



June 22, 2015

The Honorable Diane Savino
Chair
New York Senate Committee on Banks
188 State Street
Room 315, Legislative Office Building
Albany, NY 12247

The Honorable Jeffrey Klein
Leader
Independent Democratic Conference
188 State Street
Room 913, Legislative Office Building
Albany, NY 12247

The Honorable Martin J. Golden
New York State Senate
188 State Street
Room 409, Legislative Office Building
Albany, NY 12247

Re: Independent Democratic Conference’s report and legislation relating to subprime auto financing

Dear Senators Savino, Golden, and Klein:

I write on behalf of the American Financial Services Association (AFSA)¹ to register our serious concerns with the Independent Democratic Conference’s April 2015 report, *Road to Credit Danger: Predatory Subprime Auto Lending in New York*, and the following legislation proposed to address issues identified in the report: Senate Bills 5269, 5484, 5485, 5488, 5489, 5490, 5491, and 5506; and Assembly Bills 7865, 7866, 7935, 7985, 8010, 8066, and 8068. The report draws flawed conclusions based on outdated, discredited, and misleading data, and the proposed legislative “solutions” would have serious consequences for New York consumers and limit the availability of credit across the state.

Importance of Subprime Financing

Subprime auto financing plays an important role in the economy, with financing to consumers with credit scores below 620 accounting for around 20 percent of New York’s auto loans in 2013.² More importantly, subprime auto financing creates opportunity for individuals with poor or limited³ credit history, giving them access to credit and transportation that would not otherwise be available to them.

¹ The American Financial Services Association is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. AFSA member financial institutions offer vehicle financing, cards, personal installment loans and mortgage loans. The Association encourages and maintains ethical business practices and supports financial education for consumers of all ages.

² Federal Reserve Bank of New York, *Regional Indicators of Consumer Debt (March 2013)*, available at <http://www.newyorkfed.org/regional/regional-indicators-of-consumer-debt>.

³ Everyone starts out with no credit history. Young people and immigrants are particularly likely to have a limited credit history.

There's no defining characteristic for consumers with subprime credit. These individuals could include: a former homeowner whose credit score dropped as a result of the Great Recession; a college student or new graduate entering the workforce for the first time; or a recent immigrant looking for opportunity in a new country but with no credit history to build on. Aside from their credit scores, these individuals also have in common the need for reliable transportation. Without credit available through subprime auto financing, these individuals would not have access to reliable transportation to get to their jobs or classes in order to improve their economic situations. Outside of New York City, the need for reliable transportation is exacerbated. In some areas, public transportation is not available to get workers to work or even children to school. Longer distances also make ambulance and police responses to emergencies less immediate. These factors make ownership of a reliable vehicle essential.

Beyond the immediate benefit of providing individuals access to transportation, subprime auto financing also gives consumers a means of building their credit history and improving their credit scores, resulting in better access to credit in the future. The benefits of an improved credit score are substantial, including access to financing at lower interest rates, reduced insurance premiums and the opportunity to access other forms of credit like home loans, credit cards and education loans. This benefit is especially prominent for consumers with credit scores below 550. Over a three year period, consumers with credit scores below 550 who financed automobiles saw a median credit score increase of 52 points, versus only 32 points for deep subprime consumers with no auto financing over the same period—a 62.5 percent improvement for individuals who financed automobiles.⁴ Additionally, such consumers with auto loans were four times more likely to improve their credit scores above 640—moving them squarely into prime by many definitions—than individuals with no auto credit.⁵ Targeting the subprime auto financing industry deprives consumers of the opportunity to improve their credit score and access to more readily available credit in the future.

Subprime vs. Buy Here, Pay Here

Throughout its report, the Independent Democratic Conference (IDC) wrongly conflates the practices of Buy Here, Pay Here (BHPH) dealers with those of financial institutions that purchase subprime retail installment sales contracts. The IDC report and proposed legislative package fail to recognize the important differences between traditional subprime financing, engaged in by AFSA members, and the BHPH financing process.

BHPH dealers operate as one-stop shops that finance the sale of the vehicle and service the loan contract through the life of the loan. This differs from vehicle financing engaged in by AFSA members, which purchase subprime retail installment contracts (RISCs) from dealers on new and used cars. A RISC starts as an agreement between the dealership and the customer, in which a consumer purchases a vehicle from a dealer and agrees to pay the purchase price of the vehicle in installments over time. The vehicle dealer is the original creditor, but typically later assigns the contract to a financial institution. After the dealer transmits the RISC to the assignee and receives

⁴ Crews Cutts, Amy, Carlson, Dennis W., *Subprime Auto Loans: A Second Chance at Economic Opportunity* (February 17, 2015), pg. 2, *available at* http://www.equifax.com/assets/corp/subprime_auto_economic_commentary.pdf.

