

November 18, 2009

The Honorable Christopher Dodd
Chairman
Committee on Banking, Housing & Urban Affairs
United States Senate

The Honorable Richard Shelby
Ranking Member
Committee on Banking, Housing & Urban Affairs
United States Senate

Re: No Exemption for Auto Dealers Under the CFPB

Dear Chairman Dodd and Ranking Member Shelby:

On behalf of our organizations we commend the Chairman's introduction of a strong pro-consumer legislation that creates the Consumer Financial Protection Agency (CFPA). We applaud the decision to treat auto dealers who broker, originate, or otherwise affect the financing of auto loans the same as other parties within the legislation creating the CFPA. We believe such a decision not only protects the American consumer, but also ensures that sound auto financing is provided by credit unions and community banks rather than the large Wall Street banks who led us into the current financial crisis.¹

As the CFPA legislation moves forward, we strongly urge you to ensure that all activities of auto dealers related to the financing of cars remain under the jurisdiction of the CFPA. While we agree that the sale of just a car, where car buyers pay cash or obtain their own financing, should not (and does not) fall under the supervision of the agency, dealers are often "selling" the financing too. Currently a majority of dealer profits are derived not from the sale of the car itself, but rather from their "Finance and Insurance" departments. Consequently, much like the mortgage industry, financing practices have become more and more predatory and abusive in nature.²

Auto sales and service complaints, typically related to predatory lending practices at dealerships, rank #1 among consumer complaints lodged with state and local consumer protection agencies.³ 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, leaving most consumers vulnerable to predatory auto lending. Young people purchasing their first cars, racial and ethnic minorities, and members of the Armed Forces are particularly vulnerable.

Dealers are generally the original lenders in car sales/finance transactions. They are 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. Dealers and lenders conspire to place consumers in loans more expensive than they qualify for in a practice known as dealer mark-ups that cost Americans billions of dollars per year. Dealers

¹ "The auto finance market consists of two basic distribution channels: the dealer (or "indirect") channel, which is generally funded by a handful of large national banks and Wall Street capital markets platforms; and the retail (or "direct") channel, which generally consists of credit unions and community and regional banks. By artificially distorting the auto finance market in favor of the dealers' distribution channel, the exemption encourages the primacy of Wall Street funding sources over traditional bank deposit funding. As evidenced by the crisis, intentionally chasing businesses from traditional banks and credit unions into Wall Street funding models creates the real potential for disruptive volatility over time." See Raj Date and Brian Reed, "Auto Race to the Bottom," Cambridge Winter Center for Center for Financial Institutions Policy (Nov. 16, 2009).

² 2009 F&I Statistics, F&I Management & Technology, December 30, 2008, at 28, stating that contributions from finance and insurance "continued to rise in 2007 and 2008, representing more than half of total profits."

³ Annual consumer complaint survey, released by Consumer Federation of America, National Association of Consumer Agency Administrators, and North American Consumer Protection Investigators.

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.

Moreover, dealerships often engage in falsification of loan applications and forgery so that they can increase their profits when they sell the financing to third-party lenders. Dealers also commonly engage in bait-and-switch financing known as "yo-yo" financing or "spot delivery." Often a consumer signs a contract with a low interest rate, then weeks later is contacted by the dealer, who tells them that the loan "fell through" and that their down payment and/or interest rate will now be substantially higher. The dealer refuses to return their traded-in vehicle and any down payment, and may threaten to report their newly purchased vehicle as stolen. 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 pay 5% higher interest than car buyers who are not subjected to "yo-yo" tactics.⁴

Lastly, some dealers known as "Buy Here, Pay Here" dealers 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. Inevitably their customers wind up making payments that vastly exceed the car's actual value.

All of the above practices have driven many Americans into a vicious cycle of negative equity, as more vehicle owners sink deeper into debt for a product that for many families is a necessity. Some estimates reflect that as many as 85% of Americans with car loans have negative equity. Other studies show that these loan holders, on average, owe \$4,400 more than their cars are worth.⁵

Predatory auto lending has cost the American consumer billions of dollars – dollars that could have gone to purchasing newer, safer, more fuel-efficient vehicles and lifesaving safety systems such as side air bags and electronic stability control instead of excessive interest rate payments. We again applaud the Chairman's foresight in protecting America's car buyers by providing the CFPB authority over auto dealers.

Sincerely,

A New Way Forward
Americans for Democratic Action, Inc.
Americans for Financial Reform
Campaign for America's Future
Center for Responsible Lending
Connecticut Citizen Action Group
Consumer Action
Consumer Federation of America
Consumers for Auto Reliability and Safety
Consumers Union
Consumer Watchdog
Demos
Empire Justice Center

4 See testimony of Michael Calhoun, Center for Responsible Lending, before House Financial Services Committee, September 30, 2009.

5 Mencimer, Stephanie, "Why the Auto Bailout's a Dead End," *Mother Jones Magazine* (Dec. 22, 2008). Posted at: <http://www.motherjones.com/politics/2008/12/why-auto-bailouts-dead-end?page=2>

International Brotherhood of Teamsters
Leadership Conference on Civil Rights
NAACP
National Community Reinvestment Coalition
National Association of Consumer Advocates
National Consumer Law Center (on behalf of its low income clients)
National Consumers League
National Council of La Raza
National Fair Housing Alliance
Neighborhood Economic Development Advocacy Project
New Jersey Citizen Action
Public Citizen
Sargent Shriver Center on Poverty Law
Service Employees International Union
USAction
U.S. Public Interest Research Group

cc: United States Senate