Driving Better Compliance:

Dodd-Frank Act Brings Substantial Change and Increased Regulation and Enforcement for Auto Finance Companies

A SourceHOV White Paper

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Auto finance companies need to get ready to change how they conduct business as the Dodd-Frank Act hits the road and moves from Wall Street to Main Street. Passed in July 2010 and effective July 2011, the Dodd-Frank Act will have a substantial impact on the way all consumer finance organizations manage financial transactions, requiring lenders to put processes in place to ensure compliance with new laws from different regulatory agencies.

Designed to offer consumers increased protection in the context of financial products, the Dodd-Frank Act Wall Street Reform and Consumer Protection Act and the newly created Consumer Financial Protection Bureau (CFPB) has given the Federal Trade Commission (FTC) more authority to regulate dealers who make direct loans to consumers and over lenders such as major banks and auto finance companies. Additionally, the FTC is pushing this authority to state Attorneys General offices, giving them increased power and influence. For auto lending institutions and dealers who are direct lenders, the need to prepare for greater scrutiny into business practices and strict enforcement of the rules is the new norm.

In April 2011, the FTC conducted roundtable discussions to gauge consumer experiences with various lending institutions. In its announcement of the roundtables, the FTC highlighted the dichotomy between consumers and lenders. On one hand, dealer-arranged financing provides benefits such as convenience, special manufacturersponsored programs, access to a variety of banks and financial entities or access to credit otherwise unavailable to a buyer. According to a statement on the National Automobile Dealers Association (NADA) website, the Dodd-Frank Wall Street Reform legislation includes language that preserves dealer-assisted financing, which will continue to provide more convenience, more competition and more choices for car buyers.[1] However, financing obtained at a dealership can also be a complicated, opaque process and could potentially involve unfair or deceptive practices.

For example, some dealers charge inflated rates as a result of the "dealer reserve" – a kick-back that can add hundreds of dollars over the life of a loan. According to the Center for Responsible Lending, consumers who financed cars through a dealership will pay more than $25.8 billion in interest rate markups over the lives of their loans.[2]

While NADA notes that dealer-assisted financing is saved from additional federal oversight under the Dodd-Frank law, auto loans from major banks and consumer lending institutions are affected by the new law, which includes several provisions related to disclosure of credit terms and action creditors must take when turning down a loan application. With calls for increased regulation and greater transparency into business practices, auto finance companies and lending institutions need to understand the changes that affect loan and lease origination. They also need to have the right people, processes and technology in place to implement and comply with these new regulations. Engaging a Business Processing Outsourcing (BPO) provider and taking advantage of services and technologies that not only streamline processes, but facilitate compliance and mitigate risk can help auto lending institutions increase efficiency and effectively meet new requirements.

Get Ready for a Bumpy Ride

While the initial focus of the Dodd-Frank Act was to curtail predatory mortgage lending, its reach has now extended to the auto industry, and will have a substantial impact on the way consumer finance companies conduct business. According to a January 2011 Wolters Kluwer survey of more than 1,000 consumer lending banking professionals, one-quarter said Dodd-Frank will likely have the most impact on their operations.[3]

[1] National Automobile Dealers Association, "Affordable Auto Finance Preserved in Wall Street Reform Bill", (retrieved 12/09/2011 http://www.nada.org/legislativeaffairs/economyfinancial/dealerfinance.htm?INTKEY=195BME0)

[2] Center for Responsible Lending, "Under the Hood: Auto Loan Interest Rate Hikes Inflate Consumer Costs and Loan Losses," April 19, 2011 (retrieved 10/12/2011 http://www. responsiblelending.org/other-consumer-loans/auto-financing/research-analysis/Under-the-Hood-Auto-Dealer-Rate-Markups.pdf)

[3] Wolters Kluwer, "U.S. Financial Institutions Optimistic About Consumer Lending," press release, February 2011 (retrieved 10/12/11 http://www.wolterskluwerfs.com/NewsEvents/PressReleases/press021411b.html)

The Dodd-Frank Act, along with the Truth in Lending Act and Title X laws are some of the rules and regulations auto finance institutions need to follow. Some of the new specifications include:

- Creditors, including dealers, must provide the actual credit score used to help make the credit decision to consumers in an adverse action notice;
- Adverse action notices must now be sent to consumers who apply for credit and are denied, or when the terms are different from that requested;
- Mandatory disclosure of the range of possible credit scores based on the scoring model used;
- Key factors that impacted a consumer's credit score. This can be up to five factors if the number of inquires made is part of the rationale;
- The date the credit score was created;
- The name of the person or entity that provided the credit score and contact information;
- A statement to consumers that communicates the credit score is part of the information used in making a decision, that the score is used to set the terms of credit offered and that a credit score can change over time to reflect changes in a consumer's credit history;
- Issuance of a risk-based pricing notice when a consumer report is used in connection with providing credit with materially less favorable terms than the most favorable terms available to a substantial proportion of customers.