⁵ *Ibid.*

payment for the contract, the assignee services the account and collects payments from the vehicle purchaser. Whereas BHPH dealers may have a financial incentive to repossess and resell vehicles in the event of default, repossession is a last resort for RISC assignees who suffer substantial losses during the repossession process and thus work with borrowers to prevent it.

Existing Regulation

During the New York Senate Banking Committee’s recent hearing on subprime auto financing, and within the IDC report, the subprime auto finance industry was referred to as “largely unregulated and unmonitored.” The idea that the subprime auto financing industry is unregulated is untrue and undermines the existing regulatory structure and steps that financial institutions take to comply with federal, state, and local laws.

In addition to rules from the Office of Financial Assets Control (OFAC) and trade regulation and advertising rules from the Federal Trade Commission, financial institutions are subject to numerous federal and New York and regulations, including, but not limited to, the following:

Motor Vehicle Retail Installment Sales	
Statute/Regulation	Brief Explanation
Federal Truth in Lending Act, Regulation Z. 12 CFR Part 226	Disclosure requirements for loans and credit transactions.
Federal Equal Credit Opportunity Act, Regulation B. 12 CFR Part 202	Non-discrimination in lending.
Federal Fair Credit Reporting Act. 15 USC § 1681 <i>et seq.</i>	Requirements for files maintained by consumer reporting agencies.
Federal Gramm-Leach-Bliley Privacy Rule. 15 USC §§ 6801–6809	Disclosure of a privacy notice to consumers.
Federal Magnuson-Moss Warranty Act. 15 USC § 2301 <i>et seq.</i>	Requirements for warranties on consumer products.
USA PATRIOT Act. 115 Stat. 272	Includes requirements for identity verification, cash reporting, and anti-money laundering programs.
Federal Servicemembers Civil Relief Act. 50 USC App. §§501-597b	Suspension of civil obligations for active duty military members.
Motor Vehicle Retail Installment Sales Act, N.Y. Personal Property Law § 301 <i>et seq.</i>	Content of retail installment sales contracts, limitations on fees, prohibited conduct, required GAP waiver disclosures and procedures.

N.Y. Uniform Commercial Code, Article 2, N.Y. UCC §§ 2-101 <i>et seq.</i>	Permissible conduct in connection with sales, including sales of motor vehicles.
N.Y. Uniform Commercial Code, Article 9, N.Y. UCC §§ 9-101 <i>et seq.</i>	Perfection and enforcement of security interests. Governs conduct and requires disclosures in connection with the enforcement of security interests
N.Y. Banking Law §§ 491-502 and 3 NYCRR Parts 300 and 403.	Licensing requirements for sales finance companies. Provides the Superintendent of Department of Financial Services the power to conduct investigations of the licensee at any time “he shall deem necessary to determine whether such licensee has violated any of the provisions of [New York banking law] or any other law relating to retail instalment sales, contract, obligations or credit agreements.”
General Business Law §§ 198-a, 198-b	New York “lemon laws” include disclosure requirements and governs conduct for the sale of new and used motor vehicles.
General Business Law § 198-c	Automobile trade-in protection.
N.Y. General Obligations Law § 5-328	Limits fees for returned checks, drafts and similar instruments.
Vehicle and Traffic Law § 417	Required certification by retail dealers on sales of used motor vehicles
11 NYCRR Part 185	Credit life and credit accident & health insurance disclosures and conduct requirements.
11 NYCRR Part 186	Credit property insurance disclosures and conduct requirements.
11 NYCRR Part 187	Credit unemployment insurance disclosures and conduct requirements.
3 NYCRR 403.2	Filing of rate charts and agreements.
N.Y. Executive Law § 296-a and 3 NYCRR Part 408	Non-discrimination.
3 NYCRR Part 92	Variable rate requirements and disclosures.
Motor Vehicle Leases	
Motor Vehicle Retail Leasing Act, Personal Property Law §§ 330 <i>et seq.</i>	Extensive contract disclosures and prohibited conduct, limitations on early termination liability and excess wear and damage liability, required GAP waiver disclosures and procedures.

