

**Response to**  
**Draft Senate Banking Committee Report**  
**Advocating the Need to Subject Auto Dealers to CFPB Rulemaking and Enforcement**

The Draft Senate Banking Committee Report to S. 3217 contains a justification (pages 18-19) for extending the Bureau of Consumer Financial Protection's (CFPB's) rulemaking and enforcement authority to auto dealers. The draft report fails to reflect an accurate representation of dealer-assisted financing and fails to acknowledge written submissions that the National Automobile Dealers Association (NADA) presented to Committee staff in October 2009 and April 2010 that discredit the consumer activists' arguments upon which the draft report is based. To correct the record, NADA offers the following responses to erroneous statements contained in the draft report.

**Statement 1**    **Dealers routinely mark up loan rates that are higher than the borrower would need to pay to qualify for the credit.**

**Response**        This statement is incorrect in that consumers do not “qualify” for the wholesale buy rate that financial institutions offer to dealers for a retail installment sales contract any more than consumers qualify for the wholesale price that milk wholesalers offer to supermarkets for a gallon of milk. All wholesalers sell their products to their retail distribution outlets at a price below what the wholesalers would need to charge consumers if they had to develop their own retail distribution network to sell their products directly to consumers. Every year, millions of consumers choose to obtain optional financing through auto dealers because the rates dealers offer are more competitive than the rates those consumers can obtain directly from banks or credit unions. This is because banks and credit unions that lend directly to consumers must build both their loan distribution costs and the return on investment on those costs into the retail rates they offer to consumers. As stated by the Federal Reserve Board, “the dealer’s participation in the finance charge may serve as compensation for the work done in arranging the financing and for the risk of loss which is shared with the lending institution. Therefore, the Board believes that, in many instances, the portion of the finance charge which represents the dealer’s participation is not an amount which the consumer could save by obtaining a direct loan from a lending institution.” (Emphasis added)<sup>1</sup>

**Statement 2**    **Auto dealers may use the financing transaction as a way to sell other unrelated products to “unsuspecting buyers.”**

**Response**        This statement repeats the assertion that the CFPB is needed to prevent “payment packing”, a practice in which products that are not requested by the consumer are nonetheless sold to the consumer. As the persons who repeat this claim are well aware, this practice is prohibited under current law, would remain illegal under the Brownback Amendment to S. 3217, and thus does not require the creation of a new remedy.

**Statement 3**    **Borrowers are unaware of the “incentives” pushing auto dealers to charge higher interest rates.**

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<sup>1</sup> 42 Fed. Reg. 19,125 (Apr. 12, 1977).

**Response**

This statement, presented without any factual support, ignores information previously submitted by NADA demonstrating that dealers have an incentive to seek the lowest wholesale buy rate applicable to the consumer's request for credit. To reiterate, consider the following example: (i) two finance sources approve a consumer's credit application, with Finance Source A providing a wholesale buy rate of 4% and Finance Source B providing a wholesale buy rate of 4.5%; (ii) each finance source caps the dealer's retail margin (also known as dealer participation) for delivering the financing at 2%; (iii) the consumer is able to arrange financing from a source other than through the dealer at a retail rate of 6.25%; and (iv) in order to earn the consumer's financing business, the dealer offers the consumer a retail rate of 6%. In this example, the dealer would earn the full 2% if it arranges financing with Finance Source A, while only earning 1.5% if it arranges financing with Finance Source B.

This example, which plays out repeatedly in dealerships all over the country on a daily basis, demonstrates not only that dealers clearly have an economic incentive to seek the lowest buy rate, but also that consumers benefit when there is competition among lenders.

**Statement 4** **Auto dealers have a history of abusive and discriminatory lending requiring careful oversight in the future, particularly as current contractual rate caps on dealer participation that are imposed by court orders expire over the next several years.**

**Response**

Far from justifying the creation of a new bureaucracy to oversee auto dealers, this statement demonstrates the reliability of the current regulatory regime applicable to dealers.

The statement refers to lawsuits that were brought a decade ago against finance sources whose lending procedures allegedly had a disparate impact against minority credit applicants. (Notably, dealers were *not* defendants in these lawsuits.) Notwithstanding significant disagreement as to the merits of the allegations made in these lawsuits, several court-approved settlements stemming from the litigation resulted in finance sources placing a contractual cap on dealer participation. However, the litigation and industry's response to it thoroughly undermine the need to subject auto dealers to CFPB jurisdiction.

- First, these lawsuits were brought under current law and afforded the plaintiffs the remedies they were seeking.
- Second, finance sources across the entire industry – and not just those that were defendants to this litigation – adopted contractual rate caps. Consequently, the expiration of the court orders cannot be expected to alter the standard industry practice that has evolved.
- Third, no evidence has been presented that systemic problems of this nature have occurred since these events transpired. It is not surprising that these events are described in the past tense, as extensive efforts by industry and the government to educate consumers about vehicle financing have created an environment favorable to borrowers.

- Fourth, intense competition in the marketplace shows that the caps are now largely unnecessary as dealer participation frequently is well below the contractual rate caps.
- Fifth, passage of the Brownback Amendment would have no impact on the ability of the CFPB to ensure the continuation of rate caps. Finance sources, who were the defendants in this litigation, would be subject to CFPB jurisdiction and thus would have to comply with any subsequent rate cap or other rules and orders imposed on them by the Bureau.

The Brownback Amendment clearly would not limit the ability of finance sources to impose rate caps or other contractual requirements on dealers. Consequently, it is inaccurate to suggest that CFPB jurisdiction over auto dealers is necessary to ensure remedies remain available to minority credit applicants.

