***Moving the Metal: The Auto Finance Podcast* – Loans, Retail Installment Contracts, and Refinancing Programs**
Hosts: Brooke Conkle and Chris Capurso
Guest: Jason Cover
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Brooke Conkle:

Hello and welcome to *Moving the Metal*, the premier legally-focused podcast for the auto finance industry. I'm Brooke Conkle, a partner in Troutman Pepper's Consumer Financial Services Practice Group.

Chris Capurso:

And I'm Chris Capurso, an associate in Troutman Pepper's CFS team.

Brooke Conkle:

Today we are joined by Jason Cover, and we will be discussing refinancing and its impacts on the auto finance industry.

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Brooke Conkle:

Today, we'll be discussing refinancing and its impacts on the auto finance industry. Jason, welcome to the show.

Jason Cover:

Thanks, Brooke.

Chris Capurso:

So, before we get into the many questions we have for you, Jason, could you just tell us a little bit about your practice?

Jason Cover:

Sure, thanks, Chris. My name's Jason Cover, and I am a partner in the Philadelphia office. I'm in the CFS, what we call regulatory group. So, I primarily focus on the alphabet soup of federal and state regulation and work a lot on product design and generally helping clients find innovative solutions to complex problems.

Chris Capurso:

Great. With that kind of intro, we're going to dive right in. And, as Brooke mentioned, we're going to be talking about refinancing. But at a very basic level, one of the things I wanted to get at was in auto finance, we see a lot of what are called retail installment sales. Yet, with refinancing, we're talking about loans more often. Jason, I was just wondering, what is the difference between a retail installment contract and a loan?

Jason Cover:

Chris, I think most of us inherently understand what a loan is, right? At its most basic form. It's a cash disbursement that's payable over time, usually with some sort of finance charge associated with it, whether that's interest or something else. I think if you go to any of the conferences, us consumer credit nerds go to, you'll invariably hear someone say that credit has been around since biblical times and usury is documented and so on and so forth. Whereas credit sales or retail installment sales or retail installment contracts, whatever you want to call them. I think both clients and internal colleagues sometimes struggle with that concept. This is more of a, I suppose, an English common law concept that's been codified in various states. But at its core, it is essentially the right of a seller to set its price and defer payment over time. In most states, there is common law, case law stating that kind of concept is not subject to usury and is not a loan. It's a credit sale and it was often deregulated.

I think then, you saw like a trend in the sixties and seventies, particularly as department stores started offering revolving credit accounts for sales at their department stores. I think nearly every state, except maybe New Hampshire, and a handful of others, adopted some sort of retail installment sales act and then some states have also adopted specific motor vehicle retail installment sales acts. Generally, these things kind of codify the types of goods and or services that are subject to the act, so that if you have a seller selling any of those goods, they may have limitations and not interest typically. I mean, they may call it interest, but the common law phrasing is time price differential. So, that's sort of the finance charge for a credit sale.

I guess critically, I kind of think of these in two different ways. Like a loan, it's sort of like a tripartite arrangement, right, where I want to buy something. I speak to a seller. And then we go

and find a lender. And I agree to pay the lender the amount. The seller gives me the goods or services. Then, the lender disperses the funds directly to the seller. In contrast, a credit sale is sort of like a linear flow almost, right? I'm a buyer. I speak to the seller. I want to buy something. The seller says, “Great.” They originate the credit themselves in the form of the RIC or the retail installment sale agreement, whatever you want to call that. Then, they may pass that along to a holder or a sales finance agency that purchases that RIC for amount, either the full price or at a discount.

So, it's just a little bit – I think the eventuality is largely the same, but it's a little bit of a different structure.

