



**STRUCTURED
FINANCE
ASSOCIATION**

Michigan HB 5354

Sales Finance Company Licenses for
Purchasers of Installment Sale Contracts

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On November 14, 2023, House Bill 5354 (“HB 5354”) was introduced in the Michigan House of Representatives. If enacted into law, HB 5354 would make certain changes to the Michigan Motor Vehicle Sales Finance Act (MI Comp L § 492.101 - 492.141; the “Act”). Among other things, HB 5354 would amend the definition of “sales finance company” under the Act to *include* persons that purchase installment sale contracts from other sales finance companies. Such persons are presently *excluded* from the definition of sales finance company under the existing statutory definition.

Securitizers of installment sales contracts rely, in part, on the existing exclusion in the Act in not licensing special purpose vehicles (“SPVs”) when purchasing and financing installment sales contracts. As described in more detail below, a requirement to license securitization SPVs may lead to reduced market liquidity and increased borrowing costs for lenders and, ultimately, increased costs for Michigan consumers. A narrowly tailored change to this clause of the Act to expressly exclude securitization SPVs from the definition of sales finance company would be helpful to the securitization industry and facilitate lower costs for borrowers in Michigan.

Amendment Proposed by HB 5354.

- If adopted as proposed in HB 5354, the definition of sales finance company would be amended as set forth below. Please note the deletion of existing clause (ii), which contains the exemption for subsequent purchasers.

~~(r)~~ ~~(s)~~ “Sales finance company” means a person engaged as a principal, agent, or broker in the business of financing or soliciting the financing of installment sale contracts made between other parties, and in the business of acquiring, investing in, or lending money or credit on the security of the retail seller's interest in those contracts whether by discount, purchase, or assignment of those contracts, or otherwise. ~~The term~~ **Sales finance company** includes a licensee or other person ~~who~~ **that** as a seller finances installment sale contracts for other sellers or sales finance companies. ~~The term includes a licensed financial institution. The term~~ **Sales finance company** does not include ~~any~~ **either** of the following:

~~(i)~~ **A financial institution.**

~~(ii)~~ A person ~~, financial institution, or sales finance company~~ that takes an

assignment of or an interest in an aggregation of installment sale contracts only as security for bona fide commercial loans under which, in the absence of default or other bona fide breach of the loan contract, ownership of the contracts remains vested in the assignor and collection of payments on the contracts is made by the assignor.

~~(ii) A person who purchases installment sale contracts from a sales finance company or from a licensed financial institution.~~

Potential clarification to the statute.

- The Michigan Legislature should consider retaining existing clause (ii) of the definition of sales finance company, but revising the provision to limit it to entities formed for the specific purpose of purchasing or financing installment sale contracts. This change is set forth below, marked against the existing provision in the statute:

(ii) A person formed for the limited purpose of acquiring, selling, holding or financing installment sale contracts that purchases installment sale contracts, directly or indirectly, from a sales finance company or from a licensed financial institution.

- If the Act is amended by the Michigan Legislature with the revision proposed above, it will still require that entities that are *not* SPVs maintain a sales finance company license. If the change to the statute is enacted as proposed, only SPVs would be exempt from the definition of sales finance company.

Other states.

- A significant majority of states exclude subsequent purchasers from the requirement to obtain a sales finance company license in that state.
- Among the states that *do* require subsequent purchasers to obtain a sales finance company licenses, most have an exclusion directed at SPVs.

Requiring SPVs to obtain a sales finance company license could affect the availability of credit to Michigan consumers.

- If securitization SPVs are required to obtain a sales finance company license, lenders to consumers in Michigan would face increased costs not incurred by lenders to consumers in other states. Securitizers may exclude Michigan auto loans from securitization pools.
- Securitizers based in Michigan would also be disproportionately affected by the statute

as revised by HB 5354. A securitizer located out of state that acquires contracts from a Michigan dealer may reach a determination a related securitization SPV is not “doing business” in Michigan. Securitizers domiciled in Michigan would be less likely to make a similar determination. Thus the statute as revised would adversely affect lenders located in Michigan.

- These factors could ultimately lead to less credit availability and higher borrowing costs for Michigan consumers compared to residents of other states.

Securitization is an important funding source of automobile finance.

- Broadly, securitization is the pooling of assets entitled to receive regular cash flows—such as mortgages, lease payments, credit card receivables, or, as in this case, auto loans and leases.

After an auto loan is originated, it likely will be subject to multiple ownership assignments as part of the securitization process. While there are a variety of funding structures that may be used, the central characteristic is that ownership of the asset changes but servicing of the customer remains the same. For example, the loan will first be assigned by the lender to an SPV associated with a bank warehouse financing facility. Warehouses are designed to accumulate and finance collateral until a sufficient number of loans are pooled for a long-term securitization. Once enough loans have been amassed, they will be assigned multiple times as part of the typical long-term securitization process, with the final assignment to another legal entity, often a trust (the “Trust”), which is then the legal owner of record for those individual assets. The Trust then issues securities to investors, the interest and principal payments on which are funded by the cash flows payable in respect of the securitized assets owned by the Trust. The loan customer continues to make payments to the original lender/sponsor as the servicer of the loan. The servicer uses the customer payments to make the payments due on the notes to the investors. These investors include asset managers, pension plans, university endowments, and other financial institutions seeking exposure to safer, fixed income instruments.

Trusts and SPVs are entities that are designed to be bankruptcy-remote, which means their activities are limited and they have no employees, so trusts and SPVs will contract with the original lender/sponsor of the loans to continue to service them. The servicer earns a fee for doing so, and they can ensure that their customers receive a high standard of service. This is important because the original lender/sponsor often retains a subordinate risk position in the securitization and high-quality servicing can often mitigate losses.

As the long-term securitization amortizes, the original lender/sponsor typically elects to repurchase the remaining loans in a “clean-up call” once the collateral pool reaches a

certain percentage of the original dollar amount, 10%, for example. So at a minimum, ownership of an individual loan could be assigned at least six times during the securitization process even while the servicer never changes.

- A robust and liquid securitization market provides many benefits to the economy, including facilitating efficient access to a large and predictable source of capital, which ultimately lowers interest rates for consumers.

Given the large sums at issue in securitizations, investors expend significant resources in conducting due diligence on the origination and underwriting practices of the sponsor, issuer, or lender including compliance risk. This certainty in understanding risk and associated mitigants is essential to a functioning secondary market for auto loans, allowing original lenders to serve more consumers, and at lower prices, than they otherwise could. Absent this certainty, many investors may cease investing in auto ABS bonds.

- Over \$220 billion in auto ABS is currently outstanding in the United States.

About the Structured Finance Association

The Structured Finance Association (SFA) is the leading securitization trade association representing over 370 member companies from all sectors of the securitization market. Our core mission is to support a robust and liquid securitization market and help its members and public policymakers expand credit availability and the real economy in a responsible manner. SFA provides an inclusive forum for securitization professionals to collaborate and, as industry leaders, drive necessary changes, advocate for the securitization community, share best practices and innovative ideas, and offers professional development for industry members through conferences and other programs. For more information, visit www.structuredfinance.org.

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