Written Testimony of John W. Van Alst
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Before the Committee on Financial Services
Subcommittee on Oversight and Investigations
U.S. House of Representatives
"Examining Discrimination in the Automobile Loan and Insurance Industries"
May 1, 2019

Chairman Green, Ranking Member Barr, and distinguished members of the Subcommittee, thank you for inviting me here today to discuss discrimination and cars. I offer my testimony on behalf of the low-income clients of the National Consumer Law Center.[1]

I am an attorney with the National Consumer Law Center. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services office, government attorneys, and private attorneys representing low-income consumers across the country. I direct NCLC's Working Cars for Working Families project which works to ensure that families get a fair deal when buying and financing a car and that the lack of a car does not stand in the way of families' ability to become economically successful. We seek to bring transparency and fairness to the markets for used cars and car finance. We also promote solutions to help non-profit car-ownership programs that assist struggling families to get a car.

A car often provides not only physical mobility but also economic mobility. In many places a car is needed to get to work, access affordable housing alternatives, and take advantage of educational opportunities. Cars are also very expensive to buy. In 2018, the average used car price exceeded $20,000[2] and the average interest rate for a consumer with sub-prime credit buying a used car was over 16%.[3]

Yet for some the costs of buying, financing, and using a car can be even greater based on their race or ethnicity. Consumers of some races and ethnicities are sometimes charged hundreds and even thousands of dollars more to finance a car[4] and are charged more for the car itself.[5] They are more likely to be pressured to buy add-on products such as service contracts, sometimes

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[1] The National Consumer Law Center is a nonprofit organization specializing in consumer issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys, as well as community groups and organizations, from all states who represent low-income and elderly individuals on consumer issues.
[2] Nathan Bomey, Used car payments hit record $400 per month as prices top $20,000, USA Today, Nov. 8, 2018.
[3] Experian, State of the Automobile Finance Market, Fourth Quarter 2018.
[4] Cohen, Mark A. Imperfect Competition in Auto Lending: Subjective Markups, Racial Disparity, and Class Action Litigation, available at: http://ssrn.com/abstract=951827.
[5] Ian Ayres, "Fair Driving: Gender and Race Discrimination in Retail Car Negotiations," 104 Harv. L. Rev. 817 (Feb. 1991); Ian Ayres and Peter Siegelman, "Race and Gender Discrimination in Bargaining for a New Car," The American Economic Review, Vol. 85, No. 3 at. 304-321 (Jun. 1995) (analyzing over 300 paired audits and finding that white male car buyers were quoted significantly lower prices than African American or female buyers). *See* also Ian Ayers, "Further Evidence of Discrimination in New Car Negotiations and Estimates of Its Cause," 94 Mich. L. Rev., 109 (1995).

being told that the add-ons are required,[6] and then are charged more for those same add-ons.[7] Attempting to negotiate for better terms has been shown to not be effective to address these disparities.[8]

These disparities make cars more expensive for some races and ethnic groups and keep some families from getting a car at all. They contribute to the differences we see in the ability of families to get a car. Of households that are at or below the poverty line, 13% of White households lack access to a car, compared to 31% of African American households and 20% of Hispanic households.

Many disparities arise because the market for cars is troublingly opaque and inconsistent. A more consistent and transparent marketplace would not only benefit consumers of color but all marketplace participants, including car dealers, finance entities, and insurers that want to compete fairly and openly on price and quality on a level playing field. To move toward this goal, federal and state policymakers should:

- **Ban dealer interest rate markups.** Any compensation paid to the dealer as part of the financing process should not be based on the interest rate or other financing terms, and should be consistently applied to all transactions.
- **Amend the Equal Credit Opportunity Act (ECOA) regulations (Regulation B)** to enable and require the collection and analysis of race and ethnicity data for auto financing transactions.
- **Prohibit discrimination in the pricing of goods and services.**
- **Increase enforcement of the ECOA.**
- **Increase enforcement against general abuses in the sale and financing of cars**. Given the evidence of discrimination in the sale and financing of cars, it is likely that many other abuses, from yo-yo sales to failure to pay off existing liens, are more likely to affect people of color. Stepped-up enforcement against all abuses in the sale and finance of cars could help address disparities and level the playing field for everyone.

We have attached a draft of our forthcoming report, *Time to Stop Racing Cars*, which was written in preparation for this hearing. Also attached are our reports *Auto Add-Ons Add Up: How Dealer Discretion Drives Excessive, Arbitrary, and Discriminatory Pricing* (2017) and *New Ways to Understand the Impact of Auto Finance on Low-Income Families* (2016).

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[6] Delvin Davis, Non-Negotiable: Negotiation Doesn't Help African Americans and Latinos on Dealer-Financed Car Loans, Center for Responsible Lending, January 2014, available at: https://www.responsiblelending.org/other-consumer-loans/auto-financing/research-analysis/CRL-Auto-Non-Neg-Report.pdf.

[7] John W. Van Alst, Carolyn Carter, Marina Levy, and Yael Shavit, National Consumer Law Center, Auto Add-Ons Add Up, How Dealer Discretion Drives Excessive, Arbitrary, and Discriminatory Pricing (October 2017), available at: https://www.nclc.org/issues/auto-add-ons-add-up.html

[8] Delvin Davis, Non-Negotiable: Negotiation Doesn't Help African Americans and Latinos on Dealer-Financed Car Loans, Center for Responsible Lending, January 2014, available at: https://www.responsiblelending.org/other-consumer-loans/auto-financing/research-analysis/CRL-Auto-Non-Neg-Report.pdf.

I commend the Subcommittee for holding today's hearing on such an important topic. We stand ready to work with this Subcommittee and other interested parties in bringing consistency, transparency, and fairness to the auto market. Thank you.

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DRAFT

Time to Stop Racing Cars: The Role of Race and Ethnicity in Buying and Using a Car

May 2019

By

John Van Alst
National Consumer Law Center®

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ABOUT THE AUTHOR

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ACKNOWLEDGMENTS

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ABOUT THE NATIONAL CONSUMER LAW CENTER

Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, to help financially stressed families build and retain wealth, and advance economic fairness.

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INTRODUCTION

For most households in the United States a car is vital not only for physical mobility but also for economic mobility. Car access improves families' economic outcomes in a variety of ways. In the short term, having a car provides access to more and better job opportunities and expanded affordable housing options. In the long term, research has shown shorter commute times, which are often possible only with a car, to be one of the strongest factors in helping families escape poverty.[1] Transportation has a stronger role in social mobility than other community characteristics, including elementary school test scores, percentage of two-parent families, or crime.[2] In addition to shorter commute times, access to a car often means access to childhood extracurricular opportunities, better food options, and medical care in most areas of the country.

Given the importance of cars, it is deeply concerning that a number of analyses have shown that the costs of buying, financing, and using a car vary based on the consumer's race or ethnicity. These studies have shown that a consumer's race or ethnicity can:

- Increase the cost of credit to finance a car;
- Increase the price of the car itself;
- Increase the price of add-ons sold with the car;
- Reduce the ability of consumers to successfully negotiate for better terms;
- Increase car insurance rates; and
- Increase the likelihood that civil fines or penalties will result in driver's license suspensions.

Studies show that African Americans and Hispanics and Latinos face higher car financing costs even when their credit scores, income, and other indicators of credit worthiness are just as good as whites[3], and that they face higher liability insurance costs even if their driving history is just as good as whites.[4]

This report describes these studies. It then highlights how federal and state policy can be improved to encourage a transparent and consistent marketplace for cars that reduces or eliminates these disparities and makes the marketplace for cars fairer for all consumers and businesses dealing in good faith.

CONSUMERS FINANCING A CAR FACE HIGHER INTEREST RATES BASED ON RACE AND ETHNICITY

About 80% of car buyers obtain financing for the car at the dealership.[5] Dealers are the initial creditors but in most cases they have already arranged to sell the financing contract to a bank, finance company, or credit union before the car is even sold. These finance entities compete against each other to get dealers to send them these deals. One way they compete is to allow dealers to mark up the interest rate and keep some of the extra interest consumers pay. Each finance entity will tell the dealer the interest rate it is willing to take in a particular transaction

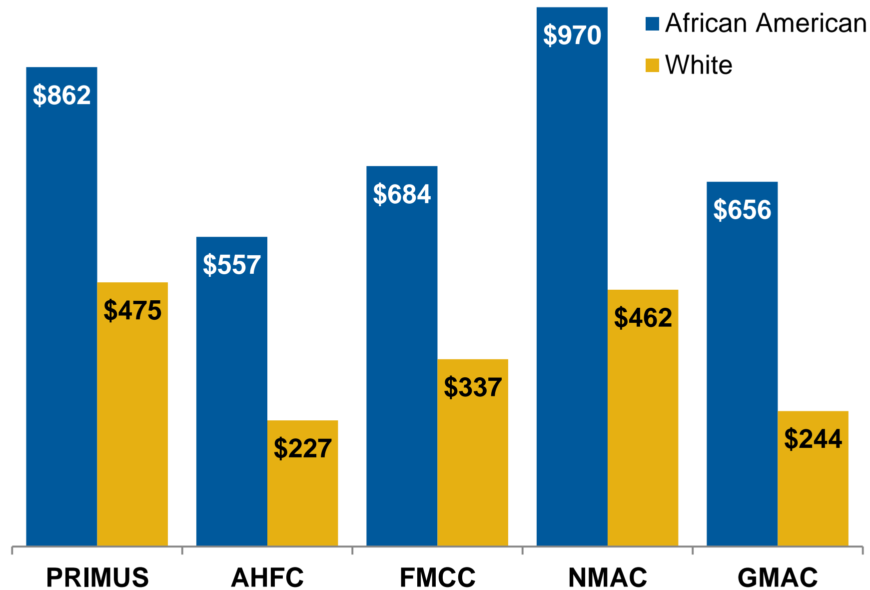
based on the consumer's credit record (the buy rate). But the finance entity, in an effort to convince the dealer to send it the deal, will allow the dealer to mark that interest rate up and keep much of the markup.

Dealers make much of their profit from marking up interest rates. An analysis by the Center for Responsible Lending found that car buyers who financed at the dealership in 2009 paid $25.8 billion in interest rate markups.[6]

These markups are not applied consistently to every consumer. As a result, consumers with the same credit risk can pay very different interest rates, depending on how much the dealer marks up the interest rate for that particular customer. Consumers have no way of knowing that their interest rate is being marked up or by how much. Even those charged with supervising auto finance for fair lending purposes find it difficult to see if there is racial bias in these markups because the Equal Credit Opportunity Act (ECOA) prohibits the collection of race data for consumers financing a car.[7]

Analyses by Professor Ian Ayers[8] of the Yale Schools of Law and Management and Professor Mark A. Cohen[9] of Vanderbilt University's School of Management in connection with class action litigation between the late 1990s to early 2000s against major automobile creditors[10] exposed the fact that minority car buyers were marked up more often and by a greater amount than other car buyers.[11] The analysis used in this litigation matched finance markup information with the drivers licenses of car buyers in states that included race data on their licenses. Professor Cohen's analysis looked at over three million transactions in which the dealer assigned the financing to a captive creditor (typically a wholly-owned subsidiary of a car manufacturer that provides financing for the sale of that manufacturer's new cars). It showed that African Americans were marked up more often than whites and that their average markup was higher (see Chart 1).[12] Since the buyer's credit score and other indicia of credit worthiness are already included in the buy rate, the differences in markup were not a reflection of any differences in credit worthiness.

Chart 1: Interest Rate Mark-ups Charged to African American vs. White Consumers at Five Captive Auto Creditors



Source: Imperfect Competition in Auto Lending: Subjective Markup, Racial Disparity, and Class Action Litigation, Mark A. Cohen (Dec. 14, 2006). ***Note***: Primus Automotive Financial Services is a wholly-owned subsidiary of Ford Motor Corporation and services many non-Ford brands such as Mazda, Volvo and Jaguar. Accordingly, Primus was considered a captive lender for purposes of Cohen's analysis. The full names of the other auto finance companies are: American Honda Finance Corporation Ford Motor Credit Corporation, Nissan Motors Acceptance Corporation and General Motors Acceptance Corporation

This troubling pattern has persisted. The Consumer Financial Protection Bureau (CFPB) and the U. S. Department of Justice (DOJ) determined that over 235,000 people of color car buyers were charged higher interest rates for their car loans between April 2011 and December 2013.[13] This analysis focused on just one major car financing company, Ally Financial, Inc. Subsequent enforcement actions based on similar analyses followed against American Honda Finance Corporation, Fifth Third Bank, and Toyota Motor Credit Corporation.[14] In these analyses, the CFPB used surname and geography as a proxy for race.[15]

Subsequent research has continued to show differences in financing terms between white and minority car buyers. In 2018, the National Fair Housing Alliance released findings from testing it conducted in 2016 and 2017.[16] The testing involved teams consisting of a white tester and a better qualified non-white tester, each of whom went to the same dealership to ask about purchasing the same new car. The better qualified non-white testers were quoted more expensive financing options than the white testers, with their average total payment $2,662.56 higher than the white testers.

CONSUMERS FACE HIGHER PRICES FOR A CAR BASED ON RACE AND ETHNICITY

Several studies have also found that some races and ethnicities are charged higher prices not only for car financing but also for the car itself. Two studies by Ian Ayres in 1995 found that African Americans were quoted higher prices than whites.[17] These studies used testers, so there was no need to use surname or geography as a proxy for race and ethnicity.

A 2003 analysis of more than half a million car purchase transactions at over 3,500 dealerships made similar findings.[18] The authors made inferences regarding car buyers' race or ethnicity by using census blocks. They found that among in-person car buyers, African Americans and Hispanics paid approximately 2% more than other consumers. While about 65% of the price difference could be explained by income, education, and other traits, the remainder could not.

Several studies have also found that some races and ethnicities are charged higher prices not only for car financing but also for the cars.

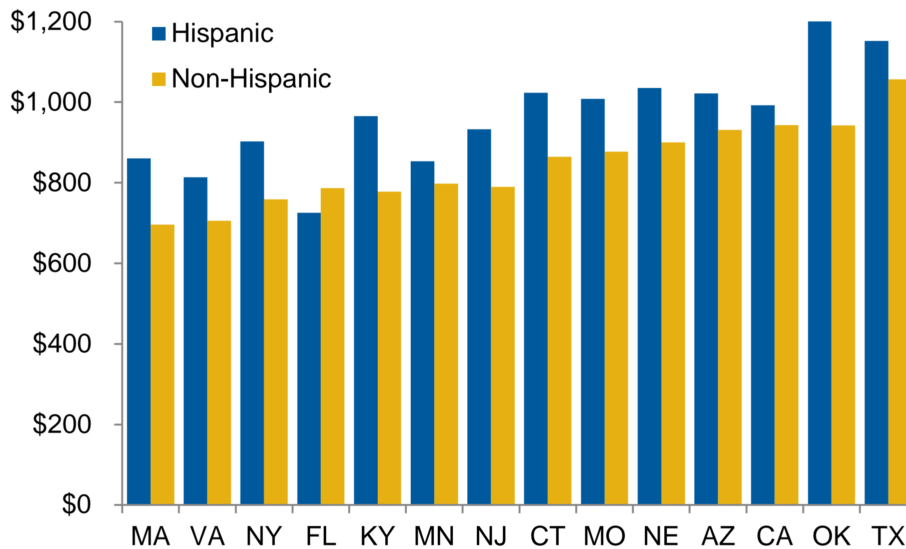
CONSUMERS FACE HIGHER PRICES FOR ADD-ON PRODUCTS BASED ON ETHNICITY

Final numbers for cars and the cost of financing them (including interest rate markups), are typically determined in the finance and insurance (F&I) office at the dealership. In these offices, many car add-on products, such as service contracts, GAP policies (meant to cover any gap between the amount the consumer's insurance pays when a car is stolen or totaled and the amount the consumer owes), and window etching (etching the Vehicle Identification Number on windows as a way to discourage theft, often including some insurance-like coverage), are also sold.[19] Perhaps not surprisingly, the prices for these products are often higher for some people than others.

In 2017, National Consumer Law Center (NCLC) examined millions of these add-ons that are sold to consumers as part of the car sale transaction.[20] We found that variation between what consumers were charged for the same product was often dramatic. Many dealers charged one consumer hundreds or even thousands of dollars more than another consumer for the same product. Some examples of these different charges for different consumers were astounding. One dealer, who paid $50 for a window etching product, marked the price up to as low as $349 for some consumers and as high as $5,000 for others.[21]

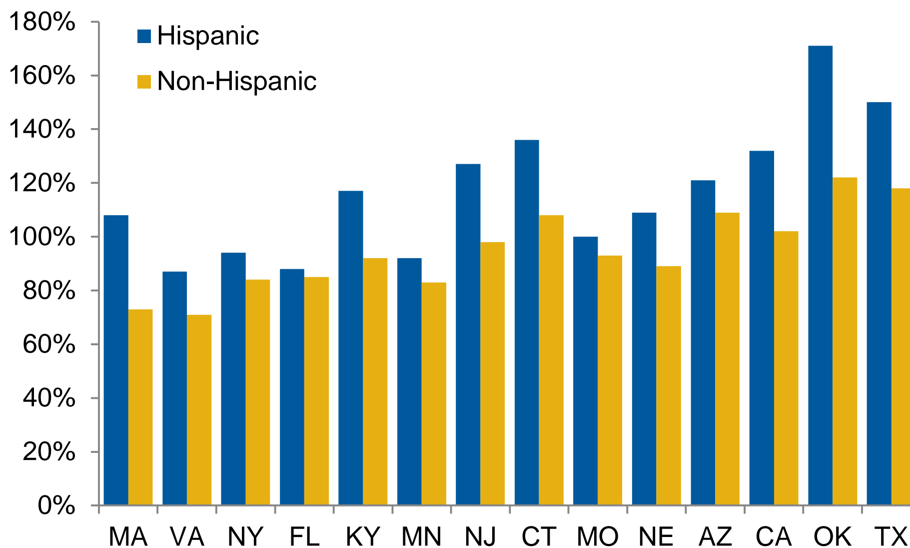
As with other discretionary charges in auto sales and finance, NCLC found that where there was discretion and inconsistency, there was disparate impact by ethnicity. Examining service contract data from 48 states and the District of Columbia, NCLC found that average percentage markups for service contracts were higher for Hispanics than for non-Hispanics in 44 states.[22] To make sure that we was not drawing unwarranted conclusions, we focused our analysis on states in which the number of transactions and other factors led to results with a high degree of statistical certainty and for which the difference in markups on both an absolute and percentage basis was statistically significant. [23] We still found that Hispanics were charged more (see Chart 2).

Chart 2: Average Dealer Markup by State for Hispanics and Non-Hispanics for Service Contracts in Dollars



Source: National data set of dealer add-on products sold in the U.S., Sept. 2009 – Dec. 2013

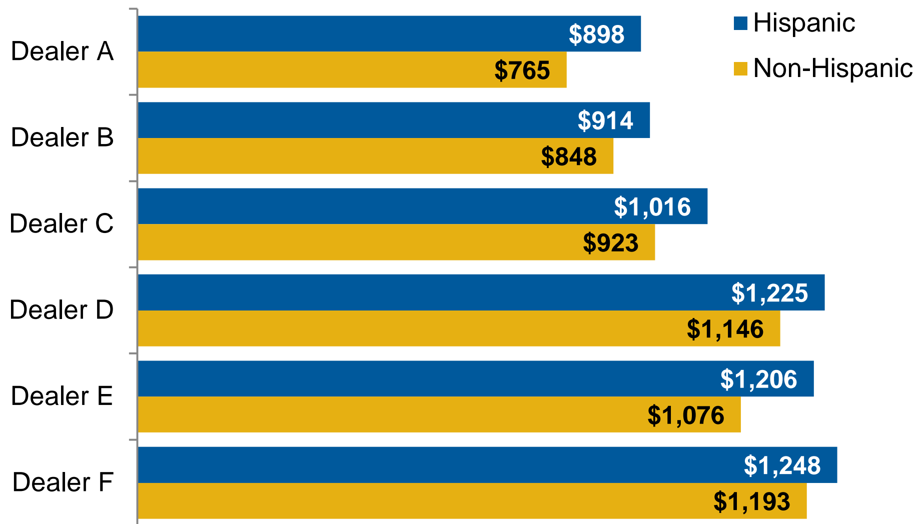
Chart 3: Average Dealer Markup by State for Hispanics and Non-Hispanics for Service Contracts in Percent



Source: National data set of dealer add-on products sold in the U.S., Sept. 2009 – Dec. 2013

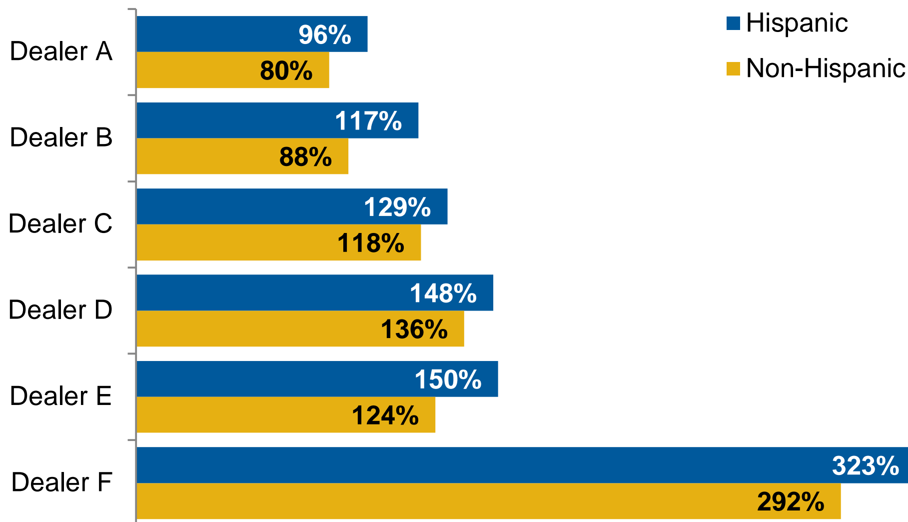
We also saw disparities when we looked at the price of service contracts within individual dealers. We identified six California dealers for which the difference between Hispanics and non-Hispanics for both markup amount and markup percentage was statistically significant. In all cases where both were statistically significant, absolute and percentage markups were higher for Hispanics.

Chart 4: Service Contract Markup by Six California Dealers for Hispanics and Non-Hispanics, in Dollars



Source: National data set of dealer add-on products sold in the U.S., Sept. 2009 – Dec. 2013

Chart 5: Service Contract Markup by Six California Dealers for Hispanics and Non-Hispanics, in Percent



Source: National data set of dealer add-on products sold in the U.S., Sept. 2009 – Dec. 2013

These differences in markups are particularly troubling since they involve the retail prices of service contracts, which are not determined or affected by credit scores. Thus, they cannot be explained by differences in buyers' credit scores.

In addition to higher prices, minorities may be targeted for more add-ons by dealers than other car buyers. A 2014 study conducted by the Center for Responsible Lending found that African

Americans and Latinos were sold multiple add-on products almost twice as often as white consumers. 30% of African Americans and 27% of Latinos were sold multiple add-ons compared to 16% of whites. The study also found that car purchases that included multiple add-ons were associated with higher delinquency rates and greater risk of repossession.[24]

TRYING TO NEGOTIATE FOR BETTER TERMS DOES NOT NECESSARILY HELP AVOID DISCRIMINATION

One hypothesis that is sometimes suggested to explain why people of color are charged more for cars, financing, and add-on products is that perhaps they just don't negotiate enough to obtain a lower price. Research by the Center for Responsible Lending looking at attempts to negotiate financing terms for car sales at dealers found that African-American and Latino consumers attempt to negotiate financing terms slightly more often than white car buyers yet were still left with worse terms.[25]

These results are in line with what we might expect from a process that places a great deal of discretion with a dealership employee in an F&I office. The need to quickly size up a potential car buyer and quickly reach the most profitable deal possibly leads many to rely, consciously or subconsciously, on race and ethnicity.

Rick Hackett, former assistant director at the CFPB who represented auto finance companies both before and after his service with the CFPB, quoted one dealer who told him, *"Look, you've got to understand, we've got a very short period of time to figure out the best way to put together all the moving parts of a complex transaction for the consumer, and how we're going to be able to negotiate to have a deal the consumer can accept and is adequate for the dealership. And so we have to make quick judgments when we sort out the process. So when you pick that initial rate for negotiating a finance rate, we all know Asians are better negotiators."*[26]

CONSUMERS EXPERIENCE INCREASED CAR INSURANCE RATES BASED ON RACE AND ETHNICITY

Even after buying and financing a car, the increased costs faced by some races and ethnic groups continue. Almost every driver must carry insurance. Every state but New Hampshire requires some level of liability insurance and almost every auto finance entity will require a consumer who is financing a car to carry some broader coverage that includes damage to the financed vehicle. This required insurance is a large part of the cost of owning a car.[27] A consumer's race can have a large impact on the rates they must pay for insurance.

