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March 12, 2020

The Honorable Kathleen Kraninger
Director
Consumer Financial Protection Bureau
1700 G St. N.W.
Washington, D.C. 20552

Dear Director Kraninger:

We write concerning troubling trends in high levels of debt, record delinquencies, and abusive practices by lenders in the auto loan market. According to reports, auto lenders are engaging in predatory practices and cutting back safeguards reminiscent of mortgage lenders before the financial crisis.[1] [2] Auto debt is now at an all-time high of $1.33 trillion,[3] making it the third largest category of household debt after mortgages and student loans. Problems in this market are often leading indicators of economic distress, because auto loans are "typically the first payment people make because a vehicle is critical to getting to work, and someone can live in a car if all else fails."[4]

Despite these mounting concerns, the Consumer Financial Protection Bureau (CFPB or the Bureau) has taken no public enforcement actions related to auto-lending since you took over as Director of the Bureau.[5] We write for information about what steps the Bureau is taking to monitor this market and how you will ensure that the agency fulfills its mission of stopping abusive practices and protecting consumers from this emerging threat. As financial markets have become increasingly unstable in recent weeks[6], it is more important than ever that this volatile debt market be closely monitored and regulated.

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[1] Wall Street Journal, "An $809 Car Payment, a $660 Income: How Dealers Make the Math Work," Ben Eisen and AnnaMaria Andriotis, December 21, 2019, https://www.wsj.com/articles/an-809-car-payment-a-660-income-how-dealers-make-the-math-work-11576924201.
[2] New York Times, "Fed Shrugged as Subprime Crisis Spread," Edmund Andrews, December 18, 2007, https://www.nytimes.com/2007/12/18/business/18subprime.html.
[3] Federal Reserve Bank of New York, "Household Debt and Credit Report (Q4 2019), https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/pdf/HHDC_2019Q4.pdf.
[4] Washington Post, "A record 7 million American are 3 months behind on their car payments, a red flag for the economy," Heather Long, February 12, 2019, https://www.washingtonpost.com/business/2019/02/12/record-million-americans-are-months-behind-their-car-payments-red-flag-economy/.
[5] Consumer Financial Protection Bureau, "Bureau of Consumer Financial Protection Settles with Santander Consumer USA Inc.," November 20. 2018, https://www.consumerfinance.gov/about-us/newsroom/bureau-consumer-financial-protection-settles-santander-consumer-usa-inc/.
[6] Washington Post, "Wild week on Wall Street ends with stocks down, bond prices up, and coronavirus fears persisting," Thomas Heath, March 6, 2020, https://www.washingtonpost.com/business/2020/03/06/stocks-today-coronavirus-markets/.

Owning a car helps working families achieve economic success, and research has documented a "positive correlation between car ownership and employment outcomes."[7] As a result, millions of Americans take out a loan to purchase a car each year.[8] As the Bureau acknowledges, "for consumers who do not purchase a home, an automobile may be the largest purchase they will ever make," and "taking out a loan to purchase an automobile can be a significant part of consumers' financial lives."[9]

In recent years, however, researchers and economists have grown concerned about the volume of outstanding auto loan debt. At the end of 2019, there were over 115 million auto loan accounts open,[10] and the total outstanding auto loan debt associated with these accounts totaled $1.33 trillion,[11] the second-largest category of non-housing debt after student loans. Moreover, nearly five percent of this debt is more than 90 days delinquent,[12] a rate not reached since the financial crisis.[13]

Consumers typically obtain auto loans through indirect or direct financing.[14] To get an indirect loan, the consumer submits their information to a dealer at the location where the car is purchased,[15] and the dealer transmits that information to lenders to solicit offers. Lenders compensate dealers through a markup on the interest rate offered to the consumer.[16] Over 80 percent of auto loans are obtained through indirect financing.[17] The remaining borrowers generally obtain their loan directly from a bank or lender before they go to buy their car.[18]

**Consumers Are Getting Squeezed by Auto Lenders**

We are concerned that the structure of the auto loan market, particularly the relationship between dealers and lenders in the indirect market, allows for consumers to be exploited. The Bureau's own research has revealed that many consumers are confused by the terms and fees associated with their auto loans. For example, some consumers "reported that they did not fully understand the level of interest rate they were paying until they started making payments."[19]

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[7] The Federal Reserve Bank of Richmond, "Importance and Impact of Cars for Family Economic Successes," Urvi Neelakantan, 2010, https://www.nclc.org/images/pdf/conferences_and_webinars/auto_webinars/presentations/ImportanceAndImpactOfCars12.10.pdf.

