

**A New Way Forward**  
**Americans for Democratic Action**  
**Americans for Fairness in Lending**  
**Americans for Financial Reform**  
**Arizona Consumers Council**  
**Calegislation**  
**California Public Interest Group (CALPIRG)**  
**Center for Responsible Lending**  
**Consumer Assistance Council (Massachusetts)**  
**Consumers for Auto Reliability and Safety**  
**Consumer Federation of America**  
**Consumer Federation of California**  
**Community Reinvestment Coalition**  
**Consumer Action**  
**Consumer Watchdog**  
**Consumers Union**  
**Demos**  
**Empire Justice Center**  
**Florida Consumer Action Network**  
**Leadership Conference on Civil Rights**  
**Maryland Consumer Rights Coalition**

**NAACP**  
**National Association of Consumer Advocates**  
**National Community Reinvestment Coalition**  
**National Consumer Law Center, on Behalf of**  
**its Low-Income Clients**  
**National Council of La Raza**  
**National Fair Housing Alliance**  
**National People's Action**  
**Neighborhood Economic Development**  
**Advocacy Project (NEDAP)**  
**New York Public Interest Research Group**  
**(NYPIRG)**  
**Privacy Rights Clearinghouse**  
**Progressive States Network**  
**Public Citizen**  
**Sargent Shriver Center on Poverty and Law**  
**U.S. Public Interest Research Group**  
**(U.S. PIRG)**  
**Virginia Citizens Consumer Council**  
**Virginia Interfaith Center for Public Policy**  
**Woodstock Institute**

October 7, 2009

Honorable Barney Frank, Chairman  
Honorable Spencer Bachus, Ranking Member  
Honorable Members, U.S. House of Representatives Committee in Financial Services  
United States House of Representatives  
Washington, DC 20515

**Re: H.R. 3126 Consumer Financial Protection Agency: Auto Dealer Exemption**

Dear Chairman Frank, Ranking Member Bachus, and Members:

We strongly urge you to ensure that all activities of auto dealers related to the financing of cars are fully included under the jurisdiction of the Consumer Financial Protection Agency. While we agree that the sale of just a car, where car buyers pay cash or obtain their own financing, should not fall under the supervision of the agency, loan financing represents a huge source of income for auto dealers. Increasing percentages -- currently a majority -- of dealer profits are derived not from the sale of the car itself, but rather from their "Finance and Insurance" departments, where seasoned, trained F & I managers, paid largely on commission, use sophisticated software programs to maximize the profits from the financing and add-ons in car sales transactions.<sup>1</sup>

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<sup>1</sup> 2009 F&I Statistics, F&I Management & Technology, December 30, 2008, at 28, stating that

While the vehicles themselves have never been better, auto sales and financing practices have never been worse. In fact, year after year, auto sales and service complaints, typically related to predatory lending practices at dealerships, rank number 1 among consumer complaints lodged with state and local consumer protection agencies.<sup>2</sup> Since motor vehicles are the second-largest purchase most consumers make, and the average price of a new car is now more than \$28,000, relatively few car buyers can afford to pay cash. As a result, most moderate and low income consumers are vulnerable to predatory auto lending. Young people purchasing their first autos and members of the Armed Forces are particularly vulnerable, sometimes suffering losses that damage their credit and have a negative impact that lasts for decades.<sup>3</sup> In turn, this has a ripple effect throughout the economy.

While improvements by manufacturers and increased safety regulation mean consumers can purchase vehicles far superior to those sold a decade ago, unfortunately, there have not been similar improvements in the quality of financial products in car sales transactions. Consumers desperately need federal protection from ubiquitous predatory auto lending practices and multi-billion dollar auto sales frauds. Because dealers are selling both the car and the financing at the same time, often in addition to taking a trade-in with an outstanding lien balance, it is impossible for consumers, or regulators, to separate the two transactions. This causes a lack of transparency and a complexity that hamper consumers from being able to protect themselves.

Dealers are generally the original lenders in car sales/finance transactions. Most dealers sell the notes almost immediately to auto finance companies. Dealers and lenders have written agreements to split the added profits dealers generate by intentionally placing consumers in more expensive loan products, with higher interest rates than the consumers are entitled to obtain, based on their credit histories. In exchange, lenders give dealers a kickback based on the size of the "dealer markup." Typically, F & I managers tell car buyers they shopped around and found them the best interest rates they could get, when they actually qualified for lower rates.

