Comments submitted by the
Center for Responsible Lending[1]
National Consumer Law Center (on behalf of its low-income clients)[2]
National Association of Consumer Advocates[3]
National Council of La Raza[4]
Americans for Financial Reform
Center for Economic Justice
Consumer Action
Consumers for Auto Reliability and Safety
NAACP
New Economy Project
Public Justice Center
U.S. PIRG
Woodstock Institute

to the Consumer Financial Protection Bureau
Regarding 12 CFR Parts 1001 and 1090
Defining Larger Participants of the Automobile Financing Market
and Defining Automobile Leasing Activity as a Financial Product or Service

Docket No. CFPB-2014-0024
RIN: 3170-AA46
79 Fed. Reg. 60,762

December 8, 2014

Thank you for the opportunity to submit comments concerning the Consumer Financial

[1] The Center for Responsible Lending (CRL) is a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, one of the nation's largest nonprofit community development financial institutions. Self-Help has provided $6 billion in financing to 70,000 homebuyers, small businesses, and nonprofits and serves approximately 120,000 mostly low-income families through more than 40 retail credit union branches in North Carolina, California, and Chicago.

[2] The National Consumer Law Center, Inc. (NCLC) is a non-profit Massachusetts Corporation, founded in 1969, providing legal expertise on consumer law issues to public and private attorneys, policy makers, and consumer advocates across the country, with a special focus on low-income consumers. NCLC publishes a series of 18 practice treatises on consumer laws, including auto sales and finance issues. NCLC's attorneys were closely involved with the drafting committee for the Uniform Consumer Leasing Act.

[3] The National Association of Consumer Advocates (NACA) is a non-profit association of consumer advocates and attorney members who represent hundreds of thousands of consumers victimized by fraudulent, abusive and predatory business practices. As an organization fully committed to promoting justice for consumers, NACA's members and their clients are actively engaged in promoting a fair and open marketplace that forcefully protects the rights of consumers, particularly those of modest means.

[4] The National Council of La Raza (NCLR) is the largest national Hispanic civil rights and advocacy organization in the United States. NCLR works with a network of nearly 300 Affiliates—in 41 states, the District of Columbia, and Puerto Rico—that provide education, health, housing, workforce development, and other services to millions of Americans and immigrants annually.

Protection Bureau's (CFPB) proposed rulemaking defining larger participants in the automobile financing market and defining automobile leasing activity as a financial product or service.

I. Introduction

Cars are the most common nonfinancial asset held by American families, and for some families, their most significant asset. Cars have become a necessity for U.S households, with more than 85% of the U.S. workforce using an automobile to commute to work.[5] Car ownership is no longer a luxury but is a prerequisite to economic opportunity. The need for a car is particularly true for many low- and moderate-income families and communities of color who live or work beyond the reach of public transit systems.

Lending plays a critical role in U.S. households' access to cars. Total car loan debt is second only to mortgage loan debt for secured household debt in total volume, while there are more auto loans than mortgages in the United States.[6] Through the first three quarters of 2014, U.S. households owed approximately $935 billion in outstanding auto loans, an amount that has been increasing steadily for more than three years.[7] In addition, subprime auto lending is again on the rise. Since 2009, lending to subprime consumers has more than doubled, while lending to prime consumers has only increased by about half.[8] Overall, new auto loan originations are at volumes not seen since 2005.[9]

Despite the importance of cars and car lending for U.S. consumers, auto finance is marked by a noted lack of regulation and transparency. As a result, predatory practices have been allowed to thrive, leading to unnecessarily expensive and likely unsustainable loans, particularly for those least able to afford it. Those with subprime credit are particularly at risk of being burdened with these predatory practices due to fewer direct auto financing options available to them.

Further complicating matters, the auto lending market is a fractured one. Market share is spread among a wide array of actors, each of which is targeting particular borrowers. The Proposed Rule recognizes the state of the market, and we believe that the proposed regulation takes the right approach to ensure the Bureau's future ability to effectively address auto lending abuses.

