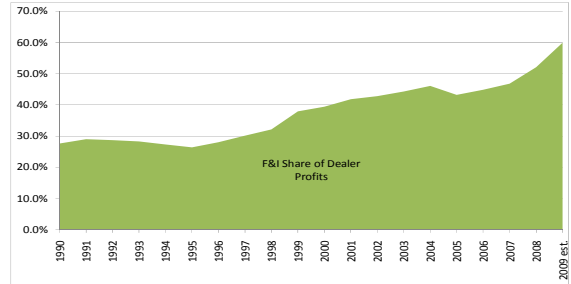


Auto Lending Abuses: The Pitfalls of Financing Cars

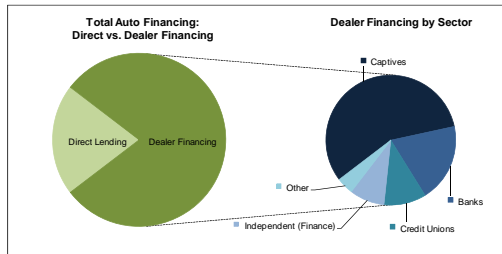
Presentation of Chris Kukla
NC State Bar Legal Assistance for Military Personnel
Meeting
October 14, 2011

Share of Dealership Profits



Source: F&I Magazine (www.fi-magazine.com/Statistics)

Direct and Dealer Financed Auto Loan Market Shares by Loan Source



Source: Richard Howse, *How Different is the Indirect Channel from the Direct Channel?*, JD Power & Associates, Mar 31, 2008. Percentages based on loan volumes for franchised dealers only.

Car Lending Abuses

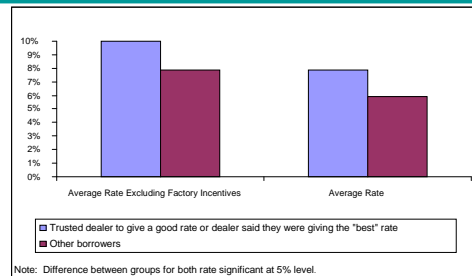
- Dealer markup/kickback:
 - Dealer has discretion to increase the interest above the rate for which the borrower qualifies
 - Dealer pockets part or all of the proceeds from the increased rate.
- Legal at the state level.
- For example, in NC dealer has no obligation to inform consumer whether markup occurred or the amount of the markup levied.

Kickback Volume

	New Vehicles	Used Vehicles	Total Vehicles
2009 Total Rate Markup Volume	\$4.1 Billion	\$21.7 Billion	\$25.8 Billion
Average Rate Markup 2009	1.01%	2.91%	2.47%
Average Markup Per Loan 2009	\$494	\$780	\$714
Dealer Gross Profit Per Retail Sale 2009	\$1,301	\$1,721	\$1,461

Sources: Data derived from CNW Marketing Research (sales data for dealer-financed purchases, excluding leases), 2010 National Auto Finance Automotive Survey (dealer markup data), and YTD 2009 NADA Average Dealership Profile (gross dealer profit). Average markup figures assume a rate markup occurs on every dealer-financed sale, leading to more conservative averages.

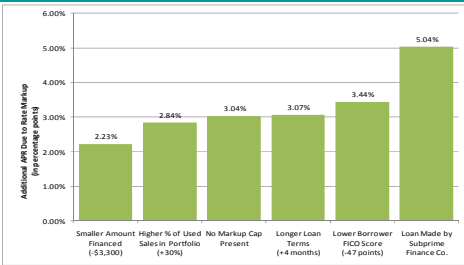
The "Trust Tax"



Note: Difference between groups for both rate significant at 5% level.

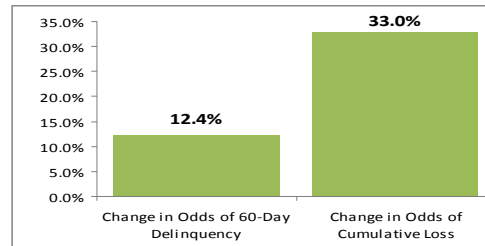
Source: CRL-sponsored survey through Macro International's CARAVAN phone interviews

Changes in Amount of Kickback



Figures are based on results from regression models using auto ABS securities data. The change in each category is assuming the increase of one standard deviation in the independent variable. Note that the markup increase of each variable does not have a cumulative effect if multiple conditions exist on one loan.

