FLOOR PLAN LENDING
Core Analysis Procedures

Examiners are to consider these procedures but are not expected to perform every procedure at every institution. Examiners should complete only the procedures relevant for the institution's activities, business model, risk profile, and complexity. If needed, based on other identified risks, examiners can complete additional procedures not included below. References to laws, regulations, supervisory guidance, and other resources are not all-inclusive.

References

- *Interagency Guidelines Establishing Standards for Safety and Soundness (FRB: 12 CFR 208, Appendix D-1; FDIC: 12 CFR 364, Appendix A)*

Findings and Conclusions

Document findings and conclusions here, and include a summary of these findings and conclusions in the appropriate Primary or Supplemental modules.

Preliminary Review

1. **Review documents that may identify changes in or issues relating to floor plan lending, such as:**
   - **Prior examination reports and workpapers**
   - **Examination planning memoranda and file correspondence**
   - **Loan review reports**
   - **Internal and external audit reports**
   - **Loan committee minutes**
   - **Documentation of action taken by management to correct prior weaknesses**

2. **Obtain and analyze internal management reports relating to floor plan lending, such as:**
   - **Lending activities (e.g., type and volume)**
   - **Problem loans**
   - **Workout strategies**

3. **Assess the quality of market-analysis reports, considering:**
   - **Information provided in reports**
   - **Reporting on specific market segments**
   - **Economic developments in the markets served**
   - **Variety in sources used**

- **Timeliness of information**

Policy Considerations

4. Assess the floor plan loan policy, and determine whether the policy remains appropriate for current and planned lending strategies. Effective policies generally address:

- **Qualified borrowers**
- **Permissible types of merchandise to finance**
- **Guidelines for granting and monitoring floor plan loans**
- **Individual and aggregate limits based on relevant risk factors (e.g., product category, vehicle type, market) relative to capital and total loans**
- **Loan-to-value collateral requirements**
- **Collateral documentation standards and lien perfection procedures**
- **Guidelines for holding titles and other ownership documents**
- **Collateral inspection guidelines**
- **Curtailment requirements**
- **Guidelines for obtaining and evaluating borrower financial statements at origination and periodically after**
- **Guidelines for obtaining manufacturer repurchase agreements**
- **Requirements for obtaining inter-creditor agreements**
- **Guidelines for tri-party (manufacturer, dealer, and bank) floor plan agreements**

Credit Administration

5. Determine whether underwriting and administration procedures require designated staff to perform the following tasks:

- **Conduct floor plan inspections, generally monthly, or more frequently based on inventory turnover**
- **Follow procedures for reviewing and retaining inspection reports**
- **Resolve discrepancies identified during floor plan inspections**
- **Evaluate dealers' financial statements[1]**
- **Review floor plan agreements and borrowers' compliance with the agreements**

6. Review a sample of floor plan arrangements. Determine whether the files contain, as necessary, the following documentation:

- **Periodic analysis of the creditworthiness and performance of the relationship**
- **Floor plan agreements**
- **Hazard insurance with the bank named as loss payee**

[1] For new vehicle dealers, these are the statements submitted to the manufacturer that contain details regarding dealership operations and compliance with manufacturer standards

- **Collateral valuations, such as National Automobile Dealers Association used car guide**
- **Manufacturer's invoices for new units**
- **Drafting agreement with manufacturer**
- **Floor plan inspections**
- **Financing statement filed with the applicable state agency[2]**
- **Inter-creditor agreements, if the borrower has more than one floor plan creditor**
- **Manufacturer's Statement of Origin (MSO), titles, and trust receipts[3]**
- **Wholesale letter of credit and drafting authority**
- **Limited power of attorney giving the bank the authority to prepare and sign lien documents for the dealer**

7. Review floor plan agreements. Effective agreements generally contain:

- **Maximum advances for each unit[4]**
- **Method used to advance funds[5]**
- **Method used to perfect the security interest (vary by state)**
- **Location of collateral**
- **Frequency of floor plan inspections**
- **Repayment schedule, including the timing of payments following the sale of units[6]**
- **Insurance requirements**
- **Repurchase agreement with the manufacturer for new units**
- **Periodic curtailment program for unsold units[7]**
- **Loan covenants relating to liquidity levels, working capital, and tangible equity[8]**

8. Determine whether credit administration practices and staffing levels are appropriate for current and planned lending strategies.

