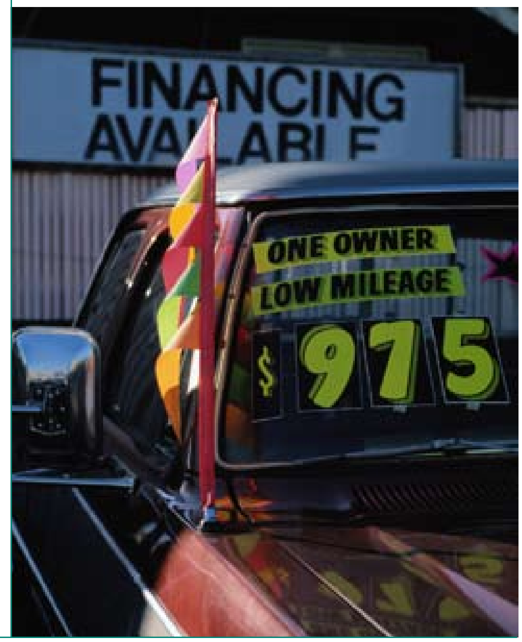

Car Trouble:

Predatory Auto Loans Burden North Carolina Consumers

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Consumers who rely on the dealer to finance their auto loans are vulnerable to a litany of predatory practices. The dealer is usually the initial creditor in the transaction, but while making the deal also arranges the sale of the loan to a bank or finance company. Without fairness and transparency in the process of financing a vehicle, consumers are subject to manipulation that can add thousands of dollars to its cost.

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Finding a good deal is no longer based on the quality of the car or the creditworthiness of the customer, but rather the customer's ability to survive a financial shell game with one of the largest investments most Americans will ever make.[1] Some of the most common practices include:[2]

- Dealer kickbacks: The customer initially qualifies for a lower interest rate. However, the subsequent purchaser of the loan agrees with the dealer that the dealer may increase the interest rate above the minimum required by the lender. The initial rate is called the "buy rate," and any additional interest added to the buy rate is commonly shared between the dealer and purchaser through a kickback to the dealer. That kickback is covered through interest the borrower pays over the life of the loan.[3]

- Loan packing: Dealers inflate the overall price of the loan through overpriced add-on products including "GAP" insurance (designed to protect the buyer when the vehicle is destroyed or stolen and the value of the car is less than the remaining loan amount), vehicle service contracts, credit life and disability insurance, and theft deterrent packages. By inflating the cost of the vehicle and the size of the loan, the potential kickback for the dealer is increased.

- "Yo-Yo" scams: The buyer is either convinced to enter into or unwittingly placed in a conditional sale agreement rather than a final sale. After the buyer drives the vehicle home, the dealer later claims to be unable to fund the loan at the agreed-upon terms. The buyer is required to return the car and renegotiate the loan, and the buyer is typically told that the down payment is non-refundable and/or the buyer's trade-in has already been sold.

- Binding mandatory arbitration clauses: Arbitration clauses essentially waive the customer's right to sue and appeal in court, leaving them with an arbitration system that is more expensive for consumers and biased toward the auto industry. Ironically, auto dealers themselves have argued that binding mandatory arbitration is unfair when they successfully lobbied the federal government to prevent auto manufacturers from requiring its use to resolve franchise disputes with dealers, but still use the agreements in their loan and sales contracts with customers.

Using several sources of industry data and a Center for Responsible Lending commissioned national consumer survey,[4] our research has uncovered several findings that jeopardize the fairness of the car buying process and could fairly be characterized as predatory:

Finding 1: Dealer Kickbacks: Kickbacks cost North Carolinians who purchased cars through a dealer in 2007 over $665 million in excess interest payments over the life of the loan.

Finding 2: "Yo-Yo" Scams: A quarter of low-income survey respondents have experienced a yo-yo scam. On average this led to a 5 percentage point higher interest rate compared to individuals with the same credit risk.

Finding 3: Loan Packing: African Americans and low-income buyers disproportionately receive overpriced add-on products. These were often sold without the buyer's full understanding or, in the worst cases, under false pretenses.[5]

DEALER KICKBACKS

Auto loan markups, also known as dealer reserves, involve kickbacks from a loan purchaser to a dealer for arranging a loan with a buyer. The car dealer is usually the initial lender in the transaction. Before arriving at an agreement with a customer, a dealer will reach out to several potential lenders or purchasers of the loan. Purchasers tell the dealer the interest rate at which they are willing to buy the loan. This is called the "buy rate." However, the purchaser often agrees to allow the dealer to arbitrarily add interest to the buy rate. The extra profit is either split between the dealer and lender or pocketed entirely by the dealer.