Odds of Default Rise When Kickback Included in Subprime Loan



Odds ratios based on coefficients from linear regression models using auto ABS securities data. Changes in odds are based on an increase of one standard deviation of rate markup for finance companies (+4.5%). Regression model for non-finance companies produced results that were not significant.

Direct vs. Dealer Financed Repossession Rates (Repos per 1,000 Loans)



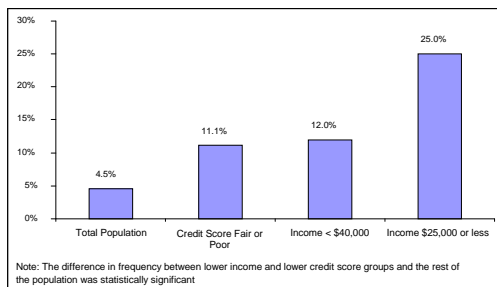
Source: American Banker Association Consumer Credit Delinquency Bulletin. Figures are seasonally adjusted.

Car Lending Abuses



- Yo-yo Scams:
 - Dealer sends consumer home with car before financing is complete,
 - Consumer is brought back to the dealer with the car,
 - Consumer is told that interest rate will be much higher than previously thought,
 - When consumer tries to rescind deal, told that trade-in has been sold and/or down payment is non-refundable.
 - Consumer who does not return the car threatened with repossession and/or criminal charges (theft).

Prevalence of Yo-Yo Scams (on average rates 5 percentage points higher)



Note: The difference in frequency between lower income and lower credit score groups and the rest of the population was statistically significant


Source: CRL-sponsored CARAVAN phone survey

Car Lending Abuses



- Loan Packing:
 - Finance and insurance office of car dealers sell a vast number of products:
 - Extended warranties, vehicle service contracts, GAP protection, wheel and tire protection, security/anti-theft devices, credit insurance, rustproofing, paint protection, roadside assistance....
 - Products usually expressed as change to monthly payment, true cost hidden.
 - Profit margins extraordinarily high.

Industry Data on Add-on Penetration



NEW VEHICLES				
F&I Add-On Product	Market Penetration	Cost Per Vehicle Per Month	Average Loan Term (months)	Cost Per Vehicle
GAP Protection	16%	\$5	62.0	\$315
Vehicle Service Contracts	26%	\$13	62.0	\$795
Theft Deterrent/Window Etching	15%	\$4	62.0	\$225
Credit Life and Disability Insurance	3%	\$8	62.0	\$496


USED VEHICLES				
F&I Add-On Product	Market Penetration	Cost Per Vehicle Per Month	Average Loan Term (months)	Cost Per Vehicle
GAP Protection	23%	\$7	60.7	\$438
Vehicle Service Contracts	30%	\$13	60.7	\$795
Theft Deterrent/Window Etching	18%	\$4	60.7	\$260
Credit Life and Disability Insurance	5%	\$8	60.7	\$486

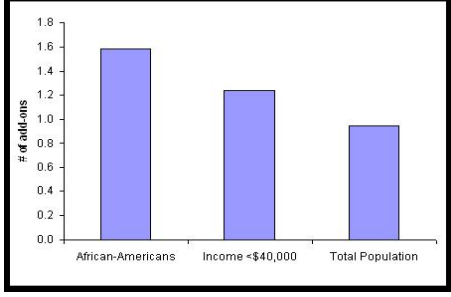
Source: F&I Magazine (www.fi-magazine.com/Statistics)

<http://www.responsiblelending.org>
13

Who Gets Add-ons

(sometimes sold as mandatory or without customer knowledge)






Source: CRL-sponsored CARAVAN phone survey

<http://www.responsiblelending.org>
14


Car Lending Abuses

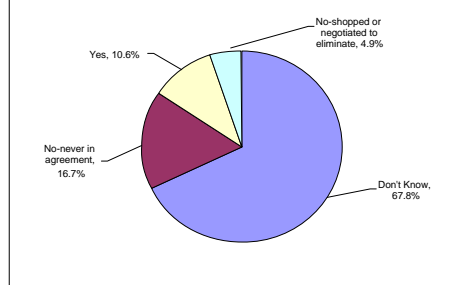


- Mandatory Arbitration
- Rolling negative equity into new loan.
- Failure to pay off lien on trade in.
- Powerbooking – using monthly payment target to set price of car and/or number of add-ons.
- Claims that ancillary products are lender requirement.