Chris Capurso:

Yes. In auto finance, most people are probably going to be dealing with some form of retail installment contract. I mean, you think of, I don't know, you think of the dealer and then they assign it to insert your manufacturer, auto finance, or finance company, or whatever they are. That's usually always the consequence of a retail installment contract where the seller is the original creditor and passing it off. But then you could have scenarios in the original buying where you go to your credit union or your local bank or something like that. Like you said, get the proceeds to go pay for it. Then, at that point, you've bought the car and then you have a separate financing agreement with whoever gave you the loan, whatever entity.

Jason Cover:

Yes, I think that's right, Chris. I mean, I think the vast majority of car financings in the U.S. are done through the credit sale or retail installment contract model. That isn't to say that you couldn't do it through a direct lending model either. It's just not set up that way for the most part. I know, we have clients in the business that just don't do – no loans at all. I've talked to some of our clients that may offer loans, but to your point, it's usually a de minimis portion of their overall volume.

Brooke Conkle:

What are some of the state law considerations for loan programs that might be different from a retail installment sales contract finance operation?

Jason Cover:

Yes. Brooke, I think one reason some of our clients like to use the credit sale or RIC model is that generally speaking, at least at the state level, I'm kind of excluding banks out of this that may have much more liberal rate authority and so on and so forth. But generally speaking, the state laws that govern RICs tend to be more flexible. They tend not to acquire as much licensing. Often rates and fees are much more deregulated. There tends to not be as much direct supervisory examination at the state level.

In contrast, the lending world, almost every state, particularly if you go beyond a certain rate trigger, will require a license. You'll be subject to routine examination or supervisory authority. Most states are going to have some sort of cap on the types of finance charges, on the way you

impose finance on various fees, et cetera. There could be periodicity or substantially equal payment amount requirements.

So, on the whole, I think the RIC/RISA world is just a little bit more, there's just not as much governing it, whereas anytime a loan is evolved, there does tend to be more and there tends to be more supervision at the state level. I do think that in some ways, there's been an explosion of growth in the RIC model outside of traditional auto finance. So, this is maybe a little bit more on the radar than it used to be, but those laws generally remain the same. I guess I would add, there's just kind of like two primary attacks on both of these types of products. For credit sales, the plaintiff's attorney or a regulator that doesn't like your transaction may try to recharacterize credit sale as a loan, right? They're essentially saying, “Well, you weren't really the seller in this transaction. It was really the sales finance agency. Therefore, it should have been – it's essentially a disguise loan.” This is just what anyone would do to try to take advantage of a statute that's more favorable to a consumer. You'd want to try to recharacterize the credit sale as a loan.

In contrast, for lending, there's this concept of dragging the body. So, that's essentially, I think the traditional model was like at the dealership, there would be a little, a hut or something across the street and they would literally drag the body across the street and say, “Have we got a great loan for you?” That may have been because it was more advantageous to lend in that state and do the RIC model or for other reasons. That's just kind of the flip of recharacterization, right, of the RIC as a loan, now we're going to try to recharacterize the loan of the credit sale, essentially saying that the seller was really the lender and it was a sham.

Chris Capurso:

That's an interesting point on recharacterization, because speaking to an auto finance audience, we're talking about potential recharacterization of a credit sale into a loan. And then there's some instances where there could be recharacterization risk of a lease into a credit sale. You kind of go down the wrong of deregulated products.

Jason Cover:

Yes, I think plaintiffs’ attorneys and regulators are always clever, so they will figure out whichever is the best way to attack something and proceed from there.

Chris Capurso:

Predictable in that sense. So, we're talking generally about RICs versus loans, but are there any differences or other considerations for refinance transactions specifically between loans and RICs?

Jason Cover:

Yes, I think for loans, Chris, I mean, refinance transaction on the whole is pretty simple, right? You sort of add that extra box to your TILA disclosure, at about amount credited to your account. Largely, you proceed from there. I mean, most licensed lending statutes, I would say, specifically authorized refinance transactions, there may be some timing limitations, right? I think this is generally more applicable to small dollar statutes, but there may be something there

that X amount of time has to go from origination until you can refinance. Then, there could be restrictions on the types of things that can go into the refinance transaction. Can principal interest and fees all get schooled into the new principal amount? But largely, it's pretty cut and simple once you're a lender or a licensed lender and you don't have to worry too much.

