanding PCP contracts increasing by 31 per cent on end-2016 contracts. This contrasts with strong annual growth in 2015 and 2016, of 139 and 79 per cent, respectively. Additionally, new contracts agreed during 2017 were 6 per cent lower than 2016, but were higher than previous years.

Interest rates charged on new PCPs averaged 4.9 per cent for 2017, with sizeable variation between providers. Annual percentage rates (APRs) as high as 6 per cent and as low as zero per cent are available to consumers, with rates typically lower than other forms of car finance. It is worth noting that the interest rate is applied to the total finance outstanding once the deposit is deducted. In the case of zero per cent offers, the car manufacturer or distributor subsidises the interest rate to the financial institution, leaving the consumer with no interest bill. It was found that the subsidy can be paid from marketing budgets and in some cases the car manufacturers assume the subsidy through a reduction in their margins. Banks charge lower interest rates, on average, than non-banks. New contracts agreed through a bank had average rates of 3.88 per cent in 2017, lower than the average rate on outstanding contracts, indicating declining bank PCP rates in recent years. For non-banks, the average interest rate was higher for 2017 at 5.91 per cent, and was in line with rates on previously agreed PCPs. In terms of further characteristics of PCPs, our findings indicate negligible arrears and default incidence to date. Average deposits on new PCP agreements were 18 per cent in 2017, in line with the previous year. As per Table 1, variations exist between lenders.

***Table 2: PCPs advanced by all Irish financial institutions***

| | Outstanding stock | | New lending | |
|---|---|---|---|---|
| | **€ mn** | **Contracts** | **€ mn** | **Contracts** |
| **2012** | 15 | 563 | 13 | 442 |
| **2013** | 67 | 3,001 | 65 | 2,586 |
| **2014** | 257 | 13,640 | 241 | 10,476 |
| **2015** | 595 | 32,555 | 489 | 21,177 |
| **2016** | 1,079 | 58,393 | 812 | 33,054 |
| **2017** | 1,393 | 76,582 | 768 | 30,964 |

### Bank-funded car finance

All car-related lending advanced to consumers for private use, is reported within *consumer credit* in the Central Bank's *Money and Banking Statistics*.[5]

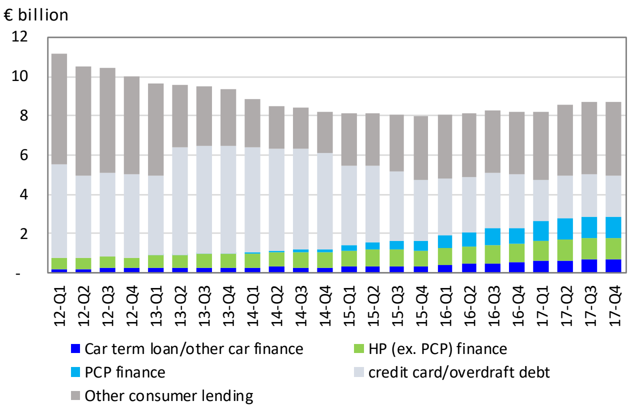
[4] The underlying car finance dataset relating to banks is available here. Further data referenced in this Letter may be added pending quality and series availability.

[5] See Central Bank of Ireland (2018).

At end-2017, consumer credit stood at €12.9 billion, accounting for 14 per cent of total on-balance sheet household credit. These statistics include credit advanced by both credit unions and resident banks only, with credit unions accounting for approximately one third (€4.2 billion) of the consumer credit market. No further breakdown of credit union consumer credit is available and credit unions do not offer PCP financing.

Figure 2 highlights the breakdown of bank-related consumer credit into car-related debt, credit cards and overdrafts, and 'other' consumer credit. The steady build-up of car-related debt, and PCPs in particular, is evident from early-2015. At end-2017, bank-related consumer credit, of €8.7 billion, was split among three broad categories, 24 per cent related to credit cards/overdrafts; 33 per cent to car-related debt; and 43 per cent to other consumer debt. PCP finance accounted for 39 per cent (€1.1 billion) of car-related bank debt at end-2017, up from 15 per cent at the end of 2014.