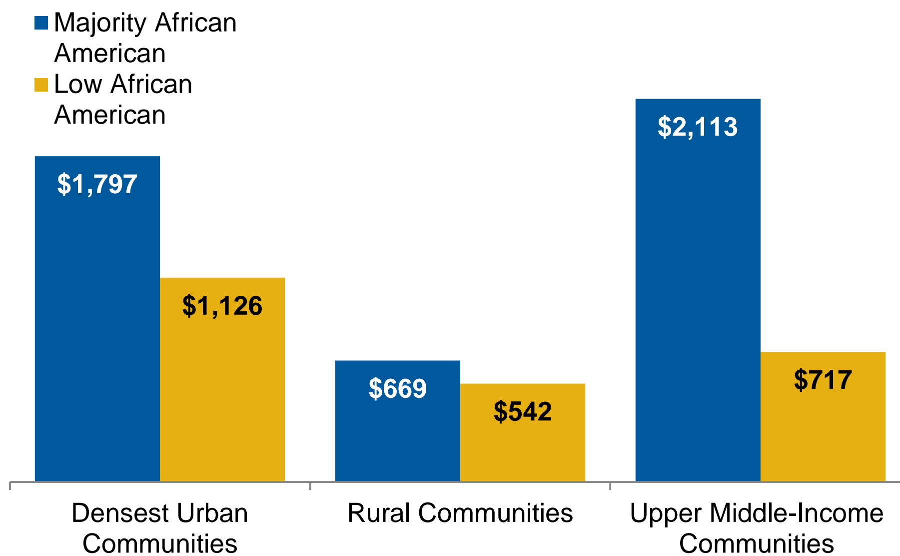
The factors upon which insurance rates can be based vary from state to state. A consumer's age, marital status, gender, credit score, address, type of car, occupation, education, and other factors will often be included in determining what rate a consumer must pay in addition to the consumer's driving record.

In a 2015 analysis, Consumer Federation of America (CFA) found that drivers living in zip codes that were predominantly African American paid higher rates for state-mandated car liability insurance than drivers in predominantly white communities who had similar backgrounds, including diving record, education, employment, and credit rating.[28] This was

true for all the five largest insurers in the country, in both urban and rural locations, and true across income levels. The findings were especially telling as the study compared rates for the same driver profile (an unmarried woman with a good driving history, who graduated from high school, held a clerical job, and rented her home) and the coverage was the minimum coverage required the state. The minimum required coverage varies from state to state and may include bodily injury liability, property damage liability, personal injury protection or no-fault coverage, and uninsured/underinsured motorist coverage. Most states require only liability coverage, not any coverage for damage to the consumer's car. This limited coverage focused on liability means that some circumstances that might arguably increase rates in some zip codes, such as frequency of damage to parked cars or stolen cars, would not come into play for setting the rates for statutorily required minimum coverage.

Subsequent analysis by CFA has continued to find racial disparities in insurance pricing. For a 2018 analysis, CFA obtained quotes from six large insurance companies in ten cities. Its analysis showed that residents of zip codes where the quotes were lower were overwhelmingly white (72% on average), while adjacent zip codes where rates were higher had more people of color and were only 29% white, on average.[29]

Chart 6: Insurance Rates for Majority African Americans vs. Low Percentage of African Americans by Zip Code



Source: High Price of Mandatory Auto Insurance in Predominantly African American Communities, Tom Feltner and Douglas Heller, (Nov. 2015)

A 2017 analysis of insurance premiums and payouts in California, Illinois, Texas, and Missouri by *ProPublica* and *Consumer Reports* also found disparate pricing for people of color. It found that insurers were charging premiums that were up to 30% higher in zip codes where most residents were people of color than in whiter neighborhoods, even though the neighborhoods had similar accident costs for the insurers.[30]

DRIVERS OF COLOR FACE INCREASED LIKELIHOOD THAT FINES OR FEES WILL RESULT IN DRIVER'S LICENSE SUSPENSIONS

There is a host of other costs associated with driving. Given how important the ability to drive is in most of the country, the right to drive is often used as a stick to compel behavior or payments—even on obligations that are unrelated to driving. Across the country a wide array of issues unrelated to driving can result in driver's license suspension, including falling behind on child support, failure to appear in court, writing a bad check, even unpaid student loans. Even among car-related issues many suspensions have no relation to public safety but are instead financial—most states suspend licenses simply for falling behind on, or being unable to afford, fines and fees owed to the government.[31]

This aspect of cars and driving is not immune to differences based upon race and ethnicity. While few would be surprised to learn that rates of driver's license suspensions due to a failure to appear or pay a ticket are correlated with poverty, they may be troubled to learn that they are also correlated with race. There is growing evidence that communities of color, and especially African-American communities, are disproportionately targeted for enforcement of minor crimes and traffic infractions that generate fines and fees.[32] Further, because African American families have less wealth to draw upon than white families when hit with unexpected fines or fees, African American motorists are more likely to be unable to pay the amounts assessed.[33]

As a result, African American and Latino motorists face higher rates of driver's license suspension than white motorists. A study by the coalition Back on the Road California from 2017 looked in California at the rate of license suspensions due to failure to appear or failure to pay by zip code. It found that of the 75 zip codes studied that had an African American population above 20%, 95% of them had a license suspension rate above the average and almost all the areas with the highest suspension rates had a high proportion of African American residents.[34] Additional research in North Carolina has found that the relationship between rates of suspension and poverty varies by race.[35]

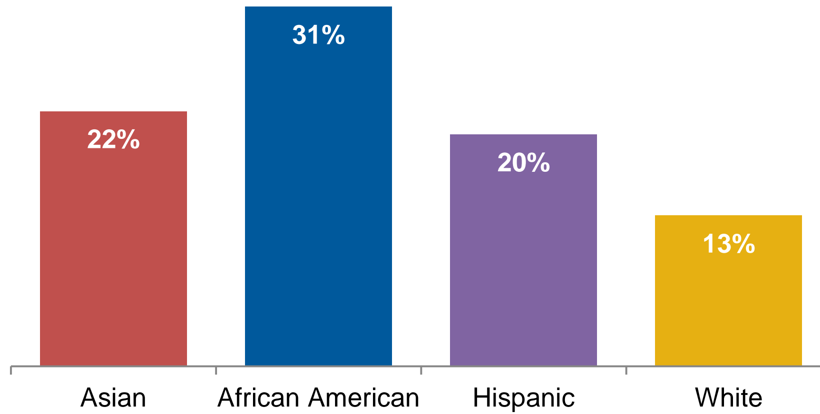
For many people, driving is necessary to maintain employment and health, and thus approximately 75% of people with suspended licenses continue to drive.[36] The disparate harm to communities of color thus deepens as African Americans and Latinos are disproportionately arrested for driving with a suspended license, and a debt may begin a cycle of arrests, further fines and fees, and deepening indebtedness and loss of liberty.[37] When Back on the Road California looked at data from Los Angeles between 2013 and 2015, it found that although African Americans make up only 9.2% of the population, they represent over 33% of the arrests for driving on a suspended license.[38] Similarly Latinos, while making up 48.4% of the population, make up 52.2% of the arrests. Meanwhile, the population is 26.8% white, but whites make up only 14.8% of arrests.

THE IMPACT OF THESE PRACTICES ON THE COST OF CARS AND ACCESS TO A CAR

Given the extent of increased prices for cars, financing, add-ons, and insurance faced by people of color, it is not surprising that they not only pay more for cars than similarly situated white households, but that they are less likely to have access to a car. Of households that are at or

below the poverty line, 13% of white households lack access to a car, compared to 31% of African American households and 20% of Hispanic households (see Chart 7).

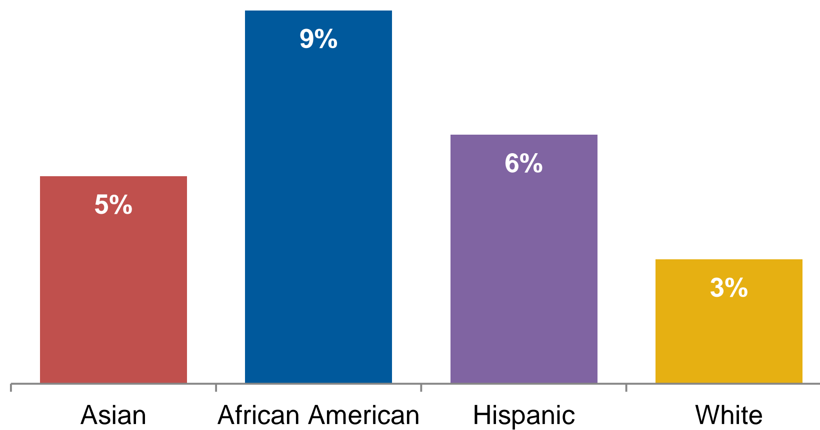
Chart 7: Households At or Below Poverty Without Access to a Vehicle, by Race or Ethnicity



Source: Integrated Public Use Microdatea Series: Version 7.0., Steven Ruggles et al., (2016)
Note: Poverty thresholds are updated each year by the Census Bureau. The federal poverty level for a family of four in 2016: $24,300.

This disparity holds true for households above the poverty level. Only 3% of white households above the poverty level lack access to a car, compared to double as many Hispanic households and three times as many African American households (see Chart 8).

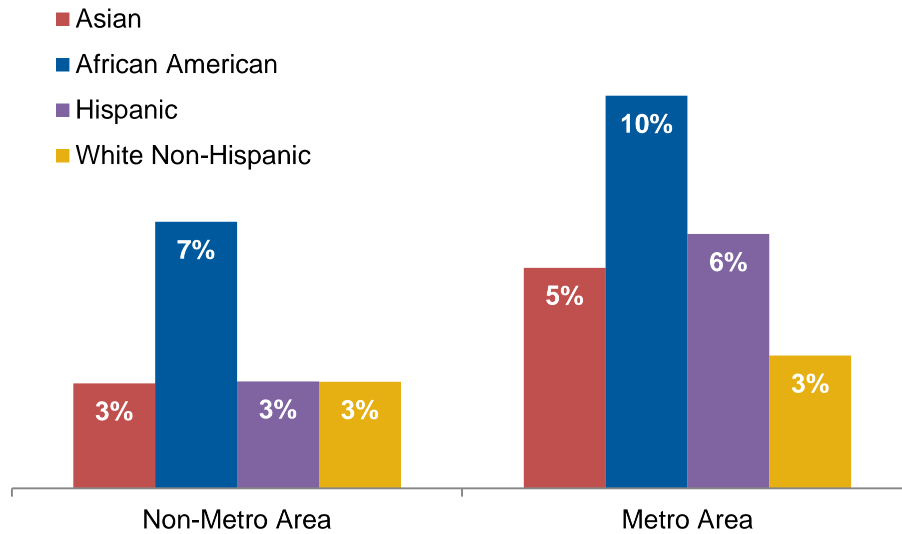
Chart 8: Households Above Poverty Without Access to a Vehicle, by Race or Ethnicity



Source: Integrated Public Use Microdatea Series: Version 7.0., Steven Ruggles et al., (2016)
Note: Poverty thresholds are updated each year by the Census Bureau. The federal poverty level for a family of four in 2016: $24,300.

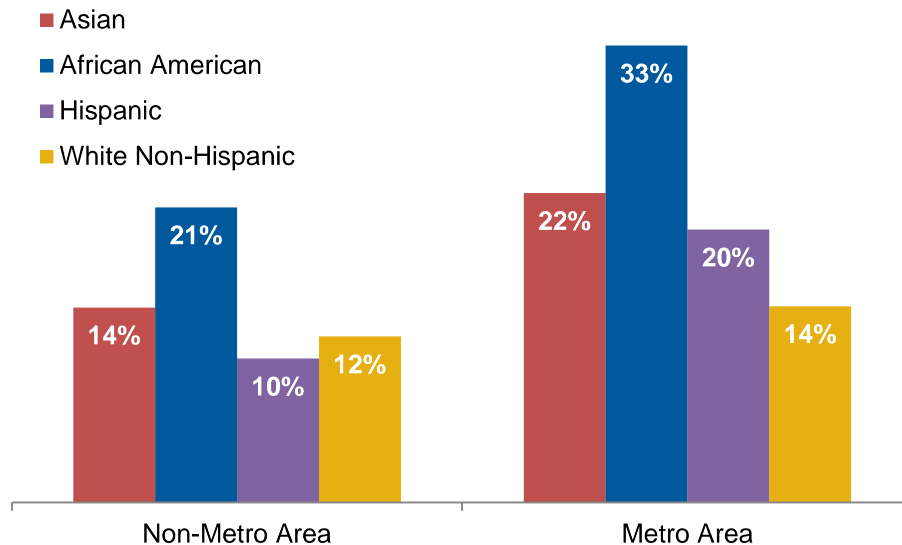
It might be argued this disparity could be explained by a higher concentration of African American households living in metro areas with greater access to public transportation. However, even when we break out metro and non-metro areas, the disparity persists both above and below the poverty guidelines.

Chart 9: Metro Area vs. Non-Metro Area Households Above Poverty Without Access to a Vehicle, by Race or Ethnicity



Source: Integrated Public Use Microdatea Series: Version 7.0., Steven Ruggles et al., (2016)
Note: Poverty thresholds are updated each year by the Census Bureau. The federal poverty level for a family of four in 2016: $24,300.

Chart 10: Metro Area vs. Non-Metro Area Households At or Below Poverty Without Access to a Vehicle, by Race or Ethnicity



Source: Integrated Public Use Microdatea Series: Version 7.0., Steven Ruggles et al., (2016)
Note: Poverty thresholds are updated each year by the Census Bureau. The federal poverty level for a family of four in 2016: $24,300.

THE NEED FOR PUBLIC AND PRIVATE ENFORCEMENT OF FAIR LENDING LAWS

Public and private enforcement of anti-discrimination statutes is critical if the pricing disparities described in this report are to be eradicated. In the past, strong enforcement actions by governmental and private parties appeared to make some progress. Class actions brought in the late 1990s and early 2000s resulted in settlements with the major auto financing entities. The settlements varied but included caps on interest rate markups, monetary relief to some class members, programs to provide more affordable credit to diverse consumers, interest rate reductions through refinancing, and other terms. The terms agreed to in the settlement of these cases, including the caps, have all now expired.

Starting in 2013, the CFPB and DOJ filed a series of enforcement actions against major car financing entities, based on data analysis by the CFPB that showed that minority car buyers were charged higher interest rate markups than white buyers without regard to credit scores. As a result of the first enforcement action, Ally Financial, Inc. and Ally Bank were ordered to pay $80 million in damages to harmed consumers and $18 million in penalties.[39] Other enforcement actions followed. American Honda Finance Corporation was ordered to pay $24 million in damages to harmed African American, Hispanic, and Asian and Pacific Islander car buyers and to change its pricing and compensation system to reduce the risk of discrimination.[40] Fifth Third Bank was required to pay $18 million to harmed African American and Hispanic borrowers and change its pricing and compensation system.[41] Toyota Motor Credit Corporation agreed, as part of its settlement, to pay up to $21.9 million in restitution to African American and Asian and Pacific Islander car buyers who were charged higher interest rates than white borrowers for their auto loans, without regard to their creditworthiness, and to change its pricing and compensation system to substantially reduce dealer discretion and financial incentives to mark up interest rates.[42]

Enforcement actions like these bring redress to consumers and give companies a strong incentive to examine and reform their financing practices to eliminate pricing disparities. They also make it easier for other finance entities to adopt pricing and compensation systems that reduce dealer discretion and the opportunity for discrimination and still be able to compete.

At the same time as it was bringing these enforcement actions, the CFPB issued a bulletin designed to assist the finance entities over which it had enforcement authority to limit their risk of violating the Equal Credit Opportunity Act (ECOA).[43] This was a proactive step to help financing companies move forward and avoid the practices that led to disparate pricing.

In recent times, however, the ability to guard against discrimination in financing cars has become more uncertain. All of the settlements reached in the class actions expired as of 2012, and similar private actions are unlikely given the widespread use of arbitration clauses and certain Supreme Court decisions that impede class actions. In addition, those class actions relied on state driver's license information to determine the race of borrowers, but the number of states that record race data on driver's licenses has declined, and the ECOA does not require or allow data about race or ethnicity of car buyers to be collected.

These restraints on the ability of consumers to address discrimination through private litigation have made vigilant enforcement of fair lending laws by public entities all the more important.

However, in 2018, Congress passed a joint resolution disapproving the bulletin that the CFPB issued in 2013 to help financing entities avoid ECOA violations. There were also indications that the attitude of the CFPB towards enforcing fair lending laws was changing. CFPB Acting Director Mick Mulvaney was widely quoted as saying at a speaking engagement that the Bureau would be "reexamining the requirements" of the ECOA and that if the rate of violations were not frequent "maybe — it's evidence of a lack of criminal intent, and maybe there's a good place … for me to execute some prosecutorial discretion."[44]

As the changes at the CFPB in regard to the enforcement of fair lending laws became apparent, the market was quick to react. Large auto finance entities, such as BB&T and BMO Harris Bank, had implemented compensation systems that paid dealers a flat fee, rather than one that varied based on the terms of the credit, for assigning car financing contracts to them. Both reverted to policies that allowed for large variable markups. BB&T, which had implemented a flat fee system in 2015, announced in early 2018 that it was moving to allow maximum dealer interest rate markups of 2% on loans up to 75 months and allow the dealer to keep a maximum of $5,000 for marking up the consumer's interest rate.[45]

Meanwhile, despite Congress's disapproval of the CFPB's 2013 bulletin, the CFPB's authority and duty to enforce fair lending laws remains the same.[46] The FTC also has authority to enforce the ECOA against businesses that fall within its jurisdiction.[47]

CONCLUSION AND RECOMMENDATIONS

The lack of vehicle access has a strong impact on the economic mobility of a family. Addressing the disparities identified can help mitigate disparities in economic success going forward.

A major factor in fostering the disparities that these reports have documented is that the current market for cars is troublingly opaque and inconsistent. Even when they do not result in discrimination, these problems harm consumers in general. Car prices, financing costs, and prices for add-ons are all decided behind closed doors. This process favors dealerships, as they are repeat players with superior knowledge and are very good at extracting the most profit from these deals that they can. In particular, dealers that are upfront and consistent about the cost of cars, add-ons, and financing are at a competitive disadvantage compared with dealers that are not.

A more consistent and transparent marketplace would not only benefit consumers of color but all marketplace participants, including car dealers, finance entities, and insurers that want to compete fairly on price and quality on a level playing field.

A more consistent and transparent marketplace would not only benefit consumers of color but all marketplace participants, including car dealers, finance entities, and insurers that want to compete fairly on price and quality on a level playing field. To move toward this goal, federal and state policymakers should:

- **Ban dealer interest rate markups by statute or rulemaking.** Any compensation paid to the dealer as part of the financing process should not be based on the interest rate or other financing terms, and should be consistently applied to all transactions.
- **Amend the ECOA regulations (Regulation B)** to enable and require the collection and analysis of race and ethnicity data for auto financing transactions.

- **Prohibit discrimination in the pricing of goods and services.** The ECOA prohibits discrimination in the terms of credit but there is no similar protection for the pricing of goods and services.
- **Increase enforcement of the ECOA and state fair lending laws.**
- **Increase enforcement against general abuses in the sale and financing of cars**. Given the evidence of discrimination in the sale and finance of cars, it is likely that many other abuses, from yo-yo sales to failure to pay off existing liens, are more likely to affect people of color. Stepped-up enforcement against all abuses in the sale and finance of cars could help address disparities and level the playing field for everyone.
- **Take action on insurance rate setting.** After reports of the impact of race in insurance costs, the California Department of Insurance began requiring more justification from insurers for their measurement of risk in rate setting and announced that it would "more closely police the clustering algorithms, and their impact on poor and minority neighborhoods, as they review future rate filing applications."[48]
- **End suspension of driver's licenses for reasons beyond dangerous driving**.

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22. In two states, the markup was lower for Hispanics and one state and the District of Columbia had no Hispanic coded service contract buyers at all. In one state, the percentage markups for both Hispanics and non-Hispanics were almost identical.

23. In some states where the difference between Hispanics and non-Hispanics was not statistically significant the number of Hispanic car buyers was likely too small. The limitations of surname coding forced NCLC to compare Hispanic car buyers with all other car buyers, not just non-Hispanic whites. The fact that just Hispanic consumers could be coded meant that the comparison group included people of color with a documented history of being charged higher prices. As a result, NCLC was comparing markups charged to Histpanics against those charged to all other

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consumers, including other consumers who have been historically discriminated against because of race, so the extent of discrimination shown by our analysis was probably understated. In the 34 states in which the difference in markup was not statistically significant on both an absolute basis and a percentage basis, the African American population exceeded the Hispanic population by an average of 13%. In the 14 states for which the differences in both percentage and absolute markup which were statistically significant, the Hispanic population exceeded the African American population by an average of 80%.

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AUTO ADD-ONS ADD UP

HOW DEALER DISCRETION DRIVES EXCESSIVE, ARBITRARY, AND DISCRIMINATORY PRICING

October 2017

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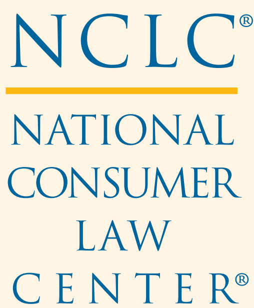

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AUTO ADD-ONS ADD UP

HOW DEALER DISCRETION DRIVES EXCESSIVE, ARBITRARY, AND DISCRIMINATORY PRICING

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EXECUTIVE SUMMARY

Add-on products sold by car dealers, such as service contracts, Guaranteed Asset Protection (GAP) insurance, and window etching, make up a large share of dealers' profits. They also significantly increase car buyers' costs. While many have questioned the value of these products for consumers, the pricing of these products has received less attention, largely because pricing is not transparent and consumers, and to some extent even regulators, lack information about what car buyers pay for these products. Dealers decide what to charge each consumer and generally only the dealer, the finance company, and the third party provider of the add-on ever know what other consumers are paying.

This National Consumer Law Center analysis of a large data set is a revealing first look at what dealers pay for these add-on products and what they charge consumers. We found that:

- Add-on products are sold at prices far higher than dealer costs. Dealers mark up add-on products more than other similar products are marked up. They mark up add-on products by a far higher percentage than they mark up cars.
- Dealers are inconsistent in the pricing of add-on products, with even individual dealerships charging some consumers many times more than other consumers for the same product with the same dealer cost.
- This inconstant pricing for the same add-ons leads to pricing discrimination, with Hispanics charged higher markups than non-Hispanics.
- Companies that provide car financing play an important role in allowing excessive and discriminatory markups of auto add-ons.

These abuses, damaging enough in themselves, set in place a chain of other consequences for consumers. The expensive add-ons increase the price of cars, putting them out of reach for some consumers. They also increase the loan to value (LTV) ratio for cars, as they increase the amount that consumers finance without providing any real increase to the value of the car. These higher LTVs result in more negative equity, which hurts consumers and other players in the auto sales and finance market because a consumer who owes more than his or her existing car is worth will have a hard time trading it in and buying a new car. High LTVs have also been associated with higher default rates, again harming consumers and the industry as a whole.

We recommend the following steps to help protect car buyers from the abuses described in the report:

- **Dealers should be required to post the available add-ons and their prices on each car in the lot, along with the price of the car.** To prevent the dealer from reintroducing non-transparency by offering discounts to some customers but not others, the prices for the add-on products must be non-negotiable.
- **To root out pricing discrimination, the federal Equal Credit Opportunity Act regulations should be amended to require documentation of the customer's race or**

national origin for non-mortgage credit transactions, as is currently required for home mortgage transactions. If discrimination remains hidden, it will not be possible to end it.

- **State and federal enforcement authorities should investigate discrimination in pricing of add-on products and bring enforcement actions** against a dealer if discrimination is shown. The Consumer Financial Protection Bureau, the Federal Trade Commission, the Federal Reserve Board, and state attorneys general all have authority in this area.

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INTRODUCTION

The largest source of dealer profit from car sales at many car dealers is not the sale of the "metal" (the vehicle itself), but the extension of financing and the sale of "add-ons"—items such as service contracts, Guaranteed Asset Protection (GAP) insurance, and window etching. Court cases and federal enforcement actions have cast much attention on dealers' role in financing. Much less attention has been devoted to the dealer's sale of add-on products in conjunction with the automobile sale.

This report uses recent data to analyze the pricing of add-ons. Our analysis finds that the pricing of add-ons involves large mark-ups and arbitrary and discriminatory pricing. We then outline recommendations to limit these abuses.

Case Study: The Hard Sell for Add-on Products[1]

In early 2013, Sharay Freeman—a nursing student, aide to developmentally disabled adults, and mother of three children—was in desperate need of a reliable, affordable car. She found a 2007 Honda Odyssey advertised for sale by A Better Way Wholesale Autos in Connecticut for $10,995, and rented a car for the 45-mile drive to the dealership.

When she got there, Sharay asked the dealer what fees would be charged in addition to the advertised sales price. She was told that there would be a conveyance fee, a VIN etching fee, registration costs, sales tax, and a finance charge, and that she had to pay a $2,500 non-refundable deposit to start the credit application process. The dealer told her the deposit was standard practice and that it would be refunded if her application was not approved, and that she would pay approximately $320 per month for 42 months. Sharay signed a purchase order for the minivan and later paid the deposit. The purchase order showed a cash purchase price of $10,995, VIN etching costing $198, a dealer conveyance fee of $598, sales tax of 6.35%, and an unspecified amount for registration of the vehicle.

After the dealer called to tell her she was approved for financing, Sharay went to pick up the minivan. When she arrived, the dealer told her that, in order to obtain the financing it had arranged, she had to buy a number of additional add-on products—ones that carry large profits for the dealer. The dealer made a number of proposals with different add-ons, including a tire and wheel package for $1,390, a service contract for $1,474, and, in one of the dealer's proposals, oil changes for life for $299.

(*Continued on next page*.)

The Hard Sell for Add-on Products *(continued)*

These add-on products would have increased Sharay's payment to $447 per month versus the initial quote of $320 per month—well more than she could afford. Sharay refused, and asked for her deposit back. The dealer refused to return the deposit, leaving her unable to buy another vehicle for a year. Sharay enlisted the help of consumer attorney Dan Blinn, filed an action against the dealer and prevailed at trial and a subsequent appeal. The dealer has appealed the matter again.

