BRIAN E. FROSH
Attorney General

ELIZABETH F. HARRIS
Chief Deputy Attorney General

CAROLYN QUATTROCKI
Deputy Attorney General

WILLIAM D. GRUHN
Chief

STATE OF MARYLAND
OFFICE OF THE ATTORNEY GENERAL

FACSIMILE NO.
(410) 576-6566 (F)

WRITER'S DIRECT DIAL NO.
(410) 576-7226

March 4, 2020

TO: The Honorable Dereck E. Davis, Chair
Economic Matters Committee

FROM: Elizabeth J. Stern, Assistant Attorney General
Consumer Protection Division

RE: House Bill 655 – Consumer Protection – Automobile Financing Charges – Required Dealer Disclosures (SUPPORT)

The Consumer Protection Division of the Office of the Attorney General supports House Bill 655 (H.B. 655), sponsored by Delegates Queen, Charkoudian, D.M. Davis, Mosby, Palakovich Carr, Shetty and K. Young, because it will bring greater transparency to the indirect auto financing process and impose reasonable limitations on one method by which auto dealerships are compensated for their role in that process.[1]

The majority of all car purchases are financed, and a substantial portion of those purchases are financed through indirect lending at a dealer, which loans often include hidden interest and markups that increase the dealer's compensation. Consumers often do not realize the full impact of such hidden interest and markups, including how they affect the amount and time of indebtedness, and ultimately they can result in delinquency and repossession. Throughout 2019, Maryland was among the states with the highest percentage of delinquent auto loan balances.[2]

In indirect financing, the consumer provides basic financial information to the dealer, who then shares that information with prospective third-party, or "indirect," lenders. Interested indirect lenders then provide the dealer with a risk-based "buy rate" that establishes a minimum interest rate (APR) at which it would purchase the retail sales installment contract between the dealer and

[1] This bill was a recommendation from the 2018 Final Report of the Maryland Financial Consumer Protection Commission. *See,* Final Report pp. 17-22.

[2] Experian's Q1 2019 State of the Automotive Finance Market as cited in *Experian spots top 10 states for 60-day delinquency after Q1* on www.autoremarketing.com/subprime/experian-spots-top-10-states-60-day-delinquency-after-q1; Experian's Q2 2019 State of the Automotive Finance Market, Melinda Zabritski, available at Experian.com/content/dam/marketing/na/automotive/quarterly-webinars/credit-trends/Experian-auto-q2-2019-safm.pdf; *Top 10 states for 30-day delinquency in Q3* available at www.autoremarketing.com/subprime/top-10-states-30-day-delinquency-q3.

the consumer. Although the buy rate already takes into account the riskiness of the loan, indirect lenders often allow dealers to mark up the interest rate by an additional amount, which markup occurs before the loan terms are presented to the consumer. For example, a lender may specify a buy rate of 6% APR and the dealer then marks the rate up by 2%, resulting in a "contract rate" of 8% APR, which is the rate presented to the consumer by the dealer. The dealer gets to keep some or all of the additional amount paid on the loan as result of the markup. The consumer is not told, either verbally or in writing, about the markup, or that the dealer gets to keep as "compensation" the additional amounts the consumer is now obligated to pay. For consumers who financed their cars in 2009 through dealers, they paid $25.8 billion in hidden interest during the life of the loans.[3]

In a 2011 study of auto loan markups, the Center for Responsible Lending found that buyers with weaker credit scores may be targeted for markups because they have fewer alternative financing options.[4] Further, dealer discretion in determining the amount of markup has the potential to result in discriminatory rate setting, which could disparately impact certain populations. Starting in 2013, the Consumer Financial Protection Bureau (CFPB) and Department of Justice filed charges against major auto financing entities over discriminatory lending practices, including minority car buyers being charged higher interest rate markups than non-minority car buyers.[5] Additionally, the CFPB issued a bulletin to finance entities about how to limit their risk of discriminatory pricing practices that violate the Equal Credit Opportunity Act.[6] Since that time, however, shifts in the federal legal landscape have occurred, including Congress' 2018 rescission of the 2013 CFPB bulletin. Additionally, some large auto lenders who had implemented a flat fee dealer compensation system, which would eliminate the potential for discrimination and for the consumer to bear the cost of the dealer compensation, reverted to policies that allowed for large, discretionary dealer markups.[7]

This bill addresses the current information disparity in the indirect lending process by increasing its transparency. Unlike in direct lending, where a consumer approaches a finance institution for an auto loan, indirect lending effectively requires the consumer to rely on the dealer as a "middle man" with potential lenders. A dealer may receive responses from multiple lenders on one consumer's application, each with varying terms, including the interest rate and amount of any markup, but it is the dealer who selects one loan to present to the consumer. The consumer typically does not learn about the other loan offers, including whether they had lower interest rates. Moreover, if the interest rate presented to the consumer includes dealer markup, the consumer does not know that either if the dealer fails to disclose that fact. This bill requires that a dealer disclose, in writing, all financing offers for which the consumer was approved, including the lender-approved APR and the term in months. Additionally, the bill requires that the dealer disclose, in writing, whether or not the dealer is being compensated for increasing the APR to an APR higher than that originally approved by the lender. The disclosure must include, among other things, the

