



Hudson Cook, LLP

Financial Reform: What it Means for Auto Dealers

October 21, 2010

Austin, Texas

Michael Benoit

Partner

Hudson Cook, LLP



Consumer Financial Protection Bureau

**Wall Street Reform and Consumer Protection Act of 2010 creates the
Consumer Financial Protection Bureau:**

Powers and Duties:

- Enforce Existing Consumer Financial Protection Laws
- Broad Authority to Create and Enforce new Consumer Financial Protection Rules subject to Limited Review by Financial Stability Oversight Council if there are Safety and Soundness Concerns
- Supervise Non-Depository Financial Institutions
- Require Periodic Reports and Gather Information
- Broad Definition of Financial Services



Consumer Financial Protection Bureau

CFPB Governance:

- Department within the Federal Reserve Board.
- Director appointed by President subject to Senate confirmation.
- Board of Governors of the Federal Reserve not permitted to interfere in operations.
- Funding not subject to annual appropriation or interference from the FRB.
- Functional Equivalent of an Independent Agency.



Consumer Financial Protection Bureau

Functions:

- Research
- Collecting and Tracking Complaints
- Office of Community Affairs
- Office of Fair Lending and Equal Opportunity
- Office of Financial Education
- Office of Service Member Affairs



Consumer Financial Protection Bureau

Other Notable Items:

- Consumer given broad rights to request information related to their accounts – Must be made available in electronic for usable by consumers.
- States permitted to pass more restrictive requirements.
- States attorneys general enforcement of the Act and Bureau's rules – Must consult the bureau before bringing action against a covered person.
- Bureau directed to report to Congress on pre-dispute arbitration and has the authority to prohibit or impose conditions or limitations on the use of pre-dispute arbitration if consistent with findings of the report.
- Civil Penalties- In Bureau or State action to enforce Act, Bureau rule or order: Any \$ 5,000 per day; Reckless \$25,000 per day; Knowing \$1,000,000 per day.



Consumer Financial Protection Bureau

Auto-financing Likely to Be in the CFPB's Cross-hairs

Senate Banking Report – Indirect (three-party financing) under attack:

- Extremely pejorative and one-sided.
- Condemns auto dealers as a class (“Auto dealers have a history of abusive and discriminatory lending”).
- States that dealers frequently exploit minorities, lower-income borrowers, and military personnel.
- States that dealers have a “significant incentive to steer borrowers to the highest rate loans ... without borrowers ever being aware of backdoor transaction” [attack on finance sources as well as dealers].
- Characterizes dealer participation as an “excess finance charge.”
- Asserts that CFPB is required since court-ordered rate caps will soon expire.



Consumer Financial Protection Bureau

Dealer Exclusion from CFPB - §1029:

- Excludes certain dealers from bureau's jurisdiction.
- Preserves current regulatory regime for excluded dealers.
- Does not exclude dealers from the full impact of the legislation.
- Grants FTC expedited rulemaking authority to define unfair and deceptive practices of dealers.



Consumer Financial Protection Bureau

Dealer Exclusion

- The Bureau may not exercise any
 - rulemaking,
 - supervisory,
 - enforcement or
 - any other authority (including any authority to order assessments)over a motor vehicle dealer that is predominantly engaged in the sale and servicing of motor vehicles, the leasing and servicing of motor vehicles, or both.



Consumer Financial Protection Bureau

Dealer Exclusion

- What is “**predominately engaged**”?
 - More than 50%?
 - Substantially all business?
 - Somewhere in between?
- What is “**servicing**”?
 - A full blown service department?
 - A toolbox and a wrench?
 - Somewhere in between?
- Will it be sufficient to be “predominately engaged” only in one or the other?



Consumer Financial Protection Bureau

Dealer Exclusion Does Not Apply If Dealer:

- Provides consumers with any services related to residential or commercial mortgages or self-financing transactions involving real property;
- Operates a line of business—
 - that involves the extension of retail credit or retail leases involving motor vehicles in which—
 - the extension of retail credit or retail leases are provided directly to consumers; and
 - the contract governing such extension of retail credit or retail leases is not routinely assigned to an unaffiliated third party finance or leasing source; or



Consumer Financial Protection Bureau

Dealer Exclusion Does Not Apply If Dealer:

- Offers or provides a consumer financial product or service not involving or related to the sale, financing, leasing, rental, repair, refurbishment, maintenance, or other servicing of motor vehicles, motor vehicle parts, or any related or ancillary product or service.