The portion paid to the dealer is called the "dealer reserve." For car buyers in North Carolina, this results in an average kickback of $642 per vehicle, based on an extra $764 for new vehicle purchases and $583 for used vehicles.[6] However, since not every car buyer receives an increased interest rate, the impact on the customers who do is much higher. According to data from five major captive auto lenders, consumers seeing loan kickbacks saw an average markup of $989.[7]

The customer is told that the marked up interest rate is what they qualify for, but the original buy rate is not revealed. **Under North Carolina law, the dealer is under no obligation to disclose either the presence of a marked up interest rate or the amount the rate was increased.**[8] This makes it harder for customers to bargain or compare rates. Dealers claim that the kickback is necessary to fully compensate the dealer's staff to negotiate loans and arrange the best deal. For many, the negotiation result is better for the dealer and worse for the consumer.

In addition to being deceptive, these kickbacks are extremely costly in comparison to the service provided by the dealer for financing. Arranging the loan turns out to be a very expensive one-time service that the buyer continually pays with interest through the life of the loan. Finance & Insurance (F&I) staff at dealers spent just over a half hour with each customer in 2007, even less if the prospective buyer took a test drive.[9] Dealerships have come to rely on automated systems to greatly improve their speed and efficiency, knowing it can improve sales. Since a kickback brings in an average $642 for NC vehicles, the dealer stands to gain over $1,088 per hour of service.

Dealer Kickbacks—the Yield-Spread Premium of the Auto Finance Market

Dealer kickbacks are a destructive feature of the auto finance market because they give dealers an incentive to act contrary to a borrower's best interest. They cause families to be steered into loans that cost more than is appropriate and that too many borrowers cannot afford over the long run. At a minimum, this means many more borrowers lose their car than necessary. In the home mortgage context, that rampant up-selling resulted in high rates of foreclosure that ultimately cost the larger economy.

These findings are significant because consumers are paying higher interest based on criteria other than creditworthiness, income, employment, etc.—factors that would normally determine a risk-based pricing decision. With the arbitrary nature of dealer kickbacks, even consumers with superior credit scores are frequently burdened with higher rates.

Using 2007 dealer reserve data from the Consumer Bankers Association Automotive Finance Survey and sales data from CNW Market Research,[10] we were able to estimate the national volume of dealer kickbacks for new and used vehicles. Using market shares by state, we estimated how much kickback volume can be attributed to North Carolina auto financing transactions. In 2007, kickbacks to auto dealers cost North Carolinians over $665 million.

Table 1: 2007 Dealer Reserve Kickback Volume in North Carolina

	New Vehicles	Used Vehicles	All Vehicles
NC Dealer-Financed Sales	340,065	695,211	1,035,276
NC Kickback Volume	$260,000,000	$405,000,000	$665,000,000
Average NC Kickback per Sale	$764	$583	$642

CRL's survey results confirm the arbitrary nature of interest rate markups. The survey was conducted among a random sample of 1,007 adults living in the continental United States. 81% of survey respondents owned a car or truck. About a quarter of the survey population (27%) used a loan at the dealership to purchase their car or truck.[11]

When controlling for credit risk and other variables using multiple regression analysis, consumers who believed the dealer when they said they were giving the consumer the "best" rate possible were found to have significantly higher annual percentage rates (APRs).[12] In fact, excluding people who received factory incentives, borrowers who were told by the dealer that they received the "best" loan actually received rates between 1.9 and 2.1 percentage points higher than rates for consumers with similar risk.

"YO-YO" SCAMS

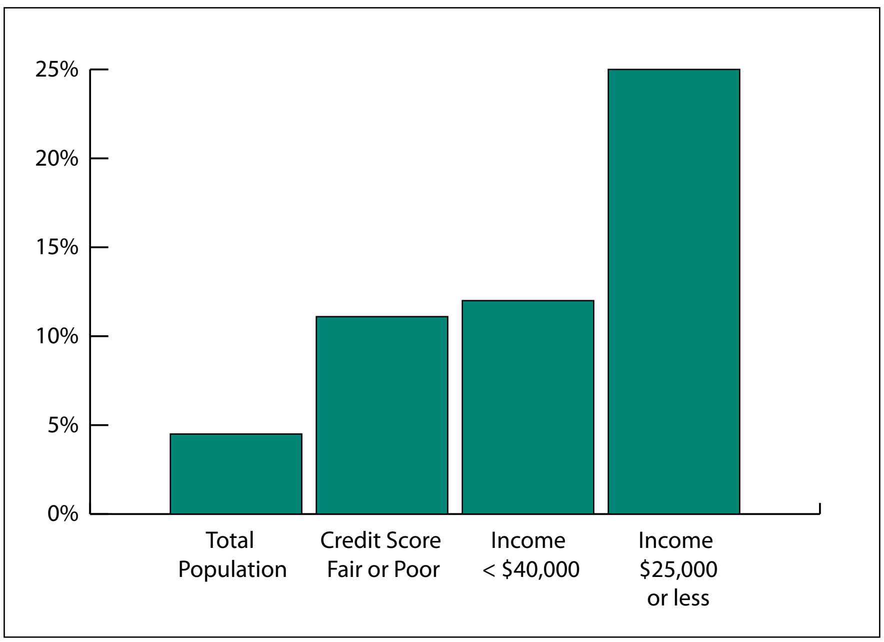
CRL's consumer survey found that the reported overall prevalence of yo-yo scams was 4.5%. However, 11% of people with fair or poor credit scores reported experiencing a yo-yo transaction, and for those with incomes below $40,000, 12% had experienced a yo-yo.[13] A quarter of people with incomes of $25,000 or less reported having experienced a yo-yo scam, suggesting that yo-yos among low-income consumers are a common occurrence that requires regulatory attention.

