Don't Let Auto Dealers Sell You a Lemon

The National Auto Dealer Association (NADA) continues to promote a loophole, exempting auto dealers from the rules and jurisdiction of the Consumer Financial Protection Bureau (CFPB), established by the "Restoring American Financial Stability Act of 2010" (S. 3217). Their opposition boils down to two arguments: 1) that CFPB will create a burdensome bureaucracy and 2) new laws are not needed because unfair practices are either already unlawful or not widespread enough to warrant attention. ***Do not let NADA sell you a lemon.*** Here are the facts on why CFPB must cover all consumer financial transactions and how it can do so without creating a new layer of bureaucracy.

NADA Claim #1: Auto dealer markups are solely compensation for work the dealer puts into packaging the loan.

FACT: NADA acknowledges that its car dealers are engaged in making loans in the same way that a supermarket sells milk. It further acknowledges that its dealers increase the rate on those loans above the interest rate at which they sell the loans to third party lenders. NADA also admits that as lenders, the dealers are in competition with banks and credit unions for the customer's business. Just like the mortgage lenders who created and sold toxic mortgages, the auto dealer as lender is the original point at which the credit contract is negotiated.

NADA does not contest the core issue, which is that dealers are directly engaged in negotiating the price, term, and structure of credit with borrowers. The issue is not whether or not consumers receive the wholesale price for financing, but that *markups are set at the dealers' discretion*. CFPB must be able to regulate by loan product, in this instance a car loan, rather than by the provider of the loan. Although in some instances the dealer's interest rate upcharge may serve as appropriate compensation for the work done in creating the credit contract, in other instances it has proven to be abusive and predatory lending. The CFPB will ensure that the rules for car loans are the same regardless of the original lender.

NADA Claim #2: There is no need to create new remedies to address such abuses; existing laws are sufficient.

FACT: NADA does not dispute the fact that abusive practices, such as "payment packing," continues to occur even though the laws on the books prohibit it. The problem is that enforcement responsibility is diluted between several agencies and is inconsistent. State and local agencies are frequently overwhelmed by the volume of auto-related complaints and have stated that they lack the resources to effectively enforce existing laws. Furthermore, NADA has obtained its own waiver from the Federal Arbitration Act for its dealers, arguing they are in a weaker position when negotiating their franchise agreements with manufacturers. Because dealers regularly use mandatory binding arbitration clauses in their car contracts, consumers are denied the right to seek redress for legal violations in a court of law.

NADA seems to be taking their cues from the subprime mortgage lenders' and brokers' playbook. They too argued that the very practices that ushered in the financial meltdown were already illegal. *Given that existing law is not stopping the practice, arguing that nothing needs to change is akin to arguing for the illegal practices to continue*. The status quo is a fragmented and ineffectual rule-making and enforcement regime that allows violations of the law to occur frequently without recourse for the borrower. A CFPB would create a more accountable, more efficient way to enforce current law.

NADA Claim #3: Dealers have a competitive incentive to lower the cost of their financing.

FACT: We applaud NADA for acknowledging that its dealers *act as lenders* in direct competition with other lenders who extend credit for cars and that they have discretion over the price of that credit. The CFPB will already have authority to address auto lending by auto finance companies, banks, and credit unions. Giving it authority to address abuses in auto dealer lending will protect consumers from hidden surcharges and give them better information so they can choose the lending option that is best for them.

NADA also states "consumers typically do not have banking relationships and often have credit profiles that make them unable to secure vehicle financing from direct lending sources." Thus, NADA admits that many of their customers rely heavily on dealer financing and that the dealer—who has the ability to set the price of credit— is fully aware of the consumer's lack of options and inability to shop for a better deal. It is hard to imagine that in this scenario, the dealer is charitably passing on cost savings to the consumer or that consumer shopping regulates the market, as NADA has suggested. In fact, because the dealer markups and incentives from lenders are not open and transparent, the practices are inherently anti-competitive. As a result, dealer markups cost car buyers an extra $20 billion in 2007.[1]

NADA Claim #4: The existing the regulatory infrastructure is sufficient to hold auto dealers accountable.

FACT: NADA's assertion that contractual caps are a regulatory force is out of sync with how the auto finance market operates. Contractual caps are a cyclical down-market phenomenon, which typically retreat once credit begins to flow more freely. The assertion is made without providing the evidence of the amount of the rate caps, the percentage of loans made by dealers subject to the rate caps, the other incentives offered to dealers when loans are sold on the financial market, the contractual requirements for these rate caps to continue, and the data about the current average interest rate markup and the range of markups that exist. Relying solely on caps would be paramount to outsourcing consumer protection to the large banks and Wall Street houses that work with dealers who are the counter parties of these participation caps.

1Center for Responsible Lending, "Auto dealers lending abuses cost consumers billions," at: http://www.responsiblelending.org/other-consumer-loans/auto-financing/auto-dealers-lending-abuses-cost-billions.html. Accessed May 4, 2010.

Moreover, NADA's argument that private lawsuits are evidence that the regulatory scheme did its job is counterintuitive. The fact that such systemic problems occurred even though the practices were illegal, forcing private citizens to sue in an effort to obtain a remedy, is hardly the hallmark of an effective structure.

Under S. 3217, the CFPB will be given the authority to identify unfair and predatory lending trends nationwide. In the event that the CFPB acts to protect auto loan borrowers, only the largest auto dealers would transition to CFPB's jurisdiction from the Federal Trade Commission (FTC). Smaller auto lenders and dealers would be required to comply with consumer protection regulations issued by the CFPB, but the FTC would continue to function as their regulator. The rule-writing power that the Federal Reserve currently has would simply be transferred to the CFPB. Therefore, most dealers are unlikely to experience any new layers of bureaucracy. Instead, unnecessary overlap in regulatory efforts is eliminated while consolidating like functions into one agency.

