

What FTC CARS Rule Means For Auto Dealers And Lenders

By **Daniel Savrin, David Monteiro and Allen Denson** (January 16, 2024, 4:51 PM EST)

On Dec. 12, 2023, the Federal Trade Commission issued a final rule that is squarely aimed at changing the way auto dealers interact with customers in the financing process.[1] The final rule, which follows a proposed rule issued in June 2022, is set to take effect on July 30.[2]

But the rule's effective date is subject to the outcome of *National Automobile Dealers Association v. FTC*, a legal challenge filed with the U.S. Court of Appeals for the Fifth Circuit by NADA and the Texas Automobile Dealers Association on Jan. 4.[3]

While the effects on auto dealers — and the consumers that purchase vehicles from those dealers — are the most obvious ones, it is expected that the rule will have an ancillary and potentially material impact on banks, finance companies affiliated with original equipment manufacturers, and other nonbank auto finance companies.

The final rule, which the FTC has restyled as the Combating Auto Retail Scams, or CARS, rule, differs in only limited respects from the proposal. The rule follows multiple FTC enforcement actions and consent orders over the last several years, particularly:

- *FTC v. Liberty Chevrolet Inc. dba Bronx Honda*, filed in the U.S. District Court for the Southern District of New York in 2020;[4]
- *FTC v. Tate's Auto Center of Winslow Inc.*, filed in the U.S. District Court for the District of Arizona in 2018;[5]
- *FTC v. North American Automotive Services Inc. dba Ed Napleton Automotive Group*, filed in the U.S. District Court for the Northern District of Illinois in 2022;[6] and
- *FTC v. Rhinelander Auto Center*, filed in the U.S. District Court for the Western District of Wisconsin in October 2023.[7]

Each of these cases has involved allegations that have made their way into the final rule.

The consequences of the rule for lenders and servicers, meanwhile, have been amplified, since the proposed rule's dissemination, by supervisory and enforcement actions that the Consumer Financial



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Protection Bureau has announced over the past year.

Key Provisions

The CARS rule is the final rule in connection with the FTC's proposed Motor Vehicle Dealers Trade Regulation rulemaking, previously issued on June 23, 2022.[8] The final rule:

- Prohibits misrepresentations about material information;
- Requires dealers to clearly disclose the offering price — "the actual price anyone can pay to get the car, excluding only required government charges";
- Makes it unlawful for dealers to charge consumers for add-ons that "don't provide a benefit"; and
- Requires dealers to get consumers' express, informed consent for certain charges.

Bringing Dealer Sales Practices and Conduct Within the FTC's Penalty Authority

In establishing this new disclosure framework, including a new FTC dealer's guide for compliance, the CARS rule brings certain already-prohibited deceptive dealer practices within the FTC's civil penalty authority.[9] The FTC has the power to seek civil penalties for deceptive trade practices proscribed by a trade regulation rule only.

In defining a specific universe of misrepresentations made in the course of selling, leasing or arranging financing for motor vehicles, the rule would subject violations of the provision to civil penalties up to approximately \$50,000 per violation — an amount that is adjusted annually by inflation.

Mandating Specific New Financing Disclosures

The CARS rule goes beyond existing disclosure requirements under Regulations M and Z, by requiring "clear and conspicuous" disclosure — now explicitly defined in the rule — of additional information about the purchase price of the vehicle, and prices for optional products.

Requiring Dealers to Obtain Consumers' Express Informed Consent to Any Charges Related to Sale or Lease

The FTC would expand the Napleton consent order's requirement of express informed consent to vehicle sale and lease charges to the entire industry.

The definition requires truthful, clear and conspicuous disclosure, both in writing and, for in-person transactions, orally, of the reason for the charge and the amount of the charge — followed by affirmative, unambiguous assent to be charged.

Prohibiting Sale of Add-On Products and Services That "Provide No Benefit" to Consumers

The CARS rule targets products and services that the FTC believes provide no value to any consumer — such as nitrogen tire products that do not include more than ambient atmospheric nitrogen. It also targets products and services that the agency says provide no value to the specific consumer — such as, per the FTC, guaranteed asset protection agreements when the loan-to-value ratio is already low, or

duplicative warranty coverage.

The FTC has not defined the universe of products or services that fit within these categories, leaving some elements to judgments that will be subjective, and the need to substantiate genuine benefits associated with ancillary products and services.

Imposing a Two-Year Recordkeeping Requirement on Dealers

Dealers would be required to create and retain records showing compliance. These would include advertisements, price lists, customer correspondence, financing documentation, loan-to-value calculations for all sales of guaranteed asset protection coverage, and customer complaints.