A spot delivery or conditional sale is any deal where the financing is not finalized until after the buyer has already taken the vehicle home from the dealership. The deal becomes a "yo-yo" when the buyer is called back into the dealership and told that the sale cannot be made as agreed. At that point the buyer is required to pay the loan balance in full and return the car, or rework financing at more expensive terms.

By this time it may be several weeks later, after the buyer has shown family and friends the car. Also, the dealer may have deposited the down payment and sold the trade-in at auction. Without the possibility of getting back the trade-in, the buyer feels more pressure to renegotiate for the new car even if it means higher rates, a larger down payment, or finding a co-signer. Sometimes the dealer will charge an additional "rental fee," "excessive mileage fee," or "restocking fee" for the use of the vehicle during those few weeks.[14]

A dealer is usually able to arrange a financing decision with automated technology in less than 30 minutes of the consumer entering the showroom,[15] prompting the question of why the dealer needs the extra time in a spot delivery sale. The dealer is under no obligation to accept any deal from a loan purchaser that is at or below the interest rate negotiated with the consumer. Therefore, claims that the financing has "fallen through" often really mean that the dealer is trying to leverage a higher kickback.

Figure 1: Prevalence of "Yo-Yo" Scams



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

Yo-yo scams were also associated with much higher interest rates. This was true even after accounting for risk factors such as credit rating and income in a regression analysis. People who had experienced a yo-yo scam received on average an interest rate that was 5 percentage points higher than someone with the same risk level who had not experienced a yo-yo scam.[16] This is especially troublesome for the most vulnerable buyers who can least afford to lose income and who may be less at risk of default with a more appropriate interest rate.

LOAN PACKING

Various types of aftermarket—or "add-on"—products can be sold to inflate both the price of the vehicle and the amount financed, increasing in turn the commission for dealers and F&I staff. A common drawback with these products is that they are overpriced, rarely benefit the buyer in practice, and often duplicate services the buyer may already get through the manufacturer or personal car insurance provider.

Dealership finance & insurance staff often present these products in bundled packages, giving the appearance that the customer will save money by buying several add-ons as a group. Others will present the products all at once in a menu format. Either way, it is often not clear that the buyer has the option of not purchasing any add-ons at all.[17] In fact, some salespeople will convince the customer that purchasing certain add-ons is mandatory for the loan to go through. Purchasing multiple products can easily add thousands of dollars to the cost of the car and the amount financed, with the true cost disguised as a modest increase in monthly payment. Some of the more heavily sold add-on products include:

In fact, some salespeople will convince the customer that purchasing certain add-ons is mandatory for the loan to go through.

Guaranteed Automobile Protection (GAP) Insurance: When a consumer owes more than a vehicle's fair market value and has a total loss of the vehicle through accident or theft, GAP insurance covers the difference between the insurance compensation and the outstanding loan balance. However, there are several items that may be excluded from GAP coverage, including overdue loan payments, costs for other add-on products and non-factory equipment, and negative equity rolled in from previous car loans. A lapse in primary car insurance may forfeit coverage entirely.[18] Since the insurance is paid as an up-front single premium, the consumer pays the GAP insurance over the life of the loan even if the "gap" disappears (such as from paying down the loan balance). At that point, the buyer is continuing to pay loan principal and interest on a product that is of no use to the buyer. This is similar to what happens with single-premium credit insurance financed on home mortgages, which many states and reputable lenders have recognized as unfair to borrowers and which North Carolina banned over nine years ago. In 2007 GAP coverage cost around $315 and $438 for new and used vehicles respectively.[19]