The dealer didn't tell Sharay how much it paid for the add-on products that it wanted her to buy, but it was likely marking them up well beyond their cost, making them very profitable. This report shows, based on newly available data, that it is common for dealers to mark up window etching—the add-on product included in Sharay's original contract—by over 300%, and that some dealers mark it up by over 1,000%. Many dealers also mark up other add-on products, including service contracts, by 300% or more. They often have no set prices for these products, but set whatever price they think the consumer can be induced to pay, leading to the potential for discriminatory pricing based on race or national origin.

BACKGROUND

The Importance of Cars and Car Sales

Cars are tremendously important for a family's economic success. They provide not only mobility in a geographic sense—getting people to work, grocery shopping, after-school activities and doctors' appointments—but also mobility in family economic status. Lack of a car can dramatically restrict employment and educational opportunities. Having a car can improve commute time, which a Harvard University study found to be a larger factor in escaping poverty than factors like exposure to crime and the quality of elementary schools.[2] For many low income families, transportation costs, which are necessary to reach jobs and services, are as high as housing costs. [3] For many families a car will be the most expensive purchase they ever make.

Although the total dollar amount of vehicle credit is less than the dollar value of mortgage credit or student loan credit, the number of vehicle financings each year far exceeds the total number of both mortgage and student loans combined.

In addition to the importance of car purchase transactions to individual families, the role of car sales and finance in the broader US economy must not be underestimated.[4] While total outstanding debt for home mortgages and student loans exceeds car debt, cars are financed much more often. In other words, although the total dollar amount of vehicle credit is less than the dollar value of mortgage credit or student loan credit, the number of vehicle financings each year far exceeds the total number of both mortgage and student loans combined (see Chart 1). Each vehicle

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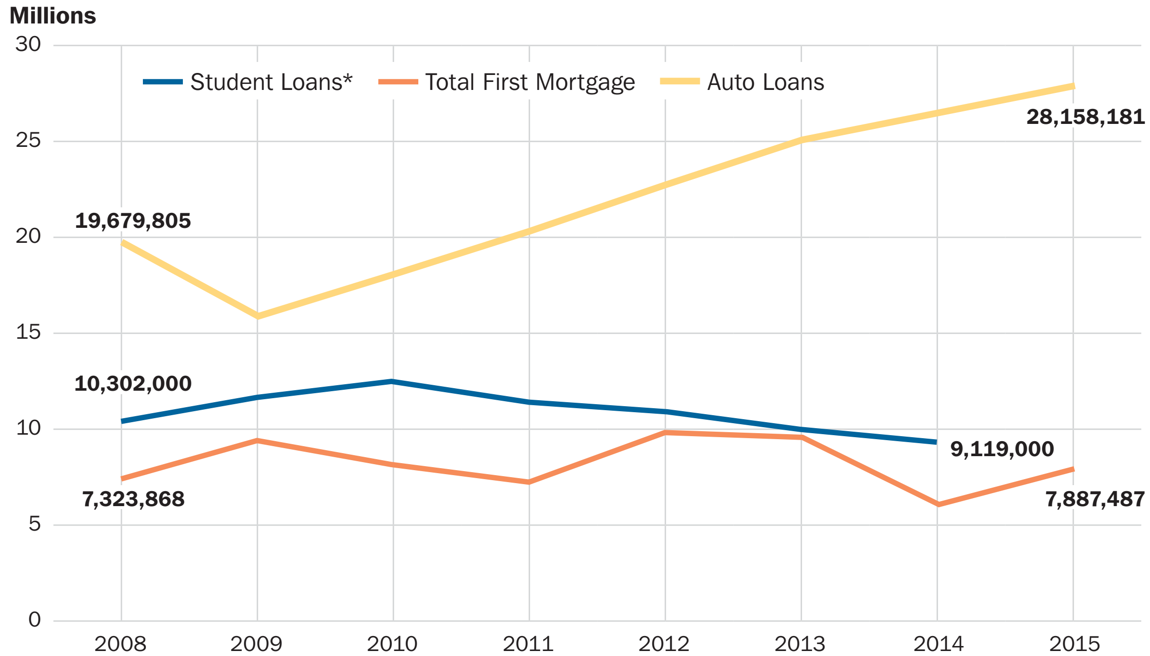
CHART 1

Total Number of Originations by Loan Type



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Sources: Federal Reserve Bank of New York Consumer Credit Panel 15:Q4; Equifax U.S. Consumer Trends, February 11, 2016; Federal Reserve Bank of New York, Student Loan Borrowing and Repayment Trends, 2015 (student loan data through 2014).

* The student loan data represents the number of borrowers originating student loans during a given year, rather than the number of loans originated.

credit transaction gives the dealer a new opportunity to sell add-on products and mark up the interest rate.

How Dealers Profit in the Car Sale Transaction

The sale of financing and add-on products in the dealer's Finance and Insurance (F&I) office is a primary source of profit for car dealers, often eclipsing the profits dealers make from selling the car itself. About 80% of car buyers obtain financing for the car at the dealership.[5] For these consumers, most dealers line up a bank or other creditor that will be the ultimate creditor that the consumer pays. The creditor that the dealer lines up then tells the dealer the interest rate it is willing to give the consumer in light of the consumer's credit record. But the creditor typically allows the dealer to mark that interest rate up, and keep much of the markup. As a result, consumers with the same credit risk can pay dramatically different interest rates, depending on how much the dealer marks up the interest rate for that particular customer. Dealers make much of their profit from marking up interest rates. An analysis by the Center for Responsible Lending found

that car buyers who financed at the dealership in 2009 paid $25.8 billion in interest rate markups.[6]

Class action litigation against major automobile creditors has exposed and to some extent limited the abusive practice of dealers' interest rate mark ups.[7] Analyses by Professor Ian Ayers[8] of the Yale Schools of Law and Management and Professor Mark A. Cohen[9] of Vanderbilt University's School of Management have demonstrated the disparate impact on African-Americans of larger and more frequent interest rate markups when compared to white consumers of equal creditworthiness. The Consumer Financial Protection Bureau (CFPB) has also addressed these practices through enforcement actions.[10]

Add-on profits often exceed a dealership's profit on the sale of the vehicle itself.

While receiving much less attention than auto financing, the sale of auto add-on products is another huge profit center for dealers. Although most dealers do not disclose information about profits from add-on sales, disclosures made by publicly traded dealer groups are instructive. In the third quarter of 2016, AutoNation Inc. showed an average gross profit from financing and the sale of add-on products of $1,617 per vehicle.[11] Group 1 Automotive Inc.'s financing and add-on profit in the United States was $1,578 per vehicle.[12] Such profits often exceed a dealership's profit on the sale of the vehicle itself. Although traditionally much, if not a majority, of those profits came from interest rate markups, recently more dealers are deriving a majority of their F&I profits from the sale of add-on products.[13]

Types of Add-on Products

Car dealers sell a dizzying and ever-evolving array of add-on products. Most, however, fall into one of two categories—hard add-ons and soft add-ons.

Hard add-on products are physical items, such as non-standard entertainment systems or navigation systems, curb feelers, pickup truck bed covers, racing stripes, vinyl roof covers, and much more. Hard add-ons have declined in popularity. Not only are many of the items out of style with consumers, but it has become easier for consumers to compare a dealer's prices for hard add-on products with third parties' prices for the same products.

Soft add-on products do not involve a physical product added to the car. Examples are service contracts and various vehicle protection products (see page 7). Soft add-ons are more popular with dealers. They have none of the costs or effort associated with physical products. They require no shipping from the supplier to the dealer, no time to install, and no storage space at the dealership. Notably, it is difficult for customers to understand what they are buying and compare the add-on with other similar products. This allows dealers to charge higher markups over dealer costs and results in larger dealer profits.

A few products combine aspects of both hard and soft add-ons. For example, customers may be sold rustproofing with a promise of compensation if the car begins to rust within a specified time, or an upholstery or paint protection package with a similar promise of compensation.

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Some of the soft add-ons or combination add-ons are either insurance, are regulated as insurance, or are very much like insurance. Whether a product is, in fact, insurance can affect consumers' rights in the transaction. If the product is considered insurance, the dealer may be required to be licensed in order to sell the product and there may be additional regulation of the pricing of the product and the amount and availability of refunds if the product is canceled.

Some Typical Soft Add-On Products

Service contracts, often called extended warranties or breakdown insurance, are written contracts to perform maintenance or repair of a car or other consumer product for a specified length of time or mileage traveled. A service contract can be sold on a vehicle not covered by a warranty or it may supplement a warranty by having a longer duration, covering additional parts or services, or providing additional remedies. Service contracts often pay out only a small portion of premiums in claims and much of the consumer's payment goes to the auto dealer.

Guaranteed Asset Protection (GAP) products ostensibly protect consumers who owe more on their car than the car is worth. Many consumers drive off the dealer's lot owing substantially more than the car is worth. In fact many consumers still owe more than the car is worth when they attempt to trade it in for a new one.[14] This "negative equity"—the amount by which the debt on the car exceeds its value—is attributable not just to depreciation, but also to consumers being overcharged for the car and sold expensive add-ons.

When a vehicle with negative equity is stolen or wrecked, the consumer's collision or comprehensive insurance coverage typically is limited to the value of the car, and is not based on the remaining amount owed on the car financing. The consumer is then liable to the creditor for the amount of the car's negative equity at the time of the theft or accident. GAP products are advertised as holding the consumer harmless for the difference between the balance on the debt and the amount paid under an automobile physical damage insurance policy in the event that the vehicle is totaled or stolen.

Dealers aggressively push GAP products because they are highly profitable. GAP products also reduce risk for the creditor[15] while at the same time adding to the amount financed, thus increasing finance charges. On the other hand, consumers often find that GAP products fail to provide the promised benefits. Most GAP products exclude cars that are uninsured or under-insured and also do not pay for interest and fees accruing from the time the car was totaled or stolen until the insurance payment is made. GAP coverage often excludes that portion of negative equity resulting from a trade-in whose pay-off exceeds its value. It may also exclude the portion of the consumer's obligation that reflects the cost of add-ons, such as service contracts, window etching, and sometimes even the GAP product itself. Some GAP policies also do not cover the deductible on the consumer's collision or theft coverage.

Window Etching (Etch) is one of a number of "vehicle protection products" marketed by dealers as deterring theft or making it easier to identify and recover a stolen vehicle.

The dealer etches an identification number, often the Vehicle Identification Number (VIN), on one or more of the car's windows. The etching supposedly deters theft, but a thief can replace the etched window relatively cheaply and the VIN is already marked in several areas on the car that are much more difficult to find and remove. Etch typically comes with the supposed benefit that, if the vehicle is stolen, the consumer will receive a discount—typically several thousand dollars—on a replacement vehicle. The contract may require the consumer to purchase the replacement vehicle from the selling dealer.

Many dealers etch all the cars on their lot, "preloading" the add-on. Dealers often find this allows them to have a much higher penetration rate,[16] although it sometimes alienates customers. This practice means that, unlike service contracts and GAP insurance, some dealers sell etch products on most of their vehicle transactions while other dealers do not sell etch products at all.[17]

Other add-on products not examined specifically in this report include key protection plans, tire protection plans, dent protection, prepaid maintenance, lease products, credit insurance, Certified Pre-Owned (CPO) programs, and warranty products:

- **Key, tire, and dent protection plans** promise to cover all or some of the replacement cost of keys or tires should they be damaged or lost under certain circumstances. Dent protection usually offers to pay claims for a type of paintless dent repair and typically comes with many exclusions.
- **Prepaid maintenance plans** promise to cover regular maintenance costs for a specified period. Dealers like these plans not only because of the profit they receive from the sale of the plan but also because the plans keep the consumer coming back to the dealer, giving the dealer the opportunity to generate more business for its lucrative service department and the potential to sell the consumer another car later on.
- **Lease products** are a growing add-on area, as almost one-third of new car transactions are now leases. While some consumers who lease might be persuaded to buy a few of the usual add-ons, such as key protection, prepaid maintenance, or tire protection, they generally will not purchase a service contract or GAP on a leased vehicle. Accordingly, add-on providers have developed lease coverage products that claim to cover occurrences that might require payment at the end of the lease term, such as the consumer's liability for unusual wear and tear, scratches, and dings. This product usually comes with many exceptions.
- **Certified Pre-Owned (CPO) programs** and **warranty products** are not typical add-ons because they are included in the price of the car when it is listed for sale, rather than being added separately later. CPO programs provide a certification claiming that a car has been inspected and found to be in good condition. Typically they also provide a warranty for the car. CPO programs may be offered by a vehicle's manufacturer or may be offered by a third party on almost any brand of vehicle. Warranty products are similar to service contracts but are included in a vehicle's sales price.
- **Credit insurance** used to be one of the more common add-ons, but its use by dealers has dwindled. Credit insurance ostensibly pays all or part of the outstanding debt on the car in the event of an occurrence such as death, disability, or unemployment.

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ANALYSIS OF ADD-ON DATA

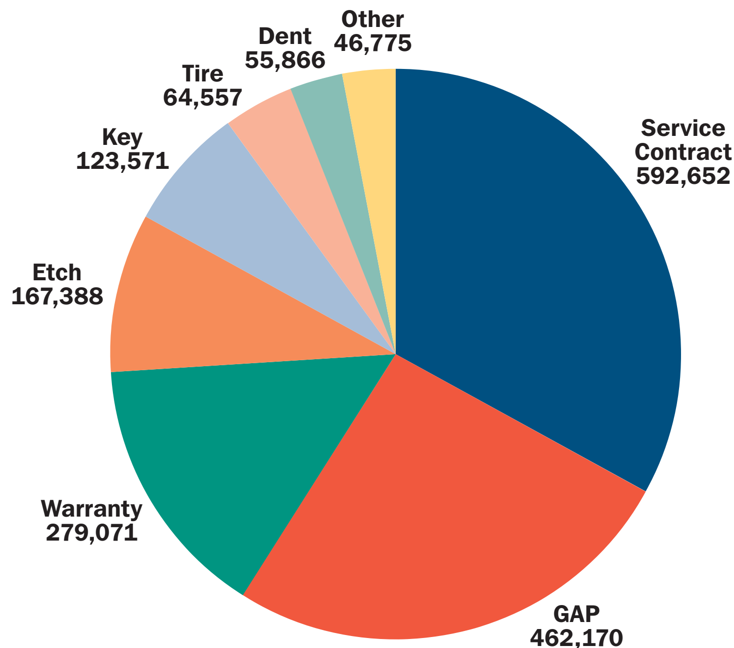
This report is based on an analysis of a nationwide data set of 1.8 million car sale transactions resulting in the sale of almost 3 million add-on products from September 2009 through June 2015. Included in the data set are transactions involving over 3,000 car dealers selling a wide range of add-on products they purchased from a single third party add-on provider (see Chart 2). A description of the data set is found in the Appendix.

As seen in Chart 2, in the data set, 33% of products sold were service contracts, 26% were GAP, 15% were various warranty-type products, and 9% were Etch. This report focuses on service contracts, GAP, and Etch, as they make up the great majority of products sold for which the consumer is charged a separate fee. Sales of warranty-type products are excluded from our analysis because the consumer's charge for these products is rolled into the price of the car.

The prevalence of service contracts and GAP in our data set is roughly consistent with published information about dealers' penetration rates in selling these products. Industry sources place the penetration rate for service contracts between 38%[18] and 54%,[19] for GAP between about 37% [20] and 50%,[21] and for Etch about 20%. The percentages are different than the percentage distribution by product in our data because the industry data refer to the percentage of vehicle sales that include a specific add-on, while the distribution percentage for our data is the percentage of a particular type of add-on as a percent of all

CHART 2

Add-on Products Sold by Category



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Source: National data set of one provider's add-on products sold in the U.S., September 2009–June 2015.

add-ons sold. Both industry figures and our data are roughly consistent, however, in that both show service contracts as slightly more prevalent than GAP, and both GAP and service contracts as significantly more common than Etch.

Our data set includes sales of add-on products sold by dealers in all 50 states and the District of Columbia. Looking at just the three add-on products examined in this report, the data set includes thousands of sales in most states. In 21 states, the data set includes over 25,000 sales of these three add-on products for that state, and in more than half of those states the number of products sold is greater than 60,000.

PRICING OF ADD-ON PRODUCTS

Comparing Add-on Markups to Markups for Other Retail Products

Car dealers mark up the price of add-on products significantly over the dealer's cost to buy the add-on product from a third party add-on supplier. Looking collectively at service contracts, GAP products, and etch products, the combined average markup was 170%.[22] Of course, other retailers also mark up retail prices above cost, but the magnitude of auto add-on markups is often exceptionally high, considering the nature of the product being sold. A review of retail markups more broadly gives some context in which to examine markups of add-on products.

The magnitude of retail markups varies greatly by industry and by product. Brick and mortar retailers, such as big box office supply or sporting goods stores, might mark up their goods by 40 to 50%. Other, more general, big box stores like Costco or Target might have markups between 10 and 50%.[23]

Some clothing retailers mark up their goods at a higher rate of 50 to 100%. These higher markups, however, are tempered by frequent sales that result in far lower markups. Styles change quickly and clothing retailers often must sell large portions of their inventory at much lower prices.

Jewelry stores have markups between 25 to 125%[24] but typically have a low turnover with significant capital invested in their inventory and high security costs. Furniture stores might mark up their stock by 80%[25] but have very large items to store and ship.

Some brick and mortar stores use lower markups. Grocery stores, for instance, often mark staples up only 2 to 8%,[26] relying on a large volume of sales and higher markups on more luxurious items. All of these industries are under pressure from online retailers whose costs are reduced because they do not maintain physical stores. Those reduced costs and higher volumes translate into markups averaging 15% for Amazon.[27]

Car dealers' markup on cars is also illustrative. In the past, dealers marked up the prices of new cars on average about 5 to 10% over the invoice price (the price stated in a document issued by the manufacturer to the dealer).[28] Recently this markup has seemingly declined,[29] but the reason may be that in response to growing awareness by consumers of invoice price, manufacturers have inflated the stated invoice price so that it exceeds

the dealer's actual cost. For example, the manufacturer's invoice price does not reflect the growing use of various incentive and other payments that manufactures make to dealers, which can reduce a vehicle's actual cost to the dealer by 2 or 3%. Altogether, the National Automobile Dealers Association (NADA) found that new car sales had a markup of 3.4% in 2015.[30] NADA numbers from 2015 for used cars found an 8.6% markup.[31]

Typical car dealer add-ons are very different from cars and other retail products. Soft add-ons, which are the majority of add-on products sold, are not tangible items and need not be shipped or stored or sold at low prices to clear inventory if they go out of style. Dealers do not buy them ahead of time and so do not need to tie up capital for add-on inventory. Unlike cars on a dealer's lot, they need not be insured and the dealer need not obtain financing to keep them in stock. Unlike used cars they need not be reconditioned. These factors should allow dealers to still make a profit while marking up add-ons at a low percentage. However, despite all the advantages of soft add-ons from a dealer perspective, the data indicate that markups of add-ons are typically much greater than those for the cars themselves.

Comparing Add-on Products Markups with Insurance Products

A useful comparison to the size of add-on markups is pricing for insurance products. Insurance does not involve a tangible item and many add-on products, such as service contracts, GAP products, and Etch, have insurance-like qualities.[32] For example, the cost to actually etch a number into a windshield is only a few dollars. Much of the alleged value is in the benefit provided to the consumer if the vehicle is stolen.

In general, pricing for insurance products is very different from pricing for non-insurance add-on products. Insurance prices are often reviewed by state regulators. Insurance agents do not mark up prices; instead, the premium (the price for the product) is set by the insurer, and the agent may receive a commission. Pricing discretion is not given to the individual selling the policy.[33] Rather, variations in price are typically based on factors such as the consumer's age, sex, place of residence, marital status, and driving record. While the use of these factors can result in unfair pricing policies,[34] they are at least standards that do not leave discretion to the individual employee trying to sell the item to the consumer. Nor is an insurance agent's compensation based on charging different consumers a higher price for the same product as is often the case in the sale of add-ons. (See discussion of compensation of F&I personnel on page 14.) Instead, the insurance agent receives a predetermined commission from the insurance company and there is a fixed pricing schedule. When an insurance policy is sold through an independent agent (somewhat akin to a car dealer selling an add-on), estimates indicate that home and auto policies typically allow a 10 to 15% commission on the first year's premium.[35]

Insurance prices are typically subject to cost-based pricing requirements – rates may not be excessive, inadequate or unfairly discriminatory and must be reasonable in relation to benefits. With credit insurance products, insurance regulators typically use loss ratios (also termed benefit ratios) to measure value to consumers. These ratios are calculated as benefits paid (claims) divided by premiums collected.[36] If for every $100 in consumer

premium payments, $80 is paid out to consumers in claims, the insurance product has an 80% loss ratio. Most property and casualty insurance products have loss ratios in the 50 to 65% range.[37]

Using the same loss-ratio approach to assess the expense of car dealer add-ons reveals that these add-ons are very expensive. Analyzing the exact loss ratios for auto add-on products is difficult due to the lack of available data. In particular, we do not know the exact amount paid out in claims. However, the data used for our analysis does reveal how much of the consumer's payment was kept by dealers as the markup on the product and so unavailable for payment of claims. In other words, the maximum amount available to pay claims is at most the portion of the price that is paid to the third-party add-on provider as the dealer cost for the add-on products. The add-on provider cannot pay more in the long run because it cannot continue to operate if it pays out more than it takes in. This allows us to calculate an upper limit on the loss ratios for these products, and the calculation suggests that loss ratios are shockingly low. In the data we reviewed, the average dealer markup for Etch products was 325% (an average markup of $189 over the dealer's average cost of $58) in 2012. For the etch products sold to those consumers, assuming that every penny paid to the third party provider was paid out in claims to the consumers, the loss ratio was still below 25%.

A 2011 advertisement[38] (see Graphic 1 on page 13) for Safeguard Products International, LLC— a company that claims to be the top add-on product provider by volume and provides a variety of add-on products, such as service contracts, etch products, GAP, and tire and key protection— provides another illustration of this point. The advertisement (directed to dealers and not to consumers) states that Safeguard has paid out $600 million in claims,[39] and generated $5 billion in profits for its clients, the dealers.

Even assuming that Safeguard kept only exactly enough money to pay out claims (and did not retain anything for claims adjusting, administrative expenses, marketing, other costs, or profit), these figures would still result in a loss ratio of just 10.7%—$600 million paid on $5.6 billion in premium payments. Of course, the loss ratio would be even lower if Safeguard kept an additional part of the consumer's payment for its own costs or as profit.[40]

Even credit insurance, commonly sold by car dealers and notorious for its low pay-out rates and high dealer profits, has a substantially higher loss ratio than this advertisement or our data set suggests for add-on products. In many states there are minimum loss ratios for some types of credit insurance, although these minimum loss ratios can be very low—40%—and actual experience may not even meet this minimum.[41] Yet loss ratios in the area of 40% are double or quadruple the loss ratios our data suggests for add-on products.

Another way to look at add-on pricing in comparison to insurance is to consider the dealer's markup over its cost as compared to the commissions that independent insurance agents receive when they sell insurance to consumers. As described previously, regular insurance agents' commissions typically range from 10 to 15%, which is the equivalent of an 11 to 18% markup.

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GRAPHIC 1

Sample Advertisement for Dealers

Strength.
Security.
Results.

It's who we are.

- #1 volume F&I product provider.
- Over 200 exceptional agent partners delivering value in all 50 states—***the absolute best in income development***.
- 26 customized OEM private-label programs, more than all other providers combined—***the undisputed leader***.
- $600 million in claims paid.
- $5 billion in profits for our clients.
- 15 million consumers protected worldwide.

Safe-Guard is committed to providing exceptional service and profit-driven results. Experience for yourself why Safe-Guard is the industry's leading F&I provider.

One Company. One Solution.

Note: The red circle has been added to the advertisement for emphasis.

By contrast, auto dealers' markups for add-on products are much higher (see charts 3 to 5). In 2012, the average dealer markup for Etch sales in our data set was 325% (an average markup of $189 over the dealer's average cost of $58). That same year, the average markup for GAP was 151% (an average markup of $378 over the dealer's average cost of $251). The average dealer markup for service contracts was 83% (an average markup of $859 over the dealer's average cost of $1,032).

These are average mark-ups across the whole data set. As will be described, there is enormous variation in the extent of markups from dealer to dealer and even from state to state and from consumer to consumer at the same dealer. This implies that actual markups in certain states, at certain dealers, and for certain consumers will be dramatically higher.

For example, an analysis of our data shows that, in 2012, 13 dealers marked Etch products up by an average of over 1,000%. One dealer sold over 1,000 Etch products, each with a dealer cost of $16 and a charge to the consumer of $189, for a markup of $173 or 1,081%. For GAP products, 38 dealers had average markups of 300% or more, and 38 dealers marked up service contracts by an average of more than 300%.

As was true for loss ratios, these markups far exceed those for credit insurance sold by vehicle dealers. Insurance regulations often permit dealers to charge higher commissions for credit insurance than insurance agents are permitted to charge for other types of insurance, but they still usually fall below 35% for credit life and credit disability.[42] A model credit insurance regulation drafted by the National Association of Insurance Commissioners (NAIC) recommends a 25% cap on compensation paid to creditors such as auto dealers for selling credit insurance.[43]

Yet another measure of add-on pricing is a comparison of dealer pricing with that by entities that do not appear to view add-ons as a special profit center. Insurance companies and credit unions often offer GAP directly to their existing customers. The GAP contracts offered by these providers are generally priced far lower than those sold by dealers. Currently, the North Carolina State Employees Credit Union offers GAP for a flat fee of $275 on all new and used vehicles it finances up to $100,000 in value. By contrast, consumers in our data set who bought GAP at the dealership paid on average $629 in 2012 and $655 in 2013.

