

SUBJECT: Automobile Leasing

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INTRODUCTION

This release applies to both state and federally chartered credit unions. In recent years, Wisconsin credit unions have been invited to participate in various types of automobile lease financing agreements. This release serves as an introduction to the regulation of leasing activities.

EXECUTIVE SUMMARY

Leasing programs come in many different forms, each of which has different documentation, compliance concerns, and operational procedures.

Credit unions may consider insisting that a leasing program dealer or vendor produce letters from:

- The Department of Transportation, showing that dealer licensing requirements have either been met or are inapplicable, and
- The Department of Financial Institutions, approving the consumer forms and procedures as complying with the Wisconsin Consumer Act and Wis. Stats. Ch. 429.

After those approvals have been obtained, the Office of Credit Unions may be asked to review the program. Many of the considerations these regulators look at are described later in this release.

BASIC CONCEPTS

Lessor vs. Lessee

In leasing terminology the *lessor* is the owner, while the *lessee* is the consumer who rents the use of the vehicle. In Wisconsin, title is held in the lessor's name, but registration, parking citations, etc., are the responsibility of the lessee.

Direct vs. Indirect Leasing

In *direct leasing*, the credit union buys personal property at the request of the member who wishes to lease it from the credit union, then leases it directly to the member.

In *indirect leasing*, the credit union purchases the lease paper after the lease has been executed between an outside vendor and a member. The purchase of the lease paper is documented by an assignment of the lease. The credit union is either the owner of the leased property or has nearly equivalent rights in the property.

Residual Value

The *residual value* is determined at the beginning of the lease. It is the projected value of the vehicle at the end of the lease, relied upon by the credit union to meet the full payout requirement described below.

Open-End vs. Closed-End Leasing

At the end of a lease, the lessee may have to pay an additional sum to the lessor, beyond any early termination penalty or vehicle disposition charge

In *open-end* leasing, the lessee takes responsibility for any difference between the estimated residual value that was relied upon and actual value at the end of the lease.

In *closed-end* leasing, it is the lessor that assumes responsibility for any difference between the estimated residual value and actual end-of-lease value. Thus, closed-end leasing is riskier for the credit union.

The additional risk to the credit union in closed- end leasing is a market risk. If the automobile model becomes unpopular or the used car market declines, then the resale value is lower than expected and the credit union's profits are lower. It is possible to purchase residual value insurance to cushion this risk.

In both open- and closed-end leasing, the lessee is still held responsible for any decrease in value due to excessive wear and tear on the vehicle, including excess mileage.

DFI-CU 71 AND NCUA REGS. PART 714

In 1992, the Office of Credit Unions adopted Wisconsin Administrative Code Chapter DFI-CU 71 "Leasing of Personal Property," which regulates leasing activities by state chartered credit unions. In 2000, the National Credit Union Administration (NCUA) issued a new rule, Part 714, which allows federally chartered credit unions to engage in the leasing of personal property to credit union members.

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- All leases must be net leases. All burdens of ownership, maintenance, repair, registration, licensing and insurance must be placed on the lessee.
- All leases must be *full payout leases*. Over the term of the lease, the credit union must recoup its entire investment in the leased property, as well as the estimated cost of financing and the estimated residual value at the end of the lease.
- The *residual value* to be relied upon for the full payout requirement may not exceed 25% of the original cost of the vehicle. The NCUA permits a higher residual value if it is guaranteed by a financially capable party (e.g., the manufacturer, or an insurance company with an A.M. Best rating of at least a B+). The credit union should have documentation that the guarantor has the financial resources to meet the guarantee.
- The credit union must retain certain *salvage powers* over the leased property, such that the credit union is able to protect the value of the vehicle in case of an unanticipated change in conditions, such as the lessee's failure to maintain insurance. Salvage powers allow the credit union:
 - As the owner and lessor, to take reasonable and appropriate action to salvage or protect the value of the property or the credit union's interests arising under the lease; or
 - As the assignee of a lease, to become the owner and lessor of the leased property pursuant to the contractual rights, or take any reasonable and appropriate action to salvage or protect the value of the property or the credit union's interests arising under the lease.
- The credit union should maintain a *contingent liability insurance policy* with an endorsement for leasing, or be named as the co-insured if it does not own the collateral. The credit union may be held liable for wrongful acts of the lessee. Use a company with a nationally recognized insurance rating of at least B+.

