

How FTC Proposal Would Tighten Rules On Auto Finance

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On June 23, by a 4-1 vote, the Federal Trade Commission issued a notice of proposed rulemaking that is squarely aimed at changing the way car dealers interact with customers in the automotive financing process — with an ancillary but material impact on finance companies, both those affiliated with original equipment manufacturers and others.

The proposed rule follows multiple FTC enforcement actions and consent orders over the last two years, particularly the Bronx Honda, Tate Auto and Napleton enforcement cases, which foretold nearly all of the provisions of the proposed rule.

If the rulemaking passes as proposed, the potential effects on dealers themselves will likely be substantial and immediate. The effects on the automotive lending market could take longer to be felt, but still have significant impacts.

These impacts could include reduced optional products revenue; Holder Rule risks to assignees; follow-on scrutiny of automotive lenders from the Consumer Financial Protection Bureau and state regulators; and additional and more complex record-keeping and compliance requirements.

Key Provisions

The FTC's proposed rule would institute the following changes.

Civil Penalty Authority Over Deceptive Dealer Practices

The rule would bring certain already-prohibited deceptive dealer practices within the FTC's civil penalty authority. The commission currently has the power to seek civil penalties for deceptive trade practices proscribed by a trade regulation rule only.

In defining a specific universe of misrepresentations made in the course of selling, leasing or arranging financing for motor vehicles, the rule would not likely prohibit any new conduct. But it would subject violations of the provision to civil penalties of up to approximately \$50,000 per violation.



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New Financing Disclosure Requirements

The rule would mandate specific new financing disclosures. The proposed rule would go beyond existing disclosure requirements under Regulations M and Z, by requiring clear and conspicuous disclosure of additional information about the purchase price of the vehicle and prices for optional products.

A price list for optional products must be posted on the dealership's website.

Requiring Express Informed Consent to Changes

The rule would require dealers to obtain consumers' express informed consent to any charges related to the sale or lease. The FTC would expand the Napleton consent order's requirement of express informed consent to vehicle sale and lease charges to the entire industry.

The definition requires truthful, clear and conspicuous disclosure — both in writing and, for in-person transactions, orally — of the reason for the charge and the amount of the charge, followed by affirmative, unambiguous assent to be charged.

In addition, for optional products, the rule would require the dealer to obtain the consumer's written rejection of an offer to sell the vehicle at a specific price without optional products before the dealer could charge a borrower for the options the buyer has accepted.

Prohibition on Add-Ons That Provide No Benefit

The rule would prohibit the sale of add-on products and services that provide no benefit to the consumer. The proposed rule would target products and services that the FTC believes provide no value to any consumer — such as nitrogen tire products that do not include more than ambient atmospheric nitrogen.

It would also cover products and services that provide no value to the specific consumer — such as, per the FTC, guaranteed asset protection agreements when the loan-to-value ratio is already low or duplicative warranty coverage. The latter category will be the most subjective and difficult to assess.

Two-Year Record-Keeping Requirement

The rule would impose a two-year record-keeping requirement on dealers. Dealers would be required to create and retain records showing compliance — including advertisements, price lists, customer correspondence, financing documentation, loan-to-value calculations for all sales of guaranteed asset protection coverage, and customer complaints.

Context

The rule comes after years of statements from Democratic FTC commissioners in response to enforcement actions against auto dealers criticizing the way in which cars are sold and financed in the U.S. as a "broken" market in need of regulatory intervention.

During the last 10 years, the FTC has brought more than 50 law enforcement actions related to automobiles, and helped lead two nationwide law enforcement sweeps that included 181 state-level

enforcement actions in these areas.

In addition, complaints from consumers related to automobiles remain in the top 10 complaint types received by the FTC, with more than 100,000 complaints from consumers annually over the last three years.

After the U.S. Supreme Court's 2021 ruling against the commission in *AMG Capital Management v. FTC* — sharply curtailing the agency's ability to pursue monetary relief where the agency had not first undertaken a rulemaking — the agency turned its focus, in part, to laying out rules that could provide such a predicate.

Under the Dodd-Frank Act, the FTC was granted the authority to issue consumer protection regulations governing auto dealers using an expedited process, which made the industry a likely target for action.

With one major omission, the scope of the proposed rule hews closely to both the fundamental allegations and the remedies adopted in recent cases, and similarly tracks factual findings from the FTC's recent research efforts into the market. The agency's concern about the prices of optional products — what the FTC's official press release terms "junk fees" — also ties in with the Consumer Financial Protection Bureau's junk fee initiative.