While all of these markups are high, some products are marked up on average at a much higher percentage than other products. The average markup percentage for service contracts is higher than that for GAP and the average percentage markup for etch products is much higher than either. There are several possible explanations. It could be that dealers with more egregious pricing policies favor certain add-on products, such as Etch. Another likely explanation for some of the difference is that dealers are marking up products that have a lower cost at a higher percentage than items with a higher dealer cost. Dealers might justify this markup structure as necessary to compensate them for the time and money they spend on having and selling the product. While that could justify some more similar absolute dollar markup and higher percentage markups on lower cost items, the overhead on these products is very small.

Another partial explanation for the very high markup on these items is the pay structure for F&I personnel. F&I personnel are often very well compensated,[44] sometimes making more than the dealership's general manager. The pay of the F&I manager is largely commission based. Some dealers simply pay a flat commission on all F&I profits. Others pay a higher percentage commission as the F&I profits increase per vehicle sold. The F&I manager's commission may be 10% unless he reaches a goal of more than $1,000 per car, at which point the commission may increase to 12%. On top of the F&I manager's commission, car salespeople also sometimes get a commission, not only for the dealer's profit on the sale of the car itself but also for profit on the sale of add-ons and other "back-end" products. When substantial commissions are based on markup, they incentivize F&I managers to maximize the markup for each consumer on an individual basis.

Dealers' Expectations for Profits from F&I can Lead to Consumer Harm

In the latter half of the 2000s, Steve VanGorder became general manager of the dealerships in the Jeff Schmitt Auto Group in Ohio. Faced with an F&I revenue of $700 or $800 per vehicle sold, VanGorder set up a system of targets for those in the F&I department based upon factors such as penetration rates. He trained a number of salespersons who were eager to move to the more lucrative F&I department. If existing F&I personnel failed to meet the new targets they could be easily replaced with the trained personnel from the sales department. As VanGorder stated in an interview with *Automotive News*, "If somebody's numbers have fallen in finance, they know there is a talent pool of aggressive salespeople who want their job."[45]

These perspective F&I people are trained to do things the way the dealership wants them done, using a "word track" the dealership wants used. VanGorder described it as similar to contestants who might cover a popular song on the TV show American Idol. "The people who can really do a good job with a song, sing the song the way it was originally sung by the artist—they sing it 1,000 times backward and forward until they know it and then they can make it their own," he says. "I'm looking for a willingness to learn the process and the word track. Once they do that, the heavy hitters can make it their own."

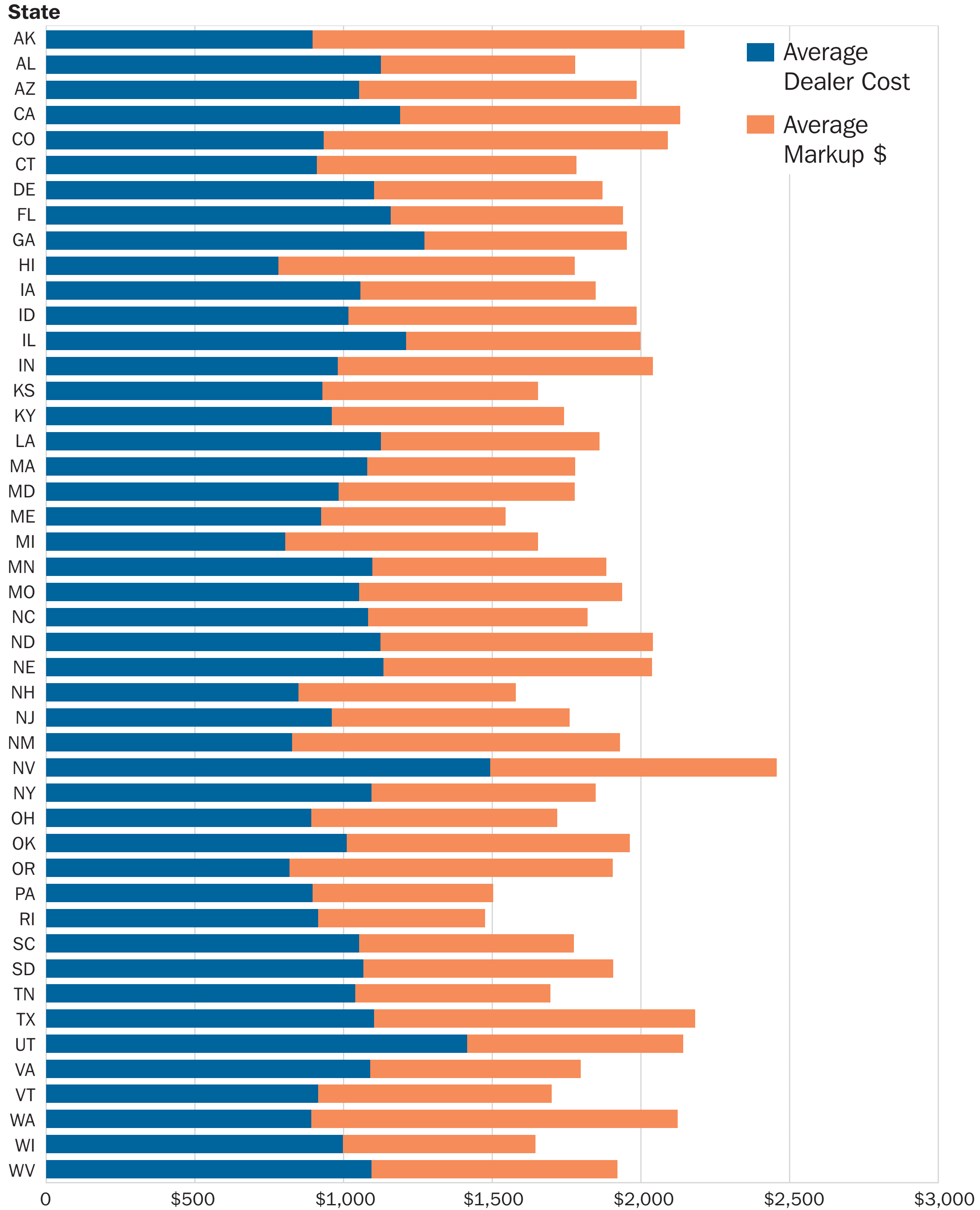
The fact that "aggressive salespeople" were ready to replace any F&I personnel who failed to meet their targets appeared to accomplish the goals of the dealership in bringing in more F&I profits. VanGorder's system raised F&I revenue per car from $700 or $800 to $1,600 or $1,700, and the penetration rate to 85%.[46]

However, while F&I revenue was up, so too were complaints from consumers. In 2013, the Jeff Schmitt Auto Group paid $625,000 to settle 16 civil lawsuits and five other complaints.[47] A number of consumers also complained to the Ohio Attorney General.[48] A number of the former customers, represented by consumer attorney Ron Burdge, alleged that they were charged up to $1,299 for rust-proofing which subsequent analysis showed was sometimes not applied, and overcharged for other add-ons such as Window Etching. Some customers also described the use of a "five-finger close," where the dealer employee's hand would cover up terms in the paperwork that were different than what the customer had been told orally in the negotiations.

The size of markups varies not only by dealer, but also by state. Charts 3, 4, and 5 show the dollar amount that the service contracts, GAP, and Etch in our data set cost the dealer and the dollar amount they were marked up by state from 2009 to 2013. Only states in which sales of a particular product exceeded 100 are included, so for a less frequently sold product, such as Etch, the chart includes fewer states.

CHART 3

Average Dealer Cost and Markup by State: Service Contracts



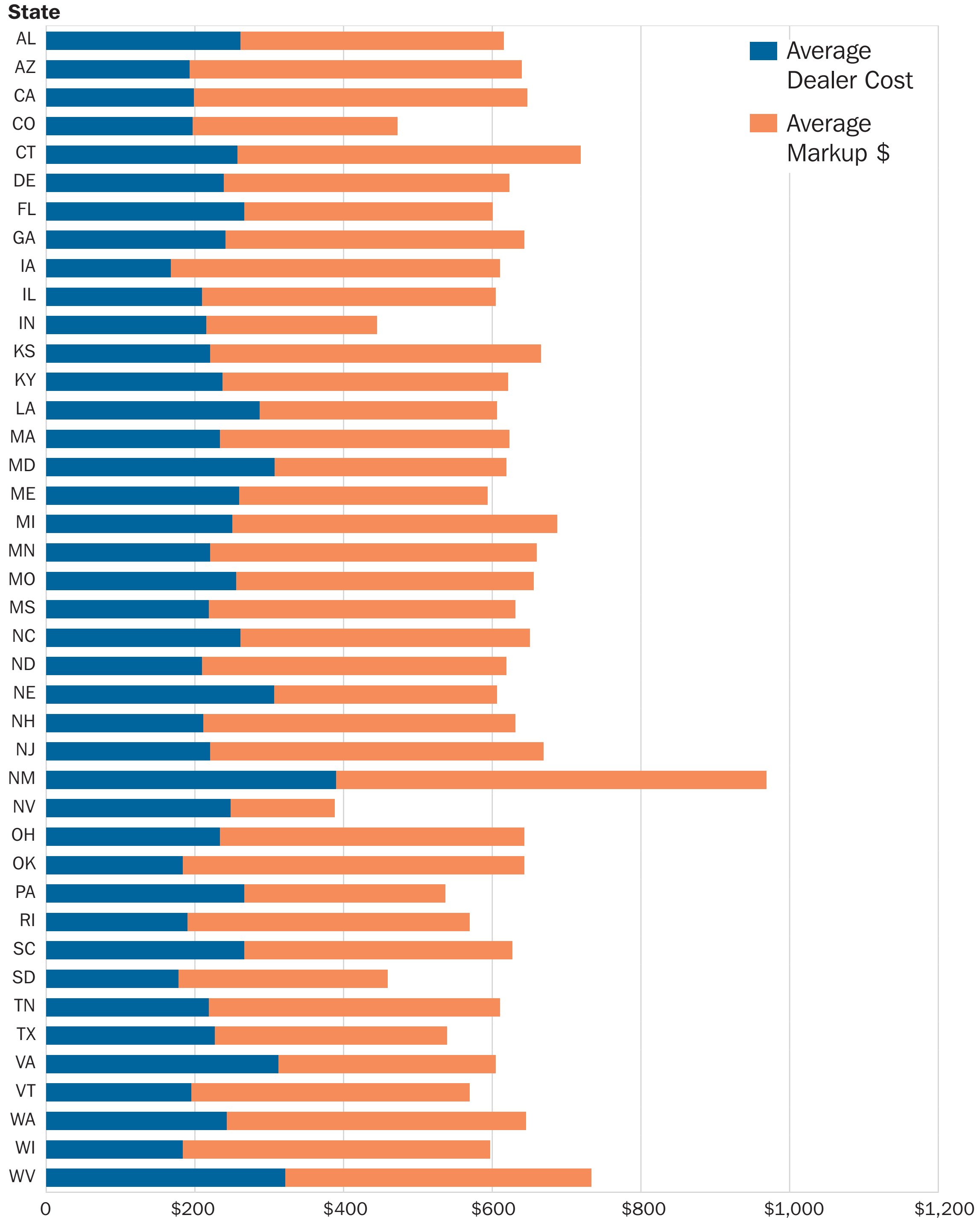
©National Consumer Law Center, 2017

Source: National data set of one provider's add-on products sold in the U.S., 2012.

Note: Only shows states with 100 or more records.

CHART 4

Average Dealer Cost and Average Markup: Guaranteed Asset Protection (GAP)



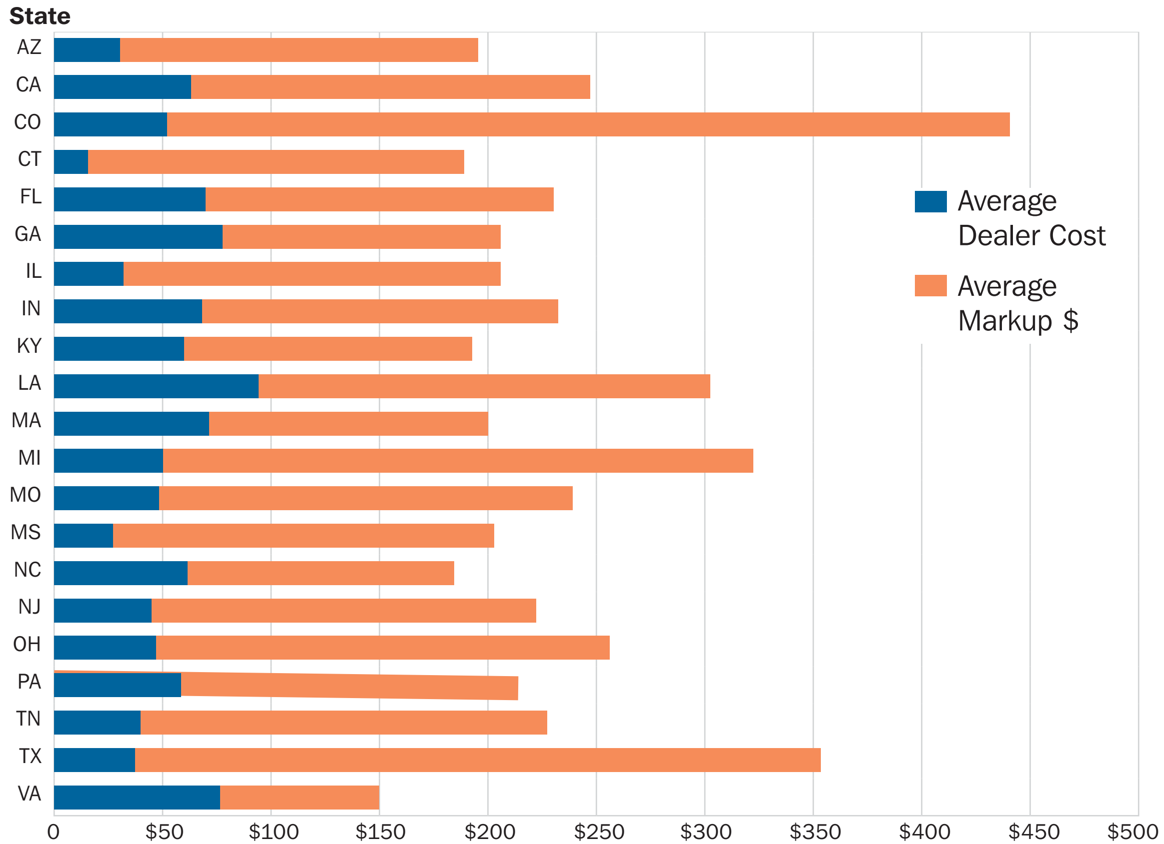
©National Consumer Law Center, 2017

Source: National data set of one provider's add-on products sold in the U.S., 2012.

Note: Only shows states with 100 or more records.

CHART 5

Average Dealer Cost and Average Markup: Window Etching (Etch)



©National Consumer Law Center, 2017

Source: National data set of one provider's add-on products sold in the U.S., 2012.

Note: Only shows states with 100 or more records.

INCONSISTENT AND ARBITRARY PRICING

Inconsistent and Arbitrary Pricing in Etch Products

Markups for add-ons are not only extremely high, but also highly inconsistent. Not everyone buying the same add-on with the same dealer cost pays the same price. This inconsistent pricing occurs not just between different dealers or for different products, but within individual dealerships for the same products and even when the dealer's cost for the product is the same. That is, two consumers going to the same dealer and purchasing the exact same product may pay significantly different prices.

Some dealers do require their F&I departments to charge everyone the same price for the same add-on that has the same cost to the dealer, but it is the dealer and not the third

party provider that establishes the price. Dealers may set this price by adding a fixed dollar markup such as $100 or $200 to their cost, or by using a consistent markup percentage, such as 100% or 200%. Or they may just set a flat price, such as $899 or $999, for each product.

Other dealers do not have fixed pricing, but instead allow the F&I manager to mark up different individual customers at different amounts. The dealer may place a cap on how high the F&I manager can raise the price of an add-on for any particular consumer, but often this cap is just the maximum amount that the creditor that finances the sale will allow the dealer to charge for the add-on product. (See page 36 for further discussion of the role of creditors.) Sometimes the cap is a multiple of the cost of the item.[49]

Whether set by the dealership or made up by the F&I manager on the spot, the prices often are not round numbers. This is often done to add an air of legitimacy to the price and the F&I manager may stick to the made-up price as if it is cast in iron. As one industry magazine put it:

> *"Utilize odd prices for every F&I product . . . $2,832 for that service contract, not $2,795. Odd prices add credibility and legitimacy to F&I product pricing, and reduce the customer's perception that they need to negotiate the price of those products. Help your F&I managers establish a set price for each product, and then encourage them to stick to it. Any reduction in price must always require reciprocity- a reduction in coverage. The first time they ask a customer "If I could, would you . . ." their credibility goes in the toilet. They might as well go to work at the carnival. The same holds true for interest rates. Whenever possible, use odd interest rates– 5.41%, not 5.25%. Everyone needs to feel like they got a good deal!"*[50]

Our analysis reveals some pricing approaches frequently used by dealers. The Etch data show dealers' pricing approaches most clearly because the cost to the dealer for Etch products generally does not vary by the price of the car, whether a car is new or used, or other characteristics that vary from car to car.

While only some dealers in our data set sold Etch products and the dealer's cost for the Etch product varied from dealer to dealer,[51] in almost all cases each dealer that sold Etch had only one cost for the Etch products it sold. In 2012, there were 124 dealers in the data set who sold the most common Etch product and of those, 105 had just one wholesale cost for every one of this Etch product they sold. Of the remaining 19 dealers, 18 had two different wholesale costs for this Etch product and one had three. Observation of pricing structures is thus easier for Etch than for other add-on products where the dealer cost for a product varies from customer to customer based upon characteristics of the car being purchased, the length of a service contract, and similar factors.

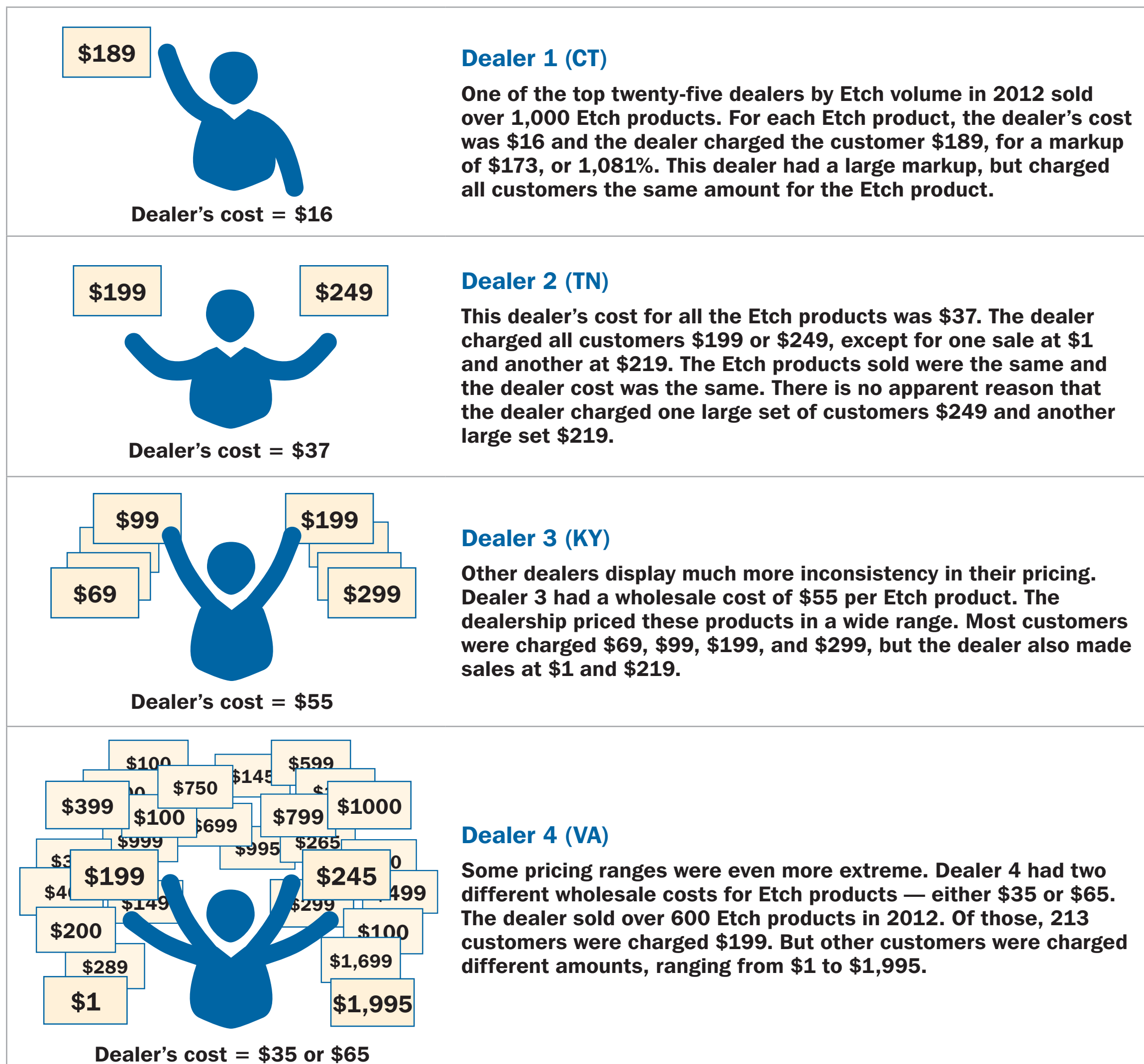
We examined the 25 dealers that sold the most Etch products in 2012, looking at the dealer cost and consumer price for about 41,000 Etch products sold by these top dealers. Graphic 2 (see page 20) shows the pricing structure of several of these top 25 dealers that are representative of typical pricing schemes.

GRAPHIC 2

Dealers and Window Etching Pricing

four dealers, four different pricing patterns

While some dealers with lots of sales of window etching (Etch) charge everyone the same price, it is not typical. In 2012, there were 105 dealers in NCLC's data set that sold Etch products that had just one dealer cost for every Etch product they sold. Only 19 of those 105 dealers sold the Etch product to each of their customers for the same price. 82% of dealers did not have a single fixed price for their Etch products, but established a different price depending on the customer. These extreme pricing inconsistencies cannot be explained by different costs to the dealer, different products being sold, or different time periods.



To increase transparency of pricing and help prevent discriminatory practices, dealers should be required to:

1. Post the available add-ons and their non-negotiable prices on each car in the lot along with the price of the car itself.
2. Collect data about consumers' race and ethnicity as part of the transaction and make the data available, just as mortgage lenders to do.

Source: National data set of one provider's add-on products sold in the U.S., 2012.

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Dealer 1, one of the top twenty-five by Etch volume in 2012, sold over 1,000 Etch products. For each and every Etch product, the dealer cost was $16 and the dealer charged the consumer $189, for a markup of $173 or 1,081%. This dealer had a large markup, but charged all consumers the same amount for the Etch product.

While some dealers with lots of Etch sales at a high profit, such as Dealer 1, do charge everyone the same price, it is not typical. In 2012 there were 105 dealers in our data set who sold Etch products that had just one dealer cost for every Etch product they sold. Of those only 19 dealers sold the Etch product to each of their customers for the same price.

82% of dealers did not have a single fixed price for their Etch products, but established a different price depending on the customer. Some of these dealers stuck to one or two prices most of the time. Dealer 2 had a wholesale cost of $37 for all the Etch products it sold. It made all of its Etch sales at $199 or $249, except for one sale at $1 and another at $219. The Etch products sold were the same and the dealer cost was the same. There is no apparent reason that the dealer charged one large set of customers $249 and another large set $199.

Other dealers display much more inconsistency in their pricing. Dealer 3 had a wholesale cost of $55 per Etch product. The dealership priced these products in a wide range. Most sales were at $69, $99, $199, and $299, but the dealer also made sales at $1 and $219.