Departures From the June 2022 Proposed Motor Vehicle Dealers Trade Regulation Rule

After the notice and comment period, the FTC, in drafting the final rule, changed some key provisions. The final rule removes the so-called add-on list disclosure provision, which would have required dealers to keep and maintain a list of add-on products, including on their website.

The final rule also removed the "cash price without optional add-ons" provision, which would have required disclosures pursuant to the proposed definition and the consumers' affirmative declination of the cash price without optional add-ons.

The final rule also changed "motor vehicles" to "covered motor vehicles," and "dealers" to "covered motor vehicle dealers." These modifications clarify that sales of recreational vehicles, marine vehicles, motorcycles and certain other vehicles are not covered.

Lastly, the final rule slightly modifies dealer record keeping requirements, to reflect the above changes.

Context

The rule comes after years of statements from FTC commissioners in response to enforcement actions against auto dealers criticizing the way in which cars are sold and financed in the United States as a "broken" market in need of regulatory intervention.

During the last 10 years, the FTC has brought more than 50 law enforcement actions related to automobiles, and helped lead two nationwide law enforcement sweeps that included 181 state-level enforcement actions in these areas. Complaints from consumers related to automobile dealer conduct remain in the top 10 complaint types received by the FTC, with more than 100,000 complaints from consumers annually over the last three years.

After the FTC lost *AMG Capital Management LLC v. FTC* in the U.S. Supreme Court in 2021 — sharply curtailing the agency's ability to pursue monetary relief where the agency had not first undertaken a rulemaking — the agency turned its focus in part to laying out rules that could provide such a predicate.^[10]

Under the Dodd–Frank Wall Street Reform and Consumer Protection Act, passed in 2010, the FTC had been granted the authority to issue consumer protection regulations governing auto dealers using an expedited process, which made the industry a likely target for action.

With one major omission, the scope of the CARS rule hews closely to both the fundamental allegations and the remedies adopted in recent cases, and similarly tracks factual findings from the FTC's recent research efforts into the market. The agency's concern about the prices of optional products — what the FTC's official press release terms "junk fees" — also ties in with the initiative by the FTC and the Consumer Financial Protection Bureau against such fees.

Conspicuously missing from both the proposed rule and the final rule is any regulation of dealer markup, which was a significant focus of the FTC's Bronx Honda, Napleton and Rhinelander cases. While a substantial part of the preamble to the CARS rule proposal explained the role of markup in automotive finance, nothing in the rule would require additional disclosures or limits on dealer markups.

The FTC and CFPB have both focused on antidiscrimination concerns associated with dealer markup for years, and at least one current FTC commissioner has explicitly called for the regulation of markup in the past.

Implications for Automotive Lenders

The potential effects on dealers themselves will undoubtedly be substantial. The effects on the automotive lending market are subtler — but lenders and servicers should begin assessing and planning for the potential impact now.

Reduced Optional Products Revenue

The FTC expressly intends the rule to reduce dealers' sales of optional products. How dealers react could result in pressures across the automotive lending market.

Dealers may increase vehicle sales prices to replace lost revenue, or seek higher dealer reserves in financing transactions. Indirect lenders should be prepared to respond to these market changes.

Holder Rule Risks to Assignees

While the rule, like the FTC Act itself, does not contain a private right of action, many states' unfair or deceptive acts or practices laws do — and many treat the FTC's determination by rule that a practice is unfair or deceptive as conclusive or persuasive.

While there are defenses for lenders and servicers, customers and plaintiffs lawyers may consider bringing suits for dealer conduct that they contend violates the CARS rule.

An argument could be made that the FTC's Holder Rule can be read to allow consumers to bring those claims against assignees for indirect auto loans — particularly following April 2021 guidance rejecting the existence of a "large transaction" ceiling on that rule's applicability.

These considerations counsel in favor of greater due diligence by assignees, establishment of standards for assignment of loans, and indemnification provisions related to noncompliance as supplements to other protective and defensive measures.

Follow-On CFPB and State Scrutiny of Automotive Lenders

Many automotive lenders are banks or other finance companies that fall outside the FTC's jurisdiction.

But the FTC, the CFPB and state enforcement officials such as state attorneys general and financial regulators collaborate closely.

Automotive lenders should anticipate that these regulators may look carefully at whether they are purchasing retail installment contracts that comply with the CARS rule, with a specific focus on financed optional products that generate additional interest revenue for the lender.

While the market dynamics are different than they perceive them to be, enforcement officials have historically been reluctant to credit arguments that the dealer is solely responsible for compliance with the rule, and may well expect lenders to monitor the contracts they are purchasing for facial violations and suspicious patterns.

