

The CFPB's first "disparate impact" rate markup case with Ally Bank continues to be the talk of the auto and auto finance industries, and took center stage at AFSA's Vehicle Finance Conference and the annual NADA Convention in New Orleans last month.

The [Ally Consent Order](#) and a perhaps not coincidentally timed Center for Responsible Lending [Report](#) on discrimination in auto financing provide much more than a hint of the kind of regulation coming for F&I add-on products and the auto finance providers and dealers involved in their sale. The [CRL](#), for those unfamiliar with it, is a powerful consumer rights lobbying group with philosophy and policy that closely mirrors, or as some have suggested, may directly influence CFPB priorities.

If applied to Add-On products commonly sold in conjunction with an automobile transaction, the controversial CFPB data analysis based process for determining discrimination **leads to some likely game changers ahead for the Add-On product world and the traditional dealership F&I process.**

And that's apparently exactly what the CRL has in mind:

"We also call on regulators to collect data on the prevalence of add-on products in car loan transactions and to monitor whether certain groups of borrowers are disproportionately affected by these practices." - Report Conclusions, Page 17

ON THE HORIZON: DISPARATE IMPACT FOR ADD-ON PRODUCTS

Dealer discretion is the issue in the spotlight when it comes to rate markup. But "points" aren't the only part of the F&I equation where dealers have discretion in pricing.

While some direct consumer finance companies and subprime dedicated indirect providers have set standardized pricing for products (usually for their own captive or preferred products), most in the Indirect auto finance business have long provided only maximum advance caps for dealer sold F&I products like service contracts and GAP - commonly from \$1,500 to \$2,500 for a service contract and \$500 to \$800 for GAP. **It is up to the Dealer on each deal to determine what products fit the deal and at what price.**

It is easy to see that pursuing finance companies under the same philosophy of consumer equality, that the **dealer controlled variable cost of similar or the same products to consumers may appear discriminatory**, intentional or not, by the same kind of data analysis used to determine disparate impact of rate markups in a finance company's portfolio.

Further as the CRL's research suggests, it is possible that a disparate impact analysis may reveal a discriminatory result in **who actually buys products and who doesn't.**

Lastly, the issue of **complete disclosure of actual cost of products** (cash price vs. total cost inclusive of financing charges) runs through all of the product related CFPB Guidance Bulletins, recent enforcement actions and the CRL's Report. **A new format of standardized disclosure of product terms and especially cost, may be the only solution to meeting CFPB expectations** - requiring an adjustment to both finance company product underwriting dealer guidelines and to established dealer F&I processes.

ONE: ADD-ON PRODUCT PRICING

Since the advent of menu selling and advancements in F&I technology, product pricing at a franchise dealership can easily be standardized. But, while many dealers have set non-negotiable standard prices for their products, many currently choose not to - and there are plenty of sound business reasons not to, market competition and the challenging deal structuring associated with subprime transactions among them. On the independent, used car dealer side, standardized product pricing can be found few and far between - a function of the lack of franchise dealer resources in both training and technology.

Yet, even with product menus and F&I technology standardizing product presentations, **exactly how product pricing is disclosed** is squarely in the cross-hairs of regulators. Since last summer's [first CFPB auto finance enforcement action](#), it is clear that regulators expect consumers to be advised that adding a product's cash price cost to their loan increases the total cost of the product based on loan term and rate. The CRL position takes it a step further, suggesting that the cost of each product be broken out of menu packages with the total cost of each product explained separately. The CRL argues that the traditional dealership practice of disclosing product pricing by **comparisons in monthly payment** (payment with and without product) is insufficient to protect consumers.

Takeaways for Auto Finance Providers:

- Auto finance providers with captive products are ahead of the curve: preferred or captive products are almost always offered at a non-negotiable consumer retail price ensuring that every customer gets the same product at the same price
- Monitor discretionary dealer product selection and pricing
- Develop new guidelines for dealer product selection and pricing
- Verify accurate product pricing disclosure in funding process
- Independent dealerships require additional training and guidelines

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WHAT'S NEXT FOR ADD-ON PRODUCTS?

