



Recognizing and Reducing Risk

Compliance in F&I is an Absolute Necessity

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The automotive industry is heavily regulated and faces **increased scrutiny**, particularly regarding finance and insurance practices. Government agencies, especially state attorneys general, increase their vigilance around finance transactions during recessions. Dealer transactions are at the forefront of this scrutiny.

To complicate matters further, the troubled banking community is raising expectations for compliance in underwriting vehicle transactions. Consumer groups are advancing a number of issues that will create **additional regulatory burdens for dealers**. Now more than ever, dealers should pay attention to their practices and processes in finance and insurance activities.

Think about it this way: Addressing compliance issues is similar to repairing a car. You can go ahead and deal with the inconvenience now while the cost is minimal, or you can wait until you're forced to do it, risking exorbitant cost. Managing compliance is also like insurance – maintaining it is far less costly than being caught without it. To be prepared, you should be asking the following questions. **What issues and regulations should I focus on now? What are some practical steps for protecting my dealership? What potential issues and regulations are looming?**

Where to Focus Now

Maintaining the right balance between meeting compliance requirements and running a profitable business can be difficult. It's important to know where your focus should be right now. Here are some key regulations you should be actively addressing in order to limit your exposure:

- The **USA Patriot Act** requires dealers to screen all consumers, prior to any sale, against the Office of Foreign Assets Control (OFAC) list of terrorists, drug traffickers, and money launderers. Every customer, cash or credit, must be checked against the list.
- The **Equal Credit Opportunity Act (ECOA)** and **Credit Reporting Act (FCRA)** require dealers to provide the consumer with a notification of adverse action when credit is denied, even when the financial institution sends a separate credit denial notification.
- The **Fair and Accurate Credit Transactions Act (FACT)** amends existing regulations governing how consumer credit data must be handled. Among other things, it requires dealers to take measures to ensure they are actually dealing with the person seeking credit in situations where an extended fraud alert is placed on the consumer's credit report.
- The **FTC Credit Practices Rule** requires dealers to provide a written notice to potential co-signers about their liability if the other person fails to pay, prohibits late charges in some situations, and prohibits creditors from using certain contract provisions the government has found to be unfair to consumers.
- The **Truth in Lending Act (TILA)** requires dealers to provide written disclosure of important terms of the credit agreement, such as APR, total finance charges, monthly payment amount, payment due dates, total amount being financed, length of the credit agreement, and any charges for late payment. Historically, state attorneys general did not have the authority to enforce TILA. Now, since the Omnibus Appropriations Act 2009, they can. Any dealer who uses retail installment sale contracts and consumer lease contracts is affected.
- The **Safeguards Rule** requires businesses to develop and implement processes to protect consumer information from the risk of fraud and identity theft and to confirm that vendors they do business with are doing the same.

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In light of these regulations, what are some practical steps you can take to protect your business?

Steps for Reducing Risk

Addressing these regulations isn't necessarily expensive. Much of this compliance effort can be addressed in-house. Believe it or not, government agencies and the courts will be far more lenient if you make some modest effort to comply with these legal demands. Here are some practical ways to address some of the challenges you face today:

- Support national and state **dealer associations** and other industry groups that are lobbying against harsh legislation.
- Take advantage of **free sources** of compliance information and support, such as NADA, state dealer associations, government sources – FTC, FRB, state attorneys general, state DMVs – and their Web sites.
- Consider designating a **compliance officer** on your staff (perhaps the F&I director or controller) or use a consultant to review your dealership policies and practices.
- Have the designated person become **AFIP-certified** (Association of Finance and Insurance Professionals).
- Make sure employees understand what practices are illegal by regularly auditing processes and conducting **compliance training**.
- Implement a **standard process** for all deals. Software solutions can help ensure all documents are properly populated and taxes and fees are calculated correctly. They can also catch mistakes and missing pieces of information that could cause problems down the road. Software can help with your compliance burden by automating tasks so you can stay focused on managing your business.
- Rely on **reputable vendors** that can substantiate their due diligence regarding compliance.
- Always have a **permissible purpose** to pull a credit report. Most credit applications contain language where the customer agrees you can access their credit report.
- Run an **OFAC check** on every customer. If a positive match is found, follow steps outlined on [OFAC's Web site](#) to determine if the match is valid. Software solutions are available for automating this process and assisting with due diligence.
- Dealers should already be complying with the **Red Flags Rule**. Keep in mind that your program should consider activities and patterns that indicate the possible existence of identity theft. Put procedures in place to detect, evaluate, and respond to red flags. Periodically update the program for changes in risk to customers that are detected during your dealership's daily experience and for new identity theft activity of which you become aware. A number of software solutions are available to help quickly and effectively confirm a customer's identity to minimize fraud-related losses. Dealers who are victims of identity theft are often forced to repurchase the contract from the lender and will not recover the full vehicle value.
- Look for conditions that would require an **adverse action notice**. If you take a customer's credit application but cannot find a lender who will accept the original terms of the deal, or you decide not to send the credit application to a lender because the credit score is below the threshold of the lenders you do business with, you need to send that customer an adverse action notice. The same is true for when you spot-deliver a vehicle and no funding source will accept the original terms of the deal or your customer rejects a counter offer. Put procedures in place to ensure letters are sent out in a timely manner and records are maintained for the required amount of time.

In light of these regulations, what are some practical steps you can take to protect your business?