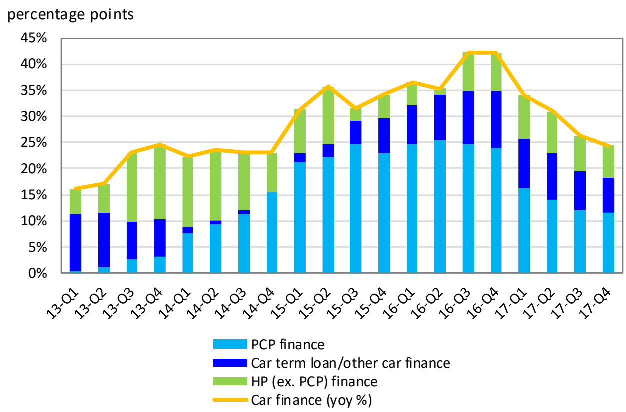
***Figure 2: Bank-funded consumer credit, outstanding stock***




The past three years have seen significant growth in the stock of car-related debt on Irish banks' balance sheets, with an increase of 137 per cent to stand at €2.8 billion at the end of 2017. PCP-related finance was the main driver of this growth, accounting for 56 per cent of the increase. The outstanding amount of bank-funded PCP debt has increased 530 per cent over the past three years.

The strong growth in car-related debt is also the main driver of consumer credit developments at present. Car-finance debt recorded annual rates of growth of circa 30 per cent in recent quarters (Figure 3). While annual growth in outstanding PCP debt has slowed over 2017 compared to 2016, Q4-17 recorded year-on-year growth of 32 per cent. Additionally, PCPs represented the most dominant form of consumer car finance since July 2017, when outstanding PCP debt surpassed the more traditional form of hire purchase.

***Figure 3: Contribution to car finance credit, annual growth***




Four banks currently operate in the Irish PCP market. While there are many car-related banks operating in Ireland, they are not necessarily all involved in the consumer car lending market. Additionally, banks have entered the PCP market at different stages, with some banks being relatively new market entrants.

There was €630 million in bank-funded PCP finance drawn down during 2017, corresponding to 25,934 contracts. This represents a 3 per cent decline on 2016 drawdowns, during which 27,059 contracts were agreed with a value of €649 million. Strong growth was evident in 2015 and 2016, with an average annual increase of 89 per cent per annum in new drawdowns. New contract values for 2017 averaged €24,500, steadily increasing from early 2015, before which they averaged €22,000, when fewer banks operated in the market.

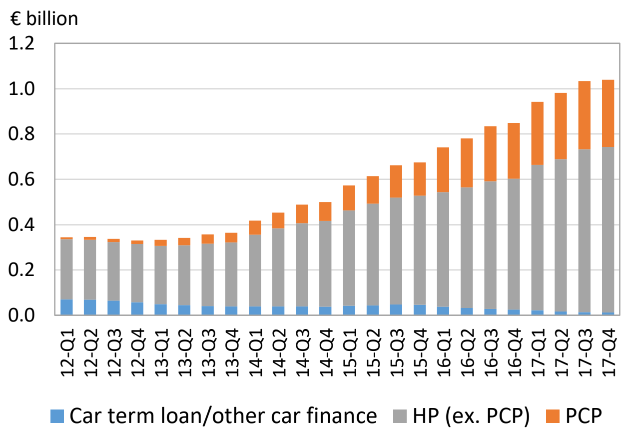
Of note in the data, is that PCPs accounted for almost 35 per cent of car finance drawdowns by value during 2017; however, they represented just under a fifth of new car finance contracts. Contract values for other forms of car finance averaged €11,000 in 2017, suggesting these forms of finance are popular for less expensive and used cars.

### Non-bank car finance

In terms of our non-bank reporting population, we focused on non-banks engaged in the car hire purchase and PCP market. The results show that non-banks hold a sizeable minority share of the PCP market, with €296 million in outstanding loans. At the end of 2017, €1 billion was outstanding in non-bank car-related debt (Figure 4). Much of this debt relates to traditional hire purchase agreements (ex. PCPs), which outweigh PCP agreements by 2.4 to 1. At the end of 2017, PCP finance accounted for 29 per cent of non-bank car-related debt.

Non-bank car-related finance recorded annual average growth rates of 30 per cent for each quarter between mid-2014 and end-2017. Recent growth is driven by non-PCP hire purchase, which increased by 25 per cent over 2017. PCP outstanding debt grew by 20 per cent over the same period, albeit from a lower base; and has seen an increase of 103 per cent over the past two years.

***Figure 4: Non-bank car finance, outstanding stock***




In aggregate, €137 million in PCP finance was drawn down from non-banks during 2017, equivalent to 18 per cent of total 2017 PCP agreements in Ireland. In terms of loan size, non-banks typically agree higher PCP loans than banks, reflective of the car brands financed. New PCP contract values remained broadly static and averaged €27,000 over the data-collection time period for the non-banks.