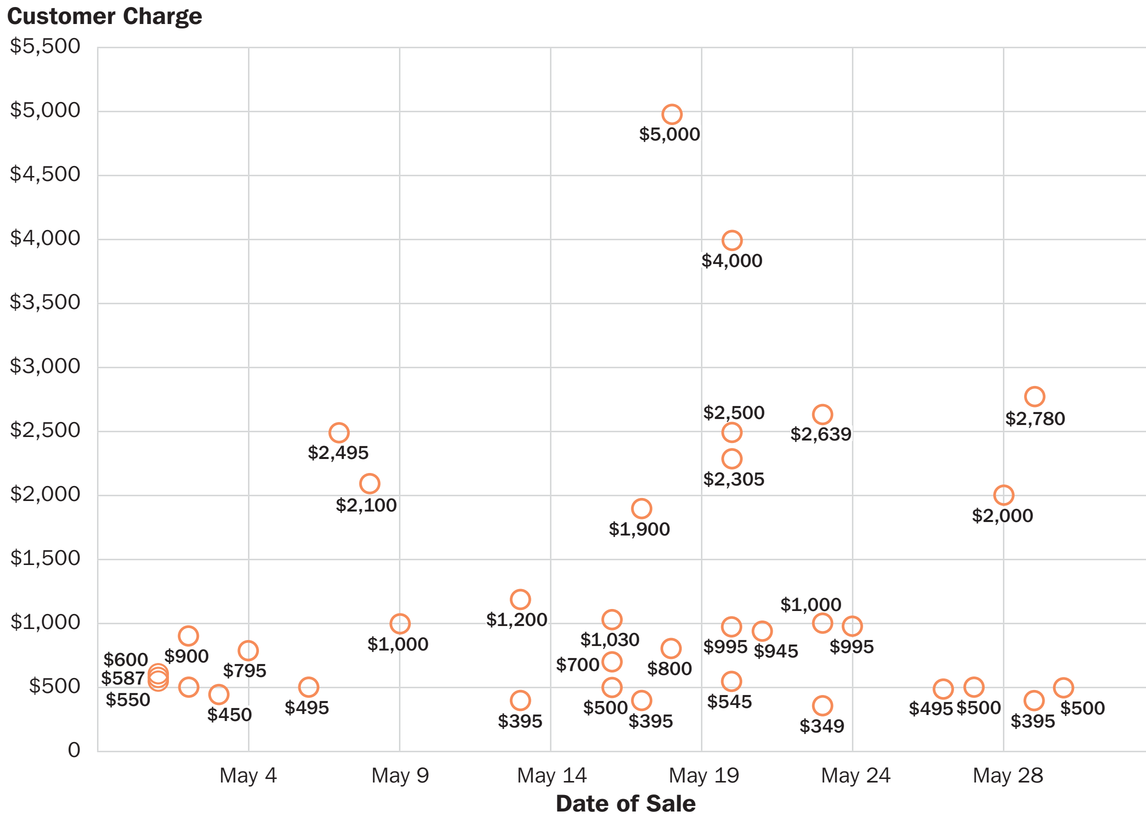
Some pricing ranges were even more extreme. Dealer 4 had two different wholesale costs for Etch products—either $35 or $65. The dealer sold over 600 Etch products in 2012. Of those, 213 customers were charged $199. But other customers paid prices ranging from $1 to $1,995.

These extreme pricing inconsistences cannot be explained by different costs to the dealer, different products being sold, or different time periods. For example, in May of 2013, a dealer selling the same Etch product with the same dealer cost of $50 charged customers between $349 and $5,000 for this product (see Chart 6 on page 22).

CHART 6

What One Dealer in Michigan Charged Different Customers for Etch, May 2013

(Dealer's Cost = $50 for Each Etch Product)



©National Consumer Law Center, 2017

Source: National data set of one provider's add-on products sold in the U.S., May 2013.

Pricing Trends in Service Contracts

Pricing inconsistencies are particularly easy to identify in a product such as Etch for which the dealer cost is constant, but they also can be seen when the dealer cost varies. A good example of an add-on product where the cost to the dealer varies is a service contract. The dealer cost for a service contract may fluctuate based on such factors as the value of the car, whether it is new or used, the cost of repair, and the length of coverage. Charts 7, 8, and 9 reflect the pricing structure of dealers drawn from the top 20 dealers of service contract sales by volume in 2011. We selected them because they were high volume dealers whose pricing structures reflected some of the general pricing trends we saw among many dealers.

CHART 7

Dealer Pricing for Service Contracts with a Trend Towards a Constant $1,500 Markup

©National Consumer Law Center, 2017

Source: National data set of one provider's add-on products sold in the U.S., 2011.

Looking at these individual dealers, some trends become clear. Dealers typically use highly variable pricing but do follow some patterns. The dealer shown in Chart 7 often marks up service contracts by $1,500 as seen by the heavy line of products sold at $1,500 above the green line. (The green line represents a 0% markup where the consumer price is equal to the dealer cost.) The trend circled in red parallel to the green line indicates a consistent $1,500 markup regardless of the cost to the dealer. However, this dealer also sells many service contracts with a fixed price of $2,000 regardless of cost, and sells many at a variety of other prices.

CHART 8

Dealer Pricing for Service Contracts with a Trend Towards Pricing at $1,999, $2,495 and $2,999

©National Consumer Law Center, 2017

Source: National data set of one provider's add-on products sold in the U.S., 2011.

Other dealers, such as the one in Chart 8, tend to charge many customers the same price for their service contracts, such as $1,999, $2,495, or $2,999, regardless of the dealer's cost for the service contract.

Some dealers, such as the dealer shown in Chart 9, employ both of these pricing approaches. This dealer often marks up service contracts $1,000 or $1,500, but other times prices them at $1,999, $2,499, or $2,999 irrespective of the cost to the dealer. In addition, this dealer, as is the case with many dealers, made a substantial number of sales at prices that followed neither trend and that varied significantly from customer to customer.

CHART 9

Dealer Pricing for Service Contracts with a Trend to Use Either a Fixed Price or a Fixed Markup

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Source: National data set of one provider's add-on products sold in the U.S., 2011.

The difference between dealers as to markups can be striking (see page 26). In Chart 10, just two of the top 20 dealers are highlighted. On the whole, the dealer highlighted in green marked up many service contracts by $500, but still sold many more priced above and below a $500 markup. However, that dealer's markups are, by and large, much lower than the dealer highlighted in red. The dealer in red clearly favors prices of $3,000, $2,500, and $2,000, even though it is selling service contracts for which it pays far less than the dealer in green. The dealer shown in red is selling service contracts with lower dealer costs for much higher prices. Both dealers show a large variation in pricing.

CHART 10

Comparison of Two Dealers' Pricing for Service Contracts

©National Consumer Law Center, 2017

Source: National data set of one provider's add-on products sold in the U.S., 2011.

DISCRIMINATION IN PRICING

Arbitrary Pricing Leads to Discrimination

Discrimination on the basis of race, sex, or other protected characteristics may be an invidious side effect of dealers' capricious pricing structures. Giving F&I managers the discretion to charge different consumers different prices for the same product and building incentives to charge high prices into their compensation systems is a recipe for abuse. Since one consumer does not know what other consumers are charged for similar items, consumers have no ability even to detect whether they are being charged more than other consumers for the same products.

Discrimination in add-on markups can come about if an F&I manager prices add-on products for a particular customer based on a judgment about what prices that customer can be convinced to pay. The F&I manager might even base the price on whether the manager thinks the customer is likely to notice that the add-on item has been included in the sale. Price disparities can also occur when F&I managers reduce prices for some customers but not for others.

> Giving F&I managers the discretion to charge different consumers different prices for the same product and building incentives to charge high prices into their compensation systems is a recipe for abuse.

A number of studies have found that pricing discretion given to dealers as to markups of *interest rates* results in African Americans and Hispanics paying higher interest rates than white consumers with the same credit risk.[52] This discrimination may not be deliberate or even conscious. Unless the F&I manager marks up every customer and uses the same markup for every customer with no negotiation, he or she will have to make a judgment call about whether or not to mark up any individual's financing and if so by how much. Consciously or unconsciously, F&I managers consider a number of consumer characteristics when making this judgment. Dealers may notice the way customers are dressed, their perceived level of educational attainment, and many other characteristics when judging how to price a customer. Race or ethnicity are likely among the characteristics that F&I managers notice when making pricing decisions.

Given that, in many dealerships, the F&I manager who decides what, if any, interest rate markup a particular consumer will pay is the same F&I manager who decides what the markup will be for add-ons, and given that the F&I office often has greater discretion in the pricing of add-ons than the amount of the interest rate markup, one would expect patterns of add-on markups to be similar to patterns of interest rate markups. And, in fact, our analysis found evidence that such discrimination *does* occur in the pricing of add-ons.

The Method We Used to Analyze Discrimination in Auto Add-ons

Our data set did not contain race coding for consumers. Indeed, no automobile data set contains information about the automobile buyers' race. Regulation B, implementing the Equal Credit Opportunity Act (ECOA), prohibits non-mortgage lenders from asking about or documenting characteristics such as a consumer's race or national origin.[53]

This rule was adopted in an effort to stop lenders from discriminating on these bases. Ironically, in an area like auto sales and finance, where the person with the discretion to set the consumer's interest rate or the price of the car or add-on is sitting across the desk from the consumer and may make assumptions about the consumer's race, the policy does not prevent discrimination, but instead makes it difficult to determine if discrimination occurs. This Regulation B provision has an effect that is counter to the ECOA's purpose.[54] As several commentators including the U.S. Government Accountability Office have noted, requiring lenders to collect and report such data could actually assist in stopping discrimination.[55]

Our data set also lacked specific addresses for consumers. Without this information, we could not use the combination of name and geocoding used by the Consumer Financial Protection Bureau to code and analyze auto finance transactions for discrimination.[56]

The lack of information regarding race/ethnicity or specific consumer-level geographic information limits our ability to analyze the data for discrimination. As a result, we employed a simple proxy method, using surnames alone to identify and code likely Hispanic consumers. The Federal Reserve Board uses this technique in fair lending examinations to code for ethnicity. Some entities that provide financing also use this technique internally to monitor for compliance.[57]

We used a list of Hispanic surnames created by the Federal Reserve Board's Office of Fair Lending Enforcement based on the United States Census identification of common Spanish surnames. We coded customers with the surnames from this list as Hispanic and then compared the pricing of add-ons for those with Hispanic surnames compared to those with non-Hispanic surnames.

This method was limited in several respects. The use of surname alone is relatively predictive for Hispanic populations, but it is not as predictive for African American populations without the use of geocoding.[58] We were therefore unable to code the data for African Americans. Because we were limited to coding for Hispanics using this analysis, when we compared consumers with Hispanic surnames to those with non-Hispanic surnames, we were comparing Hispanics not only to non-Hispanic whites, but also to African Americans and other minorities previously identified as receiving disparate, inferior treatment from car dealers on the basis of interest rates or car prices.[59] This means that pricing disparities that we identified were likely under-representative of the true extent of the disparities which would have been revealed if we had been able to compare Hispanics to non-Hispanic whites.

We focused our analysis on service contracts for several reasons. Service contracts are the most common and widespread add-on and are sold by almost every dealer in every state. Even within individual dealerships there is typically a wide variation in service contract markup and pricing. While there are trends in service contract pricing, these trends are certainly not controlling. These characteristics made service contracts a better product to look at for pricing disparities by race than Etch. We knew from our analysis of markups and pricing that a number of high volume dealers only charged one price for Etch. If one or more of these dealers had a disproportionately large Hispanic clientele it could strongly affect the pricing trends. It could mean that a disparity we found between Hispanics and non-Hispanics in Etch pricing might be heavily influenced by the demographics at a particular dealership with high etch volume rather than disparities between consumers at any particular dealership. Using service contracts made such effects less likely and the larger number of service contracts sold and dealers selling service contracts made it easier for us to look at individual dealerships and avoid any such influence.

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Overall Findings

We examined a three-year period of service contract pricing for which we had service contract data from 48 states and the District of Columbia. Looking at just the average percentage markup for Hispanics and non-Hispanics, we found that average markups for service contracts were higher for Hispanics than for non-Hispanics in 44 states. In two states, the markup was lower for Hispanics and one state and the District of Columbia had no Hispanic coded service contract buyers at all. In one state, the percentage markups for both Hispanics and non-Hispanics were almost identical.

We decided to focus on states where the results would allow us to make observations with a high degree of statistical certainty. Therefore we applied several restrictions. We limited our analysis to states in which our data set had at least 30 Hispanic service contract purchasers. We then applied traditional statistical tests for probability in samples and the nature of sampling error.[60] Using these tests we further reduced the states we analyzed to those where the number of transactions and other factors led to results with a high degree of statistical certainty.[61]

As yet another precaution, we ran two separate analyses for each state. First, we analyzed whether the percentage markups were different for Hispanic-surnamed consumers than for other consumers, and second we analyzed whether the dollar amount of the markups was different. We took this step because a markup of a given dollar amount is a higher percentage of a lower-cost service contract than it is of a higher-cost contract. For example, an $800 markup is 80% of a $1,000 service contract, but just 40% of a $2,000 contract. Thus, higher percentage markups for Hispanic-surnamed buyers could occur if the service contracts sold to Hispanics had a lower dealer cost than those sold to non-Hispanics. This could happen if Hispanics were buying cars for which service contracts had a lower dealer cost (because the cars themselves were less expensive or had lower repair costs) or if dealers sold Hispanics service contracts with lower levels of coverage and consequently lower dealer costs. To avoid the possibility that some of the differences we found between Hispanics and non-Hispanics might be attributable to this scenario, we focused our examination only on the states where the difference was statistically significant by both measures—percentage and dollar amount. In 14 states the difference was statistically significant by both measures.

In some of the states where the pricing differences between Hispanic-surnamed consumers and others were not statistically significant, the explanation was likely due to the fact that the volume of overall sales or the number of Hispanic-surnamed customers from our data set was too low to draw conclusions. We suspect that the lack of a statistically significant difference in many of the other states may be due to the issue previously discussed that our method coding those with Hispanic surnames forced us to compare consumers with Hispanic surnames to all of those with non-Hispanic surnames. As a result, we were comparing Hispanics not only to non-Hispanic whites, but also to African Americans and other minorities previously identified as receiving disparate, inferior, treatment from car dealers on the basis of interest rates or car prices.[62]

State demographic data support our belief. Of the 48 states for which we had service contract data during the relevant period, 14 had differences in both percentage and absolute markup which were statistically significant. In the 34 states for which only one or neither measure was statistically significant, the African American population exceeded the Hispanic population by an average of 13%. In the 14 states for which the differences in both percentage and absolute markup which were statistically significant, the Hispanic population exceed the African American population by an average of 80%.[63]

Analysis of Particular States

In each of the 14 states in which the differences in BOTH absolute and percentage markups were statistically significant, Hispanics were sold add-ons with higher percentage markups than non-Hispanics. In 13 of the 14 states (Florida was the exception), the average markup amount was also higher for Hispanics than non-Hispanics in absolute dollars (see Charts 11 and 12).

These differences in markups are particularly troubling since they involve the *retail* prices of service contracts, which are not determined or affected by credit scores. Thus, they cannot be explained by differences in buyers' credit scores.

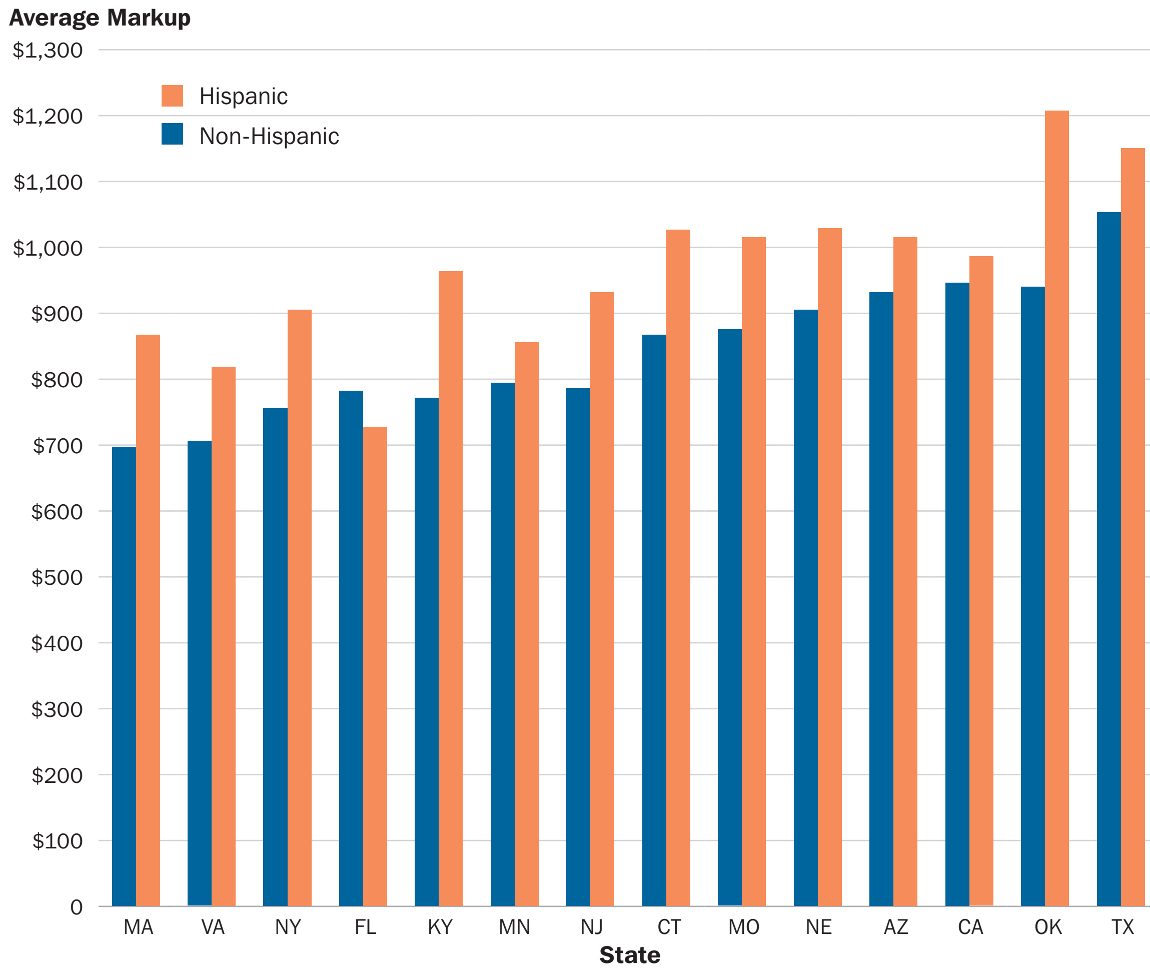
In Florida, the Hispanic percentage markup was higher but not the absolute dollar markup. As previously noted, if a dealer charges a set dollar amount as a markup on all the service contracts it sells, the percentage markup will be higher for a lower-cost service contract than for a higher-cost contract. If Hispanics were sold service contracts that had a lower cost for the dealer and some dealers followed this type of pricing policy, this could explain why they paid a higher percentage markup but not a higher dollar amount markup. The unusual pattern could also be explained by the very high number of Hispanics in Florida and the possibility that some dealers might favor Hispanics in pricing.[64]

Markup disparities between Hispanics and non-Hispanics persisted when we further controlled for the dealer cost of the service contracts by looking at products sold with similar dealer cost: (see Chart 12 on page 32). Overall, Hispanics still paid more than non-Hispanics.

We analyzed prices for service contracts that cost the dealer between $910 and $1,010 (see Chart 13). (We selected this range because it went from $50 more to $50 less than the $960 average cost for service contracts sold to Hispanics in the 14 states). Looking only at this tight range of costs to the dealer, we still see higher dollar and percentage markups for Hispanics in 12 of the 14 states, with markups almost the same for both groups in Kentucky and lower for Hispanics in Florida. Thus the discrepancy cannot be attributed to the varying costs of the service contract to the dealer.

CHART 11

Average Service Contract Markup for Hispanics and Non-Hispanics in Dollars



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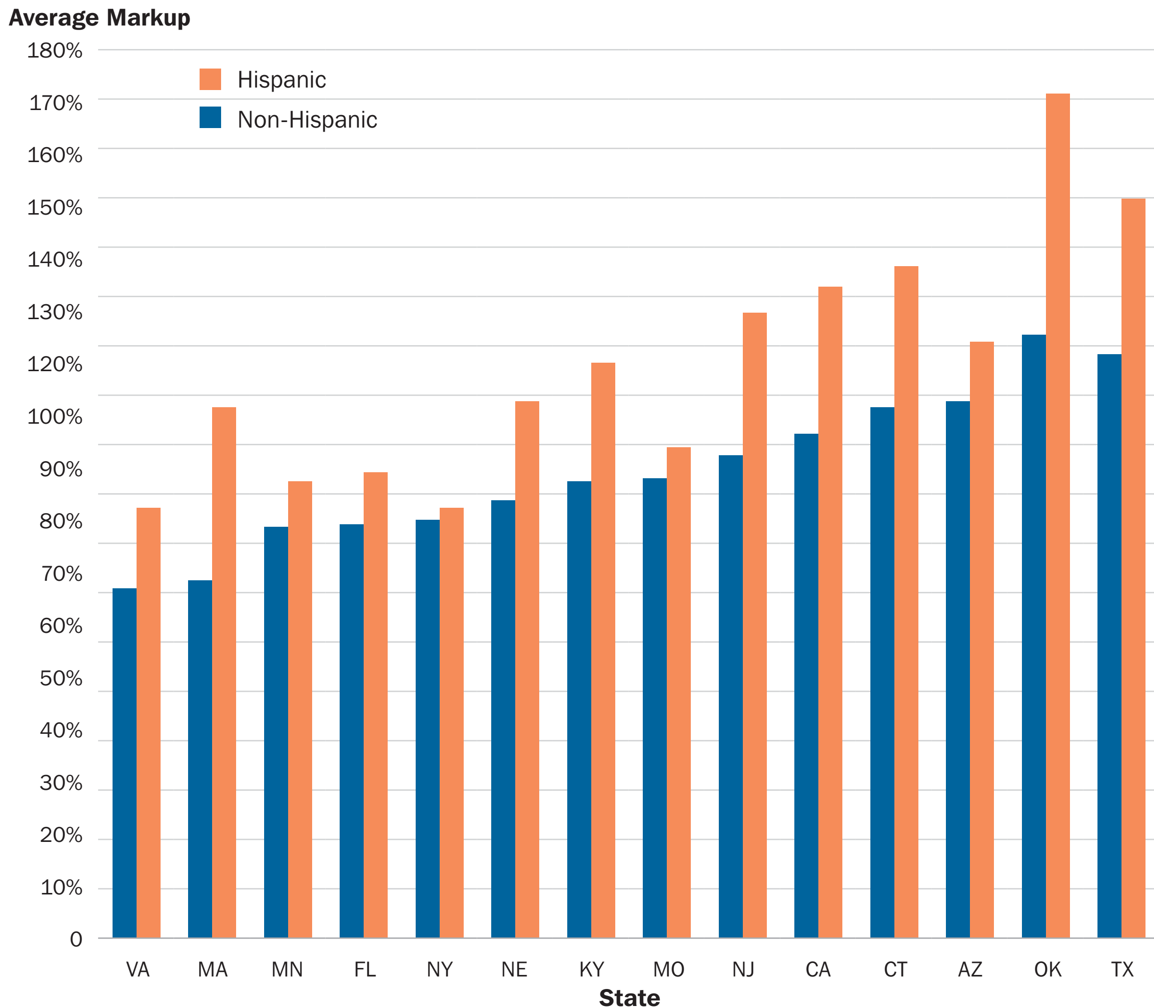
Source: National data set of one provider's add-on products sold in the U.S., 2011.

CHART 12

Average Service Contract Markup for Hispanics and Non-Hispanics by Percentage



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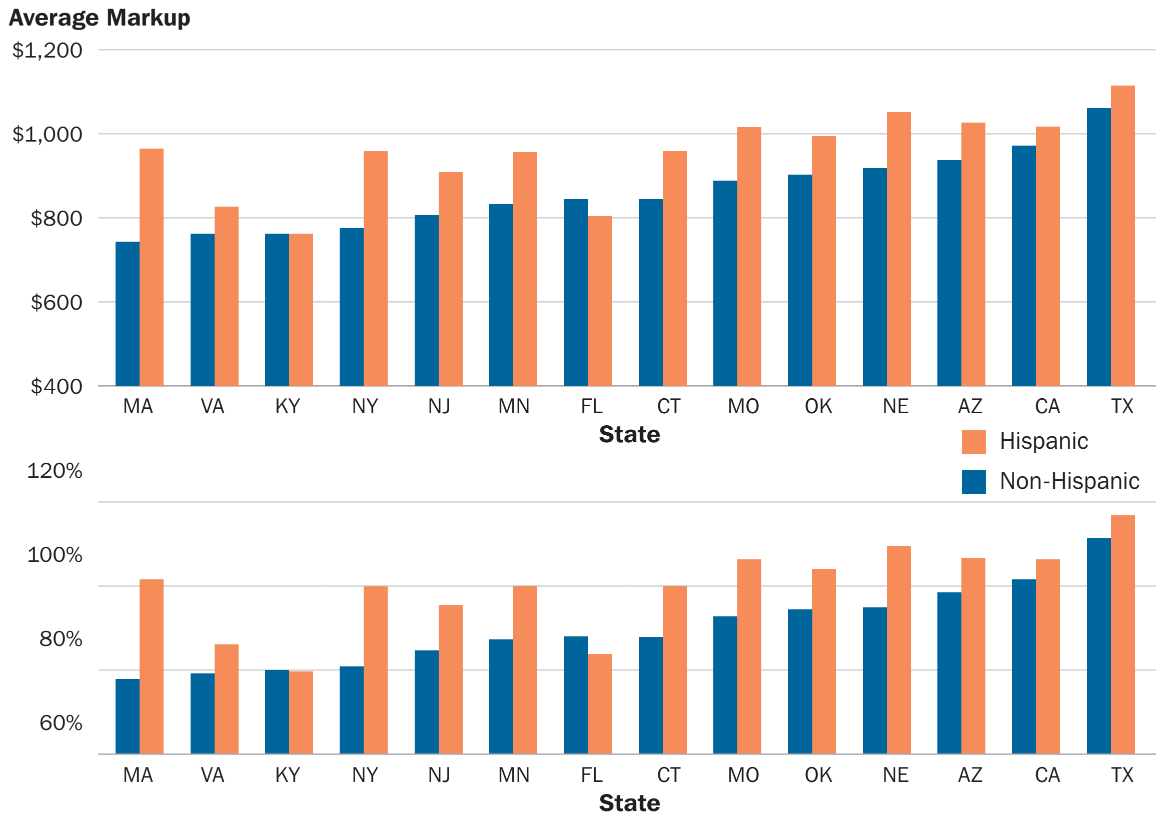
Source: National data set of one provider's add-on products sold in the U.S., 2011.

