

**INDIRECT CREDIT AND LEASE MASTER AGREEMENTS
- WHAT TO LOOK FOR**

With the passage of the federal financial reform legislation, financial institutions and lease companies are sure to issue and ask you to sign new master agreements. These agreements will increase the burdens and obligations on your dealership. You will want to be sure that these agreements don't unnecessarily infringe the dealership's rights. So what do you look for?

Most master agreements impose few obligations on finance sources and lease companies. Generally, the only obligation is to pay a dealer when a contract is fully and properly assigned after the finance source or lessor decides in its sole discretion to approve the assignment of the retail installment sale contract (RISC) or lease. On the other hand, dealers have a broad range of obligations:

- the dealer must follow the requirements of the assignee's credit and lease programs;
- the dealer makes "representations and warranties" that accompany every assignment of a RISC or lease that, when breached, justify remedies against the dealer;
- the dealer covenants to do things such as filing the security interest and properly titling the vehicle, verifying insurance, and so forth;
- the products and services that may be included with sale of a vehicle are detailed and sometimes limited; and
- If the finance source or lessor suffers a loss as a result of breach of

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FINANCIAL REFORM LEGISLATION: THE OTHER SHOES

Franchised motor vehicle dealers are right to be proud of the work done to exempt themselves from the jurisdiction of the new Bureau of Consumer Financial Protection that will be created by the federal financial reform legislation. The exemption will be important in permitting dealers to work on behalf of consumers to help them find appropriate financing necessary for sales of vehicles. Winning the exemption required hard work by dealers and their trade associations. However, as with other matters involving Congress, there are other shoes about to drop.

BCFP jurisdiction anyway?

Not all motor vehicle dealers will be exempt from BCFP regulation. Under the statute, exclusion for a dealer extends

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only “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.” Congress was thus specific that a dealer must have a service operation to be exempt from BCFP jurisdiction. All franchised new motor vehicle dealers have service operations. Many used vehicle dealerships do not. Consequently, if your dealership is a used car operation that does not have a service department, you may be subject to BCFP jurisdiction. If you are a multi-dealer company that has a separately incorporated used vehicle dealership that does not have a service department, you may find that the BCFP considers that dealership subject to its jurisdiction.



dealerships. The FTC may use this new rulemaking power to consider regulation of dealer F&I practices.

Office of Service Member Affairs

Because of the highly-publicized concerns raised during the debates on the BCFP dealer exemption about the activities of some dealers in vehicle sales to service members and their families, there is a section of the law that requires the Federal Reserve System and the FTC to coordinate with the Office of Service Member Affairs to ensure that “service members and their families are educated and empowered to make better informed decisions regarding consumer financial products and services offered by motor vehicle dealers, with a focus on motor vehicle dealers in the proximity of military installations.” Based on this language, motor vehicle dealers that do business with service members may see rules applicable to them regulating how they may deal with service members.

Finance Sources and Lessors

The biggest shoe to drop for exempt dealers will come from the finance sources and lessors who are subject to BCFP jurisdiction and who accept assignment of retail paper and leases from dealerships. These companies will be subjected to the restrictions of the financial reform legislation, and they are likely to push down onto dealers as many of the compliance burdens and obligations as they can.

In that regard, it is more critical than ever that dealers understand the agreements they sign for indirect lending and leasing arrangements with finance sources and lessors. In the past, dealers have often simply signed the agreements tendered to them by these companies. Dealers must carefully consider the master agreements they sign when forming indirect arrangements with finance sources and lessors. The accompanying article in this newsletter will discuss what you should look for.

Buy Here Pay Here Dealer

A Dealer with a BHPH business will come under the jurisdiction of the BCFP as one whose “extension of retail credit or retail leases is not routinely assigned to an unaffiliated third party finance or leasing source.” So if you are a BHPH dealer, or your dealership does BHPH transactions at a level that BCFP regulators will define as routine, your dealership will not be exempt from BCFP regulation.

Federal Trade Commission

While the statutory exemption relieves certain dealers of BCFP oversight, the financial reform legislation expands the Federal Trade Commission’s authority to implement rules with respect to them. For years, the Federal Trade Commission has groused about the limitations on its rulemaking authority. With the passage of this new legislation, the Federal Trade Commission has the authority to develop rules about what it considers to be unfair or deceptive practices by motor vehicle dealers under the processes of the federal Administrative Procedures Act that are less cumbersome than the rulemaking procedures the FTC previously had to follow.

The Federal Trade Commission has for a number of years eyed F&I practices at

Look For (Continued)

the master agreement by the dealer, there are specific remedies against the dealer.

Here is a list of general issues to watch out for as finance institutions and lease companies revise their master agreements because of the impact of the new financial reform legislation.

1. Definition of “without recourse”. Dealers are accustomed to assigning contracts to creditors on a “WOR” or “without recourse” basis. This means that the paper is completely owned by the financial institution. In the event the customer defaults, the loss is solely that of the financial institution, unless the dealer breached its obligations to the financial institution with respect to the transaction.