Please read Part 714 or Chapter DFI-CU 71, whichever applies, before engaging in leasing. Chapter DFI-CU 71 is found in your Wisconsin Credit Union Manual from the Office of Credit Unions. State chartered credit unions should also consult with the Office of Credit Unions about the operations and merits of any proposed leasing program before making any serious financial or legal commitment to a leasing program.

The credit union should formulate a *policy* on leasing, stating underwriting standards and tracking the requirements of Part 714 or DFI-CU 71. It should address rates, residual values, insurance, length of leases, amount of assets available for leasing, etc.

MOTOR VEHICLE DEALER LICENSING

State law defines a “motor vehicle dealer” as any person, firm or corporation who sells, exchanges, buys, leases, or offers or attempts to negotiate a sale, consumer lease or exchange of an interest in motor vehicles. The law requires motor vehicle dealers to be licensed. This licensing requirement will often apply to either the credit union or the vendor that supplies cars to the credit union.

Some parties have proposed leasing programs that do not, they claim, require dealer licensing by any party. Before relying on any such claim, the credit union should insist that the program be submitted to the Department of Transportation (DOT) for its written assurance that licensing as a dealer and maintenance of dealer business facilities are not required of either the vendor or the credit union.

On the other hand, some credit unions may find that the advantages of obtaining a motor vehicle dealer license outweigh the disadvantages. The particular burdens of licensing should be determined in consultation with the Dealer Section at the Department of Transportation.

WISCONSIN CONSUMER ACT & WIS. STATS. CH. 429

Consumer leases are subject to Chapter 429 of the Wisconsin Statutes. A consumer lease is one that is for a personal, family, household, or agricultural purpose, and for a term exceeding four months. However, the term does not include leases in which the total lease obligation is more than \$25,000 or leases to organizations.

Many Wisconsin Consumer Act provisions that apply to lending apply with equal force to leasing. A significant exception is that for transactions involving a consumer lease (or consumer credit sale) of a motor vehicle, a customer may be in “default” (as the Consumer Act defines that word) if the customer made a material false statement in his/her credit application. In this situation, the customer has no right to cure the default.

Chapter 429 specifically regulates consumer leases for motor vehicles. The chapter addresses:

- Refunds or returns of advance payments or trade-ins;
- Availability of lease forms prior to signing;
- Pre-lease agreements, lease disclosures and format;
- Gap liability;
- Permitted security interests;
- Restrictions on liability for early termination;
- Assessment of excess wear and damage; and
- Penalties for violations.

Credit unions should submit proposed leasing forms and programs to legal counsel and then to the Administrator of the Consumer Act (Secretary of the Department of Financial Institutions) for approval. Please do not rely on any claim by a dealer or vendor that the forms have already been approved by the Administrator.

REGULATION M

Automobile leasing is subject to Regulation M (Consumer Leasing) rather than Regulation Z (Truth in Lending). Both regulations were under the jurisdiction of the Federal Reserve Board, but since 2011, they have been under the jurisdiction of the Consumer Financial Protection Bureau (CFPB).

The basic lease disclosure and requirements are summarized below. See *Reg. M (12 CFR 1013)* for the full details.

Reg. M applies to a “lease for the use of personal property by a natural person primarily for personal, family, or household purposes, for a period exceeding four months and for a total contractual obligation not exceeding” **\$73,400, effective Jan. 1, 2026 (up from \$71,900 in 2025)**. The threshold for Reg. M protection is adjusted every year for inflation. Reg. M applies “whether or not the lessee has the option to purchase or otherwise become the owner of the property at the expiration of the lease.”