CHART 13

Service Contracts: Average Hispanic and Non-Hispanic Markup by State in Dollars and Percentages Where Dealer Cost is $910 to $1,010



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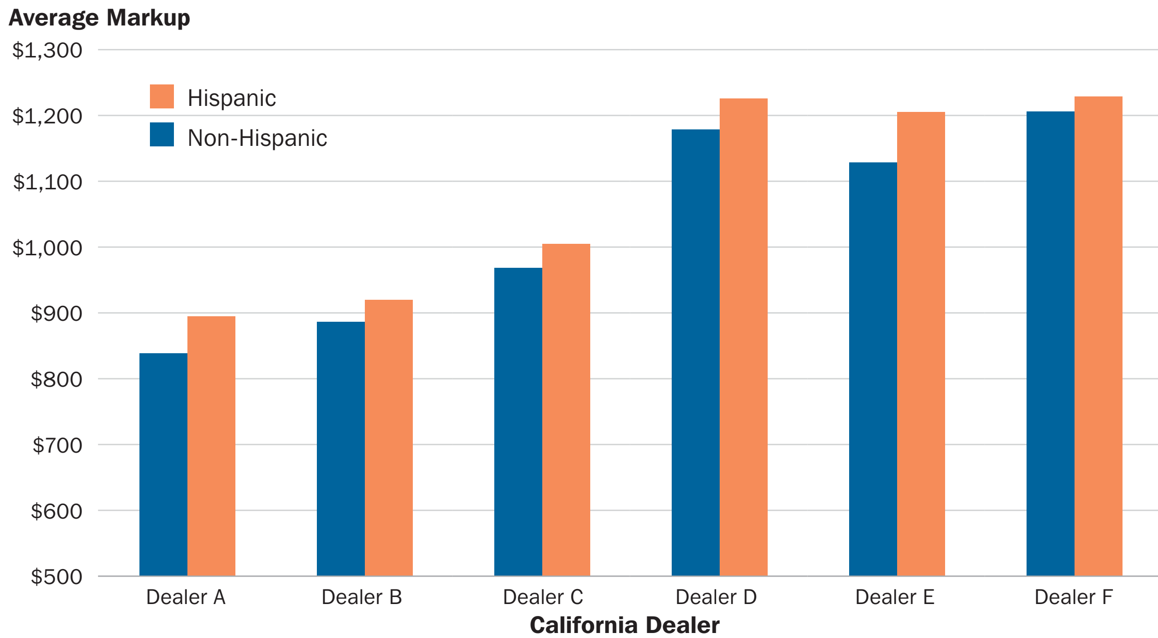
Source: National data set of one provider's add-on products sold in the U.S., 2011.

CHART 14

Hispanic and Non-Hispanic Markups for Service Contracts by Six California Dealers in Dollars



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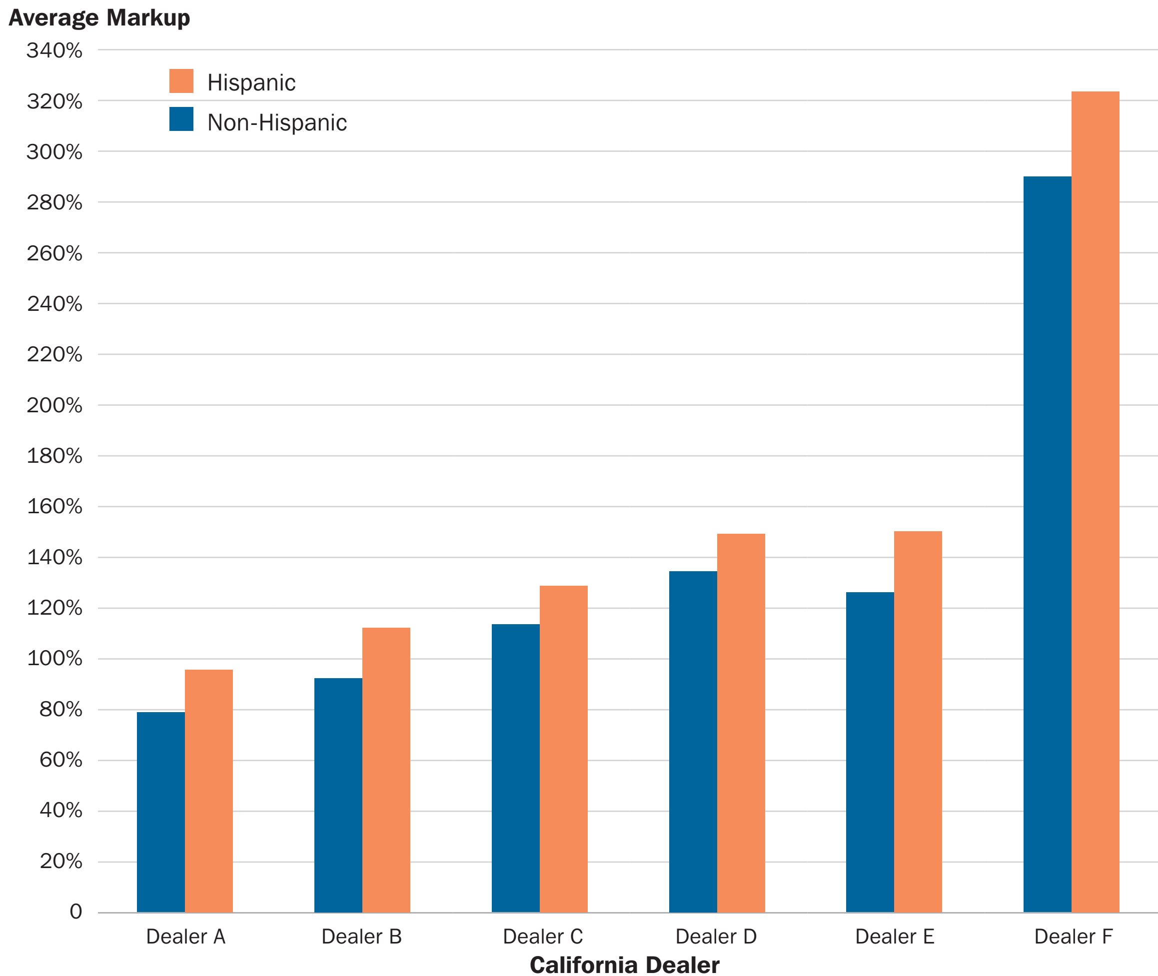
Source: National data set of one provider's add-on products sold in the U.S., 2011

We also see disparities when we look at the data by dealer. The next two charts show six dealers in California with a large number of Hispanic consumers (see Charts 14 and 15) and for which difference between Hispanics and non-Hispanics for both markup amount and markup percentage is statistically significant. In all cases where both are statistically significant, absolute and percentage markups are higher for Hispanics.

CHART 15

Hispanic and Non-Hispanic Markups for Service Contracts by Six California Dealers by Percentage



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Source: National data set of one provider's add-on products sold in the U.S., 2011.

OTHER PARTIES WITH A ROLE IN PRICING ADD-ON PRODUCTS

The add-on supplier

The amount that the dealer pays for third-party add-ons is set by the third-party supplier. Other than setting the dealer cost, however, these companies exercise very little control over the consumer pricing of add-ons. There are no suggested retail prices or other set pricing.

The add-on companies or their agents sometimes provide training and recommendations regarding pricing policies, but they allow the dealer to make the decisions regarding consumer pricing. The add-on supplier does keep track of the consumer prices charged by dealers. This is at least in part so that the dealer and the add-on supplier can calculate the portion of the consumer's price that each is responsible for refunding if the consumer cancels the purchase of an add-on product.[65]

The finance company

While the third-party suppliers of add-on products exercise almost no control over the price the dealer charges for add-ons, car finance companies do exert control because of their self-interest in reducing defaults and retaining adequate security on the credit they extend.

The vast majority of cars that are financed are financed at the dealership. When a car is financed at a dealership, the extension of credit can be structured in one of two ways. Most commonly, the dealer itself extends credit to the consumer by agreeing to accept installment payments. The consumer signs a retail installment contract agreeing to make payments to the dealer. The dealer then assigns that contract almost immediately to a bank or finance company and the consumer's obligation is then to that assignee.

Less commonly, the dealer arranges a loan directly from a bank or other financing company to the consumer. The lender pays the loan proceeds to the dealer, and the consumer repays the lender. With this financing structure, the consumer's obligation is to the lender from the start.

No matter how the financing is structured, the dealer has to obtain advance approval from the bank or finance company for the terms of the deal. In this report, we use the term "creditor" to describe the bank or finance company in both situations.

HOW AUTO CREDITORS AFFECT PRICING

Potential creditors—banks, credit unions, and finance companies—give dealers rate sheets or other programs that set out the conditions under which they may be willing to finance car sales originated by that dealer. These conditions are often very specific, as the potential creditor wants to ensure that the car buyer is likely to make the scheduled payments. The creditor also wants to make sure that if the buyer does not make the expected payments and the car is repossessed, the value of the car will cover at least a high percentage of the credit extended. The conditions specified in the rate sheets will include the consumer's minimum income and credit score, the maximum amount financed, the permissible age and mileage of the car, and much more. Some creditors that specialize in financing car purchases for consumers with subprime credit scores require certain payment-to-income ratios or debt-to-income ratios. Potential creditors also typically indicate how much they will allow dealers to mark up the interest rate.

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Potential creditors also set limits on the price the consumer is charged for add-ons. These limits reflect the creditor's real self-interest. Because most add-ons have little value to the consumer and almost no value to any purchaser of a repossessed car, they represent an amount the creditor is essentially lending with no real collateral. These excessive costs can also make it more likely that the car buyer will default, as the consumer's monthly payment will be higher to cover the add-on. Both outcomes can harm creditors.[66]

Usually, creditors set limits by specifying the maximum loan to value (LTV) ratio the creditor will accept. The amount financed is inflated by the cost of valueless add-ons. Creditors typically must allow some level of price inflation because if they don't, the dealer will use a different finance company that allows them to have more expensive add-ons for a larger dealer profit. At some point, however, the add-ons inflate the financed amount too high above the value of the car and the creditor may refuse to finance the deal. Some creditors require that the LTV fall within a certain range both when the purchase of just the car is considered, and when both the car and the add-ons are considered. These are referred to as the front end and back end LTVs. Creditors also often have specific limits for add-ons, such as caps on the price of GAP or service contracts or caps on the price of the total of add-ons.

While creditors are cautious about add-ons, several trends have increased their willingness to allow high-priced add-ons. First, federal challenges have limited how much creditors are willing to offer dealers on interest rate markups.[67] Simultaneously, there has been an increase in the desirability of auto finance as an investment because it offers high rates and relatively low defaults, resulting in more and more potential creditors competing to finance car sales for dealers.[68] Since there are new limits on how effectively they can compete for dealers' business with interest rate markups, many have been forced to compete with more permissive rules about add-ons and LTVs. This trend of increasing LTVs due in part to add-ons has been noted not only by those in the industry but even by the Office of the Comptroller of the Currency (OCC).[69]

The limits that creditors set can have a real impact on what happens to consumers. We examined the data to see if dealers marked up add-ons more for transactions financed by particular creditors, which would suggest that some creditors allowed larger markups for the add-ons. The nature of the data set only allowed analysis of transactions by creditors in Ohio.[70]

Examining Auto Creditor Market Share in Ohio

Charts 16 and 17 look at which creditors financed car sales in Ohio in which a GAP product in our data set was sold. As chart 18 shows, there are many auto creditors active in the Ohio auto finance market. While some national and regional finance companies have a larger market share, no one is particularly larger than all others.

The relative market share of individual companies changes, though, when we only look at transactions where customers were charged more than $900 for the GAP product (Chart 17). Ally Bank is over-represented when GAP products are over this amount.

CHART 16

Ohio: Creditors' Market Share Where Guaranteed Asset Protection (GAP) Insurance Was Sold*

*Companies with the largest market share are identified.

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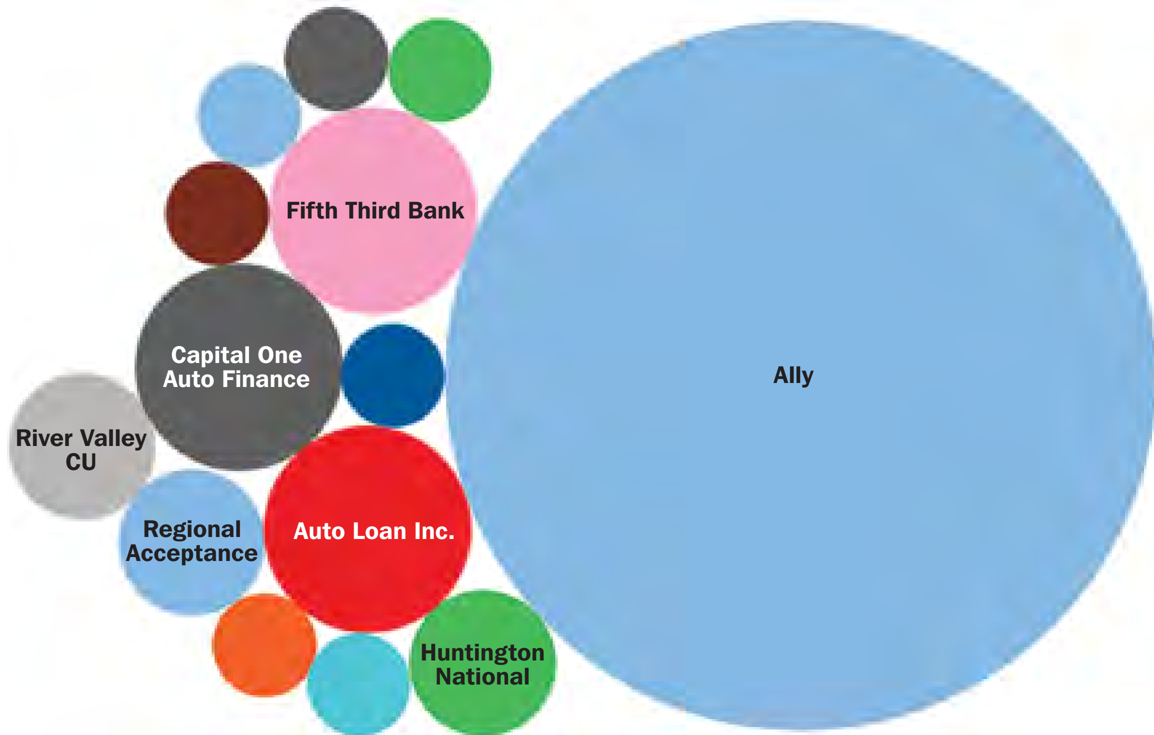
Source: National data set of one provider's add-on products sold in the U.S. 2007–2013, and title information obtained from Ohio county title offices and made available by the Ohio Department of Public Safety and the Bureau of Motor Vehicles.

CHART 17

Ohio: Creditors' Market Share Where Customer Paid More Than $900 for Guaranteed Asset Protection (GAP) Insurance*



*Companies with the largest market share are identified.

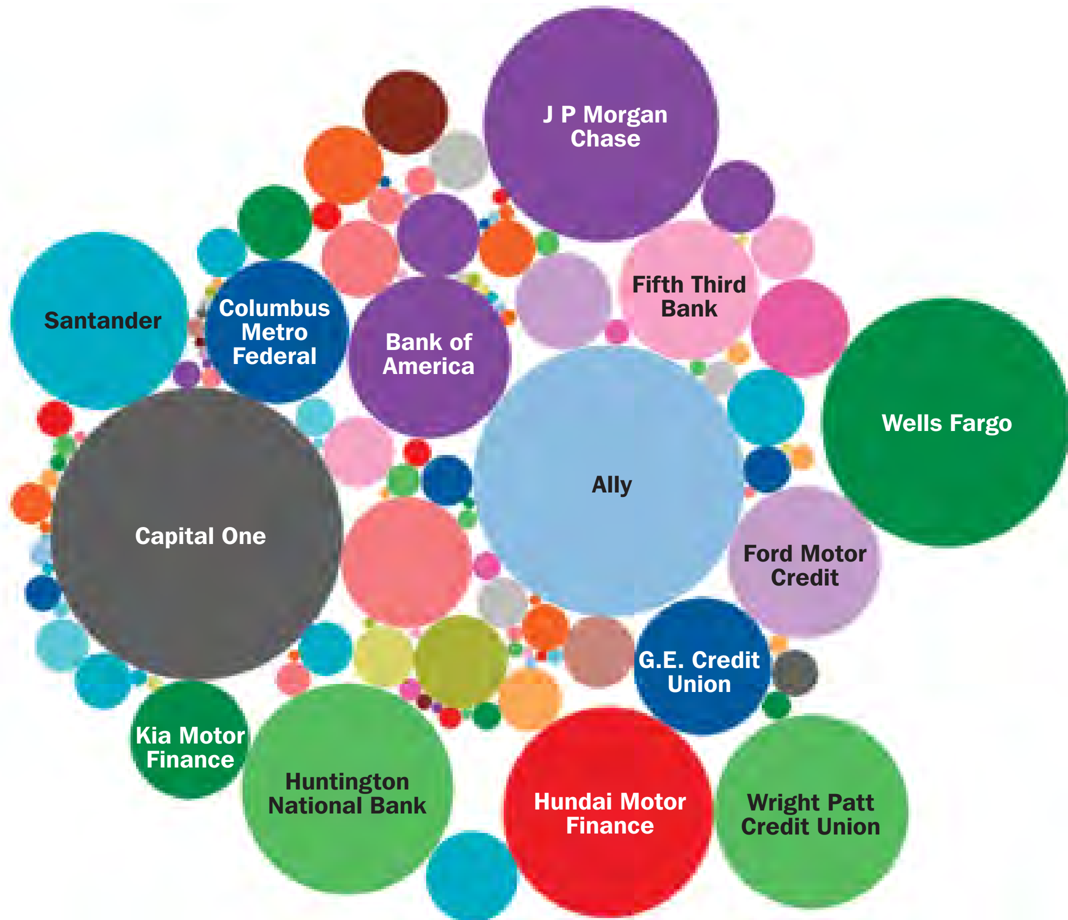
©National Consumer Law Center, 2017

Source: National data set of one provider's add-on products sold in the U.S. 2007–2013, and title information obtained from Ohio county title offices and made available by the Ohio Department of Public Safety and the Bureau of Motor Vehicles.

Just because Ally financed more car sales where the GAP cost was high does not necessarily mean that the dealers' markups were also high. Theoretically, the dealers whose sales Ally financed may have been selling more expensive GAP products, and marking them up no more than other dealers. However, the data shows that this is not the case: Ally not only financed a disproportionate share of deals that included high-priced GAP products, but also financed a disproportionate share of deals that included a high markup for the GAP product. Ally financed just 10% of the deals where the dealer cost for the GAP product was between $150 and $250 (see chart 18), but it financed 73% of those same deals where in the consumer's price exceeded $900 (see chart 19). Indeed, only two other creditors financed *any* such deals.

CHART 18

Ohio: Creditors' Market Share Where Dealer Cost of Guaranteed Asset Protection (GAP) Insurance Was $150–$250*



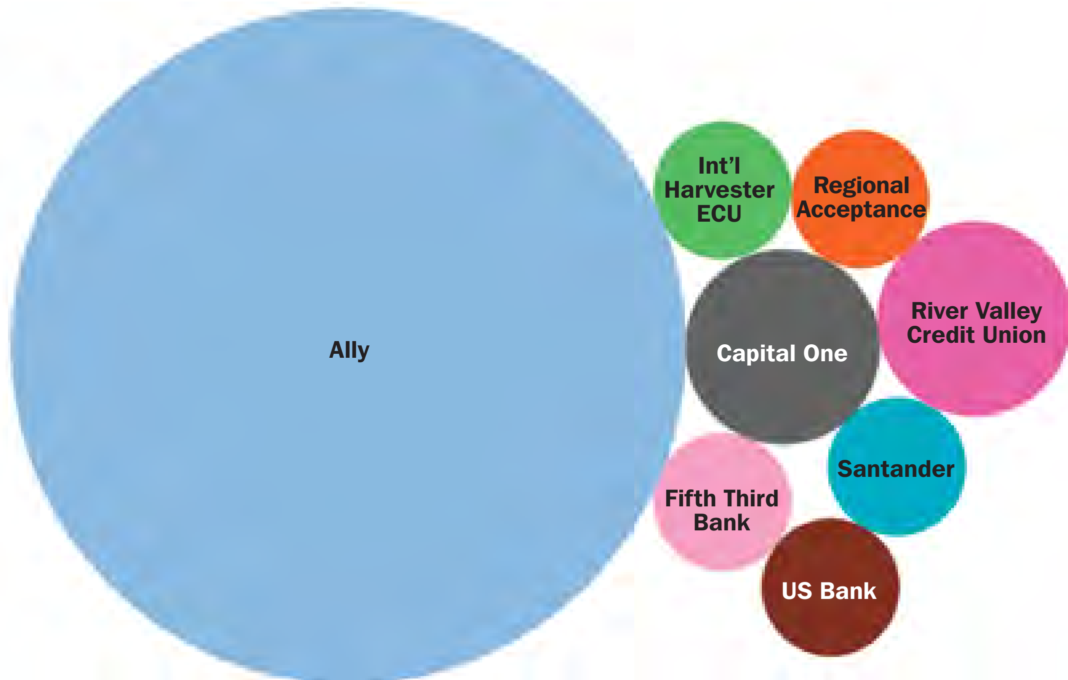
*Companies with the largest market share are identified.

©National Consumer Law Center, 2017

Source: National data set of one provider's add-on products sold in the U.S., 2007–2013, and title information obtained from Ohio county title offices and made available by the Ohio Department of Public Safety and the Bureau of Motor Vehicles.

CHART 19

Ohio: Creditors' Market Share Where Dealer Cost of Guaranteed Asset Protection (GAP) Insurance Was $150–$250 and Customer Price Exceeded $900



©National Consumer Law Center, 2017

Source: National data set of one provider's add-on products sold in the U.S., 2007–2013, and title information obtained from Ohio county title offices and made available by the Ohio Department of Public Safety and the Bureau of Motor Vehicles..

RECOMMENDATIONS

Existing practices in the sale of add-on products result in high—sometimes extraordinarily high—markups and inconsistent pricing. Inconsistent pricing is unfair to all consumers, and also leads to discriminatory pricing for Hispanics and very likely for other minorities. Current practices also lead to excessively high loan to value ratios, saddling consumers with negative equity and creditors with unnecessary risk. The current pricing practices and lack of transparency distort the market and force dealers who would rather compete on car price and quality to instead follow the practices of dealers who rely on the F&I office and opaque and secretive pricing for their profits. The following recommendations address these problems.

The origin of many of the problems with add-on products is that there are no posted or ticketed prices for the products. Consumers should be able to see the price of add-ons *before* negotiating to purchase a vehicle.

Require Transparency in Pricing

The starting point for addressing these issues should be transparent pricing. The origin of many of the problems with add-on products is that there are no posted or ticketed prices for the products. Consumers should be able to see the price of add-ons *before* negotiating to purchase a vehicle. Posted pricing would allow the market for add-ons to operate more efficiently and encourage market forces to address some of the most egregious abuses we see in pricing. New York City has successfully implemented a city-wide ordinance that requires the price of both the car and any add-on products offered with the car to be posted on each car offered for sale by a used car dealer in the city.[71]

We recommend that all new and used vehicle dealers be required to post the available add-ons and their prices on each car in the lot along with the price of the car itself. To prevent the dealer from reintroducing non-transparency by offering discounts to some customers but not others, the prices for the add-on products must be non-negotiable.

In theory, an alternative would be to post the prices of add-on products in the dealership office. However, the price of some add-on products, such as service contracts and GAP, depends on the price and other characteristics of the individual car being sold. Some add-ons will not be available for particular cars. Also, prices posted inside the dealership would not be visible to those browsing on the lot and might not be seen when the consumer comes inside. Because of these complexities, posting prices on each individual car is preferable. Posting the prices on a general basis for all vehicles offered by the dealership is probably not even feasible, as a price list would likely be so voluminous and complex that it could not even be posted in any readable form.

Making the pricing of add-ons transparent by posting the prices on the car would go a long way toward solving problems with add-on products. It would prevent "opportunity pricing" or "sucker-pricing," and would probably deter discriminatory pricing as

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well. Anyone who bought a particular vehicle would pay the same price for the add-ons for that vehicle.

Root out Discrimination in Pricing

Our report suggests that troubling discriminatory pricing is occurring in the sale of add-on products. It is imperative that retailers such as car dealers not charge different customers different prices because of their race or ethnicity.

Transparency in pricing—our first recommendation—would go a long way toward ending discriminatory pricing. However, dealers could still price add-ons inconsistently from car to car, and could steer particular consumers to those cars. Dealers could also make a "harder" push for add-on sales or for particular add-ons for some targeted consumers. Moreover, transparency in pricing is not yet the law in most jurisdictions, but is only our recommendation. For these reasons, we recommend several additional steps.

A fundamental obstacle to rooting out discrimination in pricing is that, under current law, this type of discrimination is extremely difficult to detect. This is because Regulation B, implementing the Equal Credit Opportunity Act (ECOA), prohibits non-mortgage lenders from asking about or documenting a consumer's race or national origin.[72] By contrast, for home mortgage transactions federal law *requires* lenders to ask about and document the applicant's race and ethnicity.[73]

This rule was adopted in an effort to stop creditors from discriminating on these bases. Unfortunately, in auto sales and finance, where the person with the discretion to set the consumer's interest rate or the price of the car or add-on is sitting across the desk from the consumer, the policy does not prevent discrimination. Rather, Regulation B makes it difficult for enforcement entities and even the creditors themselves[74] to determine if discrimination is occurring. Perversely, this is counter to the purpose of the ECOA.[75] As the U.S. Government Accountability Office and others have noted, requiring collection and reporting of such data could actually assist in stopping discrimination.[76]

We recommend two steps to root out discrimination in pricing.

