
The Consumer Finance Podcast x Payments Pros – Point-of-Sale Finance Series:

Navigating Merchant and Dealer Contracting

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Guests: Jason Cover, Andrew Thurmond, Samer Roshdy

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Taylor Gess: Welcome to the special edition of *The Consumer Finance Podcast* and *Payments Pros*. I'm Taylor Gess, an associate in Troutman Pepper Locke's Consumer Financial Services Regulatory Practice, and I'll be your guest host for today's episode. Today, we're going to be giving you another installment of our special highlight series on point-of-sale finance, where we will provide perspectives on contracting with merchants and dealers, and the compliance concerns presented in such relationships.

Before we jump into that topic, let me remind you to visit and subscribe to our blogs, troutmanfinancialservices.com and consumerfinancialserviceslawmonitor.com. And don't forget about all of our other podcasts. We have the *FCRA Focus*, all about credit reporting. *The Crypto Exchange*, about crypto and digital assets. We have *Unauthorized Access*, which is our privacy and data security podcast. And of course, *Moving the Metal*, our auto finance podcast. All of those are available on all popular podcast platforms. Speaking of those platforms, if you like this podcast, let us know. Leave us a review on your podcast platform of choice and tell us how we're doing.

Now, as I said, today's episode is another in our special highlight series on point-of-sale finance. Here, I'm joined by my colleagues, Jason Cover, Andrew Thurmond, and Samer Roshdy to talk about contracting with merchants and dealers. Jason, Andrew, and Samer, welcome to the podcast.

Jason Cover: Thanks Taylor.

Andrew Thurmond: Thanks Taylor.

Samer Roshdy: Thanks for having me.

Taylor Gess: So, I think our audience may be wondering what we mean by this topic of contracting with merchants and dealers. Samer, can you please help us understand?

Samer Roshdy: Yeah, absolutely. At its core, the topic is about the relationship and contracting structure between two parties. On the one side, you have a merchant or a dealer selling goods or services. On the other, you have a point-of-sale finance administrator or lender offering a financing solution for the merchant's business. This solution we're talking about allows the merchant's customers to receive credit or financing at the point of sale or checkout, with the result being the origination of loans or other financing products for the merchant's customers.

These products can take various forms. They could be installment loans, buy now pay later options, retail installment sale contracts, lease-to-own products, or other revolving lines of credit. For simplicity, I like to refer to these products as installment loans. I just wanted to flag, as we discussed this topic, that there are many variations.

Taylor Gess: Samer, is there a common principle or perspective that comes through the various negotiations between a merchant and a point-of-sale finance administrator?

Samer Roshdy: Yes, there are several factors, but it often boils down to the somewhat divergent needs of the merchant and the point-of-sale finance administrator. Typically, the merchants want to continue doing what they do best and sell their goods and services while maximizing their profit, and they want to make purchasing decisions easier for their customers. Sometimes, by offering them financing options.

However, merchants are typically protective of their brand, and their customer experience, and ultimately, they want to know what they can do to prevent the financing experience itself from negatively impacting the customer's experience with the merchant overall. From the other side, you have a point-of-sale finance administrator, and the typical administrator undoubtedly wants to originate more loans, but in doing so, your administrator will have a strong interest in ensuring the origination of these loans is done correctly, often focusing on risk mitigation.

After all, we've seen regulators try to treat merchants as an extension of the administrator lender. So, typically, the administrator aims to establish clear standards for what merchants can and cannot do to manage their own set of risks, particularly in the context of how the loan is marketed to customers. And you'll see that principle be pretty evident in the contract negotiation.

Taylor Gess: Andrew, do you want to share with us some of the common pain points you see in these negotiations?

Andrew Thurmond: Yes, absolutely. I should start by saying I am a renewable energy lawyer, so I come at this from maybe a different perspective than Samer and Jason, where I focus mostly on residential solar and the specific impacts there. I think, one thing we see is, probably the most important thing is the 50-state approach, where every state has their own laws, and own issues, and you really do have to research and know everything going into that. It really depends on the situation, too, and so, we can help our clients guide them through the 50-state process and each state's particular pain points.