NADA Claim #5: Dealers are responsible underwriters with a strong interest in loan performance and built-in incentives to avoid abusive lending tactics.

FACT: In their explanation of auto dealers' interest in loan price and performance, NADA clarifies that the dealers in fact act as lenders. Moreover, similar to other lenders and brokers, dealers choose from a wide variety of complex options when selling their own credit contracts. While touting an upstanding loan performance record, NADA fails to cite specific data and ignores the extent to which car purchasers are in negative-equity situations on their vehicles. Most importantly, NADA ignores the fact that securities backed by auto assets needed and received a bailout by American taxpayers:

> *The Federal Reserve Bank of New York (FRBNY) and the U.S. Treasury Department implemented the TALF program in March 2009 to provide leveraged, nonrecourse financing to investors seeking to purchase 'AAA' rated consumer auto loans, leases, and certain other ABS products. Prior to the introduction of TALF, auto loan ABS issuance (public and private transactions) had dropped precipitously—to approximately $14.6 billion in the second half of 2008 from $38.4 billion in the first half of the year. Issuance increased slightly to $15.1 billion in the first half of 2009 and gained momentum in the second half of the year, with approximately $29.8 billion, bringing 2009 volume to $44.9 billion. This represents a 16% decline from 2008's level of approximately $53.5 billion, which compares favorably against the 21% decline in retail auto sales year over year.*

Standard & Poors echoes this concern.[2] According to a recent outlook report, prime auto loan securitizations are in trouble, stating: "We're projecting the 2008 vintage to experience cumulative net losses, on a weighted average basis, of 2.6%; the 2007 vintage to lose 2.5%; and the 2006 vintage to lose 1.7%. Of course, performance will vary across originators and

[2] "U.S. Structured Finance 2010 Outlook: The Overall Market Continues To Stabilize, But CMBS Remains A Concern, found at http://www2.standardandpoors.com/spf/pdf/fixedincome/SF_2010_outlook.pdf, p. 7-9. Accessed May 4, 2010.

transactions. For example, the range of expected cumulative net losses from 2008 prime securitizations is currently 0.50% to 7.0%."

NADA Claim #6: Military personnel are not routine targets of auto dealer exploitation.

FACT: Once again, NADA does not dispute violations of the law, but maintains that existing laws are sufficient to protect military families. However, it is precisely the ineffective enforcement of existing laws that calls for the creation of CFPB, which will be dedicated to carrying out those same laws. Moreover, FTC's failure to enforce federal laws against auto dealers is not indicative of the absence of problems.

- The director of the FTC's Consumer Protection Bureau acknowledged that it has done little auto-related enforcement. This is despite the fact that the auto lending market involves approximately 50–60 million transactions per year.
- Consumers have a disincentive to lodge their complaints and concerns because on the FTC's website the consumer is told that lodging their complaint is not a way to obtain any action.
- FTC staff testified in Congress last year admitting that it was unaware that auto finance is a problem for the military, and consequently has done nothing to protect military personnel from auto dealer scams. The military, however, has said that predatory auto lending has become so bad that it jeopardizes troop readiness.[3]
- The abuse against the military is under reported due to the fact that service members know that financial debt can jeopardize their security clearance.
- FTC's lack of awareness is in part due to most consumer complaints being filed with the Better Business Bureau (BBB) and state and local agencies. Auto dealer abuses are the number one source of consumer complaints to the BBB and state and local agencies, many of which lack the resources necessary to follow up on complaints.

Finally, *the CFPB will not eliminate nor reduce legitimate dealer-assisted financing*. On the contrary, excluding auto dealers that are clearly acting as lenders will give them an unfair advantage over community banks and credit unions that may offer more favorably priced loans. Banks, credit unions, and nonprofit lenders with low-cost car loans often lose customers to the high-pressure sales tactics employed by dealers with a profit motive to push customers into accepting increased car payments, extended warranties, or add-ons, which have been shown to cost customers $1.1 billion every year.[4]

Lose the Lemon

CFPB is a proposed agency that will bring *existing* consumer laws under one roof. New regulations will only be issued when industry-wide abuse is detected, and then only the largest of

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[3] Testimony of Eileen Harrington, Acting Director, Bureau of Consumer Protection, Federal Trade Commission, hearing before the House Energy and Commerce Subcommittee on Commerce, Trade and Consumer Protection, "Consumer Protection in the Used and Subprime Car Market," March 5, 2009.

[4] Carolyn Hayden and Sheela Cooper, *Disclosure and Transparency in the Automobile Finance Industry: A Call for Action* (Baltimore, MD: The Annie E. Casey Foundation, 2009), http://www.opportunitycars.com/documents/documents/DisclosureandTransparencyintheAutomobileFinanceIndustry.pdf (accessed April 27, 2010).

auto dealers will come under CFPB's direct jurisdiction. Small dealers would comply with the new rules of the road, but would not be subject to new or different bureaucracies. Furthermore, NADA routinely describes situations in which dealers act as lenders and brokers. With no additional layers of bureaucracy, no new consumer law being proposed, and auto dealers clearly involved in the business of lending, NADA's arguments for the special treatment of auto dealers via an exemption to rules that will apply to their competitors fall short. The *only* reason to seek a "carve-out" is to avoid scrutiny that can detect predatory practices and evade accountability.

To be successful, the CFPA must be created with the authority to regulate all consumer transactions. Exemptions will only create loopholes for unethical players to hide from laws that aim to protect hardworking families. In the wake of the worst economic recession in generations, millions of families are struggling to keep pace with their credit card, car loan, and mortgage payments. Now is the right time to lay the groundwork for a strong financial system that will help families save and build wealth rather than line the pockets of auto dealers.