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MEMORANDUM

To: Paul Metrey
Senior Vice President, Regulatory Affairs
National Automobile Dealers Association

From: Tom Buiteweg
Admitted in Michigan Only

Date: June 29, 2023

Subject: Subprime Finance Source Acquisition Fees and Discounts

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You asked me to provide an analysis of the effect Federal Reserve Board Truth-in-Lending Regulation Z ("Reg. Z") has on a motor vehicle dealer's ability to recover from a consumer vehicle buyer an acquisition fee or discount off the amount financed charged to the dealer in connection with a finance source's purchase of a motor vehicle credit sale from a dealer (also known as a retail installment sale contract or "RISC").[1]

Background:

Some finance sources charge a dealer an "acquisition fee" that is deducted from the amount the finance source pays the dealer for the RISC. The deduction of the acquisition fee often results in the dealer receiving less than the amount financed under the RISC.

Similarly, some finance sources simply offer to pay the dealer for the RISC an amount that is less than the amount financed under it. This amount by which the sale price is less than the amount financed under the RISC is sometimes called a "discount."

Both acquisition fees and discounts can result in the dealer receiving less than the full sale price of the goods and services financed under the RISC. Thus, a dealer's first instinct is likely to try to recover the amount of the acquisition fee or discount directly from the buyer under the RISC for which such fees or discounts are assessed.

But if the dealer attempts to recover the acquisition fee or discount directly from the buyer as either an itemized charge under the RISC or by raising the vehicle price to cover the acquisition fee or discount, the dealer will likely face compliance issues under Reg. Z. As discussed below, a court or regulator will

[1] The Truth in Lending Act is codified at 15 U.S.C. §§ 1601 – 1666j. The Federal Reserve Board's Regulation Z is codified at 12 C.F.R. Part 226. Note: The FRB and the Bureau of Consumer Financial Protection ("BCFP") have published separate versions of Reg Z. The BCFP's version of Regulation Z would apply to most assignees of motor vehicle credit sales but both versions of Reg. Z are presently substantially identical as applied to motor vehicle credit sales. The BCFP's Regulation Z is codified at 12 C.F.R. Part 1026.

likely conclude that the itemized charge or increase in the vehicle price to cover the acquisition fee or discount is a finance charge that must be disclosed properly in the RISC and taken into account in the computation of the Annual Percentage Rate ("APR") disclosed in the RISC.

Described below are (i) the dealer's options for properly handling acquisition fees or discounts that the finance source charges the dealer when it takes assignment of the RISC; and (ii) a dealer's compliance risks if they do not properly handle acquisition fees and discounts.

Proper Handling of Acquisition Fees and Discounts.

Option 1 – Treat Acquisition Fees and Discounts as a Cost of Doing Business when Setting Pricing:

A dealer does not violate Reg. Z if an acquisition fee or discount is absorbed by the dealer as a general cost of doing business, even if the dealer takes the overall amount of acquisition fees or discounts paid into account in setting finance charge rates and cash prices offered to all customers. Commentary to Reg. Z makes this clear:

> Costs of doing business. Charges absorbed by the creditor as a cost of doing business are not finance charges, even though the creditor may take such costs into consideration in determining the interest rate to be charged or the cash price of the property or services sold. However, if the creditor separately imposes a charge on the consumer to cover certain costs, the charge is a finance charge if it otherwise meets the definition. For example: A discount imposed on a credit obligation when it is assigned by a seller-creditor to another party is not a finance charge as long as the discount is not separately imposed on the consumer.[2]

So, under federal law, if a dealer increases the price of all the cars the dealer sells – those sold for cash, those sold to "prime" and "near-prime" buyers, and those sold to "subprime" buyers, the across-the-board price increase is not a finance charge. In effect, the aggregate of such charges becomes part of the dealer's overhead, a cost of doing business as stated in Regulation Z above, and not attributable to or reflected in any individual transaction. A dealer electing this option would want to confirm that it does not create issues under state law in the dealer's state.

Option 2 - Properly Disclose the Recovery of Acquisition Fees or Discounts as a Prepaid Finance Charge:

A dealer can impose the fee charged by the finance source to the dealer on the customer as a separate charge, provided that –

1) The fee is properly disclosed as a "prepaid finance charge" under Regulation Z, which means the fee is:

[2] 12 C.F.R. § 226(4)(a)(2)(Supp. I).

a) Included in the disclosed finance charge;

b) Properly taken into consideration in calculating the APR; and

c) Properly disclosed in itemization of the amount financed. Prepaid finance charges are typically itemized by including the prepaid finance charge in the Itemization of Amount Financed as one of the fees imposed in the transaction, but then subtracting the prepaid finance charge from the total of the cash price (less the downpayment) and all such fees when computing the "Amount Financed."

