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October 23, 2013

The Honorable Edith Ramirez
Chairwoman
Federal Trade Commission
600 Pennsylvania Ave. NW
Washington, DC 20580

Dear Chairwoman Ramirez;

I write to request that the Federal Trade Commission (FTC) initiate an examination of reports[1] of car dealers using potentially unfair or deceptive financing practices to sell cars to consumers and then take all appropriate action to address these practices to protect consumers.

It appears that many car dealers may be engaging in secret dealer markups of interest rates, a practice where a car dealer colludes with a third party lender to increase the interest rate on a customer's car loan to above-market rates, with the dealer then keeping a portion of the rate increase as a form of 'kick-back'. Second, some car dealers appear to be using so-called "yo-yo schemes" to sell cars. In such a scheme, a car dealer allows a customer to drive off with a car as though the sale of the car is complete, but then requires the customer to return to the dealership and agree to pay more than was previously agreed or surrender the car back to the dealership.

Based on the industry's own data from 2009, "the average dealer interest markup was $714 per customer with an average rate markup of 2.47 percentage points," yet the overall gross profit per retail sale was $1,461.[2] Additionally, "[c]onsumers who financed cars through a dealership will pay over $25.8 billion in interest rate markups over the lives of their loans."[3] These practices cause significant and unnecessary increases in the cost of an automobile for

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[1] ABC News, "Beware the Car Dealer Yo-Yo," August 28, 2013, available at http://abcnews.go.com/Nightline/video/beware-car-dealer-yo-yo-20102098; Jim Henry, "The Surprising Ways Car Dealers Make the Most Money Off You," *Forbes*, February 29, 2012, available at http://www.forbes.com/sites/jimhenry/2012/02/29/the-surprising-ways-car-dealers-make-the-most-money-off-of-you/; Ann Carrns, "Getting the Best Rate on a Car Loan," *New York Times*, May 4, 2011, available at http://bucks.blogs.nytimes.com/2011/05/04/getting-the-best-rate-on-a-car-loan/; Consumer Financial Protection Bureau, "CFPB to Hold Auto Lenders Accountable for Illegal Discriminatory Markup," March 21, 2013, available at http://www.consumerfinance.gov/pressreleases/consumer-financial-protection-bureau-to-hold-auto-lenders-accountable-for-illegal-discriminatory-markup/.

[2] 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, page 2, available at http://www.responsiblelending.org/other-consumer-loans/auto-financing/research-analysis/Under-the-Hood-Auto-Dealer-Rate-Markups.pdf.

[3] 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, page 2, available at

average Americans and suggest that some dealers may be engaged in unfair or deceptive trade practices that may be in violation of some of the federal laws within the Commission's jurisdiction. As you know, the Dodd-Frank Wall Street Reform Act granted new powers to the Commission to issue regulations to protect consumers from unfair car financing practices. I encourage the Commission to exercise these new powers, along with its authority under the Federal Trade Commission Act, to investigate this matter and ensure that car dealers are not unlawfully harming consumers in the pursuit of profits.

Car dealers often enable consumers to secure loans to finance their car purchases. When consumers buy a car, they may not separately seek out financing for the car in the marketplace; instead, they often secure financing from the car dealer from whom they are purchasing their vehicle, as it may be more convenient to effect both the purchase of the vehicle and the arrangement of financing for it at the same time. The consumer may be unaware that the dealer often uses a third party lender who might be interested in holding the consumers' car loan. Once the dealer finds a third party willing to lend money to the consumer, the third party tells the car dealer the interest rate that it will offer for the consumer's loan.[4] Ultimately, the car dealer and the third party lender then partner together to finance the consumer's car loan. According to a report by the Center for Responsible Lending, car dealers reaching out to third parties accounts for over 79 percent of auto loan volume.[5]

Yet, car dealers are not always merely setting these loans at market rates. According to both the Center for Responsible Lending and the Consumer Financial Protection Bureau, these loans often have higher interest rates than the consumer would receive on the open market: a loan for a new vehicle would receive an average rate markup of 1.01 percentage points, while a used vehicle would receive an average rate markup of 2.91 percentage points.[6] Additionally, the dealer receives a portion of the profits from the surcharge.

> Indirect auto lenders often allow the dealer to charge the consumer an interest rate that is costlier for the consumer than the rate the lender gave the dealer. This increase in rate is typically called "dealer markup." The lender shares part of the revenue from that increased interest rate with the dealer. As a result, markups

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[4] Consumer Financial Protection Bureau, "CFPB to Hold Auto Lenders Accountable for Illegal Discriminatory Markup," March 21, 2013, available at http://www.consumerfinance.gov/pressreleases/consumer-financial-protection-bureau-to-hold-auto-lenders-accountable-for-illegal-discriminatory-markup/.

