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Discrimination Against Latinos in Auto Lending

Submitted to

House Financial Services Committee
Subcommittee on Oversight and Investigations

Submitted by

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Introduction

UnidosUS, formerly the National Council of La Raza, is the largest national Hispanic* civil rights and advocacy organization in the United States. For more than 50 years, we have worked to advance opportunities for low-and moderate-income Latino families so that they can achieve economic stability and build wealth. In this capacity, UnidosUS, with its network of nearly 300 Affiliates—local, community-based organizations in 35 states, the District of Columbia, and Puerto Rico—provides education, health care, housing counseling, workforce development, and financial coaching programs to millions of citizens and immigrants in the United States annually.

For almost three decades, UnidosUS has conducted research and analysis and has testified before Congress on issues related to improving the financial well-being of Latinos; including strengthening the Community Reinvestment Act and the Home Ownership and Equity Protection Act (HOEPA), supporting strong fair housing and lending laws, and expanding access to affordable credit. In addition, UnidosUS manages a network of more than 30 community-based, financial coaching agencies in more than 20 states across the country. Since its inception, the UnidosUS financial coaching network has helped more than 50,000 families better understand the financial landscape and improve their credit standing to pursue their financial goals. Additionally, UnidosUS was a supporter of the Dodd–Frank Wall Street Reform and Consumer Protection Act and the creation of the Consumer Financial Protection Bureau (CFPB). The establishment of CFPB marked a new era for Latino consumers, with a "cop on the beat" to ensure that every day people interacting with the financial system would be treated fairly.

This written statement focuses on how Latinos are affected by the auto loan industry and its pattern and practice of discriminatory lending—especially regarding indirect auto lending and dealer markup practices. It also addresses how discrimination in auto lending impacts the financial standing of Latinos.

Background

Automobiles are an important mode of transportation in the United States. In many areas public transportation alternatives either do not exist or are not a viable substitute for a car.[1] Americans' reliance on cars is demonstrated by the fact that 86% of all households and 76% of minority households own a car.[2] Additionally, transportation is the second-largest expense for American households after housing.[3] The average American household spends more than $4,000 a year on vehicle purchases, nearly $2,000 on fuel and motor oil, and nearly $1,000 each on vehicle insurance and repairs.[4] The high cost of car ownership forces many Americans to borrow money in order to have reliable access to a car, and the share of Americans with vehicle debt has grown over time. For example, in the third quarter of 2018, 85% of all new car purchases relied on financing, compared with 75% in 2009.[5] The amount owed by the average American on their car

* The terms "Hispanic" and "Latino" are used interchangeably by the U.S. Census Bureau and throughout this document to refer to persons of Mexican, Puerto Rican, Cuban, Central and South American, Dominican, Spanish, and other Hispanic descent; they may be of any race.

loans increased from $2,960 in 2003 to $4,520 in 2017—an increase of 53% in nominal terms and 33% when adjusted for inflation.[6]

Automobiles are especially important for Latinos. Cars are the second-largest financial transaction that a Latino family makes, and most take out a loan to finance their purchase.[7] Often Latino families receive this loan from an auto dealership rather than directly from a financial institution—a practice known as "indirect auto lending."[8] In indirect auto lending, the dealer uses a third party lender—such as a bank, credit union, or other financial institution—to establish an interest rate for the loan.[9] When the dealer relays this interest rate to the customer, it is generally higher than the rate the lender quoted to the dealer. This increase in rate is typically called a "dealer markup."[10] The lender shares part of the revenue from the increased interest rate with the dealer. Interest rate markups generate compensation for dealers while providing them with discretion to charge consumers a different rate than the lender, regardless of consumer creditworthiness, costing customers $1.1 billion annually.[11] It is estimated that between one-third and more than one-half of car buyers use dealer financing.[12]

The ability for auto lenders to increase a customer's interest rates has led to differences in pricing based on race, national origin, and other illegal bases.[13] In 1991, Yale Law Professor Ian Ayers conducted a studyby sending testers of various races and ethnicities to new car dealerships in Chicago and found that Black male testers were asked to pay more than twice of what was asked of White male testers.[14] More recently, both the CFPB and the Department of Justice (DOJ) concluded in recent investigations that car dealerships' practice of marking up interest rates for auto loans results in discrimination for minority buyers.[15]

Latinos are frequently targets of these discriminatory practices and are often charged higher markups than other similarly situated consumers. For example, according to a 2018 study by the National Fair Housing Alliance (NFHA), 62.5% of the time non-White testers who were more qualified in terms of credit scores and income-to-debt ratios than their White counterparts, received higher pricing options and less favorable lending terms.[16] Because of these discrepancies, NFHA found that non-White testers who experienced discrimination would have paid an average of $2,662.56 more over the life of their auto loan than less-qualified White borrowers. Additionally 75% of the time, White testers were offered more financing options than non-White testers. And, dealers offered to help reduce interest rates and car prices using incentives and rebates for White testers more often than they did for non-White testers.[17]

