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Subprime stips

by Gil Van Over

Stips on subprime deals are a pain in the posterior. Unfortunately, the subprime companies rely on them to affirm the application data is correct. This policy helps them tell the world (re investors) that they have a solid underwriting policy in place and adhere to that policy. Why then aren't the subprimers reviewing the stips that accompany deals? Why are the subprimers purchasing receivables with stips that do not confirm the application data? Because it is the dealer's responsibility.

Background

This little game we play with third party lenders is a little more complex than just submitting a credit app and getting a decision. In most states and with most lenders, the dealer is the creditor and is entering into an installment sales agreement with the consumer. The dealer then looks for a willing third party lender to purchase the receivable from him.

The dealer is not making a loan to a consumer. The lender is not making a loan to a consumer.

As such, the dealer signs a nefarious document commonly titled a Dealer-Lender Agreement (DLA). Most DLAs set forth a number of reps and warrants that the dealer agrees to. If you haven't read yours lately, do so.

A few common reps:

- The application data is correct
- The down payment is not borrowed
- The vehicle's book value is properly stated
- The dealer positively identified the consumer
- The consumer on the contract is the one paying for the vehicle
- Etc, etc, etc

Stips

A deal is often conditionally approved on the dealer providing additional documentation to support the data already submitted, commonly referred to as stips.

Stips can include from proof of income, proof of residence, copies of phone bills, electric bills, bank statements, tax returns, bankruptcy discharge papers, and bookout sheets. This list is not all inclusive, but the underlying theme is to prove one of the three C's of credit: collateral, capacity and character.

Lenders Demand, but Don't Check

Too many dealers are reporting that subprime lenders are asking for payoffs on defaulted transactions because the dealer did not satisfy the stip requirement at funding, or that the stip turned out to be a fake. Dealers wonder why the third party lender did not review the stip in detail when the deal was submitted for funding.

The answer – they don't have to. Under a standard DLA, it is the dealer's responsibility to make sure the stips are correct. In the past, apparently some lenders have loosened their internal funding processes. The analyst continued to stip the deal to make it look like the lender is adhering to its underwriting standards. The funding clerk apparently checked off that there is a POI in the file; he or she just didn't take the time to check the validity of the POI.

When the deal becomes a repo, the collector scrutinizes the POI and the lender asks the dealer for a payoff check. If it is a federally insured institution, it likely also files a Suspicious Activity Report.

Solution
Dealers looking to protect themselves against requests for payoffs must do two things.

First, have your attorney review your DLA. If the language in the DLA appears to put the entire burden of proof on the dealer, attempt to insert some modifying language. Some attorneys I work with suggest starting with "To the best of the dealer's knowledge" or something like that.

Second, modify your stips process. No longer can you just collect and send off. Now, you must collect the stip, review it for consistency and accuracy, copy it for your file and send the original to the lender.

Gil Van Over is the President and founder of gvo3 & Associates, a nationally recognized F&I, Sales and Red Flag Rule compliance consulting and training firm (www.gvo3.com).

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