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[2] Prudent risk management practices typically involve at least two UCC searches with the Secretary of State or applicable state agency. The first search would be completed before filing to determine the existence of prior secured creditors. The second search would be completed after filing - and before disbursement - to determine whether the bank's security interest was appropriately recorded.

[3] Titles and MSOs may be retained by the borrower to facilitate the sales process, for example to get a new title issued for a sold vehicle. If the borrower is in weak financial condition, management should consider holding these documents. In most banks, the security interest to floor plan inventory is evidenced by a trust receipt. This document is issued to the lender by the dealer. It establishes the bank's rights to the inventory collateral.

[4] For new units, advance rates are usually expressed as a percentage of cost. For used units, the advance rate may be expressed as a maximum percentage of value from a defined valuation source (e.g., Kelley Blue Book).

[5] Methods may include advancing funds directly to the manufacturer or dealer. Drafts advanced directly to a dealer elevate risk to the bank.

[6] The timing of payments is commonly referred to as the release period. The greater the release period, the more risk assumed by the bank.

[7] May not be necessary if there is a repurchase agreement.

[8] Examiners should compare the bank covenants with any manufacturer-required minimums.

Credit Analysis

9. Review dealers' financial statements and assess the ability to service the debt. Debt and inventory levels should move in the same direction. Be aware that floor-plan items might be shifted between dealers.

- **Compare the number of units sold as shown on the statement with floor plan payoff activity**
- **Evaluate the mix of units and vehicles sold (e.g., new, used, full-size, and compact)**
- **Review the inventory reconcilement. Reconcilements for new and used inventory contain different elements, as shown in the following tables:**

For New Inventory[9]	
New Unit Inventory (Before LIFO Adj.)	$X,XXXM
Plus New Unit Contracts in Transit*	$X,XXXM
Total New Assets	$X,XXXM
Less New Units Floorplan Liability	($X,XXXM)
New Unit Equity (Deficit)	$X,XXXM

* Inventory sold through retail installment contracts for which the dealership has not yet been paid

For Used Inventory[10]	
Used Unit Inventory (Before LIFO Adj.)	$X,XXXM
Plus Used Unit Contracts in Transit	$X,XXXM
Total Used Assets	$X,XXXM
Less Lien Payoff Liability*	($X,XXXM)
Less Used Units Floorplan Liability	($X,XXXM)
Used Unit Equity (Deficit)	$X,XXXM

*Units taken as trade-ins where the customer's existing loan has not yet been paid-off by the dealership

- **Evaluate the revenue mix to identify trends in new and used vehicle sales, parts and service revenue, and income from finance and insurance activities (e.g., fee income from financing the loan or the sale of credit life insurance)**
- **Review accounts payable and determine whether the dealer owes other dealers for inventory purchases**
- **If the dealer has more than one floor plan creditor, assess how management ensures the dealer is not double pledging the collateral (e.g., use of an inter-creditor agreement governing collateral allocation in the event of default)**
- **Review accounts receivable and payable aging reports**
- **Review inventory turnover reports**

[9] When deficit balances exist, management often assesses the deficit relative to the cost of vehicles expected to be sold during the dealership's release period (cost of average day's new vehicle sales times the number of days in the release period). A deficit that significantly exceeds the amount expected based on the release period may indicate a default of the floor plan agreement. In these situations, management typically assesses whether the dealership maintains sufficient cash to offset the deficit.

[10] Because used units are not typically financed at full value, used inventory reconcilements normally show significant used equity. A reconcilement with an equity deficit may indicate a default in the floor plan agreement and a lack of working capital at the dealership. Well-capitalized dealerships often maintain significant amounts of used-unit equity as a source of working capital, as these units can be quickly converted into cash.