[5] 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, page 8, available at http://www.responsiblelending.org/other-consumer-loans/auto-financing/research-analysis/Under-the-Hood-Auto-Dealer-Rate-Markups.pdf.

[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, page 10, available at http://www.responsiblelending.org/other-consumer-loans/auto-financing/research-analysis/Under-the-Hood-Auto-Dealer-Rate-Markups.pdf.

> generate compensation for dealers while frequently giving them the discretion to charge consumers different rates regardless of consumer creditworthiness.[7]

These interest rate markups are immensely profitable to car dealers. An analysis of 2009 industry data by the Center for Responsible Lending revealed that "the average rate markup was $714 per customer with an average rate markup of 2.47 percentage points."[8] Collectively, these markups of a few interest points place a massive financial burden on consumers. In total, "consumers who financed cars through a dealership will pay over $25.8 billion in interest rate markups over the lives of their loans."[9] Additionally, as a point of comparison, the average gross profit per retail sale for car dealers was just $1461 in 2009. [10] In other words, rate markups were responsible for as much as 48% of the average total profit per car sale.

Some car dealers have argued that this markup is nothing more than fair compensation for the service of finding loans for their customers.[11] Yet, a 2010 survey by Public Policy Polling found that 79% of surveyed respondents "were not aware that dealers have the ability to markup interest rates." If the vast majority of consumers are unaware that they can be assessed a surcharge on their car loans by their dealer and that they are likely to be able to find much more favorable loan terms on their own, it becomes very difficult to deem such surcharges as 'fair' compensation.

Disturbingly, these surcharges are also apparently not applied uniformly to all consumers. People with poor credit scores, many of whom have faced financial distress in the past and are trying to rebuild their lives, typically are hit with larger interest rate markups than the average person. In fact, a regression analysis by the Center for Responsible Lending found that "loans from finance companies which have a greater focus on serving subprime borrowers may see an extra 5.04 percentage points added to their interest rate" over the market rate in the form of a

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[7] Consumer Financial Protection Bureau, "CFPB to Hold Auto Lenders Accountable for Illegal Discriminatory Markup," March 21, 2013, available at http://www.consumerfinance.gov/pressreleases/consumer-financial-protection-bureau-to-hold-auto-lenders-accountable-for-illegal-discriminatory-markup/.

[8] 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, page 2, available at http://www.responsiblelending.org/other-consumer-loans/auto-financing/research-analysis/Under-the-Hood-Auto-Dealer-Rate-Markups.pdf.

[9] 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, page 2, available at http://www.responsiblelending.org/other-consumer-loans/auto-financing/research-analysis/Under-the-Hood-Auto-Dealer-Rate-Markups.pdf.

[10] 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, page 2, available at http://www.responsiblelending.org/other-consumer-loans/auto-financing/research-analysis/Under-the-Hood-Auto-Dealer-Rate-Markups.pdf.

[11] 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, page 11, available at http://www.responsiblelending.org/other-consumer-loans/auto-financing/research-analysis/Under-the-Hood-Auto-Dealer-Rate-Markups.pdf.

dealer markup.[12] As a result, these interest rate markups are harming those Americans with the least resources, many of whom desperately need a car to get work and keep their families out of poverty.

As financially damaging as dealer markups are, however, so-called "yo-yo schemes" may be even more pernicious. As noted above, these schemes involve situations where a car dealer allows a car buyer to leave the dealership with the car. In this situation, the "consumer is led to believe, through acts or omissions by a car dealer providing financing, that the loan financing is final when in fact the dealer has not finalized the financing at all."[13] The car dealer then draws the consumer back to the dealer "like a yo-yo on a string."[14] The car dealer then states that the financing situation has changed and presents the buyer with a Hobson's choice: either agree to pay a higher interest rate or larger down payment than previously agreed or surrender the car.

Other details of yo-yo schemes are even more troubling. Car dealers do not necessarily ask the purchaser to return to the lot within a few hours or days of the initial sale. Instead, some car dealers wait weeks to demand that the purchaser return and renegotiate the sale.[15] Additionally, some car dealers appear to be sending car purchasers home while harboring doubts that the third party terms will work or even believing that no third party lenders will agree to lend money to the car buyer.[16] In other words, the dealer can simply decide on a whim after a few weeks that he is unhappy with the loan terms actually offered by third party lenders, demand that the consumer return to the dealership, effectively ransom the consumer's new vehicle until the consumer agrees to either give back the car or pay the dealer's new, higher price.