N.Y. Uniform Commercial Code, Article 2A, N.Y. UCC §§ 2-A-101 <i>et seq.</i>	Code governing sales transactions.
General Business Law §§ 198-a, 198-b	New York “lemon laws” include disclosure requirements and governs conduct for the lease of new and used motor vehicles.
General Business Law § 198-c	Automobile trade-in protection.
N.Y. General Obligations Law § 5-328	Limits fees for returned checks, drafts and similar instruments.
N.Y. General Obligations Law § 7-101	Treatment of funds taken as deposit.
N.Y. General Business Law § 396-q	Addresses fixing rates of interest when deposit is taken and addresses trade-in allowances.
N.Y. General Business Law § 396-qq	Disclosure and limitations regarding fees for registration and Titling.

In addition to the state laws included in the table, auto finance transactions are also subject to New York’s Unfair and Deceptive Acts and Practices (UDAP) statute, which gives wide-ranging regulatory authority to the state to oversee business practices, including auto sales, and all sales finance companies are required to be licensed by the New York Department of Financial Services (DFS), which performs some of the most comprehensive and thorough examinations of any agency across the United States. DFS also previously exercised authority under the federal Unfair, Deceptive, or Abusive Acts or Practices (UDAAP) provisions of Dodd-Frank to take action against an auto finance company.

The IDC’s “Top 8 Deceptive Practices” List

The IDC’s report identifies what the Conference deems “The Top 8 Deceptive Practices in the Subprime Auto Loan Industry”; this list of practices is deeply flawed and an inaccurate representation of subprime auto financing.

1. The first practice identified is so-called “Abusively High Interest Rates.” This characterization is misinformed and assumes subprime borrowers lack the ability to assess the costs and benefits associated with their auto loan. A more detailed review of the facts shows that subprime borrowers receive substantial value at a fair price.

First, since consumers with low credit scores are more likely to default on their auto loan than consumers with higher credit scores, finance companies must charge higher rates in order to preserve the economic viability of subprime financing. Higher default rates mean higher credit losses for finance companies, which must be offset by a corresponding increase in revenue. The interest rate charged, by necessity, takes into account many factors, including the consumer’s financing needs and the risk of default. Subprime auto financiers, like any consumer or commercial finance company, require capital in order to

make loans. Returns on this capital must be maintained at sufficient levels or capital will not be available to make loans. There are many examples of finance companies that did not charge enough to offset losses and were not able to access capital required to make new loans. This system of loan pricing is the most fair and equitable method of compensating financial institutions for making loans that carry a higher probability of default and ensuring the availability of credit for borrowers.

Second, the rate an individual consumer is charged is based on a highly competitive market. In 2014 the average interest rate for auto consumers with credit scores of 660 and below was only 11.46 percent,⁶ less than half the extreme example cited in the report. New Yorkers have access to many auto dealers, most of which have relationships with multiple auto finance companies. Loan documents must prominently display the terms of each transaction, including the number of payments required, the amount of each payment, the interest rate being charged, and the total amount of interest charged over the term of the loan. Because this information is made readily available to borrowers, each finance company has an incentive to offer the most attractive terms that are economically sustainable, and consumers have ample ability to shop competing offers in order to identify a combination of interest rate, payment, term, and vehicle that they find most attractive.

Finally, the fact that hundreds of thousands of consumers voluntarily enter into subprime auto finance contracts annually is not evidence that they were tricked into an abusive transaction but instead reflects the opposite conclusion: an understanding by these individuals of the substantial benefits that are afforded at a relatively modest cost.

2. The second practice identified is financing with high loan-to-value (LTV) ratios. The analysis in the IDC report on this issue is deeply flawed for several reasons. For a used vehicle the LTV ratio reflects the difference between the amount financed and the trade-in value. The report indicates that an LTV of 100 percent is reasonable, since it means that “when a prime consumer takes out a loan for a vehicle, after the cost of financing, they are paying about what the vehicle is worth,” but this conclusion is erroneous for several reasons. As a depreciating asset, a vehicle will always have a lower trade-in value than what it cost to purchase. The trade-in value also does not include the amount of any additional products that are included in the financing, such as vehicle service contracts that cover repairs and the cost of taxes, title, and registration fees; however, these costs are included in the amount financed and skew the LTV away from 100 percent. The average LTV on used vehicles for consumers with credit scores of 660 and below was 143.07 percent,⁷ well below the poorly sourced 200 percent number cited in the report.

More important than these numbers is that the IDC report assumes that the value of a vehicle is limited to its monetary trade-in value. The value of a vehicle to a consumer is the functionality that it represents: the security of having reliable transportation to and from multiple jobs or classes, or the ability to pick up children after school. Unlike

⁶ National Automotive Finance Association, American Financial Services Association, Non-Prime Automotive Financing Survey 2015 (May 2015), pg 33, *available at* <http://nafassociation.com/events/1505Furmidge.pdf>.