**Statement 5    Auto dealers receive upfront compensation for originating the loans, without regard to the ongoing performance of the loan.**

**Response**    This statement mischaracterizes the standard dealer-finance source compensation arrangements in three-party vehicle financing transactions.

Dealers generally are paid dealer participation through one of two means. Under the first, the finance source that takes assignment of the retail installment sales contract pays to the dealer every month the dealer participation portion of the monthly payment that the consumer remits to the finance source. If the consumer defaults or prepays, dealers do not receive the unearned portion of the dealer participation. Obviously, under this approach, the dealers have a very strong interest in the ongoing performance of the loan.

Under the second approach, dealers agree to forego a portion of the dealer participation (approximately 25%) in exchange for (i) shifting to the finance source the dealer's risk of losing the unearned portion of the finance charge if default or prepayment occurs more than 90 days after the dealer assigns the contract to the finance source, and (ii) receiving at the beginning of the finance term the remaining amount of dealer participation discounted to present value. The upfront payment is essential to many dealers since, unlike mortgage brokers, dealers maintain and finance an extensive inventory of vehicles and, in addition to monthly interest payments, dealers must pay to the inventory finance source (also known as a floorplan finance source) the amount owed on each vehicle usually within three days of its sale. Dealers who have this payment arrangement also have a strong interest in the ongoing performance of the loan.

Moreover:

- dealers are responsible for default or prepayment that occurs within the first three months of the contract term and dealers must place funds into a separate account to satisfy chargeback obligations that they incur from the finance source (either because default or prepayment has occurred in the first three months or because other events specified in the contract have occurred after this period).
- assuming finance sources believe dealers have assigned risky paper to them, the finance source can either (i) discontinue the discounted payment arrangement, (ii) raise the premium (which, as noted above, is approximately 25%) they charge for this

accommodation, or (iii) cease taking assignment of contracts from that particular dealer. Of course, this is not a typical scenario, since, with regard to three-party vehicle financing, the finance source conducts underwriting on a consumer's credit application before the dealer enters into the credit contract with the consumer and thus understands the obligation it is assuming.

- unlike mortgage brokers, the dealer's relationship with the consumer does not end immediately after the finance contract is executed. Dealers have a significant incentive to offer consumers finance terms that they are satisfied with and can afford so the consumer can make its payments on the vehicle and will choose to have it serviced at the same dealership.

Finally, the draft report cites auto loan performance as supporting the need for CFPB jurisdiction over auto dealers, despite the fact that (i) auto loan delinquencies have remained relatively stable during the credit crisis while mortgage loan delinquencies skyrocketed, and (ii) auto retail asset-backed securities had the lowest downgrade rate of any structured finance sector in 2009. Clearly, auto lenders, unlike many mortgage lenders, recognize and have built into their underwriting model the need to focus on the repayment ability of the borrower (due to the rapid depreciation of vehicle collateral). The draft report's apparent assumption that the relationship between mortgage broker lending and mortgage performances must similarly apply to dealer-assisted financing and auto loan performance is misplaced and significantly undermines its contention that CFPB regulation of auto dealers is required in this area.

**Statement 6** **Military personnel are among those whom are frequently exploited by auto dealers.**

**Answer**

This irresponsible statement is particularly troubling since it –

- (i) fails to cite timely and comprehensive data from the Federal Trade Commission that NADA provided to Committee staff indicating that under 2% of consumer complaints received by the FTC in 2009 – which included complaints received directly from consumers (including service members), better business bureaus, state consumer protection agencies, and others – were “auto-related” and many of the sub-categories in this complaint category are unrelated to dealer-assisted financing;
- (ii) cites unscientific data (and fails to label it as such) from a DOD official in support of its proposition;
- (iii) fails to mention a critical qualification contained in the DOD official's letter in which the official encourages protections from a new consumer agency only if “such protections would not limit access to legitimate credit products”; and
- (iv) cites four abuses (bait and switch financing, falsification of loan documents, failure to pay-off liens, and payment packing) that already are prohibited under current law as justifying the need for CFPB jurisdiction over auto dealers.

The draft report also fails to mention the authority military installation commanders already possess to declare specific businesses that engage in unlawful or unfair consumer behavior as off-limits to service members. This authority provides a very precise tool for the military to use to address any problems that arise in this area.

In addition, the draft report again asserts an argument for extending CFPB jurisdiction to auto dealers that actually supports the need for the Brownback Amendment – namely, the importance of providing automobile financing to low-income families so they have access to a reliable automobile “for finding and keeping jobs.” The draft report’s attack on dealer-assisted financing evidences an intent to eliminate or severely curtail dealer-assisted financing. Should this occur (either directly or by making dealer-assisted financing economically unsustainable), the result will be market conditions that will harm the very consumers the bill seeks to help. Aside from significantly reducing rate competition among auto lenders and thereby driving up interest rates, eliminating dealer-assisted financing would price many low-income families out of the vehicle financing market. These consumers typically do not have banking relationships and often have credit profiles that make them unable to secure vehicle financing from direct lending sources. Dealers, who work with a variety of lending sources that have an array of lending programs, often can help such consumers secure vehicle financing under responsible and affordable terms. Removing or curtailing this source of financing will disproportionately harm this group of consumers. Unfortunately, this likely unintended consequence of this legislation is ignored.

For more information, please see the attachment of federal consumer protection regulations applicable to automobile dealers’ financial operations.