But some of the more overarching ones we see, especially in solar, are certainly data issues, so privacy issues, data issues, aggregating, how you're able to share that. Just general compliance, there's a lot of hoops that folks have to jump through, they have to work with a lot of third parties, so not just the consumer. But also, in solar, there's utilities, and other folks at regulatory agencies that you're working with all the time. There's also mortgage companies, so a different lender that you are also having to focus on, especially in the financing space where you have a direct security interest on the solar system, but the mortgage lender might be trying to take an interest on everything attached to the home.

So, that's a common pain point we deal with some of our clients. There's many more we could go through too, and I'm sure we'll get there as Jason and Samer talk more about some of the other contracting structure issues.

Jason Cover: Just to belabor Andrew's point, Taylor. I think some of those are specific to solar, but depending on the industry you're in, there can be lots of applicable state laws. So, if your

merchant is a provider of medical services, there's state laws that could be applicable to that. There may be HIPAA concerns or other privacy concerns related to medical financing or patients. Home improvement is adjacent to solar, and there's lots of laws that may apply to one or both of a home improvement contractor or a solar installer. Door-to-door sales laws, generally apply to both of those, but could apply to other types of sales. First and foremost, you really need to know what kind of business you're in or that you're intending to finance, and start there when thinking about contracting.

Samer Roshdy: Yes, I couldn't agree more on the industry-specific focuses and how that's important to setting up any sort of payment point-of-sale financing program because you used to have these traditional point-of-sale financing through car dealerships or other dealerships of that sort. But now, you're seeing point-of-sale financing in virtually every industry, which is, as Andrew and Jason alluded to, medical providers, solar providers, department stores, even your classic grocery stores have some point-of-sale financing solution now. So, it's very important to consider the industry as well.

Andrew Thurmond: I would add one thing there, is that, bundling items, even if they seem somewhat related, may not be related and you really need to run a full analysis of every type of product you're trying to finance. And whether you can really use one agreement, one financing to do all the products you want to finance or if they really do need to be separate. So, if you want to finance everything in the home, you would think maybe that is rational, maybe you could finance repairs of a roof, and a solar system, and a new HVAC system, or heat pump for someone. But they actually end up having very different regulatory regimes and some are fixtures, some are not. You really need to do the analysis every time of what the products are that you're looking to finance.

Jason Cover: I guess that's another important point, right, Andrew? Whether or not you're taking a security interest in the goods that are sold may impact some of these downstream contract issues as well.

Andrew Thurmond: Yes, that's right.

Jason Cover: Taylor, I think some of the other things I typically see that are pressure points in negotiations are provisions that address what goes wrong or what happens when something goes wrong. Some clients have thought about having set off rights, or reserve accounts, or all kinds of things like this, and shockingly enough, the merchants don't really like that. I mean, the intent is, something is originated improperly or something along those lines and then the finance company has the ability to set off or access those reserve account rights. I've noticed, particularly in the last year or two, that, that has become a particular pressure point.

Andrew Thurmond: I can jump in and add there too. In solar, that's a particular issue, because you're actually financing an ongoing construction project. They might be short, but there are multiple stages of construction that occur. Because of certain tax issues and things like that, you take ownership earlier than maybe you would think you would, or the homeowner does. So, you lay out money earlier, and so, there's a lot more set off and clawback issues. The percentages that financing parties are willing to lay out front for signing a deal or getting a deal signed up with the homeowner versus waiting until construction is complete is a pretty contentious commercial negotiation, I think. One that changes all the time as well as like clawback provisions, and set off rates, and everything like that.

Taylor Gess: Thank you all, that was really helpful to let us understand those issues. Samer, do you have anything else that you want to share with us about issues related that may impact the contracting structure?

Samer Roshdy: Obviously, each negotiation will be different. Each side will have unique issues to manage. And as we talked about a little bit ago, some of it is industry specific. But what I've found helpful in my practice is to always keep in mind what the other side is generally managing in the background. In the point-of-sale finance administrator standpoint, they set up the loan process, obviously, and that's important. But sometimes, they're also managing other parties in the background. Because sometimes, this is actually pretty frequent too, the administrator themselves isn't the lender, and they're managing bank partners in the background, and they're trying to pass through relevant terms to the merchants in order to accommodate their bank partners.