⁷ *Ibid*, pg. 29.

homes, consumers do not purchase cars expecting to resell them at a profit; they purchase cars because a reliable form of transportation is invaluable.

Vehicles for Change—a non-profit organization in Maryland that provides vehicles to families in need through a program funded from private donations—studied the impact of car ownership on the families they assist and found that individuals without a vehicle struggle to reach jobs for which they are qualified because they lack transportation. Many are forced to turn down higher paying jobs in order to take lower paying jobs accessible by public transportation. Vehicle for Change found that 75 percent of families that received a vehicle through their program reported obtaining a better job as a result, with an average increase in annual income of \$7,000. In addition, they found that owning a vehicle provided substantial quality of life benefits including shorter commute times, the ability to take their children to after school activities and greater access to medical care. Those reporting shorter commute times indicated that vehicle ownership saved on average 90 minutes per day as compared to public transportation, time that was spent in ways that improved both health and family life.⁸ Last year 217,113 New York consumers with a credit score below 640 financed the purchase of a car.⁹ As a result of the subprime auto finance industry these New Yorkers have realized the same substantial benefits of owning a vehicle as those consumers who received a car from Vehicles for Change.

Consumers are maintaining their personal vehicles longer than ever. With the average age of a registered vehicle rising to 11.4 years,¹⁰ the value of a reliable vehicle represents much more than just its trade-in value.

3. The third practice attacked by the IDC report is dealer reserve, which it calls “mark ups.” The basis for this criticism relies entirely on a flawed, outdated, and discredited¹¹ report from the Center for Responsible Lending (CRL). The CRL report examined data from 2009, in the middle of the financial crisis, and derived statistics based on faulty assumptions and poor reasoning. Both the CRL and IDC reports demonstrate a clear lack of understanding of the auto financing process.

Dealerships secure RISC financing for consumers at lower rates than would be otherwise be available to them directly from a financial institution, with the average discount 9.7 percent on financing for borrowers with credit scores of 660 and below.¹² Although dealers sometimes reserve a small fee for assisting in making financing available, borrowers still receive financing at a lower cost than they would elsewhere. It is

⁸ Vehicles for Change, *Our Impact*, available at <http://www.vehiclesforchange.org/about-vfc/our-impact>.

⁹ AutoCount® market report information available from Experian® Automotive.

¹⁰ Crews Cutts, Amy, Carlson, Dennis W., *Subprime Auto Loans: A Second Chance at Economic Opportunity* (February 17, 2015), pg. 4, available at http://www.equifax.com/assets/corp/subprime_auto_economic_commentary.pdf.

¹¹ Kessler, Glenn, Warren’s false claim that ‘auto dealer markups cost consumers \$26 billion a year’ (May 15, 2015), available at <http://www.washingtonpost.com/blogs/fact-checker/wp/2015/05/05/warrens-false-claim-that-auto-dealer-markups-cost-consumers-26-billion-a-year>.

¹² National Automotive Finance Association, American Financial Services Association, *Non-Prime Automotive Financing Survey 2015* (May 2015), pg. 34, available at <http://nafassociation.com/events/1505Furmidge.pdf>.

inaccurate to claim, as both reports do, that dealers reserve cost consumers when this financing would not otherwise be available, if not for the dealer reserves.

Additionally, the report notes that there are currently no disclosure requirements for the dealer reserve amount.¹³ While this is true, the point is irrelevant as disclosure of this amount would not offer the consumer any added protection because the financing is already available at a discount and would likely only create confusion at the time of the sale.¹⁴

The IDC report also claims that discriminatory patterns exist in the application of dealer reserve amounts, but a separate comprehensive study, commissioned by AFSA and conducted by Charles River Associates, found little evidence that dealers systematically charge different dealer reserve on a prohibited basis.¹⁵ Rather, variations in dealer reserves across contracts can be largely explained by objective factors other than race and ethnicity. In addition, the use of race and ethnicity proxies creates significant measurement errors, overestimates minority population counts, and results in overstated disparities. These overestimates and overstatements can contribute to inflated estimates of alleged consumer harm.