## 4. Wider considerations and international context

Numerous parties, including the Competition and Consumer Protection Commission (CCPC, 2017), the Bank of England (Bank of England, 2017), and the media have expressed concerns over PCP financing. The CCPC have highlighted the complexity of the contracts, and the risk that consumers do not fully understand the agreements into which they are entering. The Bank of England's focus is on the risks to the car industry itself and the broader economy. Risks relate to falling demand for new and used cars, increasing interest rates and a contraction in residual values that would push contracts into negative equity. This last concern may be particularly relevant for the Irish market. The fall in Sterling due to Brexit has led to an increase in cheaper used car imports, potentially depressing future used car prices and pushing existing PCP contracts towards negative equity. The impact on the entity carrying the shortfall risk will be dependent on how conservative the GMFV figure was set. If it has been set relatively high (i.e. with smaller monthly repayments), then a small decrease in prices could be enough to move the contract into negative equity. This would realise a loss for the entity carrying the shortfall risk.

As PCPs are designed to have positive equity at the end of the contract, it would take a shock to, or miscalculation of, the market to realise the scenario where car dealers and garages are negatively affected. At the end of 2017, Irish resident banks' direct exposure to the Irish motor trade sector is €1.7 billion, equivalent to 4 per cent of total NFC (non-financial corporations) credit.

This is in addition to the €1.1 billion outstanding in PCP credit advanced to Irish households. Current data show that 1 per cent (or 650) of all PCP contracts are in arrears, with almost no amounts written-off.

## Advantages and Disadvantages of PCPs for involved parties

The benefits and disadvantages arising from PCPs are presented in Table 3 below. It provides a non-exhaustive high-level overview of the advantages and disadvantages of PCPs from the perspective of consumers, dealerships and lenders.

*Table 3: PCP pros and cons:*

| Consumer | |
|---|---|
| **Advantages** | **Disadvantages** |
| • Cheaper APR than typical bank term loan<br>• Lower monthly repayments than typical bank term loan<br>• Can obtain more expensive/higher-specification vehicle<br>• Potentially new car every three years<br>• Can return car at end of contract at no extra cost - useful if resale value is lower than GMFV (GMFV offers protection against decline in car value)<br>• Deferral of high proportion of loan principal to end of contract | • Large lump sum due at the end of the contract<br>• Usage conditions impose limitations on use of car and costs if breached<br>• Complex product<br>• Less able to negotiate car purchase price<br>• May opt for higher value car/loan than could normally afford<br>• May need separate borrowing for deposit/final payment<br>• Do not own the car until final payment<br>• Cannot sell the car, without lenders' permission, to finance a new car or for personal reasons |

| Dealership | |
|---|---|
| **Advantages** | **Disadvantages** |
| • Higher new car sales<br>• Do not need to negotiate on car purchase price<br>• Enables selling higher spec cars due to attractiveness of lower monthly repayments/low APR<br>• Fosters return business and brand/ dealership loyalty<br>• Good quality/ servicing record of returning used stock | • Can be liable when the resale value is below GMFV[6]<br>• Must accept car in lieu of final payment if consumer chooses<br>• Dependent on used car market prices<br>• Vulnerable to oversupply of similar cars upon PCP rollover |

| Financing institution (lender) | |
|---|---|
| **Advantages** | **Disadvantages** |
| • Allows for increased secured car finance business<br>• Reduced arrears/ default incidence due to low monthly repayments<br>• Facilitates return business<br>• Loan secured by vehicle asset | • Can be liable when the resale value is below GMFV[7]<br>• Typically lower interest rates received than for other car finance products<br>• Liable in case of default |

## Market size

Using monthly data from the Society of the Irish Motor Industry (SIMI) as a proxy for total new cars sold in Ireland, and comparing it with the number of contracts underwritten by individual reporting entities, indicates that approximately 25 per cent

[6] In situations where the dealership/distributor has guaranteed the GMFV.

[7] In situations where the manufacturer bank has guaranteed the GMFV.

of new cars are financed by PCP contracts. We do not adjust for pre-registrations by dealerships, where vehicles are registered before they are sold, as reliable data is unavailable. While second-hand cars are included in our PCP data, qualitative responses indicate that, on average, less than 10 per cent of PCP contracts relate to second-hand cars.

