

ABOUT TAKE ACTION!

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CFPB/NYS vs. Credit Acceptance

Letitia James and the CFPB re-open the old war on subprime auto finance with some new twists. FNI's take on three big issues to watch in the battles ahead.

According to New York's attorney general, and frighteningly fully endorsed by the federal government's most powerful regulatory agency, subprime auto lenders are now presumed legally responsible for the actions of their dealership affiliates. Consumers on the other hand, especially those with long, negative credit histories, are not responsible for their financial decisions. And what's more, best practices to ensure all customers are treated equally and fairly, like loan-to-value finance limits, payment-to-income caps, one rate/no-dealer-incentive interest rates, and even standardized add on product costs at below average industry pricing, are no defense when a subprime auto finance company does the unforgivable: *Profits*.

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We always knew "profit" was a dirty word for the factions in consumer protection whose real goal is to reform our economic system, but the 59-page Complaint against subprime auto finance innovator and industry giant Credit Acceptance Corporation takes it to a whole new level, and one that every profitable, or these days, struggling to be profitable company in this high risk industry, should be concerned about.

CFPB/NYS vs. Credit Acceptance

"The human cost is enormous. Borrowers struggle to meet monthly payments that are beyond their reach, and they expend great effort to pay the late fees CAC imposes. Over and over, repossession, garnishment, and bankruptcy result. Consumers who lose their vehicles then sometimes lose their jobs and face family difficulties as well. **But despite the significant human toll borne by consumers, CAC continues to profit.**" - Paragraph 86

Consumer Ability to Repay / Loan Affordability

The Complaint alleges that CAC, through targeted marketing and its dealer affiliates, deceives customers into entering into loan contracts they know customers cannot afford. This is allegedly accomplished by enticing dealers to sell vehicles for higher than average prices and by providing additional financing for optional protection products that are added to the loan. What doesn't matter to Ms. James and the CFPB, is that regardless of how the loans are internally scored by CAC, or who makes more money - the dealer or CAC, every customer is shown the real selling price of the vehicle, the real cost of the products, what their real monthly payment will be, the real amount they are financing and the real total cost of the loan with interest - *and that they agreed to those terms*. CAC's controls limiting dealers' retail pricing, requiring proof of income, and consumer payment to income protections, are all summarily dismissed. Instead, CAC and their affiliated dealers are admonished for not demanding customers provide them intimate details of their living expenses, specifically citing personal healthcare costs and childcare expenses, to decide, as if they were some new kind of Inquisitors (or Assistant Attorneys General), if their customers can really afford the monthly payments they say they can.

Optional Products

We've also known for a long time that regulators have difficulty understanding the value of optional protection products like vehicle service contracts and GAP total loss waivers. Primarily because most lawyers who work for the government, like those who buy or lease new cars for their families every two years, who don't get their comprehensive auto insurance from "The General", and who can afford to pay for any rarely needed new car repairs from savings, have no clue how the consumers they are supposedly protecting actually live. That's not new news. It's also not new that regulators like to turn product cash prices into total-cost-with-interest prices in their analysis - so for example here they can turn a \$780 GAP policy retail price into a much worse sounding \$1,600 customer cost. What is new is that the Complaint offers zero analysis or concern about what matters most about protection products - customer value received for the price paid. Instead, the Complaint relies solely on a tiny percentage of total complaints received about the products - "over 1000" total product related complaints - out of more than 1,000,000 or so sold, to allege that CAC-enabled dealer deceptions about product pricing and the voluntary nature of the products are systemic issues causing consumer harm. This very, very thin "evidence" is attempted to be bolstered by the bare allegation these products are "profitable to CAC" - another prominent play of the P-word trump card. Not surprisingly, Profitable CAC's consumer protection efforts on this topic, which are more sophisticated than many in auto finance (and not just those in subprime), including standardized product retail pricing well below auto industry averages and equally sub-industry average dealer product incentives, along with multiple written optional product disclosures, are summarily dismissed.

Dealer Management

Paragraph 184 of the Complaint makes it sound like the NYS AG's Office ought to be spending a whole lot more time protecting consumers from what's allegedly going on inside New York State auto dealerships. Citing an (a) through (h) laundry list of alleged bad dealership behavior, the Complaint states that CAC, as a holder of the retail installment contract purchased from the dealership, is subject to all consumer claims and defenses based on the dealership's actions. The real point of raising this kind of imputed contractual responsibility is to reinforce the much more novel theory upon which the action is based - that CAC should be held responsible for how its affiliated dealerships negotiate vehicle sale prices with their customers.