• **Evaluate overdraft activity and returned items for dealers** • **Determine whether drafting agreements are abused by the dealer** • **Assess dealerships' global cash flow to determine whether they sufficiently cover fixed and variable expenses, as well as service all debt (including dealership related debt personally owed by dealership principals)**[11]
10. Determine whether the lending staff is over-advancing funds compared to collateral values.[12]
11. Determine whether the lending staff is familiar with the dollar fluctuations in floor plan loans and periodically evaluates the level of floor plan debt relative to inventory values.
12. Determine whether the lending staff is aware of risks associated with inventory financing. The following items may indicate problems with floor plan arrangements: • **Delinquent notes, unpaid interest, lack of required curtailments, and maturities extended beyond reasonable expectation** • **Increasing dealer errors (e.g., wrong vehicles paid off, wrong vehicles added to floor plan, sold inventory not paid off, and wrong retail draft submitted)** • **Increasing number of reversed sales** • **Vehicle transfers between multiple business locations** • **Identified errors predominantly favor the dealer** • **An unusual number of follow-ups are required to resolve errors** • **Previously detected errors continue to occur** • **Increasing employee turnover at the dealership** • **Increasing amount of missing information on retail sales (e.g., folders missing copies of the sales contract, purchaser's insurance information, or forms to register and title the vehicle)** • **Floor plan activity inconsistent with special promotions at the dealership** • **Vehicles added to demonstrator service occur right before or during a floor plan inspection, which could indicate misuse of the units** • **Changes in external factors, such as competition or the national, regional, and local economies**
Risk Management and Collateral Monitoring
13. Review floor plan lending reports generated for management and the board.

[11] A common reason for floor plan defaults is the diversion of sale proceeds.

[12] Generally, new and used automobiles are financed at a maximum of 100 percent of invoice cost and 90 percent of wholesale value, respectively. Advance rates for other items (e.g., manufactured homes and boats) are typically capped at 100 percent of the invoice for new units and some percentage of market value for used items.

- **Determine whether the bank's accounting system for floored units is appropriate (e.g., identified by make, model, VIN number, dealer control number, date floored, and curtailment history)**
- **Determine whether well-developed monitoring systems and risk management practices exist commensurate with the size and complexity of the bank's exposure. Reports for the floor plan lending portfolio generally include information such as the following:**
    - **Overall portfolio exposures**
    - **Concentrations (e.g., dealers, vehicle types, geographic, and risk ratings)**
    - **Policy exceptions, including discrepancies that indicate out-of-trust activity**
    - **Covenant compliance**

14. Assess the collateral inspections, considering :

- **Whether the scope and frequency of collateral inspections match risk profiles and include an element of surprise**
- **The expertise and independence of collateral inspectors, including sufficient rotation of inspectors to avert collusion**
- **The completeness and accuracy of inventory reconcilement[13]**
- **Timely reporting of, and responsiveness to, adverse inspection findings (e.g., payments outside of the dealership's release period, or use of units not designated as demonstrators)**
- **Adequacy of the floor plan inspection template (e.g., serial number, condition, location of unit, and date inspection performed)**
- **Independent review of the collateral inspection process**

15. Determine whether designated staff perform the following procedures during floor plan inspections:

- **Check financed units to confirm the accuracy of inventories, physical conditions, locations (if other than normal place of business), and odometer or hour-meter readings, as applicable**
- **Investigate discrepancies**
- **Promptly notify bank management of inventory not found on the dealer's premises during inspections**
- **Maintain written documentation on all inspections, including follow-up on units not found on the dealer's premises**
- **Verify that units reported as sold and unpaid are documented by related finance contracts in transit or payments-in-process, and that such processing is reasonable**
- **Ensure the dealer immediately pays off units that are reported as sold, but are not in the process of payment and are outside of the established release period**
- **Report inspection results to bank management**

16. If the bank uses a third-party provider for collateral inspections, determine whether the bank has appropriate processes and controls to evaluate, establish, maintain, and monitor the relationships.

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[13] **Inspections evidence that the dealer's floored inventory list reconciles to the dealer's general ledger and to the bank's listing of floored units.**

17. If the situation warrants, examiners should perform a floor plan inspection or direct management to obtain an independent third-party inspection given certain conditions, such as:

- **Infrequent or nonexistent floor plan inspections**
- **Items consistently found missing during floor plan inspections**
- **Dealer experiencing financial difficulties**
- **A significant out-of-trust situation is discovered during the bank's most recent inspection of units or reconciliation of the financial statement**
- **Inventory reconcilements reflect an equity deficit that significantly exceeds the amount expected based on the release period**

End of Core Analysis.