Vehicle Service Contracts and Extended Warranties: Vehicle service contracts (VSCs) are advertised as protection against mechanical breakdowns not covered by the manufacturer's original warranty. Similar products will cover regular vehicle maintenance (oil changes, tire rotations, etc.). In 2007, VSCs represented 14% of dealership profits and cost $795 per vehicle on average.[20] During the same year VSCs were included in 26% of new car deals, and 30% of used car deals.[21] Some VSCs duplicate the original warranty and do not extend much longer than the original warranty. Some contracts also exclude services to car components involving engines, suspensions, electrical, cooling, and fuel systems.[22]

Theft Deterrent Packages: Theft deterrent packages pay the customer a large lump sum, often around $5,000, if the car is stolen. Ironically, some packages require comprehensive theft insurance from another provider (which can serve the same purpose) as a prerequisite for coverage. In 2007, theft deterrent packages were included in 16% of new car deals, and 18% of used car deals.[23] The contract's fine print sometimes includes a provision that a portion of the theft compensation is contingent upon the consumer buying another car at the same dealership. Like GAP insurance, several conditions in the contract can possibly jeopardize coverage, including not reporting the theft in a timely fashion, and damage to the point of total loss.[24]

Credit Life and Disability Insurance: This coverage promises to either make payments or pay the balance of the loan upon the car owner's death or disability. Like the previous protection products, this often duplicates features the customer may already have through outside life and health insurance plans. In a given year, credit insurance can cost close to $400 on a new vehicle purchase.[25] And, as with other insurance products, the borrower may continue to pay for the cost of financing the premium long after the coverage has expired.

CRL's survey of consumers found that, on average, African Americans purchased 1.6 add-on products while other respondents purchased an average of 1.0. This difference was statistically significant. Those respondents with lower incomes (less than $40,000) also purchased more add-on products, with an average of 1.2.[26] For a typical good, economists expect more to be purchased at higher income levels. These types of goods are referred to as "normal goods." However, for some goods, more is purchased at lower income levels. Economists refer to these as "inferior goods." The survey results show that add-on products are an inferior good. In this case, the negative association with income may be a sign that these products are part of a sales and lending process that takes advantage of vulnerable buyers with fewer options. Borrowers with higher education levels also took fewer add-ons.[27]

Low-income customers were also more vulnerable to purchasing add-on products sold to them under false pretenses. They were significantly more likely to be told the product was required (19%), and to purchase a product without realizing it until later (13%). These results imply that dealers target those they suspect are financially vulnerable or unsophisticated. In anecdotal reports, ex-employees of car dealerships have admitted that racial and financial demographics in their experience were often used to determine who is less likely to decline a bad deal or shop around for a better one—allowing the dealer to pile on multiple add-ons without fear of losing the sale.[28]

In interpreting the prevalence of add-ons and the sales of add-ons under false pretenses, it is important to keep in mind that lack of knowledge may also play a role in survey responses. While some people acknowledged that they know they received add-on products without realizing it at the time of sale, it is likely that others never learned about receiving these products. Therefore the frequency of being charged for add-on products without knowing it is probably higher than the survey results indicate.

People with a high APR given their credit risk were also likely to have experienced a yo-yo scam and to have received at least two add-on products. The presence of yo-yo scams, two or more add-on products, and binding mandatory arbitration were combined into a 3 point "controversial practices scale." The "controversial practices scale" was significantly related to a higher APR given the respondent's risk level. This suggests that APR markups and other questionable practices are not substitute methods for dealers to get a fair return. Instead, finance and insurance managers tend to heap several of these questionably advantageous products on the same consumers.

BINDING MANDATORY ARBITRATION

Clauses for binding mandatory arbitration (BMA) are written into auto loan agreements as a means to resolve disputes without going through court proceedings. For the consumer, agreeing to mandatory arbitration essentially waives their legal right to sue and appeal in court, or participate in a class action lawsuit—even if their dealer is guilty of a clearly illegal or predatory act.

An arbitrator ruling against the dealer may result in a loss of future business for the arbitrator—creating a clear conflict of interest and possibly leading to imbalanced rulings. For example, the National Arbitration Forum, a major arbitration firm which manages consumer debt and credit card disputes for issuers like MBNA, is being sued in California state court with the plaintiffs complaining of consistently biased rulings against consumers. After examining 33,933 of their state arbitrations between January 2003 and March 2007, of the 18,075 that were not dropped, dismissed, or settled, consumers won only 30 (less than 1%) of the cases.[29]