In addition to new rules to eradicate unfair and deceptive practices, finance companies also need to prepare for stricter enforcement, including investigations and surprise audits. State Attorneys General note they plan to take this increased authority seriously and will be on the lookout for violations, not just to protect consumers, but generating fines and penalties as a way to produce revenue for their states.

Increased compliance, legislation and oversight of the auto finance industry require more intensive document management processes and audit trails. That's because failure to handle these notices properly and comply with increased regulation can result in significant financial loss, reputation damage and destruction of shareholder value. The Dodd-Frank Act provides that in order to enforce their authority the Bureau can issue these civil penalties to covered persons found to be in violation of any Bureau rule or order: Any violation: $ 5,000 per day; Reckless violation: $25,000 per day and knowing violation: $1,000,000 per day.[4]

The right technology solution will not only help lenders and dealers implement and comply with new regulations during the loan origination process, but increase efficiencies and reduce costs.

Hitting the Brakes on Manual Processes

Companies that take a proactive approach towards compliance will have a competitive advantage over those who do not. One way to do that is by tapping the brakes on manual—and duplicative—processes.

Relying on paper-based practices is not only laborintensive, but inefficient and contributes to increased risk. For example, compliance requirements mandate dealers to provide documented proof of notices indicating they obtained multiple credit scores from consumer reporting agencies in making a credit decision. Failure to comply with regulations can lead to penalties, fines and reputation damage. However, building an in-house solution may not be the right answer to put lending practices in order. Building an in-house solution prevents valuable resources from focusing on core competencies and other business priorities. It's also not strategically sound due to volume and resource demands and increased expenses and lost opportunity costs. Plus, a changing regulatory environment invites additional risk.

Working with a Business Process Outsourcing provider, financial institutions can take advantage of a strategic solution that improves processes, facilitates compliance and mitigates risk—capturing the benefits of best practices without having to invent them or support the technology platforms internally. The right partner will have the resources,

[4] American Financial Services Association, "The Dodd-Frank Wall Street Reform and Consumer Protection Act", August 2010 (Retrieved 12/09/11 http://www.kwik-loan.com/fullpanel/uploads/files/wall-street-reform-white-paper-00001.pdf)

technology, experience and expertise to streamline and improve processes through electronic workflows and facilitate compliance. Business process outsourcing and Software-as-a-Service (SaaS) technology alleviates the need for additional capital expenditures, improves cash flow and accelerates processing time.

A hosted, web-based image repository can be quickly implemented with little upfront capital expense and can help finance companies efficiently manage, track and execute a high volume of documents. Electronic workflows and digitized documents create a more efficient paperless process and a digital trail of documentation ensures dealers meet their legal obligations and avoid unnecessary bottlenecks in the process.

A standardized workflow also supports collaboration between departments and enables appropriate parties to gain access to information in real time. Information is automatically stored electronically for easier search, retrieval and audit trail documentation. Increased visibility also improves communication between employees and enables company representatives to have productive dialog with consumers and provide quality customer service.

An automated workflow process also supports auditing and validation requirements as well as providing key productivity metrics that management can use to improve processes. Organizations gain insight into when correspondence was received and what action was taken. Strict service level agreements (SLAs) and systemtriggered events reduce cycle time and support compliance goals. By taking a best practices outsourcing approach, auto finance institutions and dealers can demonstrate transparent business practices and effectively comply with regulatory demands.

The Road to Success

The passage of the Dodd-Frank Act will have a substantial impact on consumer finance companies. New financial protection rules, increased monitoring of the industry and enforcement of the laws require dealers and auto finance institutions to have the right people, processes and technology to facilitate compliance and improve business processes. Attorneys generals have historically pursued lenders for unscrupulous practices and now they will be armed with new enforcement tools and penalties. Organizations that improve processes through business process outsourcing will be able to streamline processes, efficiently communicate with borrowers and effectively meet compliance requirement both today and down the road ahead.

About the Author - Michael Zwall is the Director of Mortgage Services for SourceHOV. Zwall has more than 20 years of operations and financial management experience in the mortgage industry. He has worked as a loan consultant, operations manager and business development leader for Wells Fargo, Guild Mortgage and Accredited Home Lenders, bringing clients valuable insight from a lender's perspective as well as project management expertise. A seasoned industry veteran, Six Sigma Black Belt and PMP, Zwall is instrumental in assisting clients with process improvement and establishing best practice business processes. For more information, email michaelzwall@sourcehov.com or visit www.sourcehov.com.

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