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5 steps to ensuring your dealership is F&I compliant, and free from costly penalties

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THE ISSUE:

CREDIT STORAGE APPLICATION

What might be happening in a dealership:

Peter Jones, an expert in finance and insurance compliance at Galt Enterprises, set up a common scenario dealers might face.

"On defined applications, the first thing is that the dealership is required to store defined applications for 25 months," Jones said. "On an approved application where a loan is consummated, the app goes to the lender, so the lender is storing it. On a declined application, by law, any time a customer is refused credit, by law, they are required to receive an adverse action letter."

What's wrong, and what fines the dealer faces:

"The rules they break there are, number one, application retention, and it must be in a stored secure environment. That's the safeguard rule. So it has to be in a locked filing cabinet or inside a locked room or it has to be inside a secured storage area," Jones said.

By failing to properly store or retain applications, the dealership would be in violation of the Federal Trade Commission's Safeguard Rules, which are part of the Gramm-Leach-Bliley Act.

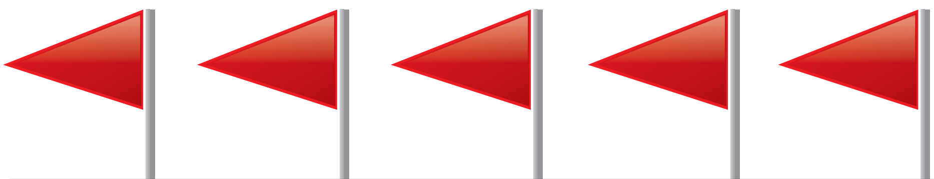
$11,000 per occurrence

Expert advice

- "The first thing for any dealership is to take a tour and see if they find any pieces of paper that contain any pieces of customer information that they can't find in the phone book. If the answer is 'Yes,' then that information must be secured," Jones said. "Personal, non-public [information] is how they phrase it in regulations [date of birth, driver's license number, social security number, etc.]."
- "The best thing the dealership should do is really put together a checklist. Go through it and look at their own dealership and say 'Where are our weaknesses? Do we secure the information? Do we have locked filing cabinets and locked offices?'"

THE ISSUE:

RED FLAGS RULE



What might be happening in a dealership:

Nat Franklin, director of operations for FreedomRoad Financial, has seen what can happen to dealers when they fail to adhere to the FTC's Red Flag Rules – particularly when that dealership has more of a national presence or is close to the border of another state.

Franklin offered a situation in which an out-of-state customer who has never been in the store contacts a dealership. The customer sees a motorcycle online, applies for credit and gets approved. Because the dealer had never met the customer, the dealer wants to find a way to protect himself.

Another scenario could include a customer who provides identification that looks suspect.

What's wrong, and what fines the dealer faces:

Dealers are required to have a program already in place to deal with such situations.

"They really need to have a program in place that has to be consistent," Franklin said. "Everyone in the dealership needs to understand the procedures. If they don't – if there's an issue with it – not only can they have a customer who goes bad from a lending side of it, but there are also regulations and penalties in place for the dealership."

"There are not only financial, but also reputation risk. Regulators can come in, look at the dealership, look at the procedures, look at how they do everything, where they keep the information. You certainly don't want to be in that seat," Franklin added.

"There are no criminal penalties. It's just going to leave the dealership at risk. If someone falls victim to identity theft in their store, they can file civil charges against the company and the dealership. It's not necessarily fines and things like that. They certainly could be taken to court by an identity theft victim."

Possible civil charges against the dealership that could result in an untold amount of money.

Expert advice

- "There are 26 specific Red Flags," Franklin said. "You look at the ones that are mostly relevant to your business. We recommend that the dealers have a kind of spreadsheet that denotes each one."
- The spreadsheet should include the list of Red Flags, a prevention and mitigation procedure for each Red Flag, and a resolution for each.
- "For example, the Red Flag is that the ID appears to be altered or forged, or the customer is using a driver's license that looks funny for whatever reason. The mitigation would be to stop the application process and require additional satisfactory information to identify. You get that second form of ID. And the resolution would be to provide that additional documentation and you proceed. So if you have a step-by-step process like that for the dealership, that's probably the best bet," Franklin said.
- "The little things you gloss over as a dealership, you've got to look at the DOB, and you've got to look at the social security number, all of that stuff. You've got to look at it more carefully. It just protects you," Franklin said.

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THE ISSUE:

FAIR CREDIT REPORTING ACT

What might be happening in a dealership:

Param Ramakrishnan set up a situation in which it is quite easy for a dealer to fail to comply with the regulations within the Fair Credit Reporting Act. Ramakrishnan is the chief technology officer of indirect lending at Wolters Kluwer Financial Services, with more than 10 years of experience in the financial services industry to help powersports dealers and lenders efficiently manage compliance requirements and mitigate risk.

A customer enters the dealership and picks out a motorcycle. As part of the sale, the customer meets with the F&I manager, who pulls the customer's credit rating. The customer has bad credit and the F&I manager knows that none of the lenders will be able to help. The F&I manager then informs the customer that no credit will be extended and the sale cannot be completed.

Risk-based pricing is also a practice in which dealers can get tripped up. A dealer might be able to grant credit to the customer based on one of the lenders, but the terms being offered to the customer are materially less favorable than the general population or the most favorable terms available, according to Ramakrishnan.

What's wrong, and what fines the dealer faces:

In the first scenario, if the dealer elects not to submit the application to any lender because the customer does not meet the criteria, then adverse action has taken place. The dealer is responsible for providing an adverse action notice to the customer.