<http://www.responsiblelending.org>
15

Most Consumers Unaware of Mandatory Arbitration






Source: CRL-sponsored CARAVAN phone survey

<http://www.responsiblelending.org>
16


North Carolina Law



- Dealer markup of interest rate is legal.
 - G.S. 20-101.2 requires that, in order to charge a fee or receive a commission for providing, procuring or arranging financing, a dealer must:
 - Post a conspicuous notice in the sales or finance area that says that the dealer may be receiving a fee or commission for providing, procuring or arranging financing and for which the consumer may be responsible for paying, and
 - Disclose on the purchase order, buyers order, or separate form providing to the consumer prior to closing of the sale of the vehicle that the dealer may be receiving said fee or commission.
 - And, the dealer is not required to disclose the contractual arrangement between the dealer and potential purchaser of the RISC, nor disclose the amount of the markup, profit or compensation the dealer may receive in the deal.

<http://www.responsiblelending.org>
17

North Carolina Law



- Conditional Delivery Allowed
 - A dealer may enter into a contract with a purchaser where delivery of the certificate of origin or certificate of title is conditioned upon the purchase obtaining financing for the vehicle.
 - Dealer's insurance must cover vehicle until such financing is approved and certificate of origin or title is executed in purchaser's name.

<http://www.responsiblelending.org>
18

North Carolina Law



- Installment sale must be in writing (G.S. 20-303):
 - "Every retail installment sale shall be evidenced by one or more instruments in writing, which shall contain all the agreements of the parties and shall be signed by the buyer."
 - "For every retail installment sale, prior to or about the time of the delivery of the motor vehicle, the seller shall deliver to the buyer a written statement describing clearly the motor vehicle sold to the buyer, the cash sale price thereof, the cash paid down by the buyer, the amount credited the buyer for any trade-in and a description of the motor vehicle traded, the amount of the finance charge, the amount of any other charge specifying its purpose, the net balance due from the buyer, the terms of the payment of such net balance and a summary of any insurance protection to be effected. The written statement shall be signed by the buyer."

North Carolina Law



- Limits on interest rates for used cars under RISA (G.S. 25A-15):
 - 18% per annum for vehicles one and two model years old,
 - 20% per annum for vehicles three model years old,
 - 22% per annum for vehicles four model years old, and
 - 29% per annum for vehicles five model years old and older.

Impact of Financial Reform Law



- Bureau of Consumer Financial Protection created.
- BCFP received consumer protection functions from all regulators July 11, 2011.
- Can write rules for "providers of consumer financial products and services" with limited exemptions.
- Will have enforcement and supervision authority for larger lenders.

Impact of Financial Reform Law



- BCFP has rulemaking authority under consumer financial laws and to prevent unfair, deceptive or abusive acts.
- Car dealers that primarily engage in the sale or lease of vehicles to consumers AND service of vehicles AND routinely assign finance contracts to unaffiliated third parties are exempt.
- Takes most franchise dealers out (those with service departments), leaves independents w/o service department and Buy Here-Pay Here lots in.

Impact of Financial Reform Law



- BCFP will have authority over lenders who purchase auto loan contracts from dealers.
- FTC will have rulemaking and enforcement authority over dealers, with regular rulemaking process.
- FTC holding 3 roundtables on auto lending and sales issues.

Buyer Tips



- Remember that sale, trade-in and financing are separate transactions.
- Shop around – you do not have to finance with the dealer.
 - Beware of low or zero interest loan promotions
- Don't use monthly payment as your guide.
- Take your time – don't buy or sign that day.
 - Take finance documents home
 - Never buy that day
- Add-on products are not required for financing.
 - Know what you are buying and how much it costs.
- Beware of "pay off your trade in no matter what" promotions.

Contact Information



Chris Kukla

chris.kukla@responsiblelending.org

919-313-8520