# Auto Lending Abuses in Dealer-Financed Loans

***Loan Markups Cost Americans $25.8 Billion Over the Lives of Their Loans***

CRL Issue Brief April 2011

## DEALER MARKUPS

Auto loan markups, also known as dealer reserves, involve kickbacks to an auto dealer from lenders who wish to buy the auto loan from the dealer. Before presenting a loan to a customer, a dealer will reach out to several potential lenders to whom the dealer may sell the loan. Those lenders tell the dealer the interest rate at which they are willing to buy the loan. This is called the "buy rate." However, the lender often agrees to allow the dealer to increase the interest rate. The extra profit from the increased interest rate is either split between the dealer and lender or pocketed entirely by the dealer. The dealer typically does not present all the different loan options available to the customer but chooses the one that presents the best deal for the dealer.

The portion paid to the dealer is called the "dealer reserve" or "dealer participation." **According to CRL research, those who buy cars today are paying $25.8 billion in excess interest over the lives of their car loans just to pay the dealer kickback.**[1]

The customer is told that the marked up interest rate is that for which the customer qualifies, and the original buy rate is never revealed. This makes it impossible for customers to truly compare the costs of different loans. Dealers claim that the kickback is necessary to fully compensate the dealer's staff to negotiate loans and arrange the best deal. But, the customer is not aware that part of the interest rate is used to pay for this "service" or that he or she may be paying more for the same service than someone else. Further, the dealer's incentive is to find the loan with the biggest kickback instead of the lowest rate.

## YO-YO SCAMS

A spot delivery or conditional sale is any deal where the financing is not finalized until after the buyer has already taken the vehicle home from the dealership. The deal becomes a "yo-yo" when the buyer is called back into the dealership and told that the sale cannot be made as agreed. At that point the buyer is told to either return the car or accept financing at more expensive terms.

The dealer may have deposited the down payment and sold the trade-in at auction or, in some cases, will represent to the customer that the dealer has done so even if the dealer has not. Faced with having to do without a car, the buyer is pressured to accept financing with higher rates, a larger down payment, or finding a co-signer. Sometimes the dealer will charge an additional

[1] Delvin Davis and Joshua M. Frank, *Under the Hood: Auto Loan Interest Rate Hikes Inflate Consumer Costs and Loan Losses Consumers,* Center for Responsible Lending, April 2011.

"rental fee," "excessive mileage fee," or "restocking fee" for the use of the vehicle during those few weeks.[2]

**A dealer is usually able to arrange a financing decision with automated technology in less than 30 minutes of the consumer entering the showroom**.[3] In some cases, the finance company wants additional information or won't buy the loan at the terms the dealer has promised to the customer. In either case, the dealer has taken a risk in sending the customer home with a car when the financing is not completed. Therefore, claims that the financing has "fallen through" often really mean that the dealer is trying to leverage a higher kickback or made a mistake in letting the customer drive off the lot with the car.

Yo-yo scams are also associated with much higher interest rates. People who had experienced a yo-yo scam received on average an interest rate that was five percentage points higher than someone with the same risk level who had not experienced a yo-yo scam.[4] This is especially troublesome for the most vulnerable buyers who can least afford to lose income and who may be less at risk of default with a more appropriate interest rate.

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## LOAN PACKING

Various types of aftermarket—or "add-on"—products inflate both the price of the vehicle and the amount financed, increasing in turn the commission for dealers and F&I staff. A common drawback with these products is that they are overpriced, rarely benefit the buyer in practice, and often duplicate services the buyer may already get through the manufacturer or personal car insurance provider.

Dealership finance & insurance staff often present these products in bundled packages, giving the appearance that the customer will save money by buying several add-ons as a group. Others will present the products all at once in a menu format. Either way, it is often not clear that the buyer has the option of not purchasing any add-ons at all.[5] **In fact, some salespeople will convince the customer that purchasing certain add-ons is a lender requirement**. Purchasing multiple products can easily add thousands of dollars to the cost of the car and the amount financed, with the true cost disguised as a modest increase in monthly payment.

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[2] Don Oldenburg, "*Yo-Yo Deals: Stringing Car Buyers Along,"* Washington Post, (Oct 19, 2004).
[3] *F&I Factors,* F&I Management and Technology Magazine, (2007).
[4] *See " Car Trouble."*
[5] *Attorney General Hardy Myers Announced Settlement with Salem Car Dealership Ending Sales Practices of 'Packing.'* Oregon Department of Justice press release, (Aug 20, 2008). (This settlement involved an investigation of an Oregon dealer finding that in every new and used car sold, the dealer was selling packages of add-on products without the customer's knowing they did not have to purchase them.)

## POLICY RECOMMENDATIONS

Predatory practices in auto financing force the consumer to struggle not only for a competitive and affordable loan, but for a fair and honest one. Finding a good deal is no longer based on the quality of the car or the creditworthiness of the customer, but rather the customer's ability to survive a financial shell game with one of the largest investments most Americans will ever make. As a result, CRL proposes the following policy recommendations:

**Recommendation 1: Ban the back-end compensation dealers receive for selling more costly loans with unfavorable terms to consumers.** There should be no incentive for a dealer to finance car buyers in worse loans than that for which they would otherwise qualify. Dealers should disclose the cost to the customer for arranging the loan and customers should not be charged different rates for the service. Further, this change would shift the incentive from higher profits to finding the best deal for the customer.

**Recommendation 2: Prohibit yo-yo scams and ensure more meaningful enforcement to prevent them.** Dealers should be prohibited from selling a customer's trade-in before the deal is finalized. If the consumer declines the new deal, the dealer should also return the trade-in, down payment, and any taxes or fees associated with the deal. This way, the dealer can continue to make conditional sales while customers can be protected in case the deal becomes too expensive.

**Recommendation 3: Provide a consistent and transparent means of presenting the cost of the vehicle, all fees, and add-on product sales.** It should also be explicit that the purchase of add-ons is completely optional and separate from both the purchase and the financing of the vehicle. There should be clear disclosure of how each add-on product impacts the overall price of the vehicle, not just the monthly payment. Ideally this would be in documentation distinct and separate from the paperwork involved with the vehicle purchase or financing.

**About the Center for Responsible Lending**

The Center for Responsible Lending (CRL) is a national nonprofit, nonpartisan research and policy organization dedicated to protecting home ownership and family wealth by working to eliminate abusive financial practices. CRL is affiliated with Self-Help, one of the nation's largest community development financial institutions.

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