II. Defining Larger Participants in the Nonbank Auto Finance Market

---

[5] Brian McKenzie, U.S. Census Bureau, *Modes Less Traveled—Bicycling and Walking to Work in the United States: 2008-2012*, *available at* http://www.census.gov/hhes/commuting/files/2014/acs-25.pdf.
[6] Phil Izzo, *More Car Loans Than Mortgages in U.S.*, Wall Street Journal, Aug. 14, 2013, available at: http://blogs.wsj.com/economics/2013/08/14/more-car-loans-than-mortgages-in-u-s/.
[7] *See* Fed. Res. Bank of N.Y., *Quarterly Report on Household Debt and Credit* (Nov. 2014), *available at* http://www.newyorkfed.org/householdcredit/2014-q3/data/pdf/HHDC_2014Q3.pdf; Andrew Haughwout, et al., "Just Released: Looking Under the Hood of the Subprime Auto Lending Market", *Liberty Street Economics*, http://libertystreeteconomics.newyorkfed.org/2014/08/just-released-looking-under-the-hood-of-the-subprime-auto-lending-market.html.
[8] Andrew Haughwout, et al., "Just Released: Looking Under the Hood of the Subprime Auto Lending Market", *Liberty Street Economics*, http://libertystreeteconomics.newyorkfed.org/2014/08/just-released-looking-under-the-hood-of-the-subprime-auto-lending-market.html.
[9] Fed. Res. Bank of N.Y., *Quarterly Report on Household Debt and Credit* (Nov. 2014), *available at* http://www.newyorkfed.org/householdcredit/2014-q3/data/pdf/HHDC_2014Q3.pdf.

The Proposed Rule attempts to define the nonbank automobile financing market and the larger participants within that market. We support the Bureau's Proposed Rule, as is explained below in further detail. Currently, a severe lack of regulatory oversight in auto finance coupled with perverse incentives result in harms to consumers. The Bureau's Proposed Rule will potentially benefit a significant number of consumers by extending regulatory oversight to most nonbank financial institutions and ensuring compliance with consumer financial protection laws and regulations.

A. Covering Nonbank Auto Financial Institutions

The auto financing market is fractured, with a wide spectrum of players. These players include banks, credit unions, captive finance companies, specialty finance companies, and Buy Here Pay Here (BHPH) dealers. A majority of consumers (approximately 80%) who use financing to purchase an automobile finance the purchase through the dealer, where the dealer extends credit, usually through a retail installment contract, and then quickly sells the contract to a third-party financial institution.[10]

Banks make up about 35% and credit unions 16% of the indirect auto finance market, while captive finance companies and other finance companies make up almost 42% of the market.[11] Accordingly, it is important to capture that portion of the market that captives and other finance companies inhabit. Further, within these cohorts market share is spread among many actors. A financial institution may have what appears to be a small market share but should be considered an influential financial institution within this space.

For instance, 11 of the top 20 financial institutions involved in new car lending hold less than 2% market share each.[12] In the used car lending market, 8 of the top 20 financial institutions hold less than 1 percent market share.[13] As such, while a financial institution may not have impressive market share numbers, if it were to double its market share, it would be within the top 5 financial institutions in the category. Given the relatively recent investor interest in subprime auto loans, a rapid increase in market share is not out of the question.[14] While that increase may then result in becoming a larger participant, the time lag before that designation is triggered would allow a financial institution to operate unsupervised for a not insignificant period of time.

Supervision of nonbank auto financial institutions will bring much-needed attention to otherwise lightly-regulated companies, will ensure compliance with consumer financial laws, and will ensure that auto financing by banks, already subject to CFPB supervision, is not at a competitive disadvantage.

B. Defining the Automobile Financing Market

---

[10] Delvin Davis, Ctr. for Responsible Lending, *Auto Loans: The State of Lending in America & its Impact on U.S. Households* (2012), *available at* http://www.responsiblelending.org/state-of-lending/reports-4-Auto-Loans.pdf.
[11] Experian, *State of the Automotive Finance Market Second Quarter 2014*.
[12] *Id*.
[13] *Id*.
[14] For instance, Perella Weinberg Partners owns two subprime auto lenders and plans to merge them in order to streamline operations and increase market share. See http://dealbook.nytimes.com/2014/11/05/perella-weinberg-said-to-merge-2-subprime-auto-lenders/?_r=0.

The Bureau is proposing to supervise those nonbank auto financial institutions that have at least 10,000 aggregate annual originations. We believe the proposed test to define larger participants should allow the Bureau to supervise market participants that impact consumers most significantly. However, because origination data for specific financial institutions is largely unavailable unless the institution is publicly-traded, we cannot determine the exact breadth of coverage of the rule. We strongly encourage the Bureau to ensure that the threshold for coverage includes finance companies that target subprime consumers, finance companies that focus on a particular region, and finance companies related to larger Buy Here Pay Here dealers.