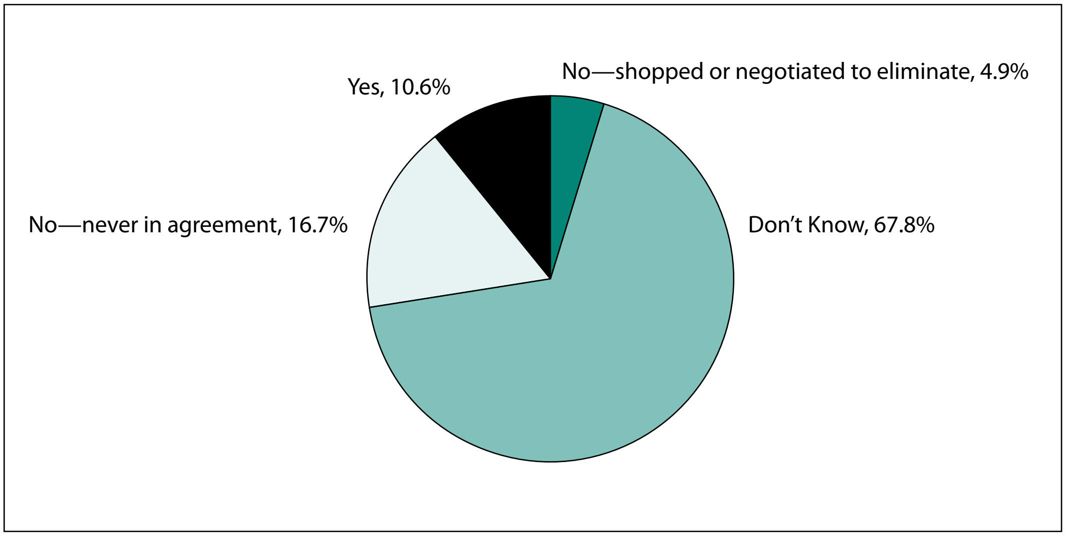
Arbitrations are typically closed hearings with limited right to discovery, meaning the consumer is handcuffed in how much information they can obtain before and during the process. Also, arbitration is not less expensive than courts as dealers would claim, since the consumer pays for every cost up-front as the case progresses, including the issuance of subpoenas, filing motions, and written explanations of the arbitrator's ruling.[30] If the consumer loses the hearing, they may also incur costs for the lender's attorney's fees.

Ironically, dealers successfully lobbied the federal government to prevent auto manufacturers from requiring the use of binding mandatory arbitration to resolve franchise disputes with dealers, arguing that BMA is unfair to the dealers.[31]

Dealers successfully lobbied the federal government to prevent auto manufacturers from requiring the use of binding mandatory arbitration to resolve franchise disputes with dealers. . .

Two-thirds of CRL survey respondents (67.8%) stated that they did not know if their contract had a binding mandatory arbitration clause after this clause was described to them. An additional 16.7% of buyers who got an auto loan from a dealership stated that there was never an arbitration clause in their loan agreement. However, typically these agreements are in fine print that often goes unnoticed by the buyer. In addition, there is anecdotal evidence that it may be difficult to purchase an auto and get a loan from a dealership without a binding mandatory arbitration clause.[32] If virtually all loans from the dealership include a binding mandatory arbitration clause, then the percentage of people who have such a clause in their contract and do not realize it may be closer to 84%. Only 5% of people stated that they negotiated or shopped to eliminate the clause, and only 11% of people are aware that there is such a clause in their agreement.

Figure 2: Percentage of Consumers Accepting Loans with Binding Mandatory Arbitration



POLICY RECOMMENDATIONS

Predatory practices in auto financing force the consumer to struggle not only for a competitive and affordable loan, but for a fair and honest one. Finding a good deal is no longer based on the quality of the car or the creditworthiness of the customer, but rather the customer's ability to survive a financial shell game with one of the largest investments most Americans will ever make. As a result, CRL proposes the following policy recommendations to help protect North Carolina consumers:

Recommendation 1: Ban the back-end compensation dealers receive for selling more costly loans with unfavorable terms to consumers. Such loans only result in a dealer windfall while interest payments pile up on the car buyer. There should be no incentive for a dealer to finance car buyers in worse loans than what they would otherwise qualify for.

Recommendation 2: Prohibit yo-yo scams and ensure more meaningful enforcement to prevent them. Dealers should not be able to use the excuse of not securing financing in a timely fashion to steer customers towards more expensive loans, especially considering automated technology and available information. In addition, the dealer should be prohibited from selling the trade-in before the deal is finalized. If the consumer declines the new deal, the dealer should also return the trade-in, down payment, and any taxes or fees associated with the deal.

Recommendation 3: Provide a consistent and transparent means of presenting the cost of the vehicle, all fees, and add-on product sales. It should also be explicit that the purchase of add-ons is completely optional and separate from both the purchase and the financing of the vehicle. There should be clear disclosure of how each add-on product impacts the overall price of the vehicle, not just the monthly payment. Ideally this would be in documentation distinct and separate from the paperwork involved with the vehicle purchase or financing.