1. **Regulation B should be amended to require documentation of the customer's race or national origin for non-mortgage credit transactions.** Regulation B's restriction is *not* required by the ECOA itself, so this change could be adopted by agency action.[77] If discrimination remains hidden, it will not be possible to end it.
2. **State and federal enforcement authorities should investigate discrimination in pricing of add-on products.** Our ability to evaluate discrimination was limited by the fact that we did not have customer addresses, so could not geocode. In addition, the data set we analyzed includes sales of only one provider's add-on products. State and federal enforcement authorities typically have the ability to issue administrative subpoenas to obtain a wide range of data once they have reason to believe that illegal practices are occurring. These authorities should obtain more detailed data about pricing, analyze it for discriminatory patterns, and bring enforcement actions if discrimination is shown.

Tips for Consumers Considering Purchasing Auto Add-On Products

The current lack of transparency in pricing for auto add-on products makes it difficult or impossible for consumers to protect themselves. The current lack of transparency in pricing for add-on products makes it difficult or impossible for consumers to protect themselves. Until state and federal policymakers and enforcement authorities reform this market, consider the following tips when purchasing a car from a dealer.

- **Avoid buying add-on products when buying a car.** Very often, these products are overpriced and of low value.
- **If you want to buy Guaranteed Asset Protection (GAP) insurance, check with your insurance agent and your bank or credit union prior to purchasing.** Many insurance agents and some banks and credit unions provide GAP insurance directly to consumers, typically at more reasonable prices than dealer pricing.
- **Finance the car directly through a credit union, bank, or other lender, if possible.** Consumers are generally better off if they arrange financing for a car purchase from their own bank or credit union. Make sure to pin down the cash price of the car from the dealer *before* disclosing your financing arrangements—otherwise the dealer might increase the cash price. There can, however, be two advantages of having the dealer arrange the financing:
  1) when the dealer arranges the financing, then an FTC rule makes the creditor responsible, along with the dealer, for deception or breach of warranty by the dealer; and
  2) a few customers may be eligible for incentive financing (such as 0%) from the manufacturer that other lenders cannot match.

For more information about service contracts, see *Consumer Reports,* "Skip the vehicle service contracts" (July 27, 2011), *available at* http://www.consumerreports.org/cro/news/2011/07/don-t-buy-a-troublesome-automotive-service-contract/index.htm, and the FTC brochure "Auto Service Contracts and Warranties" (August 2012), *available at* https://www.consumer.ftc.gov/articles/0054-auto-service-contracts-and-warranties.

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CONCLUSION

As this report shows, average markups by dealers for add-on products are high, and sometimes extraordinarily high, averaging over 1,000% at some dealerships. These markups are higher than comparable markups of retail goods and insurance products.

Not only are markups for add-ons high, but there is also a great deal of inconsistency in pricing of add-on products. Prices not only vary from dealer to dealer, but some dealers charge different prices to different customers for the exact same product—even for the exact same product, with the same dealer cost, purchased on the same day.

The practice of charging different prices to consumers for the same product that costs the dealer the same amount can lead to discrimination. Our analysis finds that dealers, on average, marked up service contracts more when selling to Hispanics than to non-Hispanic buyers. It is likely that a greater disparity would be revealed if we could compare Hispanics to non-Hispanic whites or if we could measure pricing differences between whites and blacks or other minority groups. Since these differences appear in the retail pricing of add-on products, which are not determined by credit scores, they cannot be explained by differences in buyers' credit scores.

Add-on pricing practices are largely within the discretion of individual dealers, but banks, credit unions, and finance companies that finance vehicle purchases for consumers can and do limit the size of add-on markups. Our analysis shows that some creditors place firmer limits on dealers than others.

The following recommendations, if implemented, would help protect car buyers from the abuses described in the report.

- **Dealers should be required to post the available add-ons and their prices on each car in the lot, along with the price of the car.** To prevent the dealer from reintroducing non-transparency by offering discounts to some customers but not others, the prices for the add-on products must be non-negotiable.
- **To root out pricing discrimination, the federal Equal Credit Opportunity Act regulations should be amended to require documentation of the customer's race or national origin** for non-mortgage credit transactions, as is currently required for home mortgage transactions. If discrimination remains hidden, it will not be possible to end it.
- **State and federal enforcement authorities should investigate discrimination in pricing of add-on products and bring enforcement actions** against a dealer if discrimination is shown. The Consumer Financial Protection Bureau, the Federal Trade Commission, the Federal Reserve Board, and state attorneys general all have authority in this area.

APPENDIX
THE DATA USED FOR ANALYSIS IN THIS REPORT

Add-on Data

This analysis is based on data regarding the sale of vehicle add-on products from one major add-on provider from September 2009 through June 2015. The data set includes information from approximately 1.8 million car sale transactions, resulting in the sale of almost three million add-on products, spanning over 3,000 car dealers from every state and the District of Columbia.

The data set includes transaction-level information about the sale of individual add-on products during this time period. The process of converting the data to a format that could be analyzed using statistical analysis programs involved some random data loss, which we estimate at approximately 5% of the original data set.

We were able to verify the accuracy of individual data points through several sources including litigation, newspaper articles, bankruptcy filings, and other independent sources. Our review of the data did reveal a very small number of customer charges that we believe to be potentially inaccurate, likely resulting from error in the original entry of sale information at the dealership. We believe at least some of these isolated outliers may be due to the failure to include a decimal point at the time of the data entry. The number of potentially inaccurate customer charges was small enough not to alter our conclusions, but in order to avoid overstating the markups, we treated all instances where customer charges for add-on products were greater than $10,000 as errors and excluded them. Extensive spot-checking of transactions with a consumer charge above and below $10,000 suggests that this is a conservative threshold.

We also excluded transactions regarding add-ons for recreational vehicles and for transactions outside the United States.

Lienholder and Other Data for Ohio

The Ohio Department of Public Safety maintains a public website for car title information. The site is publicly searchable based on Vehicle Identification Number (VIN). The website provides information including total purchase price, title issue date, and sometimes lienholder information.

This Department posts this information for the most recent transaction involving a particular car. For example, if a car was sold as a new car in Ohio, and then later sold as a used car, the Department's website will show more detailed information for only the later sale. Using this website, we were able to obtain information regarding the vehicle sale transactions from a number of Ohio transactions by matching the VIN and the Ohio

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title issue date when the title issue date was within 60 days after the sale date found in the add-on data. Using this process we were able to identify the lienholder information for over 23,000 Ohio transactions for the years analyzed in this report.

Rounding

Throughout this report we rounded monetary amounts to the nearest dollar.

ENDNOTES

1. The facts we describe come from the pleadings and briefings filed in this matter.
2. Raj Chetty and Nathaniel Hendren, *The Impacts of Neighborhoods on Intergenerational Mobility: Childhood Exposure Effects and County-Level Estimates*, Harvard University and NBER May 2015, available at http://scholar.harvard.edu/files/hendren/files/nbhds_paper.pdf.
3. See, Elizabeth Roberto, *Commuting to Opportunity: The Working Poor and Commuting in the United State,* Brookings Institute, February, 2008, available at https://www.brookings.edu/wp-content/uploads/2016/06/0314_transportation_puentes.pdf.
4. National Consumer Law Center, "New Ways to Understand the Impact of Auto Finance on Low-Income Families," available at http://www.nclc.org/images/pdf/car_sales/ibImportance_AutoFinanceFINAL53116.pdf.
5. Raj Date and Brian Reed, "AUTO RACE TO THE BOTTOM: Free Markets and Consumer Protection in Auto Finance," Cambridge Winter, November 16, 2009.
6. Delvin Davis and Joshua M. Frank, "UNDER THE HOOD: Auto Loan Interest Rate Hikes Inflate Consumer Costs and Loan Losses," Center for Responsible Lending, April 19, 2011, available at http://www.responsiblelending.org/other-consumer-loans/auto-financing/research-analysis/Under-the-Hood-Auto-Dealer-Rate-Markups.pdf.
7. For more information see: https://www.nclc.org/litigation/case-index-closed-cases.html#auto.
8. See e.g., Ian Ayers, Expert Report, June 2004, available at http://www.consumerlaw.org/issues/cocounseling/content/AHFCIanAyresReportExhibits.pdf.
9. Cohen, Mark A. "Imperfect Competition in Auto Lending: Subjective Markups, Racial Disparity, and Class Action Litigation." Available at http://ssrn.com/abstract=951827.
10. See CFPB Bulletin at http://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-to-hold-auto-lenders-accountable-for-illegal-discriminatory-markup/. AutoNation Continues Living Above $1,600 Per-Copy in Q3, F&I and Showroom, November 1, 2016.
11. AutoNation Continues Living Above $1,600 Per-Copy in Q3, F&I and Showroom, November 1, 2016.
12. Group 1 Automotive Chooses Margin Over Volume in Q3, F&I and Showroom, October 26, 2016.
13. See, e.g. Hannah Lutz, "Sales of Service Contracts and F&I add-ons Critical," *Automotive News*, December 14, 2015, available at http://www.autonews.com/article/20151214/FINANCE_AND_INSURANCE/312149986/sales-of-service-contracts-and-f%26i-add-ons-critical (citing data from one product provider showing that dealer profit from add-on sales constituted 63% of total F&I profit for its dealer customers).
14. "More Car Shoppers Are Underwater on Their Trade-Ins Than Ever Before," *Edmonds*, November 14, 2016, available at https://www.edmunds.com/about/press/more-car-shoppers-are-underwater-on-their-trade-ins-than-ever-before-reports-edmundscom.html (noting that, in 2016, 32% of consumers buying new cars had trade-ins on which they owed more than the car was worth, on average $4,832 more and 25% of consumers buying used cars had trade-ins on which they owed more than the car was worth by an average of $3,635).
15. See the discussion of why creditors finance vehicles for more than they are worth in the section "How Auto Creditors Affect Pricing" below.
16. *F&I Best Practices and Performance Metrics*, Zurich American Insurance Company, 2012.
17. See Jamie LaReau, "Preloading products boosts per-car F&I sales," *Automotive News*, December 26, 2012.
18. Dealers track their penetration rate or the number of a particular add-on they sell as a

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portion of their overall vehicle sales or some subset of their overall vehicle sales. Some dealers exclude particular types of transactions such as fleet sales or cash sales from the calculation of their penetration rate.

19. *State of the Industry Report 2012*, NADA p.10; see also Gregory Arroyo, "Tracking F&I Performance, F&I and Showroom," January 2012.
20. "Tracking F&I Performance," F&I and Showroom available at http://www.fi-magazine.com
21. "Zurich Elite Performance Account Benchmarks 2012," cited in *F&I Best Practices and Performance Metrics*, Zurich American Insurance Company, 2012.
22. The increase in the retail price over the wholesale price can be expressed either as a markup or as a margin. Markup is the ratio of gross profit to the wholesale price while margin is a ratio of gross profit to the retail price. For example, a product that costs a retailer $4 may be sold for $5. The $1 by which the retail price exceeds the wholesale price can be expressed as a 25% markup or a 20% margin. Throughout this report we use markup percentages. Where our source expressed the percentage as a margin, we have converted it to a markup.
23. Alsin, Arne "Retail markups and the power of Amazon" Marketwatch.com, Sept. 15, 2012, available at http://blogs.marketwatch.com/great-columnist/2012/10/15/retail-markups-and-the-power-of-amazon
24. Ian Johnston, "What Is the Percent of Profit Margin That Retailers Expect From Jewelry?," *Houston Chronicle*, available at http://smallbusiness.chron.com/percent-profit-margin-retailers-expect-jewelry-73996.html.
25. AnnaMaria Andriotis, 10 Things Furniture Stores Won't Tell You, Marketwatch.com, Feb 4, 2011, available at http://www.marketwatch.com/story/10-things-furniture-stores-wont-tell-you-1296850666159
26. See *Understanding the Grocery Industry* The Reinvestment Fund, Sept 30, 2011, available at https://www.cdfifund.gov/Documents/Understanding%20Grocery%20Industry_for%20fund_102411.pdf; *See also* Walter Johnson, "The Industry Standard for Gross Margin in Groceries" available at http://smallbusiness.chron.com/industry-standard-gross-margin-groceries-38121.html
27. Arne Alsin, "Retail markups and the power of Amazon" Marketwatch.com, Sept. 15, 2012, available at http://blogs.marketwatch.com/great-columnist/2012/10/15/retail-markups-and-the-power-of-amazon/
28. Doug DeMuro, "Buying a Car: How Much Do Dealers Mark Up a Car Over the Invoice Price?," *Autotrader*, August 2014, available at http://www.autotrader.com/car-news/buying-a-car-how-much-do-dealers-mark-up-a-car-over-the-invoice-price-228247.
29. See *How The Auto Industry has Disguised Dealer Incentive Dollars as Dealer Cost Dollars by Moving Them From the Msrp/Sticker Price Into the Invoice Price for Over 18 Years*, available at http://fightingchance.com/addon04.php.
30. National Automobile Dealers Association (NADA) Data 2015 *Annual Financial Profile Of America's Franchised New Car Dealerships*, available at https://www.nada.org/WorkArea/DownloadAsset.aspx?id=21474839497. The study found a gross margin of 3.3% for new cars and 7.9% for used cars, which are the mathematical equivalent of markups of 3.4% and 8.6%, respectively. See footnote 24 explaining the difference between margin and markup.
31. An 8.6% markup for used cars is lower than the markup suggested by the typical percentage difference between the wholesale or trade-in price for a car found in a standard pricing guide and the retail price listed in the guide for the car. For example, in early 2017, the trade-in value of a base model 2012 Honda Accord with 60,000 miles in good condition is $7,960, according to the Kelly Blue Book. For the same vehicle, the "Fair Purchase Price" from a dealer is listed as $11,697. This would be a gross markup of $3,737 or 47 percent. For dealers

selling used cars that they have taken in as a trade-in, the trade-in amount they gave the consumer plus their costs in preparing the car for resale would be the wholesale cost for the car when they sell it to a new consumer. Accordingly, using the example above, the true markup on the car would be less than 47% as there would be some costs to the dealer to prepare the trade-in vehicle for retail sale. Dealers may also attribute some of the difference between the acquisition cost at trade-in and the retail sale to a subsequent customer as a gain on the trade-in transaction, from acquiring the trade-in at a low price, rather than as part of the markup on the subsequent sale.

32. Many add-on products were previously regulated as insurance, but in recent years the industry has obtained legislation in a number of states to exempt them from insurance regulation.
33. Nevertheless, the person selling the insurance may have discretion as to which insurance company's policy or which specific policy of an insurer will be sold to a specific individual.
34. See Julia Angwin, "California to Investigate Racial Discrimination in Auto Insurance Premiums," *ProPublica*, May 19, 2017, available at https://www.propublica.org/article/california-to-investigate-racial-discrimination-in-auto-insurance-premiums , and Douglas Heller and Michelle Styczynski, *Major Auto Insurers Raise Rates Based on Economic Factors* Consumer Federation of America, June 2016 (detailing how low-income drivers are charged higher premiums than those with higher incomes based upon economic factors that are unrelated to driving safety), available at http://consumerfed.org/wp-content/uploads/2016/06/6-27-16-Auto-Insurance-and-Economic-Status_Report.pdf .
35. See Nolan Hester, "How much is your insurance agent making off you?," Insure.com, April 2, 2010, available at http://www.insure.com/car-insurance/insurance-agent-commissions.html, quoting Wesley Bissett of the Independent Insurance Agents & Brokers of America (IIABA).
36. Technically, the loss ratio used for evaluating rates is incurred claims divided by earned premiums.
37. See National Association of Insurance Commissioners Report on Profiability By Line By State, IEE Percent of Direct Premiums Earned Losses Incurred, http://www.naic.org/prod_serv/PBL-PB-16.pdf.
38. F&I Showroom, Volume 14, Issue 9, September 2011, p. 31.
39. This number may be slightly low in that certain claims have yet to be paid on the policies reflecting the $5 billion in dealer profit.
40. Insurance rates are calculated based on claims, claim settlement expenses, selling expenses, general and administrative expenses, and profit. We only know two elements from the advertisement—claims ($600 million) and selling expenses ($5 billion in profits paid to car dealers), so the total paid by consumers will be significantly more than $5.6 billion. Even if no insurance company is involved in the provision of these products, there must be some administrative expenses for tracking sales and claims, and the seller is surely intending to make a profit.
41. See Credit Life Insurance and Credit Accident & Health Insurance Experience 2011-2015, National Association of Insurance Commissioners, 2016 available at http://www.naic.org/prod_serv/CRE-ZB-17.pdf (showing that, from 2005 through 2014, annual credit life insurance loss ratios ranged from 41.5% to 47.7% and credit life loss ratios from 34.93% to 45.23%).
42. National Consumer Law Center, *Consumer Credit Regulation* § 6.2.3.1 (2d ed. 2015), updated at www.nclc.org/library (including charts compiled by Birny Birnbaum, Center for Economic Justice, from Credit Insurance Experience Exhibit (CIEE) to Statutory Annual Statements submitted by insurers to the National Association of Insurance Commissioners (NAIC)).
43. CONSUMER CREDIT INSURANCE MODEL REGULATION, 1994 National Association of Insurance Commissioners, § 5, *available at* http://www.naic.org/store/free/MDL-370.pdf . The drafters suggested that once a 60% loss ratio had been implemented the cap on compensation

might no longer be needed.

44. The average pay for an F&I manager in 2012 was $128,400. 2013 NADA Dealership Workforce Study Industry Report.
45. Jamie LaReau, "Group's F&I mantra: Sell big or bow out, If managers miss targets, trained replacements wait in the wings," *Automotive News* July 8, 2013, quoting Steve VanGorder.
46. Jamie LaReau, "Group's F&I mantra: Sell big or bow out, If managers miss targets, trained replacements wait in the wings," *Automotive News* July 8, 2013, quoting Steve VanGorder.
47. Mark Gokavi, "Jeff Schmitt Auto Group accused of 'deceptive' business practices," *Dayton Daily News*, August 5, 2013.
48. Mark Gokavi, "Jeff Schmitt Auto Group accused of 'deceptive' business practices," *Dayton Daily News,* August 5, 2013, stating that "The Ohio Attorney General's Office logged 24 complaints against the Jeff Schmitt Auto Group from Jan. 1, 2012 to April 2013. These complaints are recorded independently of any lawsuits. Only one other area dealer came close with 17 complaints. Most dealers had zero to one complaint each."
49. Gil Van Over, "Pricing Guidelines for Fun and Profit," *Dealer Magazine*, July 2010.
50. Ronald Reahard, "10 More Ways To Help Your Dealers Sell More Products!," *Agent Entrepreneur Magazine*, January 19, 2012.
51. The cause for these variations from dealer to dealer is not always clear but may reflect additional commissions given to agents who sometimes act as middlemen between the dealer and the add-on provider. It could also reflect volume pricing.
52. See, e.g., Ian Ayers, Expert Report, June 2004, available at http://www.consumerlaw.org/issues/cocounseling/content/AHFCIanAyresReportExhibits.pdf; Cohen, Mark A. "Imperfect Competition in Auto Lending: Subjective Markups, Racial Disparity, and Class Action Litigation." Available at http://ssrn.com/abstract=951827; and CFPB enforcement activities at http://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-to-hold-auto-lenders-accountable-for-illegal-discriminatory-markup/. *See also* Delvin Davis, *Non-Negotiable: Negotiation Doesn't Help African Americans and Latinos on Dealer-Financed Car Loans*, Center for Responsible Lending, January 2014, available at http://www.responsiblelending.org/other-consumer-loans/auto-financing/research-analysis/CRL-Auto-Non-Neg-Report.pdf (documenting self-reinforcing nature of discriminatory pricing: If minority customers are charged higher prices at many dealers, then F&I managers may have less reason to negotiate with them as they may be forced to accept higher prices out of necessity).
53. 12 C.F.R. § 1002.5(b), 12 C.F.R. § 1002.12(a), (b).
54. "It is the purpose of this Act to require that financial institutions and other firms engaged in the extension of credit make that credit equally available to all creditworthy customers without regard to [sex, marital status, race, religion, national origin and age]." Equal Credit Opportunity Act, Pub. L. No. 93-495, S 502, 88 Stat. 1521, 1521 (1974).
55. U.S. Government Accountability Office, *Fair Lending: Race and Gender Data Are Limited for Nonmortgage Lending,* GAO-08-698 (June 2008).
56. See "Using publicly available information to proxy for unidentified race and ethnicity, A methodology and assessment," Consumer Financial Protection Bureau, Summer 2014, available at http://files.consumerfinance.gov/f/201409_cfpb_report_proxy-methodology.pdf (describing the use of Bayesian Improved Surname Geocoding).
57. https://consumercomplianceoutlook.org/outlook-live/2013/indirect-auto-lending/
58. Both the CFPB's analysis and industry-sponsored critiques of the CFPB's analysis find that surname analysis alone without geocoding is much better suited for creation of a proxy for Hispanics than for African Americans. See "Using publicly available information to proxy for unidentified race and ethnicity, A methodology and assessment," Consumer Financial

Protection Bureau, Summer 2014, available at http://files.consumerfinance.gov/f/201409_cfpb_report_proxy-methodology.pdf and Arthur P. Baines and Dr. Marsha J. Courchane, *Fair Lending: Implications for the Indirect Auto Finance Market*, Charles River Associates, November 19, 2014, prepared for the American Financial Services Association, available at https://www.crai.com/sites/default/files/publications/Fair-Lending-Implications-for-the-Indirect-Auto-Finance-Market.pdf.

59. See Mark A. Cohen, Ph.D., *Report on the Racial Impact of AHFC's Finance Charge Markup Policy*, June 30, 2004, available at https://www.nclc.org/images/pdf/litigation/closed/ahfc-cohenreportappendices-a-c.pdf.
60. While our data is arguably a "complete" population of transactions for which we arguably might not need to test for sampling error since it comes from one add-on provider over a number of years, a number of factors led us to treat the data otherwise. Due to possible limitations of our data set, we cannot confirm with certainty that this is the complete set of data from the single provider, and in any case it is only a portion of the larger third party add-on market. Additionally we were looking only at data from one period of time, which could be considered a sample of add-on pricing data over a longer period. Even if the data was considered a complete population, we wanted to avoid the possibility that the effects we were seeing were the result of simple random chance.
61. We only looked at the states where the p-values were less than .05, an almost universally accepted standard for statistical significance.
62. See Mark A. Cohen, Ph.D., *Report on the Racial Impact of AHFC's Finance Charge Markup Policy*, June 30, 2004, available at https://www.nclc.org/images/pdf/litigation/closed/ahfc-cohenreportappendices-a-c.pdf.
63. Based upon demographic data from Population Distribution by Race/Ethnicity | The Henry J. Kaiser Family Foundation Timeframe: 2015, available at http://www.kff.org/other/state-indicator/distribution-by-raceethnicity/?currentTimeframe=0&sortModel=%7B%22colId%22:%22Location%22,%22sort%22:%22asc%22%7D. The average percentages we state are the unweighted averages. In other words, these percentages represent the average of the percentages in all the specific states without weighting them for population. For the 34 states for which only one or neither measure was statistically significant, the African American population averaged 11.25% while the Hispanic population averaged 9.94%. For the 14 states for which the differences in both percentage and absolute markup which were statistically significant, the Hispanic population averaged 17.5% while the African American population averaged 9.71%.
64. The possibility of dealerships charging a particular minority a lower amount is not unheard of. See the Justice Department's Settlement of alleged auto lending discrimination in the case of Union Auto Sales, Inc., where the dealer allegedly charged higher interest rate markups on car loans to non-Asians than to similarly-situated Asians. See: https://www.justice.gov/opa/pr/justice-department-settles-lawsuit-alleging-auto-lending-discrimination-los-angeles.
65. David Segal, "The New Car With Mystery Add-Ons," *The New York Times*, Dec. 25, 2010 (describing how a consumer did not receive a refund for add-ons despite the dealer having received a check for a portion of the add-on from the add-on company), available at http://www.nytimes.com/2010/12/26/your-money/26haggler.html. Refunds for canceled contracts are calculated under several different formulas, which are sometimes dictated by state regulation. *See, e.g.*, Cal. Civ. Code § 1794.41. For a helpful discussion of California cancelation rebates and other service contract related issues see The California Insurance Commissioner's Guide to Automobile Service Contracts, Extended Warranties and Other Repair Agreements,

available at http://www.insurance.ca.gov/01-consumers/105-type/95-guides/01-auto/servcontextwar.cfm. Because the majority of the price paid by the consumer goes to the dealer and not the add-on supplier, the add-on company cannot refund consumers directly if a consumer cancels a contract. Instead, the add-on supplier will give the dealer a refund of a portion of the amount that the dealer paid it for the add-on product, with the calculation based on the rebate formula. Then the dealer is the entity that is tasked with refunding the money to the consumer. For this reason, add-on companies track consumer prices even though they are not generally involved in the setting of prices.

