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# Still Beating the Same Drum

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In February, the U.S. PIRG Education Fund and Frontier Group, two public interest groups, published a paper entitled "Driving Into Debt: The Hidden Costs of Risky Auto Loans to Consumers and Our Communities." The paper criticizes America's dependence on cars, absence of alternative transportation options, and the rise of automobile debt since the Great Recession. It also proffers that auto debt-strapped consumers post-recession are financially vulnerable to another economic downturn. In addition, the paper chastises the auto marketplace for loosening credit standards and "abusive, predatory, and discriminatory auto sales and lending practices." Although the paper calls for an expansion of transportation choices for consumers, a majority of the paper focuses on regulating auto dealers' and finance sources' alleged unfair, deceptive, and abusive practices. The paper's vague allegations and one-off personal stories are used to lump all dealers and finance sources in with bad actors in the industry. We've all heard these allegations before, but they bear repeating because more and more consumer advocates, regulators, and policymakers seem to be beating the same drum, and it might be getting louder.

Owning a car is paramount to success in America. The paper calls it the price of admission to the economy and society and states that the expense of car ownership drives millions of households to take on debt (so does having children, but that's another story). Blaming post-recession interest rate reductions, lengthening terms of vehicle-secured credit transactions, a belief that car credit is safer than mortgage loans, and the need for a car to produce income, the paper alleges that both creditors and consumers have taken on more risk when it comes to auto debt.

The paper continues to argue that characteristics of current car credit leave consumers financially vulnerable in the case of another economic downturn. Citing the longer repayment terms, the financing of negative equity, and higher rates to less qualified buyers, the paper alleges more people are paying more money for owning a car. The paper also claims that dealers and finance sources, especially those in the subprime market, routinely engage in "predatory, abusive, and discriminatory practices" that contribute to the economic vulnerability of an already vulnerable population.

The paper argues that creditors charge subprime buyers rates that exceed state usury rates, citing New York law. Here, the paper confuses direct and indirect credit transactions. In New York, the generally accepted maximum interest rate for **licensed lenders** is 25% for **loans** with a principal amount of $25,000 or less. Dealers are not

licensed lenders, but credit sellers. Regular readers of this publication know that indirect transactions are credit sales, not loans. A dealer in New York may contract for and charge, receive, and collect the credit service charge on an installment contract at the rate or rates agreed to by the retail seller and the buyer. There is no deception here. Usury rates simply don't apply. This confusion is not surprising. We continue to find that some consumer advocates, credit regulators, and even some industry lawyers still call credit sales "loans" and finance sources "lenders."

The paper argues that creditors provide incomplete or confusing information about credit terms. The paper claims that the use of electronic contracting creates "opportunities for abuse" where "consumers often find it difficult to review in fine print and may not even be confident that the contract they are signing matches the terms of sale agreed to with the dealer." Here, the paper fails to understand how dealers e-contract. To comply with the Truth in Lending Act (TILA) and the Electronic Signatures in Global and National Commerce Act (ESIGN), dealers obtaining electronic signatures must print a copy for buyers to review prior to obtaining the electronic signatures or comply with ESIGN's complicated consumer consent disclosures. We are not aware of any dealers to date, in any part of the country, providing the consumer consent disclosures. Typically, a consumer contracting electronically receives a printed copy of the contract and would be fully aware of the terms of the contract before signing it. Moreover, it is typical for a dealer, even in states that don't require it, to provide copies of all documents signed by the consumer upon completion of the transaction. In fact, just a few weeks ago, my husband and I financed a car and walked out of a Maryland dealership with a copy of all the documents we signed, as required by Maryland's Credit Grantor Closed End Credit provisions.

The paper also discusses spot deliveries, termed by consumer advocates as "yo-yo" sales. For years, consumer advocates have contended that all spot deliveries are unfair and/or deceptive practices. There are abusive spot delivery practices, and some dealers employ them, but spot deliveries that are neither unfair nor deceptive take place by the thousands every day. Those transactions are ignored because they do not advance the consumer protection agenda. Some states have bought the consumer advocate position and prohibit spot deliveries; others regulate the practice. In any case, with more and more dealers connected to finance sources electronically, and more and more instantaneous approvals, spot deliveries may decrease. Further, spot deliveries should be even more infrequent in buy-here, pay-here transactions because the dealer is not "shopping" the contract among finance sources but selling the contract to a related entity.