APPENDIX: DATA AND METHODOLOGY

In order to quantify the scope of dealer reserve kickbacks in the industry, we relied on two sources of data that are routinely cited. The Consumer Bankers Association conducts a semi-annual Automotive Finance Survey that includes 32 banks and finance companies that submitted over 12.5 million account records for 2007, the most full-year data available. It includes information on average buy and contract rates, as well as the dollar amount of kickback costs by grouping of LTV ratios, FICO levels, and loan terms. Total outstanding accounts, auto loans, and related costs for all 2007 survey participants was $223 billion.

Additionally, CNW Marketing Research Inc. has been respected as an industry source for auto manufacturing, sales, and financing for years. For the purposes of our research, CNW was used to ascertain the levels of new and used vehicle sales financed directly through dealerships broken down on a state-by-state basis. Annual data releases from F&I Management and Technology magazine also revealed the market penetrations of certain add-on products. Industry data on markup rates, dealer-financed sales, and add-on product market penetrations allowed us to gain scope of how pervasive kickbacks and loan packing are in auto loans.

In order to gain further perspective of the potential predatory nature of auto lending CRL commissioned Macro International to conduct a national survey through their ongoing CARAVAN® survey. The survey was designed to gauge the customer's awareness of abuse, and their ability to negotiate for better rates and terms. The survey also allowed us to gather data on yo-yo deals and auto binding mandatory arbitrations, information not readily available elsewhere. The consumer-level survey data allowed us to use multiple regression to analyze the impact on the loan APR (annual percentage rate) while controlling for other credit risk factors and borrower demographics.

Survey Model

All variables used for statistical analysis came from a telephone survey commissioned by the Center for Responsible Lending. The survey was conducted among a national probability sample of 1,007 adults (505 men and 502 women 18 years of age and older) living in private households in the continental United States. Interviewing for the survey was completed during the period November 21–24, 2008.

81% of survey respondents owned a car or truck. White respondents were significantly more likely to own a vehicle than African American or Latino respondents. About a quarter of the survey population (27%) used a loan at the dealership to purchase their car or truck. The remainder of the survey focused on this subpopulation, leaving a sample size for these questions of 268 respondents (with a smaller sample size used for analyses involving questions where some respondents chose not to answer).

The survey was conducted by Macro International as part of its regular CARAVAN survey. All CARAVAN interviews are conducted using Macro International's computer assisted telephone interviewing (CATI) system. Macro International utilizes an unrestricted random sampling procedure that controls the amount of serial bias found in systematic sampling to generate its random-digit-dial sample. The sample is fully replicated and stratified by region. Only one interview is conducted per household. Unlike published directories, the probability telephone sample includes both unlisted numbers and numbers issued after publication of the directories. All sample numbers selected are subject to up to four attempts to complete an interview. Completed interviews are weighted by four variables: age, sex, geographic region, and race, to ensure reliable and accurate representation of the total population, 18 years of age and older. The raw data are weighted by a custom designed program which automatically develops a weighting factor for each respondent. All regressions shown in this report are for weighted results.

The income variable used in this analysis is a 1-10 scale, based on ten standard income ranges used in the CARAVAN survey. Credit rating was a number from 1-4 based on a four-category scale (“excellent,” “good,” “fair,” or “poor”), with a 1 indicating the best credit rating. A cut-off of 5% was used to come up with a non-incentive APR in some regressions. In the first half of 2008, the average rate for borrowers with a credit score above 720 (the highest category) was 6.1%, making it unlikely that many unsubsidized loans by the manufacturer have rates lower than 5%.[33] This distinction was made because the dynamics of many of the issues studied (particularly the negotiation of APR) may be different for respondents receiving a subsidized rate.

While we believe our interpretation of the results yields the most likely cause of the statistical results, it should be noted that any survey has the potential for bias. This bias becomes more important if it can be a source of correlation between individual questions. For example, if people have a tendency to either believe or state their situation is more positive than it is, they may indicate their credit rating is better than it is, their income is higher than it is, and also indicate their APR is lower than it is. This would cause an appearance in this case of risk-based pricing even if there was not any. On the other hand, optimistic responses will also tend to reduce the stated prevalence of controversial practices. Yo-yo scams, binding mandatory arbitration, unsuccessful loan negotiation, and other adverse indicators may be more common than the survey results suggest. Lack of knowledge may also play a role in survey interpretation. For example, while some people acknowledged that they know they received add-on products without realizing it at the time of sale, it is likely that others did not learn about receiving these products later. Therefore the frequency of being charged for add-on products without knowing it is probably higher than the results here indicate.