---

[3] Auto Loans: The Problem, available at www.responsiblelending.org/es/issues/auto-loans/auto-loans-problem.
[4] Davis, Delvin and Joshua M. Frank, "Under the Hood: Auto Loan Interest Rate Hikes Inflate Consumer Costs and Loan Losses," Center For Responsible Lending, April 2011.
[5] Van Alst, John W., "Time to Stop Racing Cars: The Role of Race and Ethnicity in Buying and Using a Car," National Consumer Law Center, April 2019, at p. 14 (noting CFPB and DOJ enforcement actions against Ally Financial, Inc. and Ally Bank; American Honda Finance Corporation; Fifth Third Bank; and Toyota Motor Credit Corporation).
[6] *Id.*
[7] *Id.* at p.15

total amount of dealer compensation, what portion of the dealer compensation is attributable to the increased APR, and the additional amount the consumer will owe over the life of the loan as a result of the dealer compensation. In order to ensure the consumer actually receives this information, the required disclosures must be on forms separate from the financing agreement, and must be signed by the consumer.

While there is the potential for the consumer to receive a lot of information, the Division supports H.B. 655's disclosure requirement so that the consumer can make an informed decision about entering into this major financial obligation. The consumer will be benefitted by not only learning about the array of financing offers for which s/he qualified, as the consumer may decide one of those is preferable to the one selected by the dealer, but also about any compensation the dealer stands to make as the result of the dealer-selected offer. In *Green v. H&R Block, Inc.*, the Maryland Court of Appeals found a potential[8] material omission where H & R Block stood to receive a portion of the "finance charge" associated with refund anticipation loans that H & R Block helped consumers apply for, but H & R Block did not disclose this fact to consumers. "H & R Block customers may consider important the knowledge that the 'finance' costs of the loan is inflated by virtue of the various ways H & R Block stands to benefit." *Id.* at 524. Just like the customers of H & R Block deserved to know that H & R Block received a portion of the finance charge, consumers applying for auto financing through indirect lending at a dealer deserve to know whether a dealer-selected offer includes an APR that is inflated for the benefit of the dealer. For the same reason, consumers deserve to know what other offers they qualified for and whether those APRs might be more financially advantageous for them, particularly given the length of the loan term.

The bill does not ban dealer markup, but rather, imposes reasonable caps on the amount of markup. While the Division believes that flat fee payments are a preferable way for lenders to compensate dealers, as such payments avoid both the potential for discriminatory markups and the perverse incentive to increase consumers' financing costs by maximizing the dealer's compensation, the Division also recognizes that many lenders still employ dealer markup as a compensation method. The bill caps dealer markup at 2% APR for loans with a term of 60 months or under, and 1.5% APR for loans with a term over 60 months. By capping how much a dealer can markup a consumer's already-approved APR, the bill is designed to limit both the impact of the dealer's compensation on the consumer's financial obligation to the lender and the potential for discriminatory markup practices. At least two other states, Louisiana[9] and California,[10] have statutes that cap dealer markups. Notably, California passed its law in 2006 and having such dealer compensation caps has not caused the end of indirect auto financing in California. Also, similar to the bifurcated rate cap set forth in H.B. 655, California's statute has a lower rate cap (2%) for loans over 60 months as compared to the 2.5% cap for loans 60 months or under. Loan terms are getting longer, which is not necessarily beneficial for consumers. Although a longer loan term ensures a lower monthly payment, thereby increasing the short-term affordability of an auto

---

[8] *Green v. H.R. Block, Inc.*355 Md. 488 (1999), was before the Court of Appeals on an appeal of a motion to dismiss and accordingly, the issue before the court concerning the Maryland Consumer Protection Act (CPA) was whether the complaint included viable CPA claims. The Court held that it did.

[9] La. Rev. Stat. Ann. § 32:1261(2)(k): limits dealer markup to 3%.

[10] Cal. Civ. Code § 2982.10(a): limits dealer markup to 2.5% for loans at or under 60 months, and 2% for loans over 60 months.

purchase, the long-term effect of extended loan terms is that a consumer ends up paying more interest over the life of the loan, and further, may end up with a depreciated vehicle and be "under water" on the loan.[11] Accordingly, and seemingly in acknowledgment of the greater financial burdens placed on a consumer by a longer term loan, H.B. 655 reasonably provides for a lower rate cap for those loans over 60 months. H.B. 655's rate caps are slightly lower than those contained in California's statute as a result of the increase in reports of consumers being negatively impacted by subprime auto lending in the years since that law was enacted. Further, the Division understands that the spread today typically stands around 2% APR.

The Division respectfully requests that the House Economic Matters Committee give House Bill 655 a favorable report.

[11] Cross, R.J., Tony Dutzik, Ed Mierzwinksi and Matt Casale, "Driving Into Debt | The Hidden Cost of Risky Auto Loans to Consumers and Our Communities," U.S. PIRG Education Fund and Frontier Group, February 2019, at page 23.