And even if the administrator is lending directly, administrators might package and sell loans, or receivables to third parties after the product's originated. So they need to have flexible contracts with their merchants to accommodate for those scenarios as well. From the merchant's perspective, they may also be looking to integrate the financing solution as part of an overall waterfall that they're managing, potentially as a second-look financing solution that is based on the merchant's own in-house financing platform.

So in that context, you'll see a merchant concerned with how this new solution will impact the other options in their existing waterfall as well. And the merchant will be looking to provide consistent processes to accommodate all of these different and independent financing solutions. Ultimately, I've found that understanding these nuances helps in drafting effective contracts that goes a long way, along with considering the industry-specific terms that we alluded to.

Taylor Gess: Jason, are there specific regulatory and compliance concerns that we should be thinking about when we're contracting with merchants or dealers?

Jason Cover: Absolutely. I think Samer pointed this out earlier that regulators are increasingly looking to the merchant as an arm of the finance company, or the lender, or what have you. So, it's really become increasingly important to nail these contracts down, and monitor your merchants. But first and foremost, I think the contract needs to align with whatever your finance model is. So, if it's retail and installment contracts, we need to be talking about credit sales and not loans, and vice versa if it's loans, and so on and so forth.

Samer and I actually had a really interesting opportunity to help a few clients that have multiple finance products come up with a uniform contract that allowed them to switch in and out in various states of operation, or even have multiple products in the same state. It just belies the importance of making sure you're clear about what products you're offering.

Another area that I've focused on is regulatory guidance in this regard. The thing I always come back to is the CFPB Bulletin 2016-02. That's a reissue of a previous CFPB Bulletin. This is essentially telling people what their responsibilities are when they work with third-party service providers and contract with them in particular. I've found that very useful as a guideline in at

least the regulatory aspect of this. There's similar interagency guidance from the prudential regulators that came out in 2023.

I feel a little bit more in-depth from the CFPB Bulletin, but that CFPB Bulletin to me gets to the core of your regulatory requirements. The first thing the CFPB mentioned is onboarding diligence. I know this is somewhat before the contract happens, but having been in-house the most frustrating thing in the world was getting a contract saying it needs signed tomorrow, and I have no idea what it's about, or who the counterparty is.

A little different world here with merchants, but getting back to that risk of who our counterparty is, it's important to know that we're dealing with good actors that are legitimate. I think, you can also then bring that diligence into the contract itself, whether that's representations and warranties about the information that was provided in the diligence, things about the policies and procedures that they may have provided being accurate. It's an opportunity to solidify that that material was representative of what that merchant or company actually does.

The second thing the CFPB noted was they'd expect clear expectations about the compliance obligations, as well as the appropriate and enforceable consequences for violations thereof. This is really your opportunity to spell out all of the things that particularly – I guess I'm coming from this from the sales finance agency's perspective, but equally applicable to a merchant. This is where you need to spell out the obligation, the legal obligations, particularly from a consumer protection standpoint.

I would say that, 10 years ago, maybe most of these were like a general compliance with law type of rep without spelling things out. But increasingly, we've seen our clients add really specific obligations, whether things about the holder rule, or rescission rights, or things of that nature, really granularly spelling those things out in the contract. So it's, I don't know, a violation of material law is great and that probably helps, but when you have them in the agreement itself, I think it helps from a regulatory perspective explaining to your regulator that, "No, I really am observing and monitoring these folks." So, that to me is very important.

I think in line with that would be, what happens when there is a violation of law or there is an issue. So, that could be anything from remediation, like additional audits, compliance reviews, up into termination. So, at a bare minimum, I always recommend clients include a termination right in the event of a material violation of law, things of that nature. But in theory, that should be an escalation up to termination. Your mileage may vary as to what you want to do there. I think, this is also just a good opportunity to establish your internal controls, which the CFPB expects.

I always recommend including monitoring and audit rights. I want those generally to include going to your regulator. I've had issues where the regulator says, "Hey, give us all the merchant or the contract party's information," and they don't want to do it. But when it's in the contract, that allows you to at least point to something. I'm routinely amazed how much pushback there is on these types of obligations, but I view this as something that's critical, and I think examiners are focused on these types of provisions that clearly spell out the company's monitoring audit rights to the counterparty.

