

Litigation Defense Strategy – Auditing For Compliance
Jeff Sack's Dixon Odom Newsletter – January 2004

Since last fall, we've published a series of articles outlining a litigation defense strategy that dealers should implement in the F&I Office. This comprehensive strategy includes:

- Conducting a thorough forms review
- Understanding the process your customer goes through to purchase and finance a vehicle
- Documenting your policies, procedures and processes
- Performing initial and ongoing deal jacket and TILA audits
- Providing training and industry certification
- Doing it again and forever

In this month's newsletter, we'll look at auditing deal files for compliance with your published policies and procedures.

If you have been following the step-by-step strategy development outlined in the previous newsletters, you've already taken a hard look at your forms, conducted a walk through of your processes, documented your expectations in the form of a policy and procedures manual and started the compilation of a corporate diary.

Now, it is time to perform two initial audits: a deal jacket audit and a Reg Z and Reg M audit.

Deal Jacket Audit

A deal jacket audit is the most critical procedure you can perform in your dealership if you want to understand how your deal jackets will withstand the scrutiny of a class action attorney. The process requires time (approximately 30 minutes per file), a consistent methodology (same review process on a monthly basis) and should be conducted by the Dealer Principal, Chief Financial Officer, Controller or Office Manager.

The first task is to select the files to be reviewed.

The easiest way to select files is to use last month's F&I log. Start with the 5 deals per F&I Manager with the highest back-end profit, and then expand your selection until you are able to fulfill the following criteria:

- Every F&I product sold
- New and Used
- Retail and Lease
- Prime and Subprime

Now that you have your files to review, you must understand what you are looking for. The following list of prohibited practices is a good start:

1. Payment packing
2. Trading rate for product
3. Bundling products

4. Including F&I product in the price of the vehicle
5. Signature on file
6. Handwritten entries
7. Completing documents after the fact
8. Falsifying information to lenders
9. Straw purchases
10. Scooping rebates
11. Blank, signed documents
12. Product stuffing
13. Credit card down payments
14. Inconsistent product pricing
15. Missing enrollment forms
16. Forging customer's signatures
17. Front end improvement
18. Menu manipulation

Most of these prohibited practices can be discovered by critically reviewing 5 documents: 4 Square worksheet, F&I Menu, Buyer's Order, Retail or Lease Contract and F&I Product Enrollment Forms. Generally speaking, the meeting of the minds on the sale of the vehicle from the 4 Square must flow to the top of the F&I Menu. These terms include purchase price, trade in allowance, trade in payoff, cash down, balance with taxes and fees, base monthly payment, term in months and APR.

Next, the agreed upon purchase of F&I products, their price and the new monthly payment must be consistent from the bottom of the F&I Menu to the Buyer's Order and the Retail or Lease Agreement.

Finally, the product enrollment forms must have the price and term of the product, the customer signature acknowledging acceptance and the pricing and terms must be consistent with all other documents that disclose the F&I product.

Reg Z and Reg M Audit

Reg Z is the regulation written to enforce the Truth In Lending Act (TILA). Reg M is the comparable regulation for the Consumer Leasing Act (CLA). They each require certain disclosures on the retail and lease contracts (and some would argue all other documents in the file).

This review should be undertaken on a quarterly basis. A primary goal is to ensure that your Dealership Management System (DMS) set ups, which can be customized to a large degree by dealership personnel or your DMS provider, does not establish a pattern of disclosure issues that plaintiff's attorneys can rely on to certify a class action lawsuit.

A common Reg Z violation surrounds the sale of F&I products. The regulation requires that payments made to certain third parties identify the third party, the reason for the

payment, the amount of the payment and the fact that the seller may be retaining a portion of the payment. This is usually the case in the sale of F&I products, for example:

To: Seller/vender For: F&I product \$ 495.00

Another Reg Z violation that some plaintiffs' attorneys are latching on to is when the product provider is misnamed, even though the coverage and the premium is the same. This usually occurs when a dealer is selling the manufacturer's extended service contract and an independent company's extended service contract. If the name of the company backing the extended service contract is not consistent from the retail or lease agreement to the product enrollment form, it is a technical TILA violation.

You start the quarterly Reg Z and Reg M review by loading a retail and a lease deal into your DMS. These test deals must include every aftermarket and F&I product sold in the dealership. Print these deals on every contract you submit to lenders. Next, take a critical eye and review every document that is printed with a focus on Reg Z and Reg M violations.

Now the important part. Insist on making the DMS programming changes rather than depending on the F&I Manager to strikeover any incorrect information, handwriting the correction and obtaining the customer's initials on the strikeover. These alterations to the contract will not happen 100% of the time and you are exposing yourself to an unwarranted risk that can be prevented through improved functionality via programming changes.

These monthly and quarterly audits must become part of your standard risk management program. You can either complete them internally or outsource the audits to your CPA – if they are automotive – or outside consultant. Whichever way you decide to go, you can mitigate your exposure to class action lawsuits by conducting periodic audits that measure compliance against your expectations.

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