4. Practices four, five, and six of the IDC report—dealership fraud, fraudulent loan applications, and spot delivery scams—can be grouped together under the general category of dealer fraud. As outlined in the table above, the auto finance market is subject to regulation under numerous existing state and federal laws; the fraudulent activities listed in these sections are already illegal under New York law, and the answer to preventing fraud is transparent, consistent enforcement of existing laws, not the addition of costly new legislation.
5. The IDC erred by labeling as fraud ancillary products offered by dealerships, including service contracts, warranties, insurance, and anti-theft measures.
6. The seventh practice identified is the use of GPS tracking devices. While GPS tracking is used in the event of repossession, the IDC’s report implies that lenders may abuse these devices and track borrowers at other times. No evidence of privacy violations is provided, and this unsubstantiated claim seemingly serves no purpose other than to alarm consumers regarding a legal device used by lenders if repossession becomes necessary.
7. The final practice identified is the use of starter interrupt devices. Although the IDC crassly refers to starter interrupt devices as “kill switches,” these devices *cannot* “kill”

¹³ Some AFSA members voluntarily include language in finance contracts stating that the Annual Percentage Rate is negotiable and the dealer may retain a portion.

¹⁴ The Federal Reserve Board considered and specifically decided against requiring such a disclosure, noting: “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,” and additional disclosure “could lead to confusion or misunderstanding by consumers.” See 42 Fed. Reg. 19,124, 19,125 (April 12, 1977).

¹⁵ Baines, Arthur P., Courchane, Dr. Marsha J., Fair Lending: Implications for the Indirect Auto Finance Market (November 19, 2014), available at <http://www.afsaonline.org/library/files/FINAL%20Study.pdf>.

the engine of a vehicle in operation and only prevent a vehicle's engine from being re-started once it has shut off. Starter interrupt devices do not create safety problems because these devices cannot disable a vehicle while it's moving. The report relies on an article citing testimony from a single consumer in Nevada, and there has not been a single verified instance—the Nevada case included—of a lender disabling a vehicle while moving.

The activation of a device should not come as a surprise to any consumers. Borrowers know when they are behind on payments, and advance notice is given, sometimes days, before their vehicle's starter interrupt device is activated. In the event of an emergency, the devices also allow drivers to reactivate their vehicle for 24 hours. In addition to the ability to temporarily use their vehicle during an emergency, this method makes it much easier for borrowers to make a payment and have immediate access to their vehicles.

Both GPS and starter interrupt devices may be used in the event that a borrower falls behind on payments, but starter interrupt technology makes physical repossession of a vehicle unnecessary except in the most extreme cases of default. The starter interrupt feature is used as an alternative to traditional physical repossession and allows a consumer to avoid costs of repossession, the embarrassment of having a repossession company take the vehicle (often from a home or office), the inconvenience of retrieving the vehicle, the cost of tow and impounding, the risk of damage to the vehicle, and a repossession notation on a consumer report.

Repossession is Not Good for Business

As stated earlier, vehicle finance companies seek to avoid repossessing their collateral whenever possible, using it only as a last resort. It is an unfortunate outcome that neither borrowers nor financial institutions want. Financial institutions nearly always lose money in the repossession process due to the costly act of physical repossession and the replacement of loan contracts with depreciating assets in the form of vehicles. For these reasons, financial institutions put a considerable amount of time and effort into proactively reaching out to their customers experiencing financial difficulty to work with them to resolve account issues and avoid repossession whenever possible.

Conclusion

The market for subprime auto loans is currently efficient and highly competitive. This market benefits consumers and auto finance companies alike and has a positive impact on the economy in New York. Consumers without access to vehicles are at an economic disadvantage and are left unable to compete effectively in the job market. Dealers without access to financing sources sell fewer vehicles and employ fewer New Yorkers.

The health of the subprime market depends on the supply of capital. While the market has improved since the financial crisis, there have been times in history when capital was in short supply and auto loans were both more expensive and harder to access. The supply of capital and availability of the benefits discussed above depend on a financial stability of the lenders who

participate in this market. As a result, any regulatory changes which may negatively impact the financial health of the industry should be carefully evaluated. The proposed package of solutions would make subprime auto financing too risky for financial institutions and tighten the availability of consumer automobile credit across the state. The end result will deprive subprime borrowers of access to a reliable form of transportation they need to get to their jobs and classes and prevent them from the opportunity to build their credit and secure financing in the future.

We respectfully ask you to consider existing law, including existing broad prohibitions against unfair or deceptive acts and practices, when addressing fraud. We also urge you to consider the significant negative effects we believe this package of legislation will have on the availability of credit in New York.

Respectfully,

A handwritten signature in black ink, appearing to read "Danielle Fagre Arlowe". The signature is fluid and cursive, with a long horizontal flourish extending to the right.

Danielle Fagre Arlowe
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