1. Measurement Metric – Annual Originations

We support the Bureau's proposal to look at "originations," and to define originations to include grants of credit for the purchase of an automobile, refinancing of those forms of credit, and purchases or acquisitions of those forms of credit. A definition of the auto financing market should include all three categories of automobile financing in order to provide sufficient benefit to consumers. There is little reason to exclude refinancing from the definition, particularly since few financial institutions distinguish between origination activity and refinancing activity, making it difficult to separate those two forms of credit.

Likewise, it is critical to include the purchase or acquisition of auto credit contracts in the definition, as the credit model used by dealers involves the "indirect financing" model. Under this model, the dealer finances the original credit transaction via a retail installment contract that an indirect financial institution purchases or acquires soon after the deal is completed. The indirect financial institution then services the installment contracts it purchases or acquires or has others service the accounts. As previously mentioned, these indirect financial institutions comprise a significant share of the market, and they have substantial interactions with consumers. Their activities should not be excluded from the definition.

The Bureau should also consider adding servicing of installment contracts as part of the threshold or ensure that the current threshold will cover large servicers as well. Although the use of non-holder servicers is not as prevalent in the auto market as in the housing market, it is also not unusual. For example, Citi Financial recently transferred the servicing of a portfolio of approximately $7.2 billion of auto credit obligations to Santander while retaining ownership of the obligations themselves. Given the potentially large size of these transferred portfolios, it is important to ensure that consumer protection laws and regulations are being adhered to in servicing.

The aggregate number of originations is a proper measure of a financial institution's impact on consumers compared to other potential measures, such as the aggregate dollar value of originations or total unpaid principal balances. Using the number of originations is a better predictor of the number of consumers impacted by a financial institution on an annual basis, since each origination likely represents a distinct consumer.

By comparison, using the aggregate dollar value of originations or total unpaid principal balances as the measurement may not adequately capture the number of consumers impacted by a financial institution's practices. For example, a financial institution that makes or owns a high number of smaller dollar value loans would not be captured by an aggregate dollar value measurement despite a significant number of consumers receiving credit from or having loans owned by the financial institution. This scenario is particularly true in the used car market, where the average amount financed is much less than that in the new car market. On the other hand, a financial institution that makes or owns a low number of high dollar value extensions of credit would likely be captured by such a measurement even though the financial institution's activities may not impact a substantial number of consumers.

Finally, as the Bureau notes in the Notice and Proposed Rule, measuring the annual originations would not be a difficult task for automobile financial institutions or the Bureau.[15] Financial institutions know the number of credit transactions they originate, purchase, acquire, and service, and such data is publicly available. As such, it would not pose a significant burden on financial institutions or the Bureau to calculate annual originations.

2. Aggregating Annual Originations of Affiliated Companies

Aggregating the annual originations of all affiliated companies in the previous calendar year is necessary in order to adequately capture a covered person's share of the market and impact on consumers. If originations of affiliated companies were not included, the Rule would incent the use of affiliated companies to originate, hold, and service loans just under the threshold level set by the Rule in order to avoid supervision.

3. Threshold Number of Annual Originations

Under the Proposed Rule, a nonbank financial institution would be considered a larger participant if the person has at least 10,000 aggregate annual auto loan originations. As discussed above, we believe that this threshold may be appropriate to capture the larger participants with all the important sectors of this marketplace. The Bureau notes that although the measurement threshold only captures about 7 percent of the nonbank automobile financing market participants, it does account for about *91 percent of the activity* in the market.[16] The threshold seems to capture the larger financial institutions in the important segments of the market, such as Buy-Here/Pay-Here affiliated finance companies, large regional finance companies, and finance companies targeting sub-prime borrowers. However, because the data is not public we cannot be certain that is the case. We recommend that the Bureau review the data available to it to ensure that it does capture the larger participants in all segments.

It is clear, however, that any higher trigger for supervision would risk excluding the larger participants from these important segments, and the threshold number should not be raised. For this reason, it is important that the Bureau re-review the data and the market to ensure that it is supervising the larger participants in the various segments of the fragmented marketplace and consider lowering the threshold to ensure that all segments are adequately captured.

C. Leasing

[15] 79 FR 60,762, 60,772.
[16] *Id*.