2) State law does not prohibit charging the consumer the fee;

3) State law permits charging the consumer a prepaid finance charge;

4) Inclusion of the fee does not cause the contract to exceed the maximum finance charge rate permitted by state law;

5) The RISC used by the dealership accommodates the proper disclosure of the fee under TILA as a prepaid finance charge in the itemization of the amount financed and under state law;

6) The dealership's DMS is programmed to accurately populate the fields in the RISC; and

7) Whatever method a dealer settles on to charge the fee does not violate the dealer's agreement with the finance source that takes assignment of the dealer's finance contracts.

Many preprinted RISCs do not have a space for prepaid finance charges and many DMSs are not programmed to include them when calculating the APR. When a dealer is faced with impediments like these, the only option often is to treat the acquisition fees and discounts as a cost of doing business as discussed above.

What Dealers Should Not Do in Handling Acquisition Fees and Discounts.

Dealers should not raise the price of the specific vehicle involved in the RISC to cover the acquisition fee or discount from the buyer. Plaintiff's attorneys have successfully sued dealers alleging that acquisition fees and discounts – when charged by dealers directly to consumers and not properly disclosed as prepaid finance charges as discussed above - are hidden finance charges that violate Regulation Z.

In one case, when the amount of the credit exceeded the retail value of the automobile by more than 20 percent, the finance company charged an additional fee to the dealer, who raised the vehicle price to cover the additional fee. As a result, the financed vehicle cost more than if the vehicle had been paid for in cash. The court determined that the excess price charged to the credit customer was a finance charge. As discussed above, this kind of a finance charge is called a "prepaid finance charge" that is subject to the special disclosure requirements discussed above. Because the dealer did not properly

disclose the increase in the vehicle price to cover the additional finance source fee as a prepaid finance charge, the dealer violated Reg. Z. [3]

In a similar case, the dealer was charged a $7,182 discount by a non-prime finance source to purchase the RISC. The dealer added the amount of the discount to the vehicle price, selling a vehicle with a "Blue Book" retail value of $8,300 for a cash price of $14,040. The court held that a charge should be considered "separately imposed" on a credit customer "when it is imposed in credit transactions but not in cash transactions." The court stated that "TILA's stringent disclosure requirements are designed to prevent creditors from circumventing TILA's objectives by burying the cost of credit in the price" of the vehicle. Thus, the discount amount that was added to the price of the vehicle was a prepaid finance charge and needed to be disclosed as such and factored into the calculation of the APR.[4]

One court summarized this rule as follows:

> [A] discount cost shall be construed as a separately imposed finance charge if the charge is imposed on credit but not cash transactions. If an auto dealer recoups the discount cost of subprime lenders by either imposing it directly upon the individual buyer, or by aggregating the costs of such discounts generally and inflating the price of cars sold on credit but not cars sold for cash, then the auto dealer has imposed a finance charge upon credit buyers, and the dealer is required by TILA to disclose the discount cost to the purchaser. However, if the dealer recoups the cost by raising the price of all its cars, cash and credit alike, then the discount becomes a "cost of doing business" and need not be disclosed to buyers.[5]

Dealers should also not separately itemize the acquisition fees or discounts as non-finance charge components of the amount financed. A court or regulator would likely conclude that separately itemizing the acquisition fee or discount as part of the amount financed, instead of treating it and disclosing it as a prepaid finance charge as described above, also violates Regulation Z's disclosure requirements for prepaid finance charges.

The improper practices described above might also violate state credit laws, unfair and deceptive practices laws, and other consumer protection laws.

Important Note: This memorandum is offered for informational purposes only and is not intended as legal advice, and does not create an attorney-client relationship with any person receiving it. Consult

[3] *Balderos v. City Chevrolet*, 214 F.3d 849 (7th Cir. 2000).
[4] *Walker v. Wallace Auto Sales, Inc.,* 155 F.3d 927, 933 & n.8 (7th Cir. 1998). In another case, a price increase above the advertised price constituted a hidden finance charge where the undisputed evidence showed that the advertised price was available to cash and prime credit customers but was not available to the plaintiff because he required subprime financing. The additional $3,095 paid by the plaintiff was ruled to be a finance charge based in large part on the testimony of the dealer's General Manager who stated that the lower advertised price was the price actually charged to both cash and prime credit customers. *Diaz v. Paragon Motors of Woodside*, 424 F. Supp. 2d 519, 530-31 (E.D.N.Y. 2006).

[5] *Sampler v. City Chevrolet Buick Geo*, 2000 U.S. Dist. LEXIS 2322, at p. 10 (N.D. Ill. Feb. 24, 2000).

an attorney familiar with federal, state, and local law in this area concerning the laws and regulations described in this memorandum.