In terms of developments in new Irish car sales, SIMI data on new Irish car registrations, and CSO data on new private cars licensed, both indicate a decline in the number of new Irish cars sold during the second half of 2017 compared to the second half of 2016.[8] Additionally, car registrations data for January 2018 are down by 5 per cent compared to January 2017. Both CSO and SIMI data show an increase, of approximately 30 per cent, in second-hand private cars imported into Ireland during 2017, compared to 2016, while data for January 2018 shows a 20 per cent annual increase.

### European and UK PCP markets

PCPs are well established in the UK market, where data indicate that 80 per cent of new cars are sold on PCPs. In contrast to the Irish market, non-banks are more heavily involved in the car financing market. The product is also much older in the UK, where rapid expansion in car finance is evident from 2006, with annual growth rates of 20 per cent since 2012. The outstanding value of car hire purchase including PCP agreements in the UK are circa £58 billion, accounting for one-third of consumer credit. Non-banks account for £34 billion of hire purchase finance.[9]

PCP-type products are also offered across Europe. In Germany, the product appears to be less popular than in the UK. *Deutsche Automobil Treuhand* (DAT, 2016) figures estimate that 55 per cent of new cars are purchased using part or full financing, of which PCPs represents one element, alongside more traditional HP options. PCP products differ in some regards in Germany, however. Published advertisements indicate that Volkswagen Germany give the option of extending the PCP contract at the contract expiration, with reduced payments, instead of an option to roll into a new contract on a different car. Mercedes-Benz replace this option also; they grant the consumer the right to sell the vehicle in order to finance the final payment of the PCP.

The French market does not appear to give the option of rolling the contract into a new vehicle at expiration. Instead, it can be replaced with an option of continuing with a new lower repayment. The *Association Française des Sociétés Financières* (ASF, 2018) maintain statistics on the French PCP market for its reporting population, which show that in 2017, €6.6 billion was advanced in PCP-related lending for new cars. This represented a 26 per cent annual increase on 2016, and accounts for 74 per cent of all new car financing during the period for entities reporting to the ASF.

## 5. Summary

In summary, this Letter presents descriptive statistics and stylised facts of the Irish car finance market, and PCP market, in particular. We show that the PCP market currently stands at €1.4 billion, with the majority of PCP contracts underwritten by banks. While we do not address wider policy implications at this juncture, a number of questions arise which have potential financial stability and consumer protection implications. Some important areas to consider are;

- The incentives dealerships/banks offer consumers in an effort to retain and ensure repeat business;
- Increased indebtedness, as analysis suggests that many consumers take out a term loan to finance the final instalment of the PCP, pushing up the overall cost of credit to the consumer;

[8] See CSO (2018) and SIMI (2018).

[9] See Bank of England (2016), (2017), and Bank Underground (2017).

- The extent of affordability and credit checks on PCP finance arrangements; and
- The banking system's exposure to the car finance market in general, should a shock to the second-hand car market occur.

The Irish PCP market is in its early years and some of the above concerns will not yet be examinable. However, using this new data source, we can track and analyse future developments in the sector as they occur.

## References

Bank of England (2016), *Credit Conditions Review,* 2016 Q3, pp. 12-13.

Bank of England (2017), 'Overview of the UK consumer credit market', *Financial Stability Report*, June 2017, Box 6, pp. 18-19.

Bank Underground (2017), Car finance, what's new. Bank of England staff blog. Available from: https://bankunderground.co.uk/2017/08/15/car-finance-whats-new/

CCPC (2017), Announcement on '*CCPC study of PCP car finance*'. Available from: https://www.ccpc.ie/consumers/2017/07/17/ccpc-study-pcp-car-finance/

Central Bank of Ireland (2018), *Money and Banking Statistics*. Available from: https://www.centralbank.ie/statistics/data-and-analysis/credit-and-banking-statistics/bank-balance-sheets

CSO (2018), *TEA12 - Vehicles Licensed for the First Time (Number) by Taxation Class, Month. Available at:* http://www.cso.ie/px/pxeirestat/statire/SelectTable/Omrade0.asp?Planguage=0

SIMI (2018), *Motorstats – the official statistics of the Irish Motor Industry*. Monthly data, by car make. Available from: https://stats.beepbeep.ie/

DAT (2016), *DAT Report 2016*. Available from: https://www.dat.de/fileadmin/media/download/DAT-Report/DAT-Report-2016.pdf

ASF (2018), *Credit a la consommation – statistique mensuelle d'activite* – Decembre 2017. Available from: http://www.asf-france.com/wp-content/uploads/Statistiques/Mensuelle-Express/201712-Credit-a-la-consommation-enquete-mensuelle-express.pdf