Under the financial reform bill, the Securities and Exchange Commission has authority to require those securitizing commercial paper, such as auto loans, to retain 5% of the risk of loss for those obligations. Finance sources are likely to try to pass along the risk to dealers whether they securitize the paper or not. Watch out for financial institutions or lessors that redefine the term “without recourse” to nevertheless include some obligation of a dealer in the event of a customer’s default. Make sure that you review any master agreement to ensure that the definition of “without recourse” or “WOR” is exactly that. Make sure that it is fully without recourse to the dealer, except in the event of breach of the dealer’s obligations. If it is not, you will have to negotiate this term of the agreement or consider changes in how you account for these obligations.

2. Dealer Reserve. Dealers that assign RISCs have become accustomed to establishing dealer reserves for the APR in excess of the “buy rate” of the finance source that accepts assignment of RISCs from the dealer. Historically, these reserves have either been released to dealers with the right of chargeback or a portion of these reserves have been funded with no right of chargeback. Given the financial reform legislation, there may be substantial changes to reserve rights. Carefully review the provision of the master agreement concerning the dealer

reserve that will be permitted and how chargebacks will be assessed.

3. Dealer Practices. There are likely to be BCFP regulations restricting differences in terms or rates that may be charged to customers. Dealers saw a hint of these concerns in the FTC Risk Based Pricing Rule that will go into effect at the end of this year. Finance sources and lessors will likely seek to get a jump on this by requiring representations and warranties about dealer practices and tightening caps on interest rates that may be charged.

4. Dealer/finance source disputes. Where are disputes between the dealer and the finance source or lessor required to be determined? Where the dealer does business? Or where is it more convenient for the finance source or lessor? If there is a dispute it should be decided where the dealer is located. Given increased regulation, finance sources and lessors will be more inclined than ever to attempt to have disputes determined where it is most convenient for them – in their home state. Be on the lookout for these provisions and make sure that you do not have to travel long distances to protect your rights.

5. Warranty of Customer Information. Some master agreements require dealers to warrant not only what they know and represent to the finance source or lessor about the customer, but also that everything the customer has represented is true. While it is reasonable for the finance source or lessor to require the dealer to represent that it has properly described what it knows, it is overreaching to require a dealer to guarantee the truth of all representations made by the consumer. Any such warranty or representation should contain a “knowledge” of the dealer qualifier.

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6. Insurance. Does the master agreement require the dealer to verify insurance? Or does the agreement require the dealer to guarantee that fully paid insurance covers the vehicle for an extended duration? A requirement that the dealer verify insurance is appropriate. A requirement that the dealer guarantee the existence of insurance for an extended period is overreaching.

7. Delivery Prior to Assignment. Does the master agreement include a representation by the dealer that the vehicle was not delivered to the customer prior to assignment of the contract to the finance source or lessor? In spot delivery situations, vehicles are almost always delivered to the customer prior to assignment of the contract to the finance source or lessor. This is an obsolete representation that should be deleted.

8. Time to perfect a security lien. What period is given to the dealer to do title work and to perfect a security interest? U. S. bankruptcy law changed a few years ago to extend the period for perfection from twenty to thirty days. However, some agreements still require that liens be perfected within twenty days. That is improper, and it should be changed.

9. Sales of other products. Does the master agreement limit sales of other products such as extended service agreements? If so, is there a process for approval of the products the dealer sells? Or does the finance source or lessor reserve to itself the right to determine what products may be sold? Quite clearly, the dealer should have an opportunity to sell its products in connection with a RISC or lease that it assigns. These provisions are sure to be changed for the benefit of finance sources and lessors once the Bureau of Consumer Financial Protection commences regulation of financial

institutions that do business with dealers.

10. Scope of indemnification. For what does the dealer indemnify the finance source or lessor? It is appropriate to ask for indemnification for dealer breaches of the master agreement or for improper actions by the dealer. However, a dealer should not have to indemnify against problems caused by the finance source or lessor, including actions as a result of the form RISC or form lease that the dealer does not design.

11. Complaints. Does the finance source or lessor have the right to demand that the dealer repurchase a RISC or lease if the customer

makes a complaint against the dealer? Or does that right accrue only after there has been some determination of the customer's complaint that affects the rights of the finance source or lessor? Never agree that paper can be returned to the dealer simply because there is a complaint raised by the customer or because there is a dispute between the customer and dealer before there

is a litigated or arbitrated decision about that dispute.

12. Remedies Against the Dealer. Be careful of the remedies against the dealer if there is a breach of the master agreement. The finance source or lessor is entitled to demand that it may tender the RISC or lease for repurchase. However, some master agreements provide that upon a breach, the dealer can be required to repurchase the entire portfolio. That is never acceptable.

Dealers are sure to see dramatic changes in master agreements for indirect lending and indirect leasing. Know and understand what you are signing before committing to a new relationship or a revised master agreement.