CFPB Supervision announced in its July 2023 Supervisory Highlights that it had taken action against an auto financing company, on the theory that knowingly benefiting, in the form of increased interest, from an auto dealer's inclusion of nonexistent features on a financed vehicle is an abusive practice in violation of the Dodd-Frank Act.[11]

While this is an aggressive reading of the abusiveness authority, the risk that the CFPB takes the same view of add-on products prohibited by the new CARS rule is high.[12]

Additional and more complex recordkeeping and compliance requirements create added financial costs for dealers as well as the automotive lenders that must police those requirements. The prospect of significant per-violation penalties means that the costs of compliance measures, although significant, are necessary.

Next Steps for Lenders and Servicers

Lenders and servicers should start reviewing compliance processes, and consider proactive steps to address dealer noncompliance. The final compliance deadline of July 30 will arrive quickly, though the outcome of the NADA challenge to the rule and motion to stay the rule's effective date, which seeks an expedited ruling before March 31, could change the deadline.[13]

Lenders should consider particularly:

- What information is already available about retail installment contracts and vehicles that would help monitor for dealer violations of the rule — especially dealer violations of the rule that might be argued to benefit the lender?
- What level of testing and monitoring is appropriate to identify dealerships that create greater risk?
- What additional information is needed from dealers to make that testing more effective?
- Which dealer-marketed optional products create the greatest potential risk for the lender?
- What tools, such as reserve accounts or enhanced monitoring of higher-risk dealers, can be deployed to create dealer incentives toward compliance with the rule?

- What lines should be drawn that strike the right balance between mitigating upstream risk to lenders and servicers, administrability of a compliance program, and reasonable interpretations of the more nuanced aspects of the regulation?

For lenders and servicers in particular, the key in regulatory interactions following, and even leading up, to the effective date of the rule will be to demonstrate that they understand the effect of the rule — and have a deliberate plan for compliance.

Automotive finance companies should address issues with dealers early on, so that they can and do confirm compliance, or compliance undertakings, and can make informed decisions on how to proceed in terms of accepting RIC assignments and mitigating associated risks.

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[1] <https://www.ftc.gov/news-events/news/press-releases/2023/12/ftc-announces-cars-rule-fight-scams-vehicle-shopping>.

[2] <https://www.morganlewis.com/pubs/2022/06/proposed-trade-regulation-rule-on-auto-dealer-sales-practices-could-dramatically-affect-auto-finance>.

[3] See Pet. for Review, Nat'l Auto. Dealers Ass'n v. Fed. Trade Comm'n, No. 24-60013 (5th Cir. filed Jan. 4, 2024).

[4] <https://www.ftc.gov/news-events/news/press-releases/2020/05/auto-dealership-bronx-honda-general-manager-pay-15-million-settle-ftc-charges-they-discriminated>; Compl., FTC v. Liberty Chevrolet Inc. dba Bronx Honda, No. 1:20-cv-03945-PAE (S.D.N.Y. filed May 21, 2020).

[5] <https://www.ftc.gov/news-events/news/press-releases/2018/08/ftc-charges-auto-dealerships-arizona-new-mexico-falsifying-consumers-information-financing-documents>; Compl., FTC v. Tate's Auto Ctr. of Winslow Inc., No. 3:18-cv-08176-DJH (D. Ariz. filed July 31, 2018).

[6] <https://www.ftc.gov/news-events/news/press-releases/2022/04/ftc-takes-action-against-multistate-auto-dealer-napleton-sneaking-illegal-junk-fees-bills>; Compl., FTC v. N. Am. Auto. Servs. Inc. dba Ed Napleton Auto. Grp., No. 1:22-cv-01690 (N.D. Ill. filed March 31, 2022).

[7] <https://www.ftc.gov/news-events/news/press-releases/2023/10/ftc-wisconsin-take-action-against-rhineland-auto-center-illegally-discriminating-against-american>; Compl., FTC v. Rhineland Auto. Ctr., No. 3:23-cv-737 (W.D. Wis. filed Oct. 24, 2023).

[8] 16 CFR Part 463.

[9] FTC CARS Rule: Combating Auto Retail Scams — A Dealers Guide, <https://www.ftc.gov/business->

guidance/blog/2023/12/ftcs-cars-rule-why-new-rule-combat-auto-retail-scams-great-news-consumers-honest-dealers.

[10] <https://www.morganlewis.com/pubs/2021/04/us-supreme-court-ftc-cannot-seek-equitable-monetary-relief-in-section-13b-cases>.

[11] https://files.consumerfinance.gov/f/documents/cfpb_supervisory-highlights_issue-30_2023-07.pdf.

[12] <https://www.morganlewis.com/pubs/2023/04/abusive-acts-and-practices-putting-the-cfpbs-policy-statement-into-practice>.

[13] Pets.' Opposed Mot. for Stay of Final Rule and for Expedited Consideration, Nat'l Ass'n of Auto. Dealers v. Fed. Trade Comm'n, No. 24-60013 (5th Cir. filed Jan. 8, 2024).