We agree with the Bureau that leasing should be included as part of the criteria for defining larger participants. Automobile lease arrangements make up a large and growing segment of the auto finance market. As noted in the Proposed Rule, leasing currently makes up about 30% of the new car finance market.[17] Lease activity is growing across all segments of the market. Specifically, leases are a large and growing part of financing obtained by those with lower credit scores. Of the 30% of new car transactions that were leased, about 30% of those were leased to consumers with nonprime, subprime, or deep subprime credit scores.[18]

The leasing market also contains opportunities for abuse. Negotiation of key terms of the lease, including the amount of the capitalized cost, rent, and depreciation, has a tremendous impact on the true cost of the transaction to the consumer. Lease transactions also pose a different level of difficulty for consumers. In a traditional retail installment sale transaction, consumers often know that the price of the car is negotiable even if they do not know that the cost of credit, add-ons, and other terms is negotiable. However, in lease transactions, consumers often do not know there is an ability to negotiate *any* of the terms of the deal, including those related to the cost of the car. Consumers can also be harmed in lease transactions through the use of complex and poorly explained early termination and default charge calculations, as well as misapplication of stated calculation methods.[19]

Leases are designed around expected residual values of the leased car. Because of the unprecedented decline in new car sales over the worst of the recent recession, the destruction of many cars in the cash for clunkers program, and the increasing usable lifespan of cars, values of cars over the recent past have been particularly high.[20] Now, however, with the return of high new cars sales and an increase in cars coming off lease, there may very well be a decline in the residual values of off lease cars. Leases designed around inflated residual values can present a risk, in the event of an early termination or default, to consumers, to finance companies, and the broader market.

We also urge the Bureau to continue to monitor the evolution of auto leases to ensure continued coverage. For instance, a number of Buy Here Pay Here dealers have developed rent-to-own programs. Some of these models may develop characteristics inconsistent with a “net lease” definition under the Competitive Equality Banking Act of 1987 that the Bureau has incorporated into its definition of lease transactions. While such models are currently of a small enough scale not to impact the application of the Bureau’s Proposed Rule, those and other new models may develop into products which must be included in order to successfully capture larger participants in segments of the market such as the Buy Here Pay Here affiliated finance companies.

D. Auto Title Loans

---

[17] *Id*. at 60,765.
[18] Experian, *State of the Automotive Finance Market Second Quarter 2014*.
[19] National Consumer Law Center, Repossessions § 14 (8th ed. 2013), *updated at* www.nclc.org/library
[20] Arlena Sawyers, *Manufacturers brace for the used-car flood- Off-lease vehicle surge in 2016 could hit buyers' wallets, overwhelm dealers,* Automotive News, April 21, 2014, *available at:* *http://www.autonews.com/article/20140421/RETAIL04/304219978/manufacturers-brace-for-the-used-car-flood*.

In the Notice and Proposed Rule, the Bureau notes that it is not proposing to include auto title loans and other automobile-secured loans in its definition of the auto financing market. We support this decision. Whereas the credit transactions contemplated under the Proposed Rule occur in connection with the purchase of an automobile (or the refinancing of an existing account), auto title loans are high-cost small-dollar loans that are based on the value of an auto that a borrower owns free-and-clear. Auto title loans are also typically short-term loans (30 days) and are due in full at the end of the term, though there is a trend towards longer-term installment auto title loans.

While we do not believe that auto title loans should be analyzed as part of the auto financing market subject to the Proposed Rule, title loans should be addressed by the Bureau in a future rulemaking. Title loans are triple-digit interest, asset-based loans – loans made without evaluating a borrower's ability to repay. The very structure of auto title loans is predatory and leads to a cycle of debt. Because a borrower is unable to pay the loan amount in addition to the exorbitant fees in one balloon payment within one month, repeat borrowing is common in order to stay afloat financially. Furthermore, since the borrower's car serves as collateral for the loan, there is always a threat of repossession should the loan not be repaid (or another loan not taken out to stave off repossession).

The predatory nature of auto title loans requires the Bureau to address them in a future rulemaking. However, their structure and nature are distinct from the auto financing subject to the Proposed Rule and should therefore not be included in the definition of the auto financing market.

E. Conclusion

The method for determining coverage in the proposed rule strikes the appropriate balance and covers those activities relevant to the auto finance market. We urge the Bureau to closely review the data not publicly available to ensure that larger participants in all segments of the market are included and reconsider a lower origination threshold if necessary and to consider including servicing activity in its measurement metric. We appreciate the opportunity to comment on the proposed rule.