In the second scenario, Ramakrishnan explained, "If you're extending terms to the customer but you have undertaken a risk-based customer and the terms the customer is getting, if he has a lower credit score so he's getting a higher rate, you need to disclose that fact to the customer."

"Consequences for non-compliance related to the Fair Credit Reporting Act vary according to the circumstances and the violation," said Ted Dreyer, senior attorney at Wolters Kluwer Financial Services. "In many cases, the violations involve large numbers of consumers, which multiplies the penalties. There have been a number of cases brought by the Federal Trade Commission that have resulted in large money penalties, some in the millions of dollars." In addition, section 616 and 617 of the Fair Credit Reporting Act provide for consumers to seek civil damages, including punitive damages in some cases."

Fines vary, but potentially millions of dollars.

Expert advice

- "Make sure that as part of your training of your finance managers – whether it's internal or external – that you present an adverse action notice if you're not able to extend credit to that customer. Make sure that's being done 100 percent of the time," Ramakrishnan said. "Make sure you have some type of spot check from time to time or, if you have some type of software system, it is capable to audit that a disclosure was provided."
- "You're going to need some type of system that will keep track of that for you. The same would extend for risk-based pricing on the ones where you are making an extension of credit offer. Make sure you're able to document and prove that a credit score disclosure notice was provided," he added.

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THE ISSUE:

GRAMM-LEACH-BLILEY ACT

What might be happening in a dealership:

Param Ramakrishnan is the chief technology officer of indirect lending at Wolters Kluwer Financial Services, with more than 10 years of experience in the financial services industry to help powersports dealers and lenders efficiently manage compliance requirements and mitigate risk. He offered a situation in which it is quite easy for a dealer to fail to comply with the regulations within the Gramm-Leach-Bliley Act.

A common situation would be when a customer comes into the dealership and submits a credit application. The dealer sends that application to one or more lenders to see if they're going to be interested in purchasing that installment contract from that customer. However, the credit application that the dealer has used does not disclose the lenders by name. Additionally, the dealer has not provided the customer with a privacy notice.

A violation of a safeguard rule is $11,000 per occurrence.

What's wrong, and what fines the dealer faces:

"Technically there's information sharing going on there," Ramakrishnan explained. "If I'm a customer signing the credit app and the dealer is going to send this to three different lenders, the customer needs to know that. The best practice would be to name each specific lending institution as well."

"The second aspect [of GLBA] that most dealers don't know is the Safeguards Rule," Ramakrishnan said. "What that states is that dealers must design, implement and maintain safeguards to protect this customer data that they're getting. Part of that also includes development, implementation of and monitoring and testing of an information security plan. All the way from paper, deal jackets, credit applications, to even software systems. How are they protecting and safeguarding the customer data?"

A violation of a safeguard rule is $11,000 per occurrence, which could lead to millions of dollars in fines, but there's the additional risk of consumers pursuing class action.

"Then there are all those burdens and costs and reputational risks that a dealer needs to be concerned with," Ramakrishnan said.

Expert advice

- "Make sure you have an audited process to ensure that you're providing each one of your customers with a privacy notice. Every dealer can implement it differently," Ramakrishnan said.
- "Go through your processes and ensure that whether it's on the sales side or the F&I side, that all of the right disclosures, notices and forms have been provided to the consumer and that you have a way to audit and prove that. There are a lot of organizations out there that provide consulting on it, and tool kits for that matter," he said.
- "Red Flag rules state that the dealership must develop and implement an identity theft prevention program. They must designate a compliance officer and must update or review that program every year. So again you can go and get tool kits. It's going to be a Herculean task for a dealer to create a program from scratch," Ramakrishnan said.

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THE ISSUE:

TRUTH IN LENDING ACT

What might be happening in a dealership:

Peter Jones, an expert consultant in finance and insurance compliance at Galt Enterprises, has seen a very common violation of the Truth in Lending Act.

"Dealerships will say, 'Well, I have to quote payments to my customers on the floor in order for them to buy.' They can do that, that's fine. It's not illegal to quote a payment. There are just laws on what payment you can quote," Jones said.

"Dealers will pack the payment. Let's say the bike is $10,000, and they'll add $30 to the payment or they'll figure the payment, but add $1,500 to the amount financed." Another factor in truth in lending is that dealers must be using the latest contracts per federal regulations.

What's wrong, and what fines the dealer faces:

In the situation in which a dealer quotes a price to a customer, the dealer must do so within the laws of Truth in Lending. If the dealer is packing payments, that dealer is committing a criminal offense as part of Truth in Lending.

In keeping up with changes to regulatory acts, Jones said the onus is on the lender to provide the most up-to-date contract to the dealer.

"At the end of the day, the lenders are responsible to provide that dealer with the contract that meets the rules. That will fall under lender liability, so if there was a problem with it, the liability would be on the lender and not the dealer," Jones said.

Fines vary, but potentially hundreds of thousands of dollars.

Expert advice

- "Dealers should hire some sort of consultant to come in and help them out with compliance. If not, appoint someone within the dealership to be the point person for it," Jones said.
- "The local, state and federal governments are very short on funds right now, so they're constantly looking avenues of revenue. The easiest way for them to do this is through fines. We know police departments have done this for years. When they need to raise money, they write more tickets. The same holds true with every federal agency. They need revenue and they get fines. They will be looking for more of these things. They will send people out looking for Red Flag Rules, looking for safe guard, looking for application retention security. They will be doing more audits. It's just something that will happen and is happening, I'm sure," he said.

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