[8] Federal Reserve Bank of New York, "Household Debt and Credit Report (Q4 2019), https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/pdf/HHDC_2019Q4.pdf.

[9] Consumer Financial Protection Bureau, "Consumer Voices on Automobile Financing," June 2016, https://files.consumerfinance.gov/f/documents/201606_cfpb_consumer-voices-on-automobile-financing.pdf.

[10] Federal Reserve Bank of New York, "Household Debt and Credit Report (Q4 2019), https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/pdf/HHDC_2019Q4.pdf.

[11] *Id.*

[12] *Id.*

[13] *Id.*

[14] Congressional Research Service, "The Automobile Lending Market and Policy Issues," Cheryl R. Cooper, April 25, 2019, https://www.crs.gov/reports/pdf/IF11192.

[15] *Id.*

[16] *Id.*

[17] "Auto Dealer Loan Intermediation: Consumer Behavior and Competitive Effects," Andreas Grunewald, Jonathan Lanning, David Low, and Tobias Salz, October 1, 2019, https://economics.mit.edu/files/17589.

[18] *Id.*

[19] *Id.*

Other consumers have identified instances where dealers submitted loan applications to lenders without their permission.[20] Academic research and press reports have also identified various harmful practices including:

- Dealerships inflating consumers' income on loan applications, resulting in consumers taking out loans that they cannot afford. According to reports, lenders have not implemented the necessary safeguards to detect and monitor this type of fraud.[21] In recent years, the share of loans where the lender verified the consumer's income, ensuring they were able to repay the loan, declined by over 50 percent, and the auto financing branches of certain lenders such as Ally, CarMax, and Nissan verified income on less than 1 percent of all loans.[22]

- Dealerships "kicking the trade," a practice in which they tell consumers who are having trouble paying off their loan and want to trade-in their vehicle to instead voluntarily have their old cars repossessed and then sell the consumer a new car with a new loan.[23] Because the value of the repossessed car may not be enough to cover the balance of the original loan, the consumer can be on the hook for two loans.

- The "yo-yo scam," in which dealers notify consumers days or weeks after the vehicle purchase that there is an issue with their financing and require the consumer to renegotiate the deal at a higher interest rate or larger down payment.[24]

- Lenders and dealers raising the market value of these vehicles and convincing consumers to take out larger loans that they may not be able to afford.[25] Dealers' commissions are tied the size of the loan the consumer signs, not the values of the car, giving them the incentive to push the consumer into the largest possible loan.

- Longer loans. Previous research by the CFPB showed that consumers are taking out loans with longer terms.[26] The share of auto loans with terms of six years or more increased

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[20] Consumer Financial Protection Bureau, "Consumer Voices on Automobile Financing," June 2016, https://files.consumerfinance.gov/f/documents/201606_cfpb_consumer-voices-on-automobile-financing.pdf.
[21] Wall Street Journal, "An $809 Car Payment, a $660 Income: How Dealers Make the Math Work," Ben Eisen and Annamaria Andriotis, December 21, 2019, https://www.wsj.com/articles/an-809-car-payment-a-660-income-how-dealers-make-the-math-work-11576924201?mod=article_inline.
[22] *Id.*
[23] Wall Street Journal, "Dealerships Give Car Buyers Some Advice: Just Stop Paying Your Loan," AnnaMaria Andriotis and Ben Eisen, February 15, 2020, https://www.wsj.com/articles/dealerships-give-car-buyers-some-advice-just-stop-paying-your-loan-11581762601.
[24] NBC News, "Yo-yo scam exploits credit-challenged car buyers," April 12, 2012, https://www.nbcnews.com/business/autos/yo-yo-scam-exploits-credit-challenged-car-buyers-f712479
[25] NPR, "The Big Business of Subprime Auto Loans," Anjali Kamat, December 12, 2019, https://www.npr.org/2019/12/12/787337997/the-big-business-of-subprime-auto-loans.
[26] Consumer Financial Protection Bureau, "Quarterly Consumer Credit Trends: Growth in Longer-Term Auto Loans," Kenneth P. Brevoort, Jasper Clarkberg, Michelle Kambara, and Ryan Kelly, November 2017, https://files.consumerfinance.gov/f/documents/cfpb_consumer-credit-trends_longer-term-auto-loans_2017Q2.pdf.

from 26 percent in 2009 to 42 percent in 2017.[27] As the Bureau noted, while these longer-term loans are associated with lower monthly payments, the loans "amortize more slowly and, as a result, financing costs will be higher over the life of the loan."[28] Consequently, these longer-term loans are associated with negative equity in which the amount of debt owed ends up exceeding the value of the car.[29]