For any consumer lease subject to Reg. M, the lessor must clearly and conspicuously disclose the following information, as applicable, to the consumer prior to consummation:

- A brief description of the leased property;
- An itemization and the total amounts due prior to or at signing of the lease, or by the time of delivery of the property;
- The payment schedule and the total amount of periodic payments;
- The total amount of other charges, itemized by type and amount, that are not included in the periodic payments;
- The total of payments, with a description such as "the amount you will have paid by the end of the lease." In an open-end lease, a description such as "you will owe an additional amount if the actual value of the vehicle is less than the residual value" must accompany the disclosure.
- In a motor-vehicle lease, a detailed mathematical progression of how the scheduled periodic payment is calculated;
- A statement of the conditions under which the lease may be terminated prior to the end of the lease term, the amount of any penalty, and, in a motor-vehicle lease, an additional special notice;
- A statement specifying whether the lessor or the lessee is responsible for maintaining or servicing the leased property, together with a brief description of the responsibility; a statement of the lessor's standards for wear and use; and, in a motor-vehicle lease, a special notice regarding wear and use;
- A statement of whether or not the lessee has the option to purchase the leased property, plus details regarding such option;
- A statement that the lessee should refer to the lease documents for additional information on early termination, purchase options and maintenance responsibilities, warranties, late and default charges, insurance, and any security interests, if applicable;
- A statement of the lessee's liability, if any, at early termination or at the end of the lease term for the difference between the residual value of the leased property and its realized value;
- If the lessee's liability is based on the realized value of the leased property, a statement that the lessee may obtain, at their own expense, an independent third party appraisal of the value of the property;
- If the lessee is to be liable for the difference between the residual value of the leased property and its realized value, then the details of rent and other charges, rules for excess liability, and that a mutually agreeable final adjustment is permitted;
- The total dollar amount for all official and license fees, registration, title, or taxes required to be paid;
- A brief identification of insurance, whether obtained through the lessor or through a third party;
- A statement identifying all express warranties and guarantees from the manufacturer or lessor;
- The amount or the method of determining the amount of any penalty or other charge for delinquency, default, or late payments, which must be reasonable;
- A description of any security interest (other than a security deposit disclosed as an amount due at consummation) held or to be retained by the lessor, and a clear identification of the property to which the security interest relates;
- If the lessor states a percentage rate in an advertisement or in documents evidencing the lease transaction, then a notice stating that "this percentage may not measure the overall cost of financing this lease" must accompany the rate disclosure. The lessor cannot use the term "annual percentage rate," "annual lease rate," or any equivalent term; and
- That non-motor vehicle open-end leases remain subject to § 182(10) of the Act regarding end of term liability.

Reg. M generally requires lessors to provide the required disclosures in writing and in a form that the lessee may keep, but they may be provided electronically.

Electronic Disclosures

Reg. M allows lessors to provide disclosures electronically, subject to the requirements of the federal Electronic Signatures in Global and National Commerce Act (or E-SIGN). E-SIGN has special rules for giving consumers electronic

disclosures. Under E-SIGN, consumer disclosures required by other laws or regulations can be made electronically if the consumer voluntarily consents. Two conditions must be met for a valid consent under E-SIGN:

1. The consumer must be given a notice regarding his/her rights (such as the right to withdraw consent) and describing the hardware and software requirements needed to access and retain electronic records.
2. The consumer must provide his/her consent electronically in a way that “reasonably demonstrates” he/she can access the information in the electronic form that the parties will use.

E-SIGN does not affect the content or timing of any disclosures or records required to be provided to consumers.

For details on E-SIGN’s consent and notice requirements, see The League’s *ii Release No. 0175, “Electronic Signatures and Records.”*

The result is that lessors can choose to give the pre-consummation disclosures (as described in the previous section of this release) electronically *if* they have obtained lessee’s consent *after* giving the consumer certain notices that E-SIGN requires. Otherwise, the disclosures must be provided in writing. (As discussed later in this release, Reg. M makes an exception for advertising disclosures, which can be included in an electronic advertisement without getting the consumer’s consent first.)

The credit union can provide disclosures to lessees both in paper and electronic form and rely on the paper form to satisfy its compliance obligations. If so, the duplicate electronic form of the disclosures may be provided without regard to the consumer’s consent or other provisions of E-SIGN.

Even if provided electronically, Reg. M still requires that the disclosures must be in a form the consumer can retain. That requires the credit union to provide disclosures in a standard electronic format that can be downloaded and saved or printed on a typical home personal computer. If disclosures are provided through equipment under the credit union’s control – such as a terminal or kiosk in the credit union’s offices – the credit union could provide a printer that automatically prints the disclosures.

