WHEN UNDERWRITERS BECOME UNDERTAKERS!

BY KENNETH B. SHILSON, CPA

As I consult with buy here, pay here dealers throughout the nation, I notice that many don't underwrite all deals properly. In other words, they fail to match the right customer with the proper vehicle!

All good underwriters agree that there are three (3) key elements to every buy here, pay here deal as follows:

1) A good customer
2) A good vehicle, and
3) The proper deal structure.

These elements are like three tires on a vehicle, if one is flat, the vehicle doesn't run very far. If two tires are flat, the vehicle won't move at all! In good underwriting all three elements are vitally important to the ultimate collectibility of the installment contract. Although everyone seems to agree, I frequently see underwriters (or sales people) cut corners when contracting new customers when they:

1) Fail to gather and verify all customer stipulations (i.e. time on job, income, expenses, debt, time in residence, etc.).
2) Don't obtain and complete all the customer information fields in their dealer management software.
3) Don't run credit bureaus.

When asked why underwriters are allowed to deviate from prudent practices (even when formal policies exist to the contrary), I am given the following excuses:

a) Our customers all have bad credit, so what difference does it make to gather the information anyway?
b) We sell to everyone and repo the ones who don't pay!
c) We are too busy selling cars, and don't have time to gather customer information.
d) We don't run credit bureaus on repeat customers (like their credit never changes?).
e) We gather the customer information but don't really analyze it before making the credit decision.

Although these excuses sound logical, based upon a recent loss analysis study I just completed, it appears that failure to fully perform all the appropriate underwriting steps proves fatal to collections. Unfortunately, the sales person responsible is usually paid a commission for not doing their job properly. When the customer information isn't gathered and verified, the customer may not be sold a vehicle he or she can afford. Instead, they frequently purchase a vehicle which they won't be able to pay for. In other words, the underwriter buries the customer and the dealer in the transaction! The outcome is a bad debt charge-off which keeps the dealer from realizing their profit and cash flow from that deal.

At my recent NABD Collection Academy in Atlanta, Georgia, I released portfolio loss benchmarks which show that losses are substantially higher when:

1) Customer income levels are not accurately verified
2) Customer debt and expense levels are not considered, and
3) Credit bureaus are not run, including repeat customers!

In many cases underwriters gather some, but not all, of the required information. Unfortunately, all of the aforementioned items play an integral part in making the proper credit decision.

In 2007, a number of economic uncertainties exist! Several factors could adversely combine to reduce customer liquidity and hinder their ability to pay. These include, but aren't limited to:

1) Higher gasoline prices,
2) Increased heating, electric, and fuel oil prices,
3) Inflationary increases for staple products they need every day.

If these factors aren't bad enough, it is a certainty that health care costs will increase faster than their incomes! All of these conditions will mean collectors must fight for every customer dollar. In these circumstances, it is vital that customers be sold a vehicle they can afford and not necessarily one they want! Buy here, pay here customers are typically poor financial managers with virtually no financial capacity to withstand economic change. Therefore, it is imperative that each customer's ability to pay be carefully and fully evaluated at the time of sale.

So the choice is yours in 2007! Will it be a good underwriting or undertaking? The buy here, pay here cemetery awaits those who choose the latter. Good luck!

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