

Department of Legislative Services  
 Maryland General Assembly  
 2020 Session

FISCAL AND POLICY NOTE  
 First Reader

House Bill 655 (Delegate Queen, *et al.*)  
 Economic Matters

Consumer Protection - Automobile Financing Charges - Required Dealer Disclosures

This bill requires automobile dealers to register as credit services businesses and establishes standards and disclosure requirements related to indirect automobile lending.

Fiscal Summary

**State Effect:** Special fund revenues increase by \$2.5 million in FY 2021 and \$1.2 million in subsequent years due to new licensees. Special fund expenditures increase by at least \$101,000 in FY 2022; out-years reflect ongoing personnel costs. General fund revenues increase minimally due to the expansion of existing penalty provisions to additional licensees.

(in dollars)	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025
GF Revenue	-	-	-	-	-
SF Revenue	\$2,545,600	\$1,193,300	\$1,193,300	\$1,193,300	\$1,193,300
SF Expenditure	-	\$101,000	\$92,200	\$94,900	\$98,200
Net Effect	\$2,545,600	\$1,092,300	\$1,101,100	\$1,098,400	\$1,095,100

*Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate increase; (-) = indeterminate decrease*

**Local Effect:** The bill does not materially affect local government finances or operations.

**Small Business Effect:** Meaningful.

Analysis

**Bill Summary:** The bill expands the definition of a “credit services business” under the Maryland Credit Services Businesses Act to include a vehicle dealer (as defined in

§ 15-101 of the Transportation Article) who participates in finance charges associated with a contract for the sale of a vehicle by the dealer.

Prior to the execution of a financing agreement on a contract for the sale of a vehicle to a buyer, a dealer must disclose, in writing on separate documents, to the buyer (1) all financing offers for which the buyer was approved, including the “buy rate” and the term in months for each offer and (2) whether or not the dealer is being compensated for increasing the “contract rate” to a higher rate than the “buy rate,” as specified. The dealer must also obtain the buyer’s signature on the required disclosures.

The “buy rate” is the lowest annual percentage rate (APR) that an indirect lender indicates to a dealer would need to be a feature of a contract for the sale of a vehicle in order for the indirect lender to purchase the contract. “Contract rate” means the APR in a (1) contract offered for the sale of a vehicle or (2) final contract for the sale of a vehicle.

The bill prohibits a dealer from participating in finance charges that would result in a difference between the buy rate and the contract rate of more than:

- 2 APR points for a contract that has an original scheduled term of up to 60 monthly payments; or
- 1.5 APR points for a contract that has an original scheduled term of more than 60 monthly payments.

**Current Law/Background:** The bill is one of several recommendations made by the [Maryland Financial Consumer Protection Commission](#) (MFCPC) in its [2018 report](#).

According to the report, the majority of all car purchases are financed. The Center for Responsible Lending (CRL) states that 80% of cars are financed through dealers and just under 80% of automobile loan volume is through indirect lending, which often includes hidden interest rates and markups.

An automobile dealer may provide financing directly or it may facilitate indirect financing by a third party (*i.e.*, a bank, a nonbank affiliate of a bank, an independent nonbank, or a “captive” nonbank). In indirect automobile financing, the dealer collects basic information about an applicant and provides that information to prospective indirect automobile lenders. When an indirect automobile lender is interested in purchasing a retail installment sales contract executed by the consumer with the dealer, the lender provides the dealer with a risk-based “buy rate” that establishes a minimum interest rate.

The indirect automobile lender often allows the dealer to mark up the interest rate above the “buy rate.” For instance, a “buy rate” may be 4.0% and a dealer marks up the rate by

2.0%, making the real rate 6.0%. This markup is not mentioned in any documents signed by the consumer. Dealers claim the practice is justified to cover the cost of arranging customers' financing. Manufacturers' captive finance companies seemed to have settled on a limit of up to 2.5% markup, according to testimony at a commission hearing in late 2018. The National Automobile Dealers Association explained to the commission that it is customary for lenders to cap the spread. Based on information available to the Office of the Attorney General, it appears that major lenders are capping spreads at 2% or less.

In its 2011 study of automobile loan markups, CRL found that buyers with weaker credit scores may be targeted for markups because they have fewer alternative financing options. Consumers are often unaware that the available rate and terms communicated to them by the dealer may be higher than the "buy rate" set by a given lender because the dealer has an incentive to generate higher compensation by increasing the rate that is offered to the borrower. In certain cases, the dealer "markup" may be several percentage points higher than the interest rate available to a consumer, resulting in substantial dealer compensation to the detriment of the Maryland consumer.

MFCPC recommended legislation bringing greater transparency in this process and imposing reasonable limitations on the means by which automobile dealerships are compensated for their role in the indirect automobile lending process by lenders. The commission recommended licensing and oversight of the dealerships offering credit to Maryland consumers, capping back-end compensation in order to restrain abusive automobile financing practices, and providing additional disclosures to consumers relating to the financing charge.

**State Revenues:** In total, special fund revenues increase by \$2,545,600 in fiscal 2021 and by \$1,193,250 annually thereafter, assuming the number of renewals remains constant in future years. This estimate is based on the Office of the Commissioner of Financial Regulation's (OCFR) expectation that the number of credit services business licensees increases by about 1,591 under the bill, consistent with data from the Motor Vehicle Administration (MVA). These businesses must obtain licensure on the bill's October 1, 2020 effective date and renew prior to December 31, 2020. The licensing fee for a credit services business is \$850; however, a portion of that fee – \$100 – is paid to the Nationwide Multistate Licensing System and Registry (NMLS). Therefore, Nondepository Special Fund licensing revenues increase by \$2,386,500 in fiscal 2021. Licensees must also pay a \$100 investigation fee on initial licensure, resulting in an additional \$159,100 in fiscal 2021 only.

In addition, the expansion of existing penalty provisions to new credit services business licensees likely results in an increase in general fund revenues. However, any increase in general fund revenues is expected to be minimal.

**State Expenditures:** Despite the increase in licensees and related enforcement and complaint resolution activities, OCFR advises that additional resources are not necessary until fiscal 2022. This assessment is based on the administrative efficiencies resulting from use of NMLS and assumes that existing staff can handle the initial licensing and complaint workload. As a result, special fund expenditures increase by \$100,985 in fiscal 2022. This estimate reflects the cost of hiring one financial examiner (who has experience) and includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses.

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Salary and Fringe Benefits	\$95,460
Operating Expenses	<u>5,525</u>
<b>Total FY 2020 State Expenditures</b>	<b>\$100,985</b>

Future year expenditures reflect annual salary increases, employee turnover, and ongoing operating expenses. The Department of Legislative Services advises that additional resources may be necessary beginning in fiscal 2021; if so, special fund expenditures increase further.

**Small Business Effect:** Many of the business entities required to be licensed under the bill are likely small businesses. Such small businesses are subject to licensing and investigation fees as well as other regulatory requirements. Automobile dealers are currently required to be licensed by MVA pursuant to Title 15, Subtitle 3 of the Transportation Article. Therefore, to the extent any of those dealers are small businesses, the bill subjects them to licensing and regulatory requirements beyond those already required, which may result in additional licensing and compliance costs.

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### **Additional Information**

**Prior Introductions:** None.

**Designated Cross File:** None.

**Information Source(s):** Maryland Department of Labor; Maryland Department of Transportation; Department of Legislative Services

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