Bank Fees: They’re Not Just for Consumers Anymore

There has been a great deal of publicity concerning fees that financial institutions have sought to impose as a result of new laws such as the Dodd Frank financial reform legislation. Sometimes, the fees have received massive publicity like the debit card fees from which Bank of America had to retreat. Unfortunately, many other fees have not received that kind of publicity, and the epidemic of new bank fees has not afflicted only consumers. In fact, dealers who are entering all sorts of financial arrangements with their banks and other lenders should be on the lookout for fees.

One area of special concern for dealers is in floorplan financing. Today’s low interest rates, combined with the paperwork and audit responsibilities, can make floorplan financing a low profit product for some financial institutions.

Some lenders are addressing this by seeking to increase their yield. A floorplan lender wants to know that a dealer will be tied to it for a substantial length of time to justify the costs associated with setting up and maintaining a floorplan line. To ensure this, some lenders are imposing “prepayment” fees to enhance the return if a dealer changes its floorplan lender.

Generally, prepayment fees are used in term loans when the borrower pays off the balance early. For example, a borrower who pays off a five-year loan after two years to refinance at a lower rate with someone else will cost the bank its expectation of earnings. Historically lenders have dealt with this by imposing prepayment fees.

See Bank Fees Continued on page 3

Once Again, Know Your Customer

The Federal Trade Commission’s Red Flags Rule requires a dealer to know its customer in a credit transaction. For a number of reasons, it is important that a dealer know its customers no matter what types of transactions are going on. Let’s take a recent example.

Thirty used car dealers recently found out the unfortunate consequences of doing business with bad guys. On December 15, 2011, the federal government filed a 75-page civil forfeiture action which stems from an investigation by the DEA and other federal agencies. The complaint filed in the United States

See Know Your Customer Continued on page 2

IN THIS ISSUE...

Bank Fees: They’re Not Just for Consumers Anymore

Once Again, Know Your Customer

Seal Your Information Leaks

page 1

page 1

page 4
District Court for the Southern District of New York alleges that from January 2007 until early 2011 persons working with Hezbollah, a designated Foreign Terrorist Organization, developed an elaborate scheme to launder money by transferring funds from Lebanon to the US in order to purchase used cars, which were then shipped to West Africa and sold for cash. The proceeds of the car sales were then transferred, along with proceeds from narcotics trafficking and other crimes, to Lebanon. The lawsuit seeks the forfeiture to the government of all property that is traceable to the money laundering offenses, including the assets of the thirty used car dealers.

According to the complaint, nearly $250 million was wire transferred from Hezbollah to the dealers in Connecticut, Florida, Massachusetts, North Carolina, Maryland, Oklahoma, Georgia, Tennessee, Ohio, New Jersey, and Alabama. Through this forfeiture action, the government has frozen the dealer bank accounts, it seeks to take the dealers’ assets, and it essentially has shut down those dealers. The used car dealers’ assets and properties are alleged to have been involved in illegal money laundering transactions.

What did these dealers know and when did they know it? At this stage of the case, it is hard for an outsider to know that. What we do know, however, is that without having to file criminal charges against these dealers, the government has put them out of business by freezing their assets. These dealers have learned the hard way about the awesome power of a government forfeiture action.

The government’s forfeiture power can extend to many types of assets owned by a dealer. Real or personal property “involved in” a money laundering transaction may be forfeited to the United States. The term "involved in" has been liberally interpreted by the courts. Thus, property subject to forfeiture can include the land on which the illegal transaction occurred, a bank account to which the proceeds were deposited, vehicles allegedly purchased with the proceeds, and the like. While the United States Supreme Court has upheld various constitutional limitations on the government's forfeiture authority, the ability still exists for the government to seize and forfeit an entire business based upon violations of the money laundering statutes which occur at the business.

Do you think that the government has a heavy burden of proof to wield this awesome weapon? Think again. To support a civil forfeiture of property, the government need only show that there is probable cause to believe that there is a substantial connection between the property and the criminal activity. The burden then shifts to the owner of the property to demonstrate otherwise. This less rigorous standard of proof in civil forfeiture cases, combined with the government’s ability to seize or freeze assets pending a resolution of the forfeiture action, give the government tremendous power to shutter a business before it can even mount a defense.

This case should be a cautionary tale to any dealer that sells vehicles to buyers outside of the United States that has ever asked the question, “Once I have the buyer’s funds in my bank account, what could go wrong?” The thirty dealers who are now out of business can answer that: “plenty!”
1. Franchised dealers who sell new cars to out-of-country buyers risk violating their franchise agreements and subjecting themselves to penalties from their franchisors.

2. But even for new car dealers selling used cars to foreign buyers, and for independent dealers, the dangers are very real. Make sure that your employees have been trained in cash reporting and the prevention of money laundering.