Consumer Financial Protection Bureau

Query:

- Is the exclusion for the entity (motor vehicle dealer) or the activity (sale and/or leasing and servicing)?
 - It appears to be the entity, to the extent it is predominately engaged in the sale and/or leasing and servicing of motor vehicles.
- Language favors an interpretation that a motor vehicle dealer predominately engaged in the sale and/or leasing and servicing of motor vehicles loses the exclusion only with respect to the enumerated activities.
 - Will the BCFP adopt this interpretation?
 - But the FTC went beyond the statutory mandate in interpreting its authority under FCRA § 615(e) (Red Flags).



Consumer Financial Protection Bureau

Dealers as Finance Source Agents

Some dealers act as documentation agents for direct lenders (e.g., banks and credit unions).

- The greater the extent to which the dealer engages in these transactions may affect their ability to claim they “routinely” sell their paper to finance companies.
 - These transaction could subject an otherwise excluded dealer to BCFP jurisdiction as to this line of business.
 - Excluded dealers who act as documentation agents are service providers to direct lenders.
- Query: Does the § 1029 dealer exclusion operate to shield the dealer from BCFP jurisdiction as a service provider?



Consumer Financial Protection Bureau

Areas of Concern for Dealers:

- Compensation
- Rate Restrictions



Consumer Financial Protection Bureau

Finance Source Regulation Implications For Dealers:

Likely Effects:

- More substantive restrictions on dealer compensation and the types of products that can be included in contracts purchased.
- Based on the mortgage reforms, expect more extensive verifications of applicants.
- Increased fair-lending testing and reporting requirements on finance sources will trickle down to dealers through dealer agreements.
- Increased costs related to preparing and filing reports on regulatory compliance for dealers subject to CFPB.
- Generally higher compliance costs from additional federal and “me-too” state regulation.



Consumer Financial Protection Bureau

Finance Source Regulation Implications For Dealers:

Likely Effects (cont):

- More vigilance and resources than ever with respect to CFPB rule-making and enforcement actions:
 - Will likely move more quickly than they moved in the past.
 - Also likely to be more intrusive and threatening to current business practices and more expensive to address.



New Securitization Requirements

Risk Retention Requirements for Asset-Backed Securities (ABS):

SEC directed to pass regulations to require retention of credit risk in ABS transactions as follows:

- **5% Retention Requirements:** Require retention of not less than 5% of the credit risk of the financial assets transferred in the transaction between the originator (the dealer in an indirect (three-party) transaction) and the securitizer (generally the finance source).
- **Permissible Forms of Retention and Minimum Duration:** Establish the permissible forms of risk retention and the minimum duration for it.
- **Allocations of Retention Between the Parties:** Establish jointly with the federal banking agencies the allocation of risk between the originator and securitizer. Risk retention allocated to the originator reduces that required of the securitizer.
- **Exempt Classes of Assets:** Reduce risk retention requirements for certain classes of assets that meet underwriting criteria established by the federal banking agencies.



New Securitization Requirements

Implications For Dealers:

- Potential to be required to retain credit risk that is now transferred to finance sources.
- Higher costs and less availability if finance sources find it more difficult to access low-cost ABS market for funding.



New Securitization Requirements

New Disclosure Requirements:

SEC is directed to establish new disclosures for issuers in ABS transactions as follows:

- Loan-level data with unique loan broker and originator-identifiers.
- Nature and extent of the compensation of the broker or originator of the assets.
- Amount of risk retention by originator and securitizer.



New Securitization Requirements

Implications For Dealers

- Higher costs and less availability if finance sources find it more difficult to access low-cost ABS market for funding.
- Additional exposure of sensitive information about dealer compensation.



Questions & Answers

Questions?

Michael Benoit
Hudson Cook, LLP
1020 19th Street, NW. Ste. 700
Washington, DC 20036
(o) 202-327-9705
(c) 202-657-8258
mbenoit@hudco.com