

NEGATIVE EQUITY

In 1998 the Federal Regulation Board (FRB) amended its interpretation of Regulation Z [12C.F.R.226] in regards to negative equity or “upside down” consumers. The FRB made two changes that effect those situations involving negative equity. The changes were mandatory as of October 1, 1998. They were:

1. In the down payment line, the creditor should disclose “\$0” instead of a negative number.
2. The deficit “must appear in the itemization of the amount financed.” Creditors are given leeway as to how to have that amount appear.

In addition, dealers should not inflate the value of trade-in and the cost of the new vehicle in order to erase the negative equity. Such action does not fit within Reg. Z’s definition of “cash price.” Furthermore, the dealer could face the following difficulties down the road if: the new car is subject to a lemon law buyback; or the deal falls through and the customer wants the inflated amount of money for his trade-in; or the financing company sues the dealership for hiding the customer’s negative equity.

What can be done to reflect the negative equity varies with the form being used. Any forms that only state “Value of trade-in” probably would not satisfy Reg. Z since the value is zero. However, if the form read “Value of trade-in allowance” then a dealer could place the actual trade-in allowance so long as the actual lien amount was put in the proper line in the “Amount financed” section. When the customer makes both a cash down payment and trades in a car in which there is negative equity, FRB commentary made in 1999 allows the creditor (dealer) to use either a “netting” or “non-netting” approach. “Netting means that the cash down payment would be applied, or “netted,” against

the negative equity. This method results in a lower total sale price than if the netting was not performed.

Credit Forms:

Each dealer should ensure that the credit forms it uses (either through the bank or a vendor) includes the proper disclosures mentioned above. Problems may result from dealers who use computer programs to fill out the forms as the programs may not accept the negative number.

GAP Products:

Dealership personnel should probably use caution in how they sell GAP products to consumers who are upside down since some GAP products may limit the pay-out (such as 110% value of the collateral). As such, the consumers may still owe money after the GAP pay out due to being upside down. If such a situation results, a consumer may feel deceived and then consider filing a law suit. F & I personnel should be familiar with the GAP product being used to determine if such a limit is present.

Indiana passed laws regarding credit sales disclosures substantially the same as the Federal Regulations M and Z. Those statutes are IC 9-32-12 regarding vehicle lease disclosures effective July 1, 1996 (amended in 1998 & 2013) and IC 24-4.5-2 commonly referred to as the Indiana Uniform Consumer Credit Code—Credit Sales.