3. While following your Red Flags Rule compliance procedure with a foreign buyer may be complicated since US databases that you use may not help, you should nevertheless follow it to the extent you can.

4. Make sure that you know the identity of the buyer, and make sure that there are no signs of a suspicious transaction. Stop any deal that is suspicious.

5. An OFAC check is a must. You may not do a transaction with someone on the blocked persons list of the Office of Foreign Assets Control.

6. Make your parts department aware of the dangers. The same processes that landed these dealers in hot water can be used for parts purchases. There are markets for parts in foreign countries, so bad guys can buy parts in bulk for redistribution in foreign countries to launder money.

Perhaps the evidence will show that the used car dealers involved in this case knew exactly who they were dealing with and what they were doing. Or the evidence may show that they were careless in dealing with the foreign buyers that turned out to be bad guys. It does not matter. Through civil forfeiture, the government has put them out of business. Doing business blindly with someone whose money is transferred to your account is a bad practice that can cost you your dealership. Always know your customer!

But a prepayment fee on a floorplan line? After all, a floorplan line is strictly a demand line of credit. Theoretically, the lender can call the line at any time, and the dealer can pay off the line at any time. So prepayment may not be the right modifier to describe the fee.

Nevertheless, prepayment fees are showing up in floorplan line documentation. And they are not paltry charges. For example, one lender offers a diminishing fee based on the length of time the line is in place. There is a 2% fee for full payoff within the first two years, and that reduces each year thereafter until the end of the fifth year when the payoff fee goes away. The fee is not calculated just on the amount of the outstanding balance. It is calculated on the floorplan line amount. Consequently, a dealer who carries a $6 million floorplan line with $2 million outstanding, who shifts his business to a new floorplan lender after a year and a half, will face a prepayment fee of 2% or the line, or $120,000, which is actually 6% of the outstanding balance — a real disincentive to changing the floorplan source.

Dealers are well advised not to jump from floorplan lender to floorplan lender. During the recent financial meltdown, dealers found that their ability to maintain a floorplan line depended heavily on the strength of the relationship with the floorplan lender. However, when a dealer becomes unhappy with a floorplan provider or otherwise wishes to change its line, it should have the ability to do so without punishing fees. When negotiating a floorplan line, pay very careful attention to and negotiate the so-called “prepayment fee”. And that is a good idea in negotiating any financial arrangement.
Seal Your Information Leaks

There are a lot of marketers out there claiming that they perform magic. There is no end to those who claim to have a secret formula to get customers to flock to your showroom. Whether it is a program to attract customers who haven’t been in to see you for a while, or a plan to bring in customers based on a pitch to refinance their loans, or a system to prospect your customers to sell them a second car, they all have one thing in common. Simply provide them with access to your customer base, and watch the magic happen! Unfortunately, the only magic you may see is the equity in your customer list disappearing.

It is puzzling how willing dealers are to give vendors with whom they have no experience access to customer information. Sure, a marketer may give you an agreement under the FTC Safeguards Rule that it won’t misuse the non-public private information of your customers. But what good is that from a company that may have little or no assets? What good is that from a company that may fold at any time and be reconstituted with a new name at a new address?

Your customer information is a valuable asset of your business. Simply the data on buying patterns and pricing can be sold to companies who market the results. The actual names, addresses, email addresses, and phone numbers of your customers are much more valuable. Why risk making that available to someone you know little about?

If you wish to do business with a marketer who must use your customer information, what do you do? The first step, without question, is to get a safeguards agreement pursuant to the FTC Rule. The Rule requires that. But you must do much more.

- Check out the vendor. Where is it located? What does a rating service have to say about it? Are its references real, are they actual car dealers, and what do they have to say about the company? Does the company have bank references? Does the company have vendor references?

- Do not simply give open access to your DMS. Once in your DMS, the marketer can take any information it wants.

- Even when pushing information from your DMS, select the information carefully. Doing a promotion to customers whose financing is maturing? Just push that customer data. Don’t give out your whole customer list and allow your vendor to sort it.

- Under the agreement you sign with the supplier, to what use can it put your information? What limits on the use of the information are included? If there is misuse and you need to sue, can you file suit in your own home town or do you have to go across the country to sue? Is the company willing to include in its agreement that it will not use any of your information for any purpose whatsoever? Often, companies will agree to protect your private customer information but they will develop information profiles from your data that they will market. If you do not want this, get an agreement that they will not do this.

- Will the marketer’s senior executives sign a personal guaranty of its agreement with you to safeguard your customer information and protect it from misuse?

If you received an email from someone you don’t know telling you that they can magically transform your life if you just give them the opportunity to visit your home and spend a few hours one evening while you and your family are at the movies, would you do that? Of course not. You know you have a very high likelihood of returning to a house that has been cleared out. So why do that with your business? Your customer information is one of the most valuable assets of your dealership. Protect it. Make sure you know with whom you are dealing, and that you have solid assurances that your information will be protected.