

Cycles, Slumps and Compliance

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If you've been in the auto industry for any length of time you know the business is cyclical and subject to slumps. By definition, a business cycle is economic activity usually consisting of a recession, recovery, growth and decline. In that cycle, a slump is a marked or sustained decline in economic activity or prices. Being in a down cycle or slump means you're selling fewer cars and have fewer opportunities to sell F&I products.

Unless you have an unlimited supply of hybrid vehicles, most dealers would agree that we are in a slump. However, this one seems different than other slumps because it is the first one we've had since compliance took hold of the industry. You may think that the introduction of new laws, stepped up enforcement of older laws, and the ongoing attack of plaintiff's attorneys has forced dealers to a new level of compliance. While this might have been the case early on, many dealers soon realized compliance and profitability are not mutually exclusive. Dealers have made significant strides over the last six or seven years, and developed varying levels of sales and F&I compliance programs in their dealerships. Those who have committed to full disclosure and have instituted formal compliance programs are realizing higher F&I revenue per retail.

With lower sales and fewer F&I opportunities, it's inevitable that some dealership employees will revert back to the old tricks of the trade in order to sell a few more cars and max out each F&I opportunity. That's why it's important for compliance to start at the top. Dealers and general managers need to monitor the sales and F&I practices at their dealerships and ensure employees don't step back into the "good old days."

Regulators have already indicted more than 400 real-estate professionals since March for mortgage fraud, so you can bet they'll keep a close eye on the auto industry as well. In one article about the arrests, FBI Director Robert Mueller warned: "To people who have committed fraud or are contemplating to do so, we will find you, you will be investigated, and we will prosecute you."

{ +PAGEBREAK+ } **Here are a few suggestions to help you monitor your sales and F&I activities:**

Reviewing Deal Jackets

Nothing is more telling than the contents of a deal jacket. Think of the last time you had a customer complaint or the threat of a lawsuit. What was the first thing you did? Did you pull the deal jacket? Which ones should you pull? Subprime deals are a good starting point, you know, the deal jackets that are over an inch thick. Just review each document in the file; you'll be surprised at what you'll find. A good practice is to review three or four per F&I manager per month.

Establishing Pricing Guidelines

If you have pricing guidelines for unregulated F&I products, have your controller create an exception report that highlights when a product is sold over the limit. The report should be reviewed weekly. If you don't have pricing guidelines, this would be a good time to establish them. They should be reasonable and based on a maximum selling price or a maximum gross profit. Having to explain why you made a \$3,000 profit on a service contract to someone's grandmother is not a good thing.



 **Three Ways to Eliminate Fraud**

The most common types of bank fraud are straw purchases, misrepresentation of consumer information, such as residential, job and income history, and power booking, where equipment is included on the book-out sheet but is not on the vehicle. Remember, when a federally insured bank or credit union identifies fraudulent activity, they are required to submit a SAR (suspicious activity report) to the U.S. Department of Justice.

1. How to detect a possible straw purchase:

- Credit bureau report in the file is under a name other than the buyer or co-buyer.
- Several fax backs with a name not used on the final deal
- Rewritten deals with different names included in the same deal file.
- Name issued on insurance card is not the same one listed on the deal.

2. How to detect falsified credit applications:

- Look at the handwritten credit application for alterations not initialed by the customer.
- Print several DealerTrack, RouteOne or CUDL credit applications and compare them to the handwritten credit applications in the deal jacket. Check five applications per month per F&I manager.

3. How to detect and prevent power booking:

- If you use an automated inventory system to post vehicle pictures and equipment on the Internet, compare the equipment listed on the book-out sheet to the equipment listed in the inventory system.
- Require all managers who create a book-out sheet to sign the book-out sheet.
- Do not allow F&I managers or special finance managers to create book-out sheets.

Catching Payment Packing

Payment packing in most states is considered an unfair and deceptive trade practice. The practice typically occurs during the desking process when the costs of F&I products are included in the payment, but are not disclosed to the customer. Another form of payment packing is when you condition the customer to a higher payment by using an unrealistic rate or term to quote payments. An easy way to detect the possibility of payment packing is to look at the base payment on the F&I menu:



- Is the rate used to calculate the desk quote always higher than the base menu rate?
- Is the payment the customer agreed to in sales always higher than the base menu payment?
- Is the term agreed to in sales generally lower than the term used for the base menu payment?