Dealers are also the points of contact for originating auto loans that have been shown to have a discriminatory impact on millions of African American and Hispanic car buyers. Even when they have the same, or better, credit than their white counterparts, minority borrowers are more likely to be charged higher dealer markups. The dealers profit from the increased rates. The disparities are widespread and well-documented. In some cases, the disparities amount to thousands of dollars in extra hidden charges. In addition, whistleblowers and former F & I managers have stated that people of color have been deliberately targeted by dealers for discriminatory treatment.<sup>4</sup> In one recent example, the U.S. Department of Justice filed a lawsuit to curb alleged discriminatory lending practices at two Los Angeles area auto dealerships, where Hispanic and other non-Asian-American car buyers were charged higher markups in interest rates than car buyers who are Asian-American. The suit notes that the lenders failed to have policies to ensure that the markups are fair and non-discriminatory, but the

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"After experiencing slight declines in 2005, F&I's contribution recaptured some ground in 2006 and continued to rise in 2007 and 2008, representing more than half of total profits. Lower gross margins on the sale of new units has helped increase the importance of F&I contributions. Source: CNW Market Research."

2 Annual consumer complaint survey, released by Consumer Federation of America, National Association of Consumer Agency Administrators, and North American Consumer Protection Investigators. Most recent survey released July 30, 2009.

3 For ways auto dealers cheat members of the Armed Forces, see "I love a mark in uniform," *Mother Jones*, July-August 2009. Links to more reports are posted at: [http://www.carconsumers.com/military\\_ripoffs.html](http://www.carconsumers.com/military_ripoffs.html)

4 "Report concludes hidden auto finance charges cost American car buyers as much as one billion annually; industry-wide practice has led to discrimination against African Americans and Hispanics," press release issued by Consumer Federation of America, National Council of LaRaza, and Rainbow PUSH. January 26, 2004.

dealers also played a central role in raising the interest rates, and profited from the higher rates.<sup>5</sup>

Dealers also profit from the loan financing through a shady tactic known as "loan packing." This involves dealers using the fact that they are selling both the car and the financing to include overpriced add-ons, while deceiving the buyer about the cost. These add-ons include credit insurance products such as credit life insurance and credit disability insurance as well as "GAP" insurance plans that claim to cover the difference between the over-priced car loan and the true value of the vehicle, in the event of a collision or theft. In some cases, car buyers were misled into paying thousands of dollars for items worth less than \$100, such as key chains or "theft etch." In addition, dealers in many states charge "garbage" fees (such as \$250 "document" fees) -- often misrepresented as a "government-mandated" fee.

All too often dealerships engage in falsification of loan applications and forgery so that they can increase their profits when they sell the financing to lenders. Many states' laws allow dealers a window for unilaterally rescinding deals if they are unable to obtain financing. Dealers commonly use the threat of their supposed inability to sell the loan to a finance company as a pretext to engage in a type of bait-and-switch financing known as "yo-yo" financing or "spot delivery." It is estimated that this practice impacts 1 in 8 borrowers with incomes below \$40,000 and 1 in 4 borrowers with incomes below \$25,000, who end up paying 5 percent higher interest than car buyers who are not subjected to "yo-yo" tactics.<sup>6</sup>

Some dealers, known as "Buy Here, Pay Here" (BHPH) dealers, may retain the note rather than selling it to an auto finance company. Such dealers typically require a down payment that equals or exceeds the amount the dealer paid for the car, plus any repairs. Although the true cost of the financing is almost impossible to determine since dealers manipulate the sales price of the car and the interest rate, inevitably their customers wind up making payments that vastly exceed the car's actual value. As with other dealers, the BHPH dealers' business model relies on profits from financing, rather than just the sale of a car.

These practices have led to a vicious cycle of negative equity, as more vehicle owners sink deeper into debt for a product that for many families is a necessity. Rampant and unchecked auto lending abuses have led to record numbers of auto repossessions, destroying consumers' credit and impeding our nation's economic recovery. "According to industry analyst Art Spinella, president of CNW Research, fully 85 percent of Americans with a car loan have negative equity. Other studies show that these loan holders, on average, owe \$4,400 more than their cars are worth. Millions of Americans didn't get upside down on their car loans without a lot of help from car dealers."<sup>7</sup>

As part of the fallout from the growing negative equity in autos, many states are struggling to deal with a dramatic upsurge in dealers who are engaged in "car kiting." The dealers take vehicles in trade, promising to pay off the outstanding liens, and rolling over the negative equity into the next

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5 United States of America vs. Nara Bank, Union Mitsubishi, and Han Kook Enterprises, in the United States District Court, filed Sept. 30, 2009. Press release issued by U.S. DOJ, "Justice Department files suit alleging auto lending discrimination in Los Angeles," at <http://www.usdoj.gov/opa/pr/2009/September/09-crt-1063.html>. Complaint at: <http://www.usdoj.gov/crt/housing/documents/narabankcomp.pdf>

6 Testimony of Michael Calhoun, Center for Responsible Lending, before House Financial Services Committee, September 30, 2009, Appendix B.