These incentives and tactics cost consumers an average of over $350 per transaction – a total consumer surplus of nearly $2 billion.[30]

We are particularly concerned with the targeting of subprime consumers by non-bank lenders through indirect lending. Non-bank lenders constitute a significant part of the indirect auto loan market. In 2018, 50 percent of the outstanding auto loan balance at auto finance companies was held by subprime borrowers,[31] and serious auto loan delinquencies for subprime consumers have more than doubled since their post-crisis low in 2013.[32] These are alarming statistics – made even more so by the fact that they come amid a period of low unemployment and strong corporate profits. These loans present a risk to the financial stability of the millions of individual households and families – a threat that looms even larger as the economy teeters in the face of a possible coronavirus pandemic.

**The CFPB is Asleep at the Switch**

Regrettably, the Bureau has not taken meaningful action to combat these trends during your tenure as Director. Aside from noting the existence of certain abusive auto lending practices outlined in the Bureau's Supervisory Highlights,[33] the CFPB has not issued a comprehensive report on this issue since 2017,[34] and has not taken a single enforcement action against any auto lenders since 2018. Of the 15 public enforcement actions related to auto lending since the creation of the Bureau, none have occurred during your tenure as Director.[35]

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[27] *Id.*

[28] Consumer Financial Protection Bureau, "Quarterly Consumer Credit Trends: Growth in Longer-Term Auto Loans," Kenneth P. Brevoort, Jasper Clarkberg, Michelle Kambara, and Ryan Kelly, November 2017, https://files.consumerfinance.gov/f/documents/cfpb_consumer-credit-trends_longer-term-auto-loans_2017Q2.pdf.

[29] Wall Street Journal, "A $45,000 Loan for a $27,000 Ride: More Borrowers Are Going Underwater on Car Loans" AnnaMaria Andriotis and Ben Eisen, November 9, 2019, https://www.wsj.com/articles/a-45-000-loan-for-a-27-000-ride-more-borrowers-are-going-underwater-on-car-loans-11573295400?mod=article_inline.

[30] "Auto Dealer Loan Intermediation: Consumer Behavior and Competitive Effects," Andreas Grunewald, Jonathan Lanning, David Low, and Tobias Salz, October 1, 2019, https://economics.mit.edu/files/17589.

[31] Federal Reserve Bank of New York, "Just Released: Auto Loans in High Gear," Andrew F. Haughwout, Donghoon Lee, Joelle Scally, and Wilbert van der Klaauw, February 12, 2019, https://libertystreeteconomics.newyorkfed.org/2019/02/just-released-auto-loans-in-high-gear.html.

[32] Federal Reserve Bank of New York, "Just Released: Mind the Gap in Delinquency Rates," Andrew F. Haughwout, Donghoon Lee, Joelle Scally, and Wilbert van der Klaauw, August 13, 2019, https://libertystreeteconomics.newyorkfed.org/2019/08/just-released-mind-the-gap-in-delinquency-rates.html.

[33] Consumer Financial Protection Bureau, "Supervisory Highlights," Issue 19, Summer 2019, https://files.consumerfinance.gov/f/documents/cfpb_supervisory-highlights_issue-19_092019.pdf.

[34] Consumer Financial Protection Bureau, "Research and Reports," https://www.consumerfinance.gov/data-research/research-reports/?title=&topics=auto-loans&from_date=&to_date=.

[35] Consumer Financial Protection Bureau, "Enforcement Actions," https://www.consumerfinance.gov/policy-compliance/enforcement/actions/?title=&topics=auto-loans&from_date=&to_date=.

The CFPB has the power to make a difference in this market. While the agency does not have the authority to examine directly the practices of auto dealers, it does have the authority – and the responsibility – to examine the auto lending companies and financial institutions that provide auto loans. The Bureau also has the authority to write rules governing lenders, gather data to monitor the auto lending market, and file lawsuits against financial institutions that break the law. The CFPB's role in overseeing this market is especially important given the substantial and growing role of non-bank and non-credit union members, as no other regulator has jurisdiction over these entities' consumer protection practices.

The CFPB should fulfill its mission by conducting oversight of this critical, but broken consumer financial market. To better understand how the Bureau views its role in the auto lending market and what actions it plans to take to address these ongoing abuses, we request a response to the following questions no later than March 26, 2020.

1. Please describe the CFPB's jurisdiction over this market, including auto dealers, nonbank lenders, and bank lenders and the relationships between these different parties.