Conspicuously missing from the rule is any regulation of dealer markup, which was a significant focus of both the Bronx Honda and Napleton cases. While a substantial part of the preamble to the proposed rule explains the role of markup in automotive finance, nothing in the rule would require additional disclosures or limits on dealer markups.

The FTC and CFPB have both focused on anti-discrimination concerns associated with dealer markup for years, and at least one current FTC commissioner, Rebecca Kelly Slaughter, has explicitly called for the regulation of markup in the past. There are two possible explanations for the omission of this issue from the proposed rule.

One possibility is that the agency may be willing to wait and see if these enhanced disclosures result in more competitive pricing and fewer unexplained pricing variances along racial lines. The other is that a second, more contentious regulation may yet be forthcoming.

But by focusing on core unfairness and deception issues grounded in prior enforcement actions, the agency secured the vote of Republican Commissioner Noah Phillips for this proposed rule — and may thus better insulate the rule from challenge.

Implications for Automotive Lenders

The potential effects on dealers themselves will undoubtedly be substantial. The effects on the automotive lending market are subtler and may take longer to be felt — but may be no less significant.

Reduced Optional Products Revenue

The FTC expressly intends the rule to reduce dealers' sales of optional products. How dealers will react could result in pressures across the automotive lending market.

Dealers may increase vehicle sales prices to replace lost revenue, or seek higher dealer reserves in

financing transactions. The countervailing pressures of inflation and rising interest rates may mean that dealers react unpredictably and variably within their customer population. Indirect lenders should be prepared to respond to these market changes.

Holder Rule Risks to Assignees

While the proposed rule, like the FTC Act itself, does not contain a private right of action, many states' unfair or deceptive acts or practices laws do — and many treat the FTC's determination by rule that a practice is unfair or deceptive as legally conclusive. Customers and plaintiffs lawyers may therefore be more willing to consider bringing suits for dealer conduct that they contend violates the proposed rule.

The FTC's Holder Rule — which is intended to help consumers when a defective or fraudulent product or service is purchased with credit extended or arranged by the seller — can be read to allow consumers to bring those claims against assignees for indirect auto loans. This is particularly relevant after April 2021 guidance rejecting the existence of a "large transaction" ceiling on that rule's applicability.

These considerations counsel in favor of greater due diligence by assignees, establishment of standards for assignment of loans, and indemnification provisions related to noncompliance.

Follow-On CFPB and State Scrutiny of Automotive Lenders

Many automotive lenders are banks or other finance companies that fall outside the FTC's jurisdiction. But the FTC, the CFPB, and state enforcement officials, such as state attorneys general and financial regulators, collaborate closely.

Automotive lenders should expect that these agencies will look carefully at whether they are purchasing retail installment contracts that comply with the proposed rule — with a specific focus on financed optional products that generate additional interest revenue to the lender.

Enforcement officials have historically had little tolerance for arguments that the dealer is solely responsible for compliance with the rule. Officials will likely expect lenders to monitor the contracts they are purchasing for facial violations and suspicious patterns; there is no reason to believe that this will change under the new rule.

As the enforcement agencies routinely take the position that both primary and secondary actors bear the same responsibilities, there will be an increased need for due diligence, monitoring and documentation with respect to the processing and acceptance of retail installment contracts, and documentation by the lenders of the practices and charges that are not acceptable when they take assignment of such contracts.

These are all measures that, in parallel, will help mitigate litigation and regulatory exposure for sales and finance companies.

Additional Record-Keeping and Compliance

Additional and more complex record-keeping and compliance requirements create added financial costs for dealers, as well as the automotive lenders that must police those requirements.

The prospect of significant per-violation penalties means that the costs of compliance measures,

although significant, are necessary.

Possible Unintended Consequences

The notice of proposed rulemaking seeks comments within 60 days after its publication in the Federal Register. In her dissenting statement, Republican Commissioner Christine Wilson expressed concern about unintended negative consequences of the rule for innovation and consumers — and particularly solicited industry comments that would help the agency avoid inadvertently calcifying the market.

Wilson also questioned the potential effectiveness and completeness of any such rule, given the evolution of sales practices. Consumer car shopping has more recently moved online, with services that assist consumers in price negotiation and location of desired vehicles, and some companies have introduced sales models that eliminate the need to enter a dealership at all.

Next Steps for Dealers and Lenders

Dealers and lenders should consider filing comments on the proposed rule through the Administrative Procedure Act process, with a focus on the relative costs and benefits as well as the impact on the fragile marketplace. It will also be important for dealers and lenders to start the process of reviewing compliance and processes.

Automotive finance companies should have discussions with dealers early on, so that they can and do undertake to confirm compliance — or compliance undertakings — and can make informed decisions on how to proceed in terms of accepting retail installment contract assignments and mitigating associated risks.

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