7 "Why the Auto Bailout's a Dead End," *Mother Jones Magazine*. Detroit's primary moneymaking vehicle has been selling credit, not cars. The Big Three may have finally run out of road." Posted at: <http://www.motherjones.com/politics/2008/12/why-auto-bailouts-dead-end?page=2>

transaction. Then they fail to satisfy the liens, sticking hapless car buyers with two car payments, often ruining their credit. Also harmed -- used car buyers who purchase the traded-in vehicles, with the dealer's promise that the title will arrive by mail. The title never arrives. Instead, the former owner's lienholder repossesses their car -- even if they have made every payment in full and on time. In some cases, innocent car buyers are losing their only means of transportation to their place of employment, and along with it, their jobs. In California, consumer complaints to the Department of Motor Vehicles about failure to transfer title, typically linked to car kiting, have soared 93% over the past two years. This problem has reached crisis proportions due to the record numbers of dealers who are closing their doors without paying off liens on traded-in vehicles.

In order to effectively regulate auto financing, the CFPA must have authority to comprehensively regulate all financing-related activities of the dealers, including:

- Selling retail installment contracts to lenders
- Engaging in bait-and-switch financing, also known as "yo-yo" financing
- Engaging in "loan packing" -- misrepresenting the costs to finance over-priced add-ons
- Forging documents and/or signatures
- Failing to pay off outstanding liens on traded-in vehicles, as promised, aka "car kiting"
- Charging excessive, hidden dealer "markups" of interest rates
- Price gouging by Buy-Here-Pay-Here lots, where dealers carry their own paper
- Engaging in other predatory lending practices

In sum, predatory auto lending costs consumers billions. Those dollars could have been spent to purchase newer, safer, more fuel-efficient vehicles and lifesaving safety systems such as side air bags and electronic stability control, creating more manufacturing jobs and saving lives, rather than being squandered on excessive interest payments.

Thank you for your consideration of our views. Links to further information about auto dealers' practices, including Congressional testimony, are provided below. Should you or your staff have any questions regarding our position, please contact Travis Plunkett, Legislative Director, Consumer Federation of America, at 202-387-6121.

Sincerely,

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**Virginia Citizens Consumer Council**  
**Virginia Interfaith Center for Public Policy**  
**Woodstock Institute**

Further information about auto dealers' practices:

Testimony of John Van Alst, National Consumer Law Center, before U.S. House Energy and Commerce Subcommittee on Commerce, Trade and Consumer Protection:

[http://energycommerce.house.gov/index.php?option=com\\_content&view=article&id=1517:consumer-protection-in-the-used-and-subprime-car-market&catid=129:subcommittee-on-commerce-trade-and-consumer-protection&Itemid=70](http://energycommerce.house.gov/index.php?option=com_content&view=article&id=1517:consumer-protection-in-the-used-and-subprime-car-market&catid=129:subcommittee-on-commerce-trade-and-consumer-protection&Itemid=70)

Testimony of Rosemary Shahan, President of Consumers for Auto Reliability and Safety (CARS) before U.S. House energy and Commerce Subcommittee on Commerce, Trade and Consumer Protection:

[http://energycommerce.house.gov/Press\\_111/20090305/testimony\\_shahan.pdf](http://energycommerce.house.gov/Press_111/20090305/testimony_shahan.pdf)

*Fueling Fair Practices, a road map to improved public policy for used car sales and financing*, by John Van Alst, National Consumer Law Center:

<http://www.aecf.org/~media/PublicationFiles/fuelingfairpractices.pdf>

Testimony of Michael Calhoun, President of Center for Responsible Lending, before U.S. House Committee on Financial Services:

<http://www.responsiblelending.org/mortgage-lending/policy-legislation/congress/cfpa-calhoun-testimony.pdf>

Pursuit of the Dream: Cars and Jobs in America, produced by the Annie E. Casey Foundation:

<http://www.aecf.org/MajorInitiatives/FamilyEconomicSuccess/PursuitoftheDream.aspx>