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TWO: WHO BUYS ADD-ON PRODUCTS?

The CRL's Report adds another issue beyond pricing - broader questions of who buys add-on products in the first place and if there is evidence that protected classes buy more products or products more frequently than others. The report also alleges that dealerships regularly fail to disclose product purchases are optional. **There are a number of concerns with the CRL's Report.** First, it is clear the CRL fails to see value in most products - that **bias or misunderstanding of issues and operations in the product industry** can be seen in their citations to product studies focused on service contracts *direct marketed* to consumers rather than through dealerships, and a misconception of how legitimate vehicle service contracts, GAP and credit/life insurance products benefit consumers in the real world. **Secondly, by their own disclosure, the study failed to account for creditworthiness of those surveyed at the time of vehicle purchase.** Creditworthiness has a substantial impact on loan terms and the type of vehicle purchased - both of which greatly determine the value of the products at issue.

Nonetheless, the CFPB's disparate impact statistical analysis appears to provide no consideration for these and other relevant issues and accordingly the CRL's suggestion that protected classes of consumers buy products at a greater rate than others, could end up being demonstrated. Unfortunately, whether there are non-discriminatory reasons for purchase rates does not seem to be of concern to consumer advocates.

On this issue, franchise dealerships are well served by the established and prevailing F&I practice of offering, "every product to every customer, every time". A practice backed up and documented by F&I technology in virtually every dealership. Here again however, shortfalls in *independent used car dealership* training and technology create a concern for auto finance providers serving these dealers.

Takeaways for Auto Finance Providers

- Finance providers with captive products must establish a compliant dealer sales process that is incorporated into and governed by the Dealer Agreement
- Finance providers that directly sell products should adopt the franchise dealer model of consistent presentations to every customer
- Independent dealerships require additional product training and guidelines from finance provider partners
- Monitor dealer product sale/penetration rates
- Verify product purchases were optional in funding process

THREE: THE BOTTOM LINE FROM FNI

While some consumer advocates may not agree, **the fact is properly selected and presented products are a win-win-win proposition for consumers, dealers and finance companies.** Adapting to this new regulatory environment and mitigating risks associated with new compliance obligations means finance companies must provide greater guidance and control over discretionary dealer product selection and pricing; take an active role in monitoring and verifying funded product sales; and design and implement processes and procedures that ensure product benefit, limitation and total cost disclosures are provided to every customer, every time.



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FNI SERVICES

Provider & Product Due Diligence

Documented due diligence in selecting product administrators (Service Providers) and vetting of product marketing materials for consumer protection compliance is the first and most important step in your product compliance program.

FNI assists financial institutions with provider and product due diligence and documentation for new or existing product programs.

Product Compliance Process Design & Program Management

Financial institutions are ultimately responsible for a) How captive or preferred products are marketed to consumers by employees and dealer networks; b) The performance of add-on products and c) Service Providers' interactions with customers.

FNI provides complete marketing compliance, training, program and vendor management process design and implementation strategies for your existing or new product program.

Turn-Key Product Solutions

FNI products and benefit programs provide real consumer value and enhanced business profitability for financial institutions. FNI bundles superior products from vetted administrators with a proprietary vendor and product management solution designed for financial institution compliance with CFPB's Service Provider and Add-On Product Bulletins.

You can rely on FNI industry expertise for development and implementation of effective compliance management and risk mitigation processes for Service Provider relationships and product offerings subject to CFPB oversight.

ABOUT FNI

FNI President David Bafumo has sixteen years of combined experience in financial insurance product development and marketing, finance provider product implementation and sales management, and commercial litigation.

David received his J.D. from Washington & Lee University Law School and is a member of the Virginia State Bar.

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