2. As stated in the Bureau's Auto Finance Examination Procedures, when a loan is issued via indirect financing, "the dealer, rather than the consumer, typically selects the lender that will provide financing," and the dealer "may have incentives to select a particular lender over another."[36]
    a. Does the Bureau believe that this incentive structure can create risks to consumers?
    b. Does the Bureau consider whether lenders are intentionally charging rates higher than the normal market rate because of their arrangements with auto dealers?
    c. The CFPB's Examination Procedures include instructions to "obtain records of and evaluate the communications between the entity and the dealers regarding sales incentives and production goals." [37]Does the Bureau follow these procedures for each examination of an auto lending company? If not, under what circumstances would the CFPB not follow these examination procedures?
    d. What type of actions does the Bureau take when it identifies a problematic relationship between a lender and dealer? Has the Bureau ever barred a lender from associating with a problematic dealer?
    e. When was the last time the Bureau took an enforcement action against a lender for incentivizing a dealer to offer a consumer a larger loan than the market value of the vehicle? Please provide a list of all such actions.
        i. When was the last time the Bureau issued such an action against a lender that incentivized a dealer to offer a buyer a loan at a greater interest rate than what is typical for the market? Please provide a list of all such actions.

[36] Consumer Financial Protection Bureau, "CFPB Examination Procedures: Auto Finance," June 2015, https://files.consumerfinance.gov/f/201506_cfpb_automobile-finance-examination-procedures.pdf.
[37] *Id.*

3. The CFPB's Examination Procedures instruct examiners to "evaluate the underwriting practices of the entity, including the average loan to value ratios, lengths of terms, and whether the entity originates loans or leases with a high risk of default (e.g., determine if there is evidence of false or undocumented income."[38]
    a. How does the Bureau determine whether an underwriting practice presents a risk to the consumer? Are quantitative thresholds used, and if so, can you describe?
    b. Does the Bureau maintain a database with information, such as the average Loan to Value ratios, length of the loan term, and the default rate, for each lender? If so, how does the Bureau use this database?

4. The CFPB has recently decided to redefine the framework under which it applies the "abusiveness" standard in its supervision and enforcement activities.[39] The new framework severely limits the use of the standard to only matters "when the harm to consumers outweighs the benefit."[40] Previously, an abusive act or practice was defined as an act that "materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or takes unreasonable advantage of a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service; the inability of the consumer to protect the consumer's interests in selecting or using a consumer financial product or service; or the reasonable reliance by the consumer on a covered person to act in the interests of the consumer."[41]
    a. Please describe how the Bureau will evaluate whether or not an auto lender is engaging in an abusive practice.
    b. How will the Bureau measure "harm" and "benefit"? Will these be monetary thresholds? If so, please include them.
    c. The CFPB's new framework would also seek monetary relief for abusiveness "only when there has been a lack of a good-faith effort to comply with the law."[42] How will the Bureau measure whether or not an auto lender is acting in "good faith"?

5. Has the Bureau identified and evaluated concerns with auto lenders related to fair lending laws, such as the *Equal Credit Opportunity Act*?

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[38] *Id.*
[39] Consumer Financial Protection Bureau, "CFPB Announces Policy Regarding Prohibition on Abusive Acts or Practices," January 24, 2020, https://www.consumerfinance.gov/about-us/newsroom/cfpb-announces-policy-regarding-prohibition-abusive-acts-practices/.
[40] *Id.*
[41] Consumer Financial Protection Bureau, "CFPB Examination Procedures: Automobile Finance Examination Procedures," August 2019, https://files.consumerfinance.gov/f/documents/201908_cfpb_automobile-finance-examination-procedures.pdf.
[42] Consumer Financial Protection Bureau, "CFPB Announces Policy Regarding Prohibition on Abusive Acts or Practices," January 24, 2020, https://www.consumerfinance.gov/about-us/newsroom/cfpb-announces-policy-regarding-prohibition-abusive-acts-practices/

6. The Bureau determines its examination schedule based on its evaluation of the risks to consumers.[43] How does the Bureau evaluate and prioritize risks to consumers relating to auto lenders?
    a. Does the Bureau use quantitative data to evaluate risk? If so, please describe the data used.
    b. Does the Bureau use its consumer compliant database to identify consumer abuses and prioritize examinations?

7. How many consumer complaints has the CFPB received regarding auto lenders and auto lending practices? How many actions has CFPB taken based on these complaints?

Sincerely,

Elizabeth Warren
United States Senator

Sherrod Brown
United States Senator

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[43] Consumer Financial Protection Bureau, "CFPB Supervision and Examination Process," October, 2012, https://files.consumerfinance.gov/f/documents/cfpb_supervision-and-examination-manual.pdf.