66. Understanding automotive loan charge-off patterns can help mitigate lender risk, Experian Information Solutions, 2012, (finding high loan-to-value ratios predictive of potential charge-offs) available at http://www.experian.com/assets/consumer-information/white-papers/auto-vision-wp.pdf
67. See CFPB Bulletin at http://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-to-hold-auto-lenders-accountable-for-illegal-discriminatory-markup/ .
68. See Natalie Mattila, "Subprime Competition Prompts Pricing Pressures, S&P Says" *Auto Finance News*, September 20, 2016, available at http://www.autofinancenews.net/subprime-competition-prompts-pricing-pressures-sp-says/, also see Jon Marino, "Auto Financing: Wall Street is Turning Out More Car Loans" CNBC, July 15, 2016, available at http://www.cnbc.com/2016/07/15/auto-financing-wall-street-is-turning-out-more-car-loans.html .
69. Semiannual Risk Perspective, Comptroller of the Currency, National Risk Committee, Spring, 2015, available at https://www.occ.gov/publications/publications-by-type/other-publications-reports/semiannual-risk-perspective/semiannual-risk-perspective-spring-2015.pdf ("In the fourth quarter of 2014, the average LTV for used vehicle auto loans was 137 percent. Moreover, advance rates for borrowers across the credit spectrum are trending up, with used vehicle LTVs for subprime borrowers(credit score < 620) averaging nearly 150% at the end of 2014. Sales of add-on products such as maintenance agreements, extended warranties, and gap insurance are often financed at origination. These add-on products in combination with debt rolled over from existing auto loans contribute to the aggressive advance rates.").
70. We obtained lienholder data for over 23,000 Ohio transactions. Over 9,500 of these transactions involved the sale of GAP. 280 had a consumer price for GAP over $900.00. (See Appendix for details).
71. N.Y.C. Admin. Code § 20-271 (Local Laws of the City of New York for the Year 2015, No. 44).
72. 12 C.F.R. § 1002.5(b), 12 C.F.R. § 1002.12(b).
73. 12 C.F.R. § 1003.4(a).
74. Creditors may obtain permission to collect race or ethnic data in limited circumstances for self –testing but it is seldom done.
75. "It is the purpose of this Act to require that financial institutions and other firms engaged in the extension of credit make that credit equally available to all creditworthy customers without regard to [sex, marital status, race, religion, national origin and age]." Equal Credit Opportunity Act, Pub. L. No. 93-495, S 502, 88 Stat. 1521, 1521 (1974).
76. U.S. Government Accountability Office, *Fair Lending: Race and Gender Data Are Limited for Nonmortgage Lending*, GAO-08-698 (June 2008).
77. In the late 1990s the Federal Reserve Board, partly in response to comments by the Department of Justice and the federal financial enforcement agencies, proposed removing the prohibition on seeking information about an applicant's race, color, religion, national origin, and sex for non-mortgage credit products. 64 Fed. Reg. 44,582, 44,586 (Aug. 16, 1999).

New Ways to Understand the Impact of Auto Finance on Low-Income Families

May 2016

Conventional analysis of auto finance tends to ignore the number of families affected and their demographics. It also tends to obscure the rate at which new car financings are originated in comparison to other consumer debt. While economists, policymakers, and others realize the overall role that auto finance plays in the United States' financial landscape, the scale of the impact of auto finance on those with low and moderate income, people of color, and younger people has received less attention. This report looks at existing data in new ways to better understand the true scale of auto finance for low- and moderate-income families.

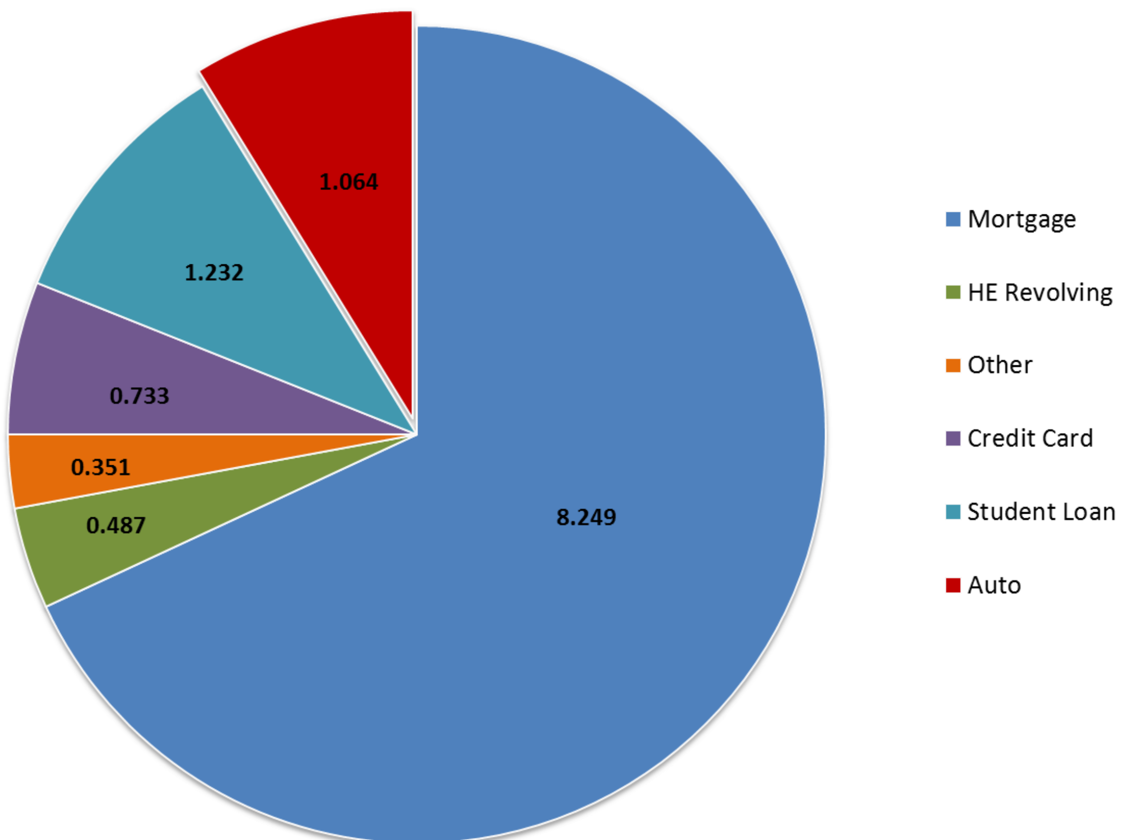
Most decision makers, when trying to understand the role of auto finance in the economy and the extent to which it affects households and particular populations, look at data regarding the total outstanding balance of auto finance. Often this debt is examined in comparison to other large and important consumer finance categories, typically mortgage loans, student loans, and credit card debt.

Delving deeper into publicly available data allows for new insight into the prevalence of auto debt and the extent to which it weighs on vulnerable consumers, particularly low- and moderate-income families.

Conventional Analysis

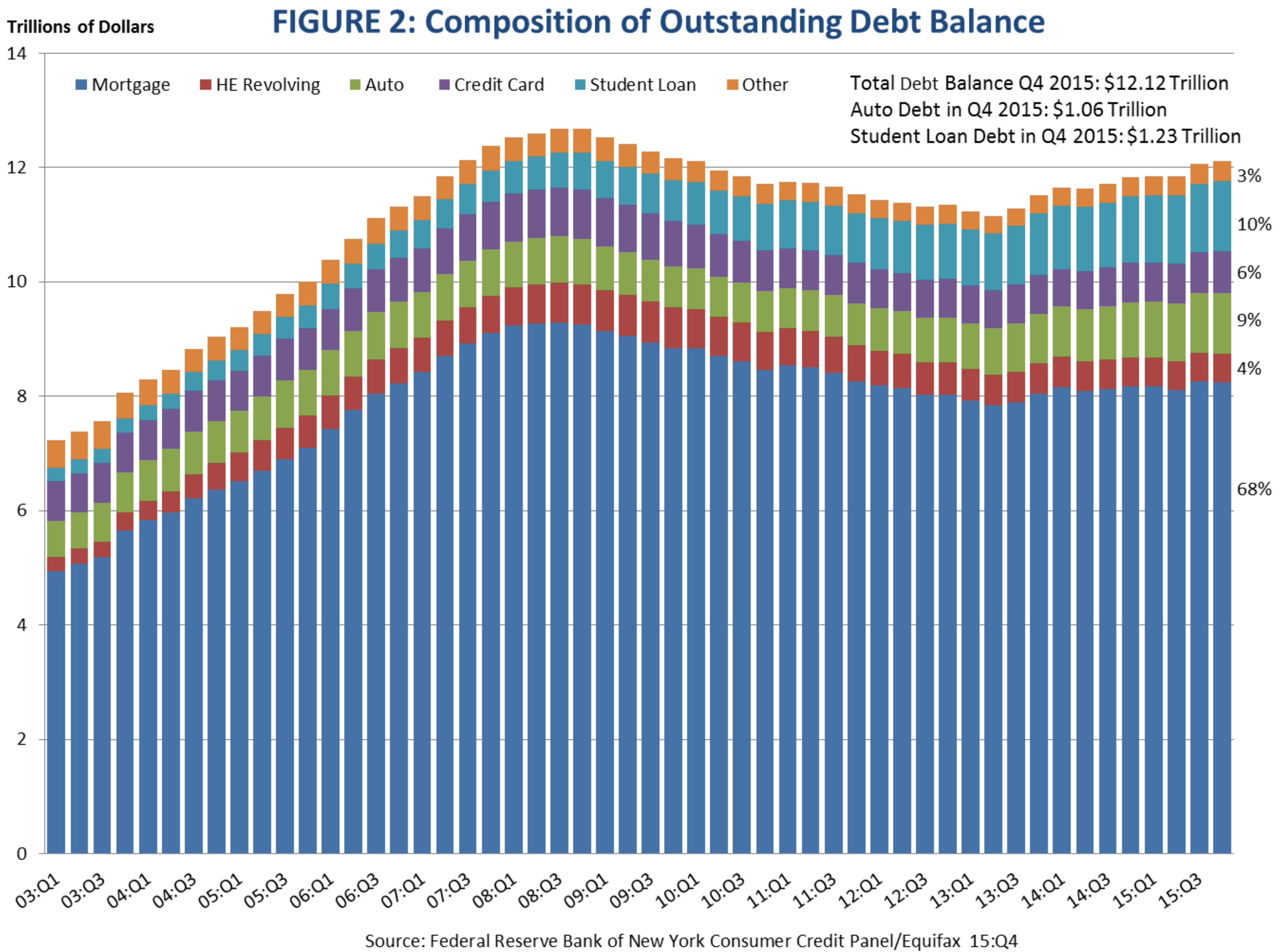
Data from the fourth quarter of 2015 shows that, by dollar volume, the vast majority of the consumer debt in the United States is mortgage debt. A small but significant portion of the total debt is comprised of student loans and auto finance. Total outstanding mortgages account for $8.24 trillion compared to $1.23 trillion for student loans and $1.06 trillion for autos (Figure 1).

FIGURE 1: Total Debt Balance Q4 2015 in Trillions of Dollars



Source: Federal Reserve Bank of New York Consumer Credit Panel/Equifax 15:Q4

The dynamic movement of these aggregate outstanding balances over time is also often monitored. Consequently, the increasing significance of auto and student loan debt on overall debt is regularly reported. (Figure 2).

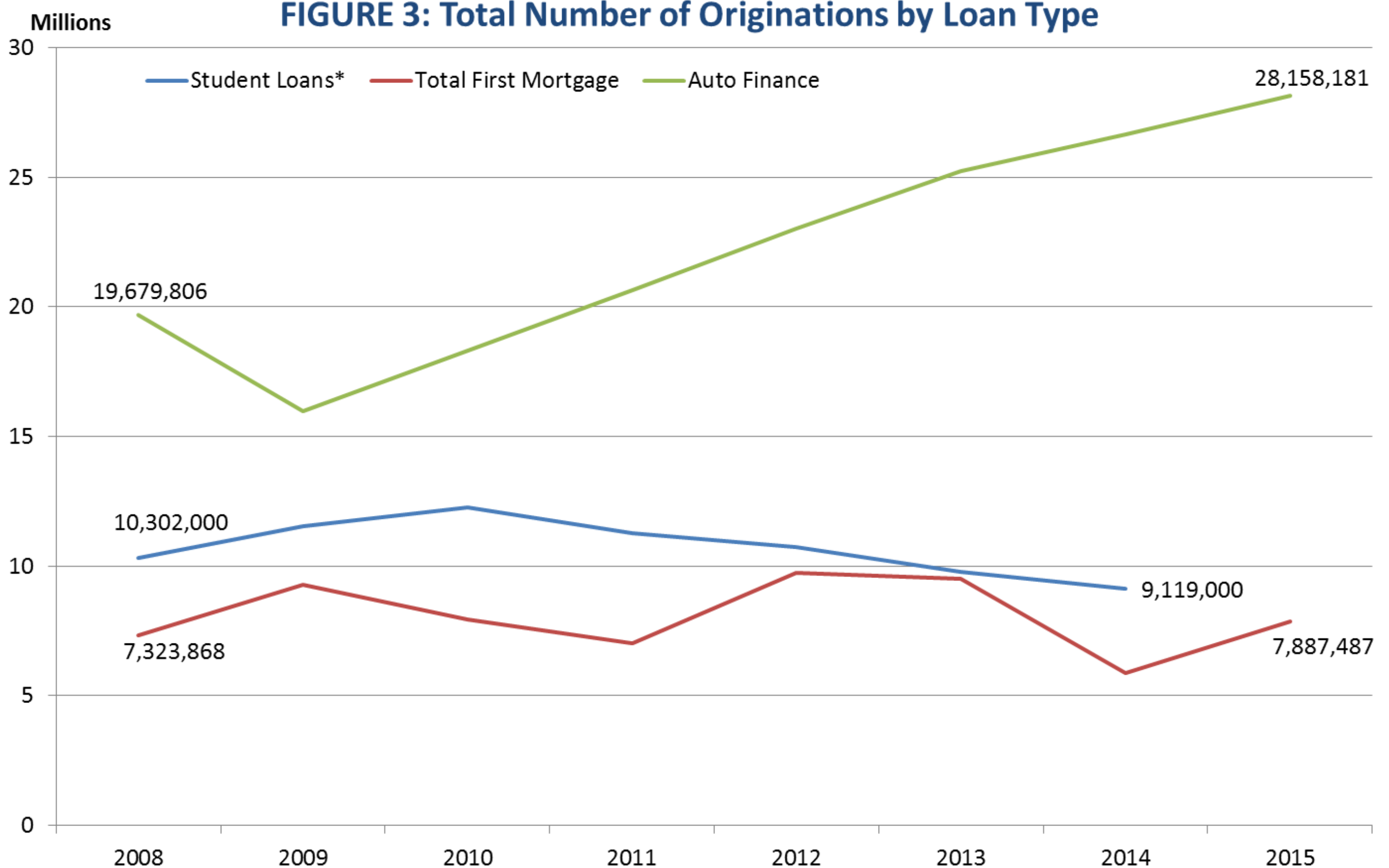


Deeper Analysis Including the Number of Families Affected and Their Economic Condition

While understanding the scale by dollar volume and the change in outstanding debt for these categories over time is helpful, there is much more to learn. Unfortunately, this is the point at which analysis often stops. These broad analyses paint an incomplete picture, ignoring both the number of consumers and new financing transactions represented by this data. Consequently, interested parties, especially industry actors and policymakers working towards the economic success of low- and moderate-income families, must look deeper.

From a perspective of family economic success, understanding the number of consumers affected by auto financing is critical. A large amount of total debt in one category owed by a smaller number of families may overshadow a smaller outstanding total debt owed by a much larger number of families. The extent of origination of new debt is also important to understand because origination is typically the point at which many abuses occur. While consumers will pay for these abuses over the life of the loan, each new financing event represents an opportunity—a time when consumers may either be saddled with new abuses or avoid unnecessary costs.

Reviewing the number of new originations rather than just the outstanding debt in dollars provides insight into how often new credit transactions occur and an approximation of how many families are affected in a given period (Figure 3). For example, in 2014 (the most recent year for which student loan data is available) there were almost three times as many families originating auto finance as borrowers originating student loans, and more than three times the number of auto finance originations as mortgage originations.



Source: Federal Reserve Bank of New York Consumer Credit Panel 15:Q4; Equifax U.S. Consumer Trends, February 11, 2016; Federal Reserve Bank of New York, Student Loan Borrowing and Repayment Trends, 2015 (student loan data through 2014)
* The student loan data represents the number of borrowers originating student loans during a given year.

Further analysis provides even more insight regarding the importance of auto finance on families of color and low-and moderate-income families. Data showing auto originations by race is not available and data by family income is not publicly available. However, there is data for both mortgage and auto finance by consumer credit score. Because credit scores have a strong correlation with race[1] and a correlation with income, in addition to correlations with educational attainment and other characteristics,[2] this data can help us understand the demographics of families who finance car purchases. This data should be of particular interest to policymakers and advocates, since those with low credit scores may be more vulnerable to abusive practices. Consumers with Experian credit scores classified as Prime (the best credit score) make up the largest individual cohort of those financing cars. Yet, collectively, consumers with lower credit scores, labeled as Nonprime, Subprime, and Deep Sub Prime, represent about 30% of open auto finance (Figure 4).

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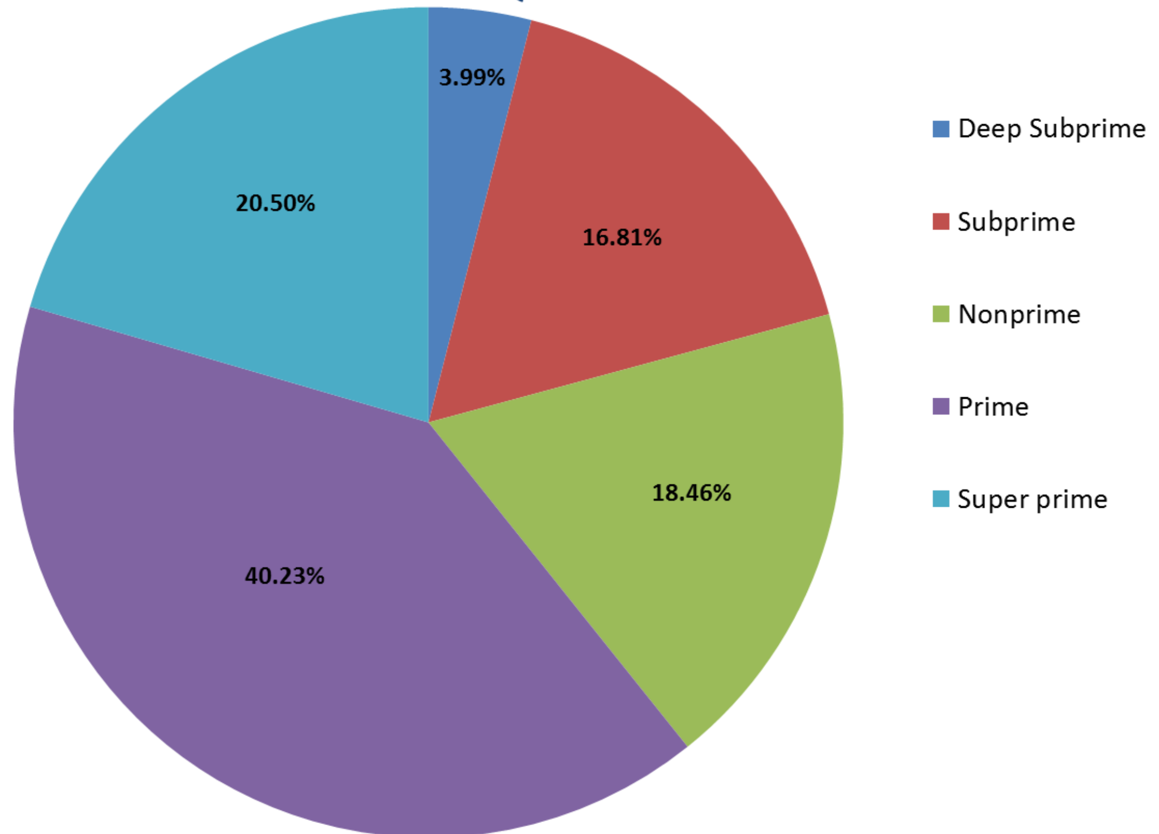
[1] See National Consumer Law Center, **Past Imperfect: How Credit Scores and Other Analytics "Bake In" and Perpetuate Past Discrimination** (May 2016) available at: http://www.nclc.org/images/pdf/credit_discrimination/Past_Imperfect050616.pdf.

[2] See Newman, Anna E. & Newman, Joseph A., The Demographic Impact on Credit Scores: Evidence From Statistical Methods and Geographic Information Systems (GIS) Mapping, Journal of Modern Accounting and Auditing, November 2013, Vol. 9, No. 11, 1497-1506

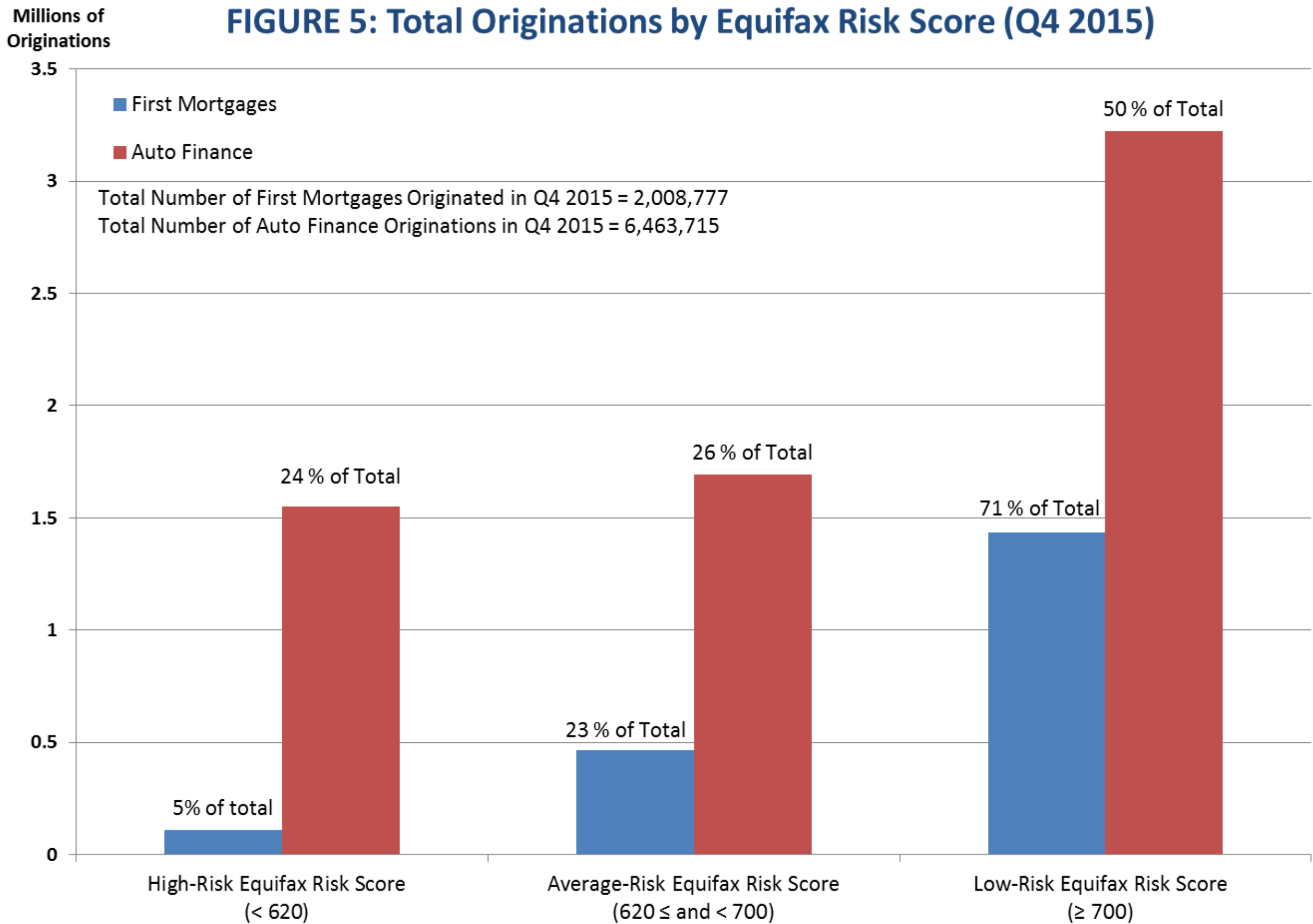
FIGURE 4: Percentage of Open Auto Finance by Experian VantageScore® 3.0 Q4 2015



Source: Experian, State of the Automotive Finance Market, Fourth Quarter 2015

Credit score categories are based on the following Experian VantageScore® 3.0 ranges:
Super Prime = 781-850; Prime = 661-780; Nonprime = 601-660; Subprime = 501-600; Deep Subprime = 300-500

Comparing mortgage and auto originations, those with "High-Risk" Equifax scores originated nearly 25% of auto finance transactions, but just 5% of mortgage transactions. There were about 2 million (2,008,777) total mortgage originations in that period and nearly 6.5 million (6,463,715) auto originations. This means that of struggling consumers with "High-Risk" scores, more than 1.5 million (1,551,292), bought and financed a car while just 100,439 financed a house (Figure 5).



Source: Equifax, U.S. Consumer Trends, February 11, 2016

Conclusion

Digging deeper into available data helps policymakers and advocates to better understand the true impact of auto finance, and government policy, on low- to moderate-income families. Moving away from the idea of dollars of debt outstanding to an appreciation of the huge number of struggling families that finance a car purchase puts into sharp focus the importance of policies that create and foster a fair and transparent market for auto finance.

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Since 1969, the nonprofit **National Consumer Law Center®** (NCLC®) has worked for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the U.S. through its expertise in policy analysis and advocacy, publications, litigation, expert witness services, and training. **www.nclc.org**