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FINANCE & INSURANCE

Retailers' need for compliance intensifies

As F&I oversight grows, vigilance and technology can thwart fraud

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As the economy worsened and credit tightened during 2008 and 2009, temptation rose for dealership finance employees across the country.

With banks pulling back, it suddenly became much tougher to match a car buyer with a willing lender. And some dealership employees, assisted by technology that makes faking documents easier, succumbed to that temptation, one industry watchdog reports.

"Clearly, when credit started to tighten up, there seemed to be a spike in smoking the credit application or smoking the worksheet," said Doug Walsh, senior assistant attorney general and consumer protection chief in the state of Washington. "Some of this has been reported to us by banks."

The biggest increase, Walsh said, involves falsifying credit applications -- creating nonexistent income or reducing debt to make the borrower's debt-to-loan ratio more appealing. Dealership staff can be complicit "to get deals bought that wouldn't otherwise get bought or to get them bought at terms they otherwise wouldn't have got bought at," he said.

Walsh had only anecdotal evidence -- his department hasn't collected statistics showing an increase. But his recent experience only reinforces the vigilance dealers must have about compliance in the finance and insurance office. And though dealerships were exempted from oversight in the new Financial Reform Act, the additional scrutiny it brings for lenders -- plus other pending oversight, such as enforcement of the Red Flags Rule -- heightens the need for dealers to be vigilant.

The risks are huge. They include lawsuits, civil fines and penalties that can cost hundreds of thousands of dollars and even criminal charges and prison time. Accused dealerships face being cut off by lenders and shunned by consumers.

In September 2008, the Washington attorney general settled with Kane Automotive Group Inc. and Wenatchee Valley Truck and Auto Outlet Inc. over allegations they violated consumer protection laws and submitted false credit applications to banks. The dealerships admitted no wrongdoing but agreed to comply with the law, work to resolve consumer complaints and pay \$20,000 in attorney fees and costs.

In October 2008, a Michigan credit union won a \$360,000 jury award from Al Long Ford, of Warren, Mich., after accusing the dealership of fraud and breach of warranty on loans that eventually went into default. The suit alleged that the dealership falsified documents and inflated borrower income for some loans.

Dealers pay attention

"For a couple of years now, this is becoming a lot more of a hot topic with the dealer community," said Robert Granados, vice president and general manager of finance solutions at DealerTrack, which offers compliance technology to dealerships. "One, there is a lot more access to data. And, two, regulatory agencies have become more aware of more issues, and they're looking for ways to protect consumers."

Dealerships are vulnerable to both insiders and outsiders, Granados said. With such tools as webinars, compliance guides and a blog, DealerTrack aims to educate dealers about processes that can pre-empt problems.

Although technology can make fraud easier, it also can help prevent it. For instance, moving to electronic deal jackets, thus eliminating paperwork, helps dealerships safeguard customer data, Granados said.

Technology helper

At Phil Smith Automotive Group, an 11-store retailer based in Florida, technology has been a solution, said Julie Chapman, director of accounting and compliance. Phil Smith created the compliance officer position more than seven years ago as new rules and regulations were being handed down.

"We've been very fortunate that we've had very few instances of identity theft or major problems thus far," Chapman said. "I think that has to do with us jumping on the bandwagon on compliance. We do look at technology as a preventative measure."

Chapman oversees compliance processes and training for about 50 finance employees at the dealerships. She stresses penalties for violations, noting it could lead to termination of employment and even charges in the case of criminal acts.

"But we try not to get into the specifics of what they could do," she said. "You don't want them to think you distrust them -- and you don't want to give them ideas for those who haven't thought of it."

In November, the dealership group completed a series of six webinars updating employees on regulatory changes.

"More disclosure, more paper, more signatures -- our poor finance guys," Chapman said. But if the rules protect consumers and prevent fraud, it's a good thing, she added.

Phil Long Automotive uses DealerTrack's compliance software. Chapman said it's made her efforts easier. The system creates an audit trail and helps her spot-check deals. It also can detect discrepancies and send out alerts - for instance, if a single Social Security number is used with different names.

"That's stuff no person would be able to find," Chapman said.

Cleaning up

While the temptation to cheat may be greater in tough times, consultant Gil Van Over says the industry has cleaned up its act over the years. The consumer often is the one who creates phony documents, he said. Van Over believes bank fraud is actually on the decline in the auto industry.

"Larger dealerships understand the risks involved and have put policies in place, trained their employees on those policies and put some follow-up audit function in place," said Van Over, a former Ford Motor Co. employee who now runs gvo3 & Associates in Chicago. "What we've found with the dealership groups we work with is that when they put a compliance program in place, their profitability improves."

Smaller dealerships, however, often underestimate the risk or believe it's too expensive to put a proper compliance program into place, Van Over said. But the cost can be minimal compared with the huge fines and penalties a dealership could face if accused of fraud.

Van Over gives pointers that dealers can follow to prevent employees from faking documents. One is to block computer access to Web sites that help create phony proof of income. Dealership IT staffers also can inspect computers for suspicious spreadsheet files.

Too easy



Dealer Jack Fitzgerald didn't realize how easy it was to falsify documents until some young employees showed him.

Maryland dealer Jack Fitzgerald hasn't busted rogue employees for falsifying documents at any of his 12 locations. But he was alarmed to learn how little effort it takes after a recent demonstration by some young employees.

"What worries me is how easy it was and how quick it was for people to change an invoice," Fitzgerald said of the two-minute demo. "I didn't realize you could do it that fast. It is a problem."

Fitzgerald posts vehicle invoices on his dealerships' Web sites. He believes such disclosure can help prevent such cheating if the customer notices discrepancies. Fitzgerald also pays his salespeople a flat rate for each sale, reducing motivation to inflate the size of the deal.

That said, "you just can't see everything a salesperson does," Fitzgerald said. "You just can't. Fraud is an awful thing, and a dealer won't even know it's happening."

That is, until the consequences begin. And they can be "horrible," Fitzgerald said, including fines, lawsuits, criminal charges, being dropped by lenders, even having the store's floorplan line pulled.

In the end, a dealership's reputation, with both consumers and lenders, means everything.

Said Chapman: "If you don't have banks to hang your paper, you can't sell cars."

5 steps to compliance

F&I consultant Gil Van Over recommends that dealerships put in place these 5 broad steps.

1. Assess the dealership's risk.
2. Develop compliance policies and procedures.
3. Train your employees on the process.
4. Conduct follow-up auditing.
5. Put corrective actions in place when problems arise.



Phil Smith Automotive created a compliance officer job seven years ago as new regulations took effect. "More disclosure, more paper, more signatures -- our poor finance guys," said Julie Chapman, the retailer's compliance chief. "But if the rules protect consumers and prevent fraud, it's a good thing."

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