CFPB Takes Aim at Buy-Here, Pay-Here

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On January 21, the Consumer Financial Protection Bureau released a law enforcement settlement that should cause dealers to take notice. The settlement, involving Herbies Auto Sales, a single-lot buy-here, pay-here dealership in Colorado, is noteworthy for its attack on pricing and sales practices that are common throughout the BHPH industry. Herbies did not admit to any of the CFPB's allegations, but the allegations are nonetheless surprising.

The CFPB's lawsuit claimed that Herbies violated the Truth in Lending Act and Regulation Z by not including in the APR and finance charge calculations the cost of a warranty and a payment reminder device it required credit customers, but not cash customers, to buy. This allegation, by itself, is unremarkable. Compliance attorneys have long advised dealers that charges imposed only on credit customers may be deemed "hidden finance charges" under TILA.

But the Bureau did not stop there. It also asserted that Herbies negotiated the sales prices of vehicles it sold for cash but refused to negotiate prices in credit sales. According to the Bureau, while that differential practice was not itself unlawful, Herbies should have included in the finance charge and APR the difference between what Herbies *would have* sold a particular vehicle for in a cash purchase, following negotiations, and what it *actually* sold the vehicle for in a credit sale. So, for example, if Herbies sold a car on credit for $5,000, it should have figured out how much lower the price would have been if the car had been sold for cash and added the difference to the finance charge. But no one … not the Bureau, Herbies, or anyone else, except for, perhaps, a soothsayer … could have predicted what Herbies *would have negotiated* in a hypothetical cash transaction for a specific vehicle. Not knowing the hypothetical negotiated cash sale price makes disclosing this "hidden finance charge" on TILA disclosures impossible. The Bureau nonetheless alleged it as a violation.

The Bureau also took aim at Herbies' sales and pricing practices. As alleged, Herbies did not display a purchase price on any of its vehicles. For credit sales, a customer qualified for a vehicle based on his or her needs and ability to pay. Specifically, Herbies identified a monthly, bi-weekly, or weekly payment amount that a customer agreed he or she could pay and allowed the customer to choose among vehicles that fit that payment amount. This practice, common in the BHPH industry, comports with how many used car purchasers shop … based on the periodic payment amount rather than the total price. Herbies did disclose the full purchase price prior to closing a transaction, along with other disclosures required under federal and state law. At that point, any customer had the opportunity to decline the transaction and walk away. In the CFPB's view, however, providing the purchase price only at the end of this process is an "abusive" practice because consumers could not adequately protect their own interests by declining the transaction. Going forward, Herbies' agreement with the Bureau requires it to post a purchase price on all automobiles available for sale. Herbies must also disclose several items of information to customers, some of which go beyond what is required by TILA and Reg. Z, when making credit sales:

- the auto's make, model, year, and VIN;
- the duration of the financing contract;
- the timing, number, and dollar amount of periodic payments;
- the total number of payments;
- the purchase price and finance charge;
- a list of any add-on products to be included in the financing; and
- the APR, including amounts for mandatory add-on products.

These disclosures must be made before or at the same time as Herbies is "offering a specific automobile to the consumer or in any way soliciting a commitment from the consumer to purchase." The disclosures must be in writing and signed by the customer.

Many (ourselves included) will take issue with the CFPB targeting a small BHPH dealer for practices that are widespread throughout the industry. This is especially true because those practices were not intended to, and in fact did not, harm consumers. Nonetheless, dealers should take away the following "lessons learned" from the CFPB's enforcement action:

- *Mixing cash and credit sales comes with a risk for BHPH dealers.* The Bureau's case hinged on the fact that Herbies made both cash and credit sales. What the settlement does not say, but what we know was the case, is that Herbies made very few cash sales at all, and those sales were for lower-quality, older inventory. But it was enough for the Bureau to take action. If a dealer wants to offer both cash and credit sales, it would be wise to (1) include the cost of any add-on products that are required only for credit sales in the finance charge and APR (in the process being mindful of state law finance charge caps and their applicability); and (2) eliminate any policy that allows price negotiations for cash sales but not credit sales (or somehow come up with a way of measuring the impact of those negotiations on the relative prices of cash and credit sales).
- *Bundling warranties will help your customers, but it may hurt your compliance.* Herbies provided its customers with a warranty to help them maintain the collateral and ensure they had access to transportation. Its customers were overwhelmingly satisfied with the warranty program. Yet, because Herbies made a handful of cash sales for which the warranty was not required, the Bureau viewed the warranty as a hidden finance charge.
- *Pricing deals solely to the payment amount is a hazardous practice.* The CFPB's concerns with Herbies' sales process essentially distill to one fact: Herbies did not disclose a final sale price until consummation, when the customer was signing the paperwork. Many BHPH dealers do not post sales prices because they negotiate deals according to payment amount. Going forward, dealers should consider posting prices on vehicles and advising customers early on of the total price and other terms, even if the customers only care about the amount of the monthly payment. Although the specific disclosure requirements to which Herbies is now subject do not necessarily

apply to all dealers, they provide a roadmap for what the Bureau expects from BHPH dealers.

- *No actor is too small.* Herbies, by any measure, is not a large-scale participant in the BHPH market. Those thinking they are too small and insignificant to draw attention from the CFPB should think again.
- *If you ignore these lessons, you may pay a steep price.* Under its agreement with the CFPB, Herbies is required to pay a total of $700,000 to past buyers, in the form of credits to those with active accounts and cash to those who have paid off their financing. In addition, the agreement assesses a $100,000 civil penalty, payment of which is suspended due to Herbies' financial condition. The CFPB routinely requires companies accused of wrongdoing to pay consumer redress and/or penalties. Investing now in your compliance management system will reap benefits down the road.

In the final analysis, we think the CFPB's settlement with Herbies indicates that the Bureau has problems with a business model that many BHPH dealers have followed for years. While the CFPB has targeted BHPH practices in the past, i.e., the DriveTime and CarHop cases, those matters focused on arcane credit reporting issues rather than the business model itself. Herbies undoubtedly will not be the last Bureau BHPH enforcement target.