CARAVAN Survey Regression Results

Using a multiple regression technique allows us to analyze the impact of various factors on APR after taking into account other variables such as credit risk. Results of several multiple regression models are shown in Table 2. When credit risk factors and other variables are controlled for using a multiple regression statistical analysis, believing a dealer when they said they were giving the customer the “best” rate was significantly associated with a higher APR for non-factory incentive APRs.[34] In fact, if one is not receiving a rate that is so low an automobile manufacturer must be subsidizing the loan, be wary of any dealer saying they are giving the “best” rate because those rates are between 1.9 and 2.1 percentage points higher than rates for people with similar credit scores and other credit risk factors.[35] Gender and race were not found to be significantly related to APR after controlling for factors that may relate to credit risk.[36]

Rates were higher for people experiencing other exploitative practices including yo-yo scams, multiple add-on products, and binding mandatory arbitration.[37] Two of these three factors were statistically significant individually in one model (Model 3). People with a high APR given their credit risk were also likely to have experienced a yo-yo scam and to have received at least two add-on products. All three of these factors were statistically significant collectively when combined into a “controversial practices scale.” As shown in Table 2 (Models 1 and 4).

Table 2: The Relationship between APR and other Variables: Regression Analysis

	Model 1	Model 2	Model 3	Model 4
Dependent Variable	Non-Incentive APR	Non-Incentive APR	APR	APR
Credit risk factors				
Income	-0.50 (0.17)***	-0.41(0.175)**	-0.42 (0.16)***	-0.51 (0.15)****
Credit rating	0.86 (0.51)	0.77 (0.50)	1.94 (0.46)****	2.07 (0.47)****
Renter dummy	3.51 (1.18)***	3.01 (1.22)**	2.32 (1.13)**	2.83 (1.12)***
Demographic Factors				
Non-Latino white dummy	1.84 (1.06)	1.64 (1.06)	0.92 (1.01)	1.22 (1.01)
Female dummy	0.96 (0.80)	1.05 (0.80)	0.39 (0.72)	0.28 (0.71)
Situational Factors				
Controversial Practices Scale*	1.26 (0.52)**	--	--	1.66 (0.50)****
Tried but failed to negotiate APR	3.02 (1.33)**	3.11 (1.31)**	--	--
Trusted dealer to give good rate	0.62 (1.08)	0.70 (1.07)	--	--
Dealer claimed it was "best rate"	1.86 (0.98)	2.11 (0.97)**	--	--
Received a "yo-yo" loan		4.26 (1.48)***	5.39 (1.53)****	--
At least two add-on products	--	1.25 (0.80)	1.66 (0.76)**	--
Loan required arbitration	--	1.16 (1.29)	0.88 (1.10)	--

Note: First term is regression coefficient, term in parenthesis is standard error.
* The Controversial Practices Scale sums whether a consumer had multiple add-ons, a yo-yo loan, and arbitration.
** Significant at 5% level
***Significant at 1% level
****Significant at 0.1% level

NOTES

1 Brian K. Bucks, Arthur B. Kennickell, Traci L. Mach, & Kevin B. Moore, *Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances*, Federal Reserve Board (Feb 2009).

2 These bad practices are also discussed in more detail, along with another recent perspective on policy recommendations in: John W. Van Alst, *Fueling Fair Practices: A Road Map to Improved Public Policy for Used Car Sales and Financing,* National Consumer Law Center, (March 5, 2008), available at http://www.nclc.org/issues/auto/content/report-fuelingfairpractices0309.pdf.

3 While the dealer is often given a flat fee in return for raising the rate, the consumer pays a higher interest rate over the life of the loan that typically more than covers the fee.

4 Survey was conducted through Macro International's CARAVAN interviews and includes a sample size of 1,007 customers across the U.S., 81% of whom owned a car or truck as of Nov 2008. The primary findings are based on approximately a quarter of those respondents (sample size of 268) who reported using a loan financed through their car dealership.

5 North Carolina car buyers were found to be similar to the rest of the nation: no statistically significant differences were found between North Carolina and the rest of the nation.

6 National averages of kickbacks from *2008 Automotive Finance Study: An Analysis of 2007 Year-End Data,* Consumer Bankers Association (2008).

7 Mark A. Cohen, *Imperfect Competition in Auto Lending: Subjective Markup, Racial Disparity, and Class Action Litigation*, Vanderbilt University (Dec 2006). (Weighted average is derived from analysis of 12.6 million records between 1993 to 2004 where 33% contained a dealer kickback.)

8 N.C.G.S. §20-101.2 (2001-487, s.123.5; 2001-492, s.2.)

9 *F&I Factors,* F&I Management and Technology Magazine, (2007). (Customer spends 35.4 minutes with F&I staff. If customer has taken a test drive, the average time drops to 18.1 minutes. For 2008, the amount of time increases to 51.5 minutes, or 27.2 minutes if customer takes a test drive. This is the only year in recent history where F&I has taken as much time with customers.)

10 CNW Market Research data: "Sales, Values Historic Data on Auto Market" (Table 270a), "Financed and Cash Used Vehicle Sales" (Table 123m), "Used Sales in Millions—Historic" (Table 1439)

11 This was true when only non-factory incentive rates were included. More details regarding the survey methodology and results are contained in the Appendix.