For RICs, I think it does cause confusion, right? Because we get back to that concept of a seller originating the credit, the extension of credit to finance the car. Once that's passed to the holder, it kind of raises the question of, okay, well, when you refinance into another credit sale, what does that mean, right? Are we the seller anymore? Do we have the ability to do this in a new credit sale? Does it have to be refinanced as a loan? You kind of have to address that initial concern of what is the transaction and is it appropriate for wherever the paper is at that point. And then, I think if you look at the retail installment sales acts or the motor vehicle retail installment sales acts, there's usually very specific provisions about, I think, like modifications or add-ons or refinanced transactions generally that may be more specific than in lending world. So, you really have to sort of hone in on the state requirements about how that works and who can do what.

Brooke Conkle:

Jason, in the current climate, we're seeing just higher and higher numbers of consumer delinquencies in auto finance. How can auto finance companies use refinance programs to try to stem this tide of delinquencies?

Jason Cover:

Yes, Brooke, I think the easiest use case is what a lot of people use a refinance for is essentially to lower the payment amount, right? I mean, this could happen not just in auto, but in mortgage or wherever, right? I'm currently paying a lot of money and I'd like to pay less. So, you can obviously use a refinance transaction in that sense.

I do think you have to give a little care and concern when you do that, right? I mean, the use case that's raised often by consumer advocates, regulators and others is like rolling over, and I think this happens more in traditional installment lending, but rolling over transactions over and over and over again to get insurance money or to get origination fees, things of that nature. So, you need to, A, be a little bit careful there. And then B, you need to give a little consideration into the appropriateness of the refinance transaction, right? I mean, are we going into a higher rate over more time, particularly for like an auto transaction? There may be a point where the loan is so long that it doesn't make a lot of sense. I think that has been, or the, I guess, the refi'd credit sale. There's been criticism that as these loans, the financings get longer and longer, that they sort of get past the useful point of the car, et cetera, et cetera.

Then I think you just need to be careful anytime you're taking a lower APR into a higher APR and suggesting to consumers that that's like a good deal or it's appropriate for them. But I think there's obviously other guidelines and you need to make sure you check all your boxes for state law and whatnot. But I think that to me is kind of the use case, but you need to give consideration.

Chris Capurso:

Yes, we'll probably be seeing, I shouldn't say probably, hopefully with fingers crossed, hopefully be seeing some lower rate environments here soon, which is what seemingly a lot of people in the mortgage and auto industry are hoping for. But kind of going on that point, and what's coming in the future, what are some things that we should be watching out for, and auto finance companies should be watching out for in the next year specifically related to refinance?

Jason Cover:

I mean, I think you hit the nail on the head, Chris. It's like, what's going to happen with rates in the next year? I think we've all been waiting with bated breath for all sectors of the consumer's finance. I think all finance generally, whether it's commercial or consumer, everyone is sort of sitting on their hands patiently waiting for the Fed to drop rates. I kind of think that that would potentially unleash a wave of refinance transaction. I'm sure in mortgage world particularly, where people have been probably paying more than they want for housing and you would like to get lower payments and a lower rate. I think that equally applies to auto finance. So, I think if you said, "pick one thing," that would be the thing I would be watching for.

Chris Capurso:

Awesome. Well, thank you so much, Jason, for coming on the podcast today and educating us all on RICs versus loans and the benefits of refinancing programs. Don't forget, this isn't directed to Jason. This is directed to all of you. Don't forget to check out our blogs where you can subscribe to the entire blog or just the specific content you find most helpful. That will be the ConsumerFinancialServicesLawMonitor.com and the TroutmanPepperFinancialServices.com blogs.

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