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Best practices – Credit card down payments

This year's columns have been dedicated to describing this whole thing called compliance. We are now in the process of describing best practices that, if implemented, are designed to help reduce exposure to litigation and regulatory inquiries. Today's topic is credit card down payments.

Background

Credit card down payments put dealers in a difficult spot. More consumers today want to use a credit card as the form of down payment because they may also be receiving affinity points with an airline or a hotel or membership points that are redeemable for merchandise.

Unfortunately, there are compliance issues and realistic business risks associated with accepting credit card down payments.

Issues

Here are some of the issues surrounding accepting credit cards for either down payments or to pay the lease starts.

Potential Violation of Dealer-Lender Agreement

In a strict sense, using a credit card to pay the down payment is using borrowed funds. Most dealer-lender agreements prohibit the use of borrowed funds as down payment on the Retail Installment Sales Contract. Some financial institutions have softened their stance in practice by stating that if they know that the down payment is being paid by credit card at the time they make the credit decision, the dealer is not violating the dealer-lender agreement. Check with the financial institutions with which you place paper to understand their position.

Possible Violation of Regulation M

Regulation M, which governs leasing disclosures, states that lease starts that are paid by credit card should be disclosed on the lease agreement as a credit card payment, not cash. Again, not many lessors are enlightened enough to permit this disclosure, so you should check with the lessor to see if accepting and disclosing a credit card lease start is acceptable.

Fees, Fees, Fees

Accepting credit cards is not an inexpensive venture. Depending on the deal you've struck with your credit card processor, I have heard of fees approaching three percent of the amount charged to the credit card as your fee. Some dealers are starting to realize the bottom line ramification and are looking at ways to cut this cost. A few have started to pass the fee along to the consumer, a potential violation of both Truth in Lending and the master agreement between the dealer and the card processor.

Limits

Other dealers have attempted to control the fees paid to the credit card companies by limiting the amount that can be charged. Again, many master agreements prohibit the limit on the amount that can be charged, up to the consumer's credit limit.

I Don't Like the Car

Finally, some credit cards permit a customer to dispute the charge, leaving the consumer in a leveraged position when it comes to rescinding the transaction.

Solution

Unfortunately, the only real sure fire solution to these issues is to prohibit the use of credit card as the source of down payments. Competitive pressures may cause you to make an informed decision about the risk you are about to accept should you continue to accept credit cards for down payments.

Gil Van Over is the President and founder of gvo3 & Associates, a nationally recognized F&I and Sales compliance consulting firm (www.gvo3.com).

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