OFAC's Web site:
www.treas.gov/offices/enforcement/ofac/

Over 9 million adults in the U.S. were victims of identity fraud in 2008, an increase of 22% from 2007.

Source: Identity Fraud Survey Report by Javlin Strategy and Research

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- Create and implement an **information security program**. Make sure unique user names and passwords are in place and change them regularly. Consider both physical and system access security. Limit customer information access to individuals who need it in the conduct of business.
- Follow **record retention** rules for various deal documents. To reduce the possibility of data theft, avoid storing customer information (both hard copy and electronic) longer than necessary.
- Discuss **all products** with each and **every consumer**. The use of an electronic menu can help with controlling pricing of products, disclaimers, and documenting the process you followed. Require a signed menu for the final transaction.
- **Review deal documents and forms** periodically to ensure they continue to meet the requirements of the law regarding mandated formats and disclosures.
- **Address complaints promptly** with a dedicated telephone line.

By implementing these practical steps requiring minimal effort, you can mitigate liability. Be aware, though, that other issues and regulations could be coming around the corner.

Impact of Looming Regulations

Dealership finance and insurance activities continue to be eagerly regulated by government. Consumer interest groups and trial lawyers, combined with a sympathetic Congress, president, and state attorneys general, are expanding the boundaries of enforcement like never before. Profit limitations, reduction of legal protection for dealers, and forced product offerings are all possible in the near future. Developments under way include:

- **New Buyers Guide**

The Buyers Guide might be substantially revised, affecting every used vehicle for sale. The model being discussed includes information concerning the vehicle's history.

- **National Car Buyer's Bill of Rights**

Bill HR 2309 could greatly expand the FTC's enforcement authority. It would specifically direct them to engage in rulemaking that would eliminate spot-delivery transactions and impose a cooling-off period on car financing transactions, dealer finance charge markups, and additional regulation of the sale of F&I products.

- **No More Arbitration but More Class Actions**

Arbitration is a fair and economic way to address consumer complaints. However, bill HR 1020 would discontinue the rights of dealers to use arbitration. Dealers should be using appropriately drafted arbitration provisions to avoid annoying lawsuits or, worse, class actions.

- **Severe Limitation of Interest Rates Dealers Can Charge**

Two bills, S 500 and S 257, could have a devastating effect on interest rates in vehicle transactions. S 500 would place a limit of 36% on vehicle transactions, but the calculation method to determine this 36% is far easier to exceed than the current APR calculations. In addition, the method is confusing. S 257 would deny creditors the right to claim the vehicle in a bankruptcy proceeding should the interest rate exceed a conservative formula for a rate cap. This would tighten credit as higher risk-based rates would not be offered by financial institutions to dealers since a bankruptcy remedy would be eliminated. Sub-prime financing could become more difficult.

- **Consumer Financial Products Safety Commission**

A sweeping bill, S 566, would create a very powerful commission similar to the Consumer Product Safety Commission that would address credit and finance products. It would have the potential to set credit terms, conditions, and rates. It could also dictate which products and services could be offered to the public and would rate financial products.

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When comparing FICO's month-over-month, scores have been slowly creeping downward since January 2009.

Source: CNW Research

- **Consumer Financial Protection Agency (CFPA)**

Bill HR 3126, all 229 pages, is an ambitious attempt to restructure financial regulation in the United States. Rulemaking and enforcement functions would be transferred from other federal agencies to the CFPA for all consumer credit statutes such as TILA and the ECOA. Jurisdiction over those involved in financial transactions and how financial transactions are defined would be broadened substantially. Fiduciary obligations would apply in business transactions where they never have been applied before. However, as this paper is being written, changes are being discussed that could exempt auto dealers from being subject to the CFPA.

The CFPA would also have the authority to issue rules addressing unfair and deceptive acts and practices pertaining to this broad expansion of financial activity and the parties involved. The plan empowers the new consumer protection agency to “prohibit or impose conditions or limitations” on forced arbitration for disputes arising under consumer protection laws if the CFPA determines it would be “in the public interest and for the protection of consumers.

You will want to stay informed about future developments on these potential regulations in order to protect your bottom line and the ongoing life of your business.

Conclusion

Thousands of lawsuits are filed every year against car dealers. These complaints average \$3,000 but often end up costing 20 to 30 times that because of attorney fees. The importance of recognizing and reducing risk is evident, and for the sake of your business, compliance is an absolute necessity.

Keep in mind that complying with the law is not an overwhelming challenge. If you haven't done so yet, make your repairs now. Don't wait and risk your business with penalties, fines, and legal challenges. The fact that the economy is difficult will not prevent lawsuits or enforcement actions. More than likely, they will increase. Regulators and consumer attorneys are not sympathetic to the plight of automotive dealers in these difficult times. But, complying with these requirements can be done effectively with modest expense if you are aware of the issues.

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About the Author

Terry O'Loughlin is presently the Director of Compliance for Reynolds and Reynolds. Prior to joining Reynolds in 2006, he served for 15 years in Florida's Office of the Attorney General, Economic Crimes Section, investigating and prosecuting non-compliant automotive dealerships, manufacturers, and finance and leasing companies. At his direction, over 100,000 dealer files were examined during that time and he settled with over 1,600 dealers for a total amount in excess of \$15 million. He was the mediator of Florida's Motor Vehicle Lease Disclosure Act, a statute he helped draft. Terry has also served as a government consultant, appeared on national television, and written various articles about the industry. He holds a Masters Degree in Business

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