Lessors may be reluctant to provide disclosures by email, since lessees could confuse them with fraudulent “phishing” emails, but Reg. M does not require the use of any particular means of electronic delivery of disclosures (such as email or by posting them online). Instead, it allows flexibility for the lessor to use whatever method may be best suited to particular types of disclosure.

If the credit union provides any Reg. M disclosures by positing them on its website, the Federal Reserve Board says that it expects the credit union to maintain them on the site for a reasonable period of time (no specific time period is required) so that consumers have an opportunity to access, view, and retain the disclosures.

Interim Electronic Disclosure Rules Withdrawn

Previously issued interim rules on electronic disclosures have been withdrawn. They would have required that:

- Disclosures could be sent to an email address designated by the lessee, or could be made available at another location, such as an Internet website.
- If the disclosures were not sent by email, the lessor would have to provide a notice to lessees (typically by email) alerting them to the availability of the disclosures.
- Disclosures posted on a website would have to be available for at least 90 days to allow lessees adequate time to access and retain the information.
- Lessors would be required to make a good faith attempt to redeliver electronic disclosures that were returned undelivered, using the address information available in their files.

The Federal Reserve struck these requirements as unnecessary. So long as the lessor complies with E-SIGN in providing its disclosures (with the exception of advertising disclosures), its compliance obligations have been fulfilled.

ADVERTISING

Regulation M imposes the following advertising rules. An advertisement for a consumer lease may not state that a specific lease of property at specific amounts or terms is available unless the lessor usually and customarily leases or will lease the property at those amounts or terms.

The advertising disclosures required by Reg. M must be made clearly and conspicuously.

Prominence

In addition to requiring that advertising disclosures be clear and conspicuous, Reg. M contains two rules about how prominently certain disclosures must appear in relation to others.

First, any reference (affirmative or negative) to any charge that is part of the total amount due at the time a consumer lease is signed (or, if later, before delivery of the leased property) cannot appear more prominently than the disclosure of the total amount due at lease signing. For example, the credit union cannot state that there is no capitalized cost reduction or state the amount of any capitalized cost reduction, in a way that makes that information appear more prominent than the total amount due at closing or before delivery.

Second, if the advertisement contains a percentage rate, then the following apply:

- The sentence "this percentage may not measure the overall cost of financing this lease" must accompany the rate disclosure.
- The percentage rate cannot appear more prominently than any of the other disclosures that are required under Section 1013.4. (That section of Reg. M contains the disclosures required to be made before consummation of a consumer lease transaction. They are listed on the previous page of this release.)
- The terms "annual percentage rate," "annual lease rate," or any term that is equivalent to them may not be used.

The "prominence" requirements of Reg. M apply in electronic advertising just as they do to print ads. However, these requirements can be applied with some degree of flexibility, to account for variations in devices consumers may use to view electronic advertisements. Therefore, the use of scrolling or links would not necessarily fail to comply with the regulation in all cases.

"Triggering Terms" That Require Additional Disclosure

Triggering terms. An advertisement that states any of the following triggering terms must also disclose the "triggered" terms listed thereafter:

- The amount of any payment; or
- A statement of any capitalized cost reduction or other payment required prior to or at consummation or by delivery, if delivery occurs after consummation.

"Triggered" terms. An advertisement stating any "triggering term" listed above must also state the following items:

- That the transaction advertised is a lease;
- The total amount due prior to or at consummation or by delivery, if delivery occurs after consummation. This triggered term must be at least as prominent as any other affirmative or negative reference to a charge, other than the periodic payment.
- The number, amounts, and due dates or periods of scheduled payments under the lease;
- A statement of whether or not a security deposit is required; and
- A statement that an extra charge may be imposed at the end of the lease term where the lessee's liability (if any) is based on the difference between the residual value of the leased property and its realized value at the end of the lease term.

Alternative advertising rules are available for television or radio advertisements. See §1013.7(f) of the regulation regarding how triggered terms may be provided via a toll-free number or a current print advertisement.

Multi-Page and Electronic Advertising

As explained previously, Reg. M requires that if an advertisement includes certain "trigger terms" (such as the payment amount), the advertisement must also include certain required disclosures.