I think an important component of that also would be of requirement that complaints get moved back and forth between the parties. That's kind of a core compliance monitoring obligation, so I always want that in there. Then, finally, off-boarding procedures. This isn't a critical vendor necessarily like maybe your IT infrastructure. You really want clear off-boarding obligations there, but that's kind of the end of the contract life cycle. So, you do want to spell out specifically what happens once the relationship is ended or terminated.

Samer Roshdy: Jason, you brought up a good point. A lot of that is very important from a regulatory compliance perspective. Obviously, a lot of us do specific work within the financial services space specifically. But even on some of your points, at least for me, coming at it from a corporate and transactional attorney perspective, utilizing diligence as a way to hold your counterparty to specific reps and warranties in the contract. I couldn't say anything's more important than that. That's one of the few ways that you're going to be able to hold a counterparty to what they promised you beforehand. So, really utilizing that diligence in that manner is effective in just any sort of transaction, even beyond regulatory compliance. These are very important negotiation points as well that they've highlighted.

Andrew Thurmond: I would say one other thing that is very important, both in the onboarding and then ongoing covenant process that we see, is making sure that the merchants also have their own process where they're tracking the agents and folks that they're working with. Because, like Jason said, it's great if you have a compliance with laws, material laws type clause, but if you're not actually checking to make sure that the merchant and whoever they're contracting with are actually doing that, then, it's really just a clause, and a contract, and you're not actually able to verify much.

Then, we see that get rolled off holder rule or other states wanting just to hold the company's financing parties responsible for the entire enterprise. So, making sure that you're kind of digging a little deeper, we have found to be pretty important, especially on the onboarding process.

Taylor Gess: This has been a very insightful conversation. I know you all mentioned some pain points in the contracting process earlier, but Andrew, beyond these issues, what are some other things you're seeing in the industry today?

Andrew Thurmond: I think a big issue we see right now is bankruptcy and foreclosure being an issue, so both really kind of all parties. The consumer going bankrupt and that is a constant ongoing issue and how do you deal with that. And like we talked about, if you're taking a security interest, how does the bankruptcy impact your security interest? How do you try to get a return on your investment still with a transfer or something like that? But also, if your merchant goes bankrupt. So I'm in solar. The biggest issue happens is, what if your installer goes bankrupt in the middle of the process? You've already put out money as a financing party for the installation, but the project actually hasn't gotten installed or they're in the middle of completing it. How do you deal with that? That's one that we work through a lot. Similarly, as foreclosure issues, if a bank is taking a foreclosure on a house, how does that impact your rights as a financing party?

Jason Cover: Taylor, I'll chime in from the contracting perspective. In particular, I think I've noticed a trend from, at least in the FinTech space, maybe a decade ago, some of these agreements were four pages long or something to that effect, and there is a high propensity to

quick conversion. But as FinTech providers have become more sophisticated, these agreements are getting more sophisticated. So, it's been interesting in my end to watch that develop over time as our clients have developed over time.

Samer Roshdy: Jason, you brought up a good point that we've seen in a number of transactions actually together too is, a lot of our clients are coming to us with prompts of, "Hey, we offer basic financing today in this respect, but we also want to preserve and leave room open to offer all these other ancillary services in the future." The contracts themselves are becoming much more complex because there are so many different services that are tangential to financing that could be incorporated.

One big example that comes to mind is a partnership or at least some sort of platform that offers both an e-commerce solution or payment processing solution. That's a prime example of a solution that could use basic financing as an ancillary service or even the main service.

Andrew Thurmond: Kind of along the lines of what both of you just said, I've seen, so rather than one four-page contract, now I'm seeing you're having five contracts between a merchant and a financing party rather than just one, and they're all pretty in-depth, and they're all interrelated, or maybe they're all attached to each other. But the expansion of services that are being offered or being used between just the two parties has definitely grown a lot, even in the last, say, five years.

Taylor Gess: Thank you, Jason, Andrew, and Samer for being on the podcast today and introducing the audience to the practical and regulatory considerations of contracting with merchants and dealers in the point-of-sale finance space. We're going to leave this special point-of-sale finance series here for now, and we'll pick back up with another very interesting topic on our next special joint episode for *The Consumer Finance Podcast* and *Payments Pros* on this topic.

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