

Physician, Heal Thyself

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The title of this article is a proverb, the meaning of which is that before criticizing or attempting to correct others, make sure you aren't guilty of the same faults. The Consumer Financial Protection Bureau should heed this lesson.

A recent American Bar Association Consumer Financial Services Committee meeting featured a program titled "The Case for Financial Literacy." The panel consisted of three CFPB staffers and two lawyers from financial institutions.

According to the program synopsis, the panelists were to present a variety of financial literacy empowerment programs that benefit seniors, veterans, youth, and the economically vulnerable, including the CFPB's financial literacy efforts and those of a credit counseling agency and a prominent lender. The ultimate goal, claimed the program description, was "to establish tangible financial literacy projects for [Business Law] Section members to undertake."

The financial literacy training process requires making choices about what details are important for consumers to understand and what details are rounding errors. It's important to make those choices, and they often result in defensible legal generalizations. But consumers are also smart and inquisitive. When you intentionally (and paternalistically) 'dumb down' important legal distinctions that consumers can understand (like "seller financing" versus a "bank loan"), it is not helpful to consumers - especially when that 'dumbing down' is driven in part by an ulterior agenda.

I have a can't-miss tangible literacy project that the CFPB can undertake to improve its own financial literacy while helping consumers understand the specific terminology used in auto finance. My suggestion is that the CFPB teach its staffers that there are significant differences between auto *loans* and auto *credit sale agreements*. The Bureau consistently calls both transactions "loans," and that incorrect description hurts consumers.

Before I tell you how the CFPB's misuse of these fundamental financial terms hurts consumers, let me, once more, explain the difference between a "loan" and a "credit sale."

A **loan** involves a **lender** who advances **money** to a borrower. In an auto finance **loan transaction**, the grant of a security interest in the vehicle securing the loan

is set out in a **security agreement**. The security agreement language can appear in the loan document or in a separate document.

A **credit sale transaction** involves a **credit seller** who transfers **goods** to a **credit buyer** in exchange for the credit buyer's promise to pay for the goods over time. That promise is contained in a document called a "**retail installment contract**." In the auto finance world, the credit seller is the car dealer. The dealer may assign the contract to a third party, such as a bank or a finance company. When a consumer buys a car and arranges financing at a dealership, the transaction is almost always a credit sale.

When the CFPB incorrectly refers to credit sales as loans, here are several ways consumers can be harmed.

Consumers can be Misinformed About Applicable Law. In many states, loans and credit sales are subject to different laws and regulations. Critical terms of the transactions can be regulated differently, including

- the maximum permitted rate of finance charge;
- limits on bad check charges;
- limits on late charges;
- required grace periods; and
- consumer rights to cure and the seller's and buyer's rights and obligations upon default.

If the CFPB is really interested in financial literacy, wouldn't it want consumers to know that these distinctions can exist?

A consumer who has visited the CFPB's website and who trucks on down to her local library and asks the librarian to help her find the laws governing "car loans" may well end up looking at laws that don't apply to her transaction. She may think she has rights that she doesn't have, or she may have rights that she is unaware of because she's looking at the wrong law.

Consumers can be Disadvantaged by Loan Documents. If a consumer believes that all auto credit comes in the form of loans, the consumer might think that it makes no difference who the creditor may be. That isn't the case. Borrowers who sign loan documents with depository institutions often agree to terms not typically included in credit sale contracts. These terms can include

- cross-collateralization clauses, in which the consumer provides the lender with security interests in other property the consumer owns;
- cross-default clauses that turn a default in the repayment of one obligation into a default in otherwise current obligations owed to the same creditor; and

- rights of setoff that give the lender the right to apply monies held in the consumer's savings and checking accounts to amounts due under a defaulted obligation.

Because car dealers are not depository institutions and because they assign their credit sale contracts to third parties, such provisions are not found in typical credit sale contracts. It seems to me that this would be a handy thing for consumers to know.

The Bureau's Misuse of These Terms Leads to Regulatory Problems. On more than one occasion, the Bureau's slapdash and careless use of the term "loan" to apply to all auto credit has created ambiguity or outright errors in its own communications. When those communications are designed to help consumers understand financial transactions and to help businesses understand their compliance responsibilities, there's just no excuse for the Bureau's sloppiness.

I believe that the CFPB deliberately fails to describe credit sale financing accurately because the inaccuracy advances its agenda. The CFPB wants to position dealers as agents of finance companies and banks - mere arrangers of credit ("loans" in CFPB lingo). That permits the CFPB to claim that acts of the dealer are acts of the finance company or bank.

In fact, in the real world, dealers are initial creditors - independent of finance companies and banks - who create credit sale contracts that they can keep (in the case of buy-here, pay-here dealers) or that they can sell to one of the many finance companies and banks they deal with. The CFPB's arguments on a number of fronts (think discrimination) are much harder to press when the dealer is independent of the finance companies and banks.

So, there's my suggestion to the CFPB: Financial literacy begins at home.

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