Continued Loosening of Lending Standards Has Created a Subprime Auto Lending Market

During the Great Recession, American homeowners including Latinos, were disproportionately steered into unaffordable, subprime loans. As a result of this practice, homeowners who lost their homes to foreclosure suffered a tremendous loss of home equity and damaged credit. In the auto lending market, lenders have also moved towards subprime loans. Specifically, these loans extend the length of repayment terms, lend at higher loan-to-value ratios, and fail to take into consideration a borrower's ability to repay. In 2009, only 14% of auto debt was subprime or below.[18] But by 2016, lending to subprime and deep subprime borrowers made up as much as 26% of all auto loans originated that year.[19]

While longer-term loans result in smaller, more manageable monthly payments that increase the affordability of a vehicle purchase, the speed with which vehicles depreciate often result in consumers becoming "underwater" on their loans. Research suggests that longer loan terms are particularly important in encouraging low-income borrowers to purchase cars, while higher income purchasers are more sensitive to interest rate changes.[20] The CFPB found that in 2017, the average credit score of a borrower taking out a six-year auto loan was 39 points below that of a borrower with a five-year term auto loan. Because subprime borrowers typically pay higher interest rates on auto loans, the effect of a longer term on the total cost of the vehicle over time is magnified.[21] A borrower with a six-year loan is twice as likely to default as one with a five-year loan.[22]

Abusive and Predatory Loan Practices Threaten Latino Economic Security

Certain lending practices in the subprime auto market are saddling consumers with excessive debt, threatening their long-term economic security. The practices described below are among the more common encountered in the subprime market.[23]

Excessive Interest Rates

Consumers with low credit scores or no credit history are typically subject to higher interest rates in their limited credit options. Some dealers who finance the vehicles themselves ("buy here, pay here" businesses) are able to charge even more excessive rates by locating in states that are exempt from state usury laws.[24] These high interest loans make the car purchase more expensive and make it more likely for a borrower to default.

Misleading and Incomplete Information

Borrowers may not be given accurate information about the total loan cost from a subprime auto lender or dealer, or misled about the presence of add-on products or the full terms of the loan. Additionally, the increasing use of electronic contracts (e-contracts) can make it easier to hide fees and loan terms and make it difficult to review important information in fine print. Another tactic some dealers have used is to first push consumers into a conditional sales agreement rather than a final sale. Once the buyer has taken the car home, the dealer will claim it is difficult to finance the loan and require the borrower to return the car and renegotiate a new loan that will most likely be to the borrower's disadvantage.[25]

Ability to Repay Not Taken into Consideration

Another troubling pattern similar to the subprime mortgage crisis is that some subprime auto lenders and dealers will inflate a borrower's income and require no income verification. This will qualify them for a higher loan than they would receive, if the loan had adhered to traditional underwriting standards. This ultimately harms consumers, who may end up with car payments they cannot afford or are unable sustain for the duration of the loan.

Bogus and Unnecessary Fees and Products

Dealers can steer customers toward overpriced add-on products and lead the customer to believe the products are mandatory, when they are not. In addition, inflated fees for items like paperwork filing can add to the initial cost of a vehicle.[26] These additional costs can be difficult for a customer to decipher or reject when they are presented in a deceptive manner by the dealer. For example, in 2018, Wells Fargo was ordered to pay a $1 billion fine for charging more than half a million car loan customers for additional insurance they did not need. Wells Fargo is also required to provide hundreds of millions of dollars in relief to affected customers.[27]

Abusive Collection and Repossession Tactics

If a customer is ultimately unable to afford their car loan, it will likely be repossessed. While this is a practice that is not necessarily predatory, some auto lenders have monetized repossessions at the expense of borrowers, making it a new business model. In many repossession cases, borrowers who are underwater on their loans end up with an outstanding balance, even after the vehicle is repossessed. This enables the lender to collect repossession fees, try to collect past-due payments, and in some cases, sue delinquent borrowers for the remaining balance.[28] Some dealers will try to pressure a customer whose vehicle was repossessed to regain their car, even in instances where it was clear the customer could not afford the payments. This has resulted in the same vehicles being repossessed several times, driving customers further into cyclical debt.[29]

Conclusion

Given these predatory practices that have a discriminatory impact on Latinos, the CFPB's oversight authority should be expanded to auto dealers to better address marketplace discrimination directly and through coordinated efforts with state Attorney's General and the Federal Trade Commission (FTC). By expanding the CFPB's jurisdiction, Latinos and other vunerable customers will be protected from predatory practices that can weaken their financial standing.

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