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"If CAC borrowers with lower-scoring loans understood CAC's scoring and origination processes, including the fact that their loans were likely to be larger, more expensive, and less likely to be repaid in full than loans made to borrowers with higher-scoring loans, **and that CAC could earn more money than it pays dealers even if borrowers failed to repay their loans in full, at least some of them would likely have opted not to take out a loan with CAC.**" - Paragraph 109

Lessons and Best Practices

(1) Ability to Repay

Who decides whether a loan is affordable? Legally, for now, that responsibility is assigned to the person applying for the loan and receiving the proceeds. Should car dealers or loan companies be responsible for setting family budgets? How about credit card companies that issue pre-approved lines of credit to millions without even credit application data, let alone any notion of personal monthly expenses? CAC's mandatory proof of income requirement should prove to be an important component to their defense. Income verification has long been the very foundation of loan underwriting, especially in the deep subprime market and historically, companies that deviate from mandatory POI policy often suffer severe losses. Similarly, reasonable payment and debt to income ratio underwriting calculations should provide a successful defense to allegations that consumers are being "set up to fail". Ultimately, the "ability to repay" issue and who is responsible for that decision will depend on where our evolving society settles on the bigger questions of personal responsibility and liberty.

(2) Optional Products

"Add on Products Benefit CAC" is the indicting header of the product related section of the Complaint. Well, yes, add on products *should* benefit lenders but that's not the whole story - they also benefit consumers. Assuming the bare allegation that CAC "makes money" on these products won't be dispositive, proof of multiple consumer disclosures will be a strong defense of the Complaint's product related allegations. But demonstrating *product value* will be the best defense. What about CAC's high rates of product sales? The Complaint states that almost 90% of all loans include additional financing for "at least one" product. A breakout of percentages for GAP and VSC sales, and any analysis of product value, are tellingly missing from the allegations. Is "almost 90%" product penetration too high and automatically indicative of fraud or concealment of the product in the financing? Arguably not in this market. For example, the Complaint itself alleges that "many CAC borrowers owe significantly more than the vehicle is worth" (Par. 84) which if true would validate a very high rate of optional GAP sales. The bottom line is that CAC customers, with limited income and tight budgets, are exactly the customers who benefit from these kinds of protection products the most and there is no easy comparison with national F&I industry average sale rates.

(3) Dealer Management

In addition to holding CAC responsible for dealers setting vehicle prices that are allegedly just too high, the Complaint makes allegations about CAC's lack of dealer oversight related to optional product sales and also includes a bizarre attack on e-contracting/e-signing. The latter for allegedly helping to "make it easier" for dealers to trick consumers. Let's hope that doesn't become some new legal standard! So how much dealer management is enough to satisfy these regulators, and how much is even possible? It appears from the allegations that NYS itself hasn't done much of a job of regulating dealers in its own state - even with all of the civil and criminal enforcement powers of government at its disposal. If there is any takeaway for a best practice here it would be to solicit consumer feedback about the dealer experience early and often - at origination and during servicing. And to enhance complaint management processes by systematically documenting dealer based complaints - and by acting on them by disciplining dealer affiliates who have violated policy.

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“CAC knew or recklessly disregarded that some of its affiliated dealers told prospective borrowers that add-on products were mandatory to obtain financing. CAC also knew or should have known that some of its affiliated dealers added add-on products to borrowers’ contracts without the borrowers’ knowledge or consent.” - Paragraph 130

The Big Battle Ahead

Industry rumors suggest that Credit Acceptance intends to fight and litigate these allegations, which if true, would be a most welcomed and needed change to the long history of unopposed auto finance related CFPB and progressive state AG settlements – by even the largest financial institutions in the country. And the outcome of this case is critical for everyone in auto and consumer finance. Indeed, it would be illuminating to quantify the financial and “significant human toll borne by consumers” inflicted by Visa and American Express, who I trust are closely watching for the outcome of this case. Without a challenge, the legitimization of these novel liability arguments, which are at odds with established law but championed by powerful politically motivated forces in and out of government, could reshape the consumer finance industry.

UPCOMING CONSUMER & AUTO FINANCE INDUSTRY EVENTS

FNI is proud to support business associations representing the consumer and auto finance industries. Please plan to attend and get in touch to meet up at this year’s industry events.

American Financial Services Association (AFSA) Independents Conference

April 17-20, 2023

Las Vegas

<https://independents-conference.afsaonline.org/>

National Automotive Finance Association (NAF) Non-Prime Auto Financing Conference

June 7-9, 2023

Plano, TX

<https://www.nafassociation.com/news/2023-annual-conference-registration-now-open>

Auto Finance Summit 2023

October 29-31, 2023

Las Vegas

<https://autofinancesummit.com/>

ABOUT FNI

FNI provides vehicle (auto, motorcycles/powersports, RV) consumer and portfolio protection product solutions and consumer protection compliance consulting to finance companies around the country. Managing Vehicle Service Contract, GAP and protection product program performance in today's regulatory environment demands a closer analysis of product value, internal product and vendor management processes, and product point of sale procedures. FNI product programs provide exceptional consumer and collateral protection benefits together with cutting edge FNI compliance services and training for maximum program performance and minimum risk.

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