In a catalog or other multi-page advertisement, the required disclosures need not be shown on each page where a “trigger term” appears, as long as each such page includes a cross-reference to the page where the required disclosures appear.

This rule also applies to electronic advertisements. For example, if a “trigger term” appears on a particular webpage, the additional disclosures may appear in a table or schedule on another webpage and still be considered part of a single advertisement if there is a clear reference to the page or location where the table or schedule begins (which may be accomplished, for example, by including a link). The Federal Reserve Board says that it expects the credit union to maintain any disclosures that it posts online on its website for a reasonable period of time (no specific time period is required) so that consumers have an opportunity to access, view, and retain the disclosures.

Ordinarily, before providing any consumer disclosures electronically, the credit union would need to obtain the consumer’s consent. (For details, see *ii Release No. No. 0175, “Electronic Signatures and Records.”*) However, Reg. M says that when a lease advertisement is accessed by a consumer in electronic form (for example, online), the advertising disclosures that Reg. M requires may be provided to the consumer in electronic form in the advertisement without getting the consumer’s consent first and without having to comply with other requirements of the federal E-SIGN law.

AGREEMENT WITH DEALER OR VENDOR

Legal counsel should be asked to review or draft the contract between the dealer and the credit union, outlining who has responsibility for what in the proposed operation. The program must be reviewed for the risk of claims against the credit union for the acts or omissions of the dealer (e.g., Equal Credit Opportunity Act, Holder in Due Course, Bankruptcy Code, inter-locking loans, etc.). Guarantees, indemnification clauses, and reserve accounts may be necessary to protect the credit union. The League has opinions from its General Counsel discussing these considerations in more detail.

Don't forget to investigate the background of the dealer or vendor before entering into the relationship:

- Ask for the names of principals, past experience, references, financial statements, sample documentation, etc.
- Call the Better Business Bureau.
- Check all references, especially credit unions that have participated in the program.
- If the information is satisfactory at this point, obtain an investigative credit report.

OPERATIONS

Consult someone with well grounded experience in leasing as to the basic soundness of any leasing program you consider. Leasing involves an entire new set of operations, regulations, and accounting procedures for the credit union to deal with. Be prepared to hire or contract for the services of an experienced “key person” to run the leasing operations (obtaining vehicles, monitoring registrations and insurance, repossessions, disposal of vehicles, etc.). The particulars on these operational aspects are beyond the scope of this release; they vary greatly from program to program.

INSURANCE

The insurance products used in auto leasing also differ from the standard insurance products used in lending.

The leasing agent responsible for delivery and disposal of the vehicles should carry interim auto liability insurance. The credit union should require proof of such insurance and should monitor the policy periodically to ensure the coverage is in effect at all times.

Other insurance coverages include:

- Contingent Liability with an Endorsement for Leasing. This insurance is required by credit union regulations, regardless of whether the credit union funds the lease or holds the title. The coverage protects the credit union if it is sued as a result of a member's operation of the leased vehicle.
- Excess Liability Coverage. This insurance coverage protects the credit union from claims that exceed member's policy limits.
- Gap Coverage. This optional coverage of the difference between what the member's insurance pays and what is owed on the loan if the car is a total loss due to an accident. Theft coverage may be added.

- Lessor's Single Interest. This is optional insurance that pays for repairs if damage is discovered when a car is repossessed for the member's failure to maintain insurance.
- Residual Value. This insurance guarantees the car's value at the end of the lease term, based on established prediction guidelines for the particular make and model of car.
- Collateral Protection Insurance. CPI provides all- risk physical damage protection for the credit union or member. It is procured by the credit union if the member fails to provide physical damage protection or fails to list the lessor as loss payee.

As with standard automobile collateral protection, members are required to maintain a primary policy of liability insurance in an amount adequate to protect the vehicle owner from financial loss. The policy must also show that coverage extends to the lessor as an additional insured.

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League publications are designed to provide accurate information with regard to the subject matter covered, with the understanding that the League does not render legal services. If you have general questions regarding this release, please call The League at (608) 640-4050 if local; or (800) 242-0833. For specific legal advice, please consult your credit union's attorney.

Legal Affairs Department

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