12 A table containing more details of the regression is in the Appendix. This finding was true when other questionable practices are included individually (Model 2). Using a "controversial practices scale" that combines other questionable practices (Model 1), the "best rate" variable was very close to statistical significance (p=0.06) at the 95% confidence level.

13 The yo-yo transaction question asked whether consumers have ever had such an experience. However, given the very strong relationship found with the current loan's interest rate, it is likely that many or most of the respondents who responded affirmatively had experienced a yo-yo loan on their current vehicle. All group differences discussed in this paragraph were statistically significant using a Chi-square or Fisher's Exact Test at the 99% confidence level. Also, the average income difference between those with yo-yo loan experience and those without was significant at the 99.9% confidence level.

14 Don Oldenburg, "*Yo-Yo Deals: Stringing Car Buyers Along,"* Washington Post, (Oct 19, 2004).

15 See *F&I Factors,* endnote 9.

16 This relationship was statistically significant in a multiple regression at the 99.9% confidence level.

17 *Attorney General Hardy Myers Announced Settlement with Salem Car Dealership Ending Sales Practices of 'Packing.'* Oregon Department of Justice press release, (Aug 20, 2008). (This settlement involved an investigation of an Oregon dealer finding that in every new and used car sold, the dealer was selling packages of add-on products without the customer's knowing they did not have to purchase them.)

18 Tim Ryles, *Probing the Gaps in GAP Insurance: Expert Commentary,* International Risk Management Institute (IRMI) (2005).

19 See *F&I Factors,* endnote 9.

20 Id.

21 Id.

22 Sharon Hernandez-Darrow, Rob Schneider, & Kathy Mitchell, *Auto Finance Add-Ons: Little Bang for the Buck,* Consumers Union—Southwest Regional Office, Mar 2003. (Toyota Extra Care vehicle service contract for a Toyota Avalon, 2000.)

23 See *F&I Factors,* endnote 9.

24 Sharon Hernandez-Darrow et al, endnote 22. (Theft deterrent contract for Olympicare 5-year anti theft guarantee.)

25 *Understanding Credit Property Insurance,* p. 8 Editor, Consumer Credit Insurance Association, available at www.cciaonline.com. Paper reports credit property insurance can cost up to $1.50 per $100 of debt per year. According to the Federal Reserve, the average amount of financing for a new car in 2008 was $26,178, meaning the cost for coverage would total $393 for the first year. This figure does not capture the cumulative cost throughout the life of the loan, as it would differ depending on how the loan amortizes.

26 Both of these differences were statistically significant at 95% confidence level.

27 This was statistically significant at the 95% confidence level based on a regression between add-ons and grade level. Customers took 0.05 less add-ons for each additional grade of education.

28 Philip Reed and Nick James, *Confessions of an Auto Finance Manager: In the Back Rooms of America's Car Dealerships,* Edmunds.com (Aug 18, 2008).

29 Robert Berner and Brian Grow, *Banks vs. Consumers (Guess Who Wins),* in *BusinessWeek* (Jun 5, 2008).

30 John O'Donnell, *The Arbitration Trap: How Credit Card Companies Ensnare Consumers,* Public Citizen (Sep 2007).

31 The Motor Vehicle Franchise Contract Arbitration Fairness Act of Nov 2002.

32 Stephanie Mencimer, *Suckers Wanted: How Car Dealers and Other Businesses are Taking Away Your Right to Sue,* Mother Jones (2007); and Stephanie Mencimer, *The Quest for a Car, Sans Arbitration Clause,* Mother Jones (2007).

33 *2008 Automotive Finance Study: An Analysis of 2008 Mid-Year Data,* Consumer Bankers Association (2008).

34 This was true when other questionable practices are included individually (Model 2). Using a "controversial practices scale" that combines other questionable practices (Model 1), the "best rate" variable was very close to statistical significance (p=0.06) at the 95% confidence level.

35 The other response that indicated the respondent trusted the dealer to give a good rate also is associated with a higher APR, but after controlling for other factors, this factor is no longer statistically significant in determining loan APR.

36 Without controlling for credit risk, race was significantly related to APR with non-whites having a higher APR. Since credit risk is controlled for using variables such as self-reported credit score, it is possible that groups such as African Americans report their credit score as lower because they have had trouble getting loans rather than the other way around.

37 Only respondents who knew they had binding mandatory arbitration were categorized as having it, and those who did not know whether they had binding mandatory arbitration were treated as if they did not have it in this regression.

About the Center for Responsible Lending

The Center for Responsible Lending is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is affiliated with Self-Help, one of the nation's largest community development financial institutions.

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