The paper argues that dealers extend credit to consumers without the ability to repay. Here, the paper equates "no document" mortgage lending with auto finance. The paper further alleges that because one company verified only 8% of buyer income in a securitized portfolio, the industry is engaged in credit transactions without determining the ability to pay for a financed vehicle. That may be true for some dealers and finance companies, but it is not an industry-wide practice. Furthermore, finance sources may not have a policy to verify all income but may have accurate statistics on defaults and complaints that should lead finance sources to dealers engaging in application fraud. Finally, many buy-here, pay-here dealers not only get pay stubs and bank statements, but also make other attempts to verify income.

The paper argues that dealers engage in discrimination related to dealer participation, claiming that dealers are violating the Equal Credit Opportunity Act under a disparate impact theory. This issue dates back to the early 2000s. It remains unclear whether disparate impact is a viable legal claim and whether anyone can really show disparate impact using the statistical analyses preferred by plaintiffs' lawyers and consumer advocates. Disparate treatment, however, is actionable under the ECOA and creditors should take great care to make credit, servicing, and collections decisions based upon objective credit criteria.

The paper argues dealers also charge bogus fees and push expensive add-on products. Many fees charged by dealers are regulated by state law. Documentary fees, for example, should be charged equally in cash and credit transactions, are often limited in amount, and carry disclosure warnings to the consumer that they are fees paid to the dealer for services related to the sale. The sales of ancillary products, such as service contracts, credit insurance, and GAP are also heavily regulated under state law. Although dealers should be wary that they do not engage in high pressure sales tactics or incentivize such practices, the sales of these products are legally permissible if optional, compliant with state law, and disclosed properly on a retail installment sale contract.

The paper argues that creditors engage in abusive collection and repossession tactics. Upon default, creditors have a right to repossess the vehicle securing the transaction and collect the outstanding amounts owed to the creditor. Yes, there are bad actors who engage in collection practices and repossess vehicles in violation of the law. Many, however, have servicing and collection policies designed to ensure compliance with federal and state laws concerning debt collection and vehicle recovery, train their staff on such policies, and mitigate the risk of UDAAP violations through legal compliance.

In response to the alleged abuses above, and to protect vulnerable consumers, the paper suggests that policymakers close excessive rate loopholes, enforce existing fraud protections, prohibit discriminatory dealer participation, require creditors to determine ability to repay, address "inherent conflicts of interest present in indirect lending," and expand responsible lending options for low-income Americans. The paper also contains an appendix entitled "Consumer Tips for Avoiding Auto Loan Tricks and Traps." Information in the appendix continues the vague allegations of UDAAPs against dealers, calling for consumers to:

- avoid buy-here, pay-here dealerships by exploring credit options before they buy;
- limit "yo-yo" financing by buying "less car" or get pre-approved financing from a bank, credit union, or online lender;
- be particularly careful when trading in a car with negative equity and try to "avoid trading it in;"
- avoid focusing on monthly payment, but look instead to the total cost of the "loan;" and
- avoid buying any add-on products which are "either unnecessary or can be found

far cheaper elsewhere."

Although exploring credit options, keeping the amount of credit extended within a consumer's limits, and looking at the total cost of the credit agreement are good advice, avoiding buy-here, pay-here dealers, not trading in vehicles with negative equity, and obtaining bank loans are just not feasible alternatives for subprime, and even many prime, buyers. Further, a claim that all add-on products are unnecessary neglects the real consumer benefits of some of the products.

The paper beats the drum of consumer advocates, misstates the structure of indirect credit, misleads the reader into thinking that there are no laws against the practices alleged to be engaged in by creditors, uses one-off anecdotes to make global allegations against the entire auto industry, and frankly, paints such a broad brush against car ownership, it is difficult to take it seriously.

That said, because the credit practices alleged to be predatory in the paper do exist and consumer advocates have long alleged them to be abusive, creditors should make efforts in their businesses to mitigate risks by ensuring customers adequately understand the terms of the transaction, understand that the purchase of add-ons is optional, risk-base the price of credit on verifiable application information, avoid spot delivery abuses, and ensure compliance with federal and state laws relating to application, origination, servicing, and collection of vehicle installment sale contracts.

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