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Financing Negative Equity

The last statistic I saw indicated that about 40 percent of all used-car trades are upside down by an average of \$3,000. In an attempt to get customers financed, sales and F&I personnel may disguise the amount of negative equity by overstating the trade value to the bank or sales finance company. This practice is potentially a violation of the Truth in Lending Act of 1968 and a violation of the dealer-lender agreement. Don't be fooled into thinking that you can arbitrarily increase the price of a used-car after a retail price is established to cover negative equity. Here are three ways to detect improperly disclosed negative equity:

1. When the trade allowance is the exact amount of the trade payoff.
2. When there is a high amount (over 110 percent of the appraised value) of over allowance on the deal.
3. Compare Internet listings, newspaper ads and inventory reports of advertised vehicle prices against the selling price of deals with negative equity.



Giving Cash Back to Customers

Other than giving some or all of the trade equity back to a customer, giving cash back to the customer can be problematic. Also known as a dealer rebate, cash back occurs in a variety of ways. Some dealers use cash back promotions to increase floor traffic by promising customers extra cash to pay bills or buy gas. Another scenario is when a financing source requires that a customer pay off an unrelated loan or remaining payments on a lease to meet a required debt-to-income ratio. In other cases, the customer may want additional cash to buy vehicle accessories the dealer doesn't offer.

There are two issues with giving cash back to the customer. The first issue could be that the bank or finance company doesn't know the customer is getting cash back, which means you have misrepresented the deal terms and violated your dealer-lender agreement. The second issue is that cash back is technically a direct loan to the customer. The problem there is dealers are not licensed to make direct loans. Remember, your sales finance license allows you to finance cars, not money. Banks and loan companies are the only ones allowed to do that. If possible, approve of all check requests for cash back to a customer.

Responding to Identity Theft

Identity theft is the No. 1 criminal activity in the country and car dealerships are a big target. Red Flag Rule solutions are being finalized and will be available prior to the government's Nov. 1, 2008, enforcement date. Currently, all of the credit reporting agencies provide fraud related information in their reports, including consumer fraud alerts, military active duty alerts, address discrepancies, social security number variances, and name and employment information.



Dealers should institute processes to ensure that fraud related information in each credit report is reviewed, customers with posted fraud alerts are contacted, and notations are made about how any identified and potentially fraudulent issues were cleared.

{ +PAGEBREAK+ } Instituting an Information Security Program

The Safeguards Rule, a provision of the Gramm-Leach-Bliley Act, required dealers to develop a written information security program (ISP) detailing the physical, electronic and administrative controls used to protect a customer's non-public information. Another provision requires businesses

to appoint a compliance officer to manage the program. Dealerships may fall victim to both external and internal schemes, or may unintentionally compromise their customer's non-public information. In either case, you will be asked to demonstrate your efforts to maintain the requirements of the Safeguards Rule. Remember to verify that an ISP has been implemented in your dealership and regularly updated as required by the Safeguards Rule.



Reviewing Window Addendum Stickers There are potential issues with information included on new-car window addendum stickers. Including soft add-ons, (e.g. surface protection products, theft deterrent products, or other F&I-related products) to the selling price of the vehicle may be considered an unfair and deceptive trade practice. The same goes for low-cost, high markup accessory packages. The National Association of Attorneys General have found these practices to be unfair and deceptive for two reasons. First, adding products and accessories to the selling price can give customers the impression that the products are not optional. Second, these products are offered only as a highly marked up discounting tool.

There is nothing wrong with disclosing additional dealer markup on hard-to-find, short supply vehicles. But a bank or sales finance company may have a problem when additional dealer markup is included with every vehicle. In those cases, the value of the collateral is overstated, which is a violation of the dealer-lender agreement.

Outside Sales Promotions

When business slows down, sales promotion companies will typically begin offering guarantees of more floor traffic, higher grosses, and improved F&I income per retail. Be very cautious of promotional companies who insist on having their teams take over your sales and finance desks. Compliance related issues usually don't surface until months after the promotion.

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