It is not easy for a consumer to return a car after they have owned a car for a few weeks and potentially rearranged their personal and professional lives around it. Some consumers may have even sold or traded in their previous vehicle, potentially leaving them with no transportation if they must surrender their new vehicle. Yet, dealers using these yo-yo schemes have the ability to make it very difficult for a consumer to simply return the car:

> "To further increase the dealer's advantage over consumers, the dealer may refuse to return the consumer's trade-in vehicle or the consumer's down payment. The

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[12] 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, page 11, available at http://www.responsiblelending.org/other-consumer-loans/auto-financing/research-analysis/Under-the-Hood-Auto-Dealer-Rate-Markups.pdf.

[13] Delvin Davis, "Deal or No Deal: How Yo-Yo Scams Rig the Game Against Car Buyers," *Center for Responsible* Lending, page 1, available at http://ftc.gov/os/comments/motorvehicleroundtable/00104-82860.pdf.

[14] Center for Responsible Lending, Consumer Federation of America, Consumers for Auto Reliability and Safety, National Association of Consumer Advocates, National Consumer Law Center (on Behalf of Its Low Income Clients), and National Council of La Raza, "Comments to the Federal Trade Commission – Motor Vehicle Roundtables," February 1, 2012, available at http://www.consumerfed.org/news/456.

[15] Delvin Davis, "Deal or No Deal: How Yo-Yo Scams Rig the Game Against Car Buyers," *Center for Responsible* Lending, page 3, available at http://ftc.gov/os/comments/motorvehicleroundtable/00104-82860.pdf.

[16] Delvin Davis, "Deal or No Deal: How Yo-Yo Scams Rig the Game Against Car Buyers," *Center for Responsible* Lending, page 2, available at http://ftc.gov/os/comments/motorvehicleroundtable/00104-82860.pdf.

> dealer may also threaten to charge the consumer fees for mileage put on the car, wear and tear, or other items. In some cases, the dealer may threaten to call law enforcement on charges of auto theft if the consumer does not return the vehicle immediately. Under the mounting pressure of the situation, many consumers agree to the new loan terms."[17]

The Federal Trade Commission Act states that "Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful."[18] As noted above, consumers appear to be unaware that they are paying more than market rates on car loans due to the widespread practice of dealer markups. If consumers do not know that they are likely to be getting a bad deal, they will not seek a new rate from the rest of the market; in other words, this situation is creating a market failure. I am therefore concerned that dealer markups are an unfair method of competition. Similarly, car dealers appear to use yo-yo schemes to unilaterally force unsuspecting consumers to either renegotiate their interest rate or surrender their car. Given that yo-yo schemes appear to allow car dealers to dictate new contract terms to consumers after the consumer believes the purchase is complete, I am also concerned that yo-yo schemes are either an unfair or deceptive act or an unfair method of competition.

Beyond the Commission's traditional powers to protect consumers, the FTC recently gained new authority to ensure that consumers are not taken advantage of by car financing practices. Under the Dodd-Frank Wall Street Reform Act enacted in 2010, the Commission has explicit authority to "prescribe rules under sections 5[19] and 18(a)(1)(B)[20] of the Federal Trade Commission Act" regarding "a motor vehicle dealer that is predominantly engaged in the sale and servicing of motor vehicles, the leasing and servicing of motor vehicles, or both."[21]

I understand that, in the wake of receiving these new powers, the Commission held a series of roundtables in 2011 on "issues that may arise in the sale, financing or leasing of motor vehicles."[22] Additionally, the Commission also received "public comments on motor vehicle sales, financing and leasing topics until April 1, 2012."[23] The subjects of dealer markups and yo-yo schemes were discussed in some of these roundtable sessions,[24] and comments were received on them.[25]

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[17] Delvin Davis, "Deal or No Deal: How Yo-Yo Scams Rig the Game Against Car Buyers," *Center for Responsible* Lending, page 3, available at http://ftc.gov/os/comments/motorvehicleroundtable/00104-82860.pdf.
[18] 15 U.S.C. § 45.
[19] 15 U.S.C. § 45.
[20] 15 U.S.C. § 57a(a)(1)(B).
[21] Dodd-Frank Wall Street Reform Act, Section 1029, available at http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf.
[22] "The Road Ahead: Selling, Financing & Leasing Motor Vehicles – a Roundtable," *Federal Trade Commission*, available at http://www.ftc.gov/bcp/workshops/motorvehicles/.
[23] "The Road Ahead: Selling, Financing & Leasing Motor Vehicles – a Roundtable," *Federal Trade Commission*, available at http://www.ftc.gov/bcp/workshops/motorvehicles/.
[24] See Transcript of Session Two of Third Roundtable on November 17, 2011, page 26, available at http://www.ftc.gov/bcp/workshops/motorvehicles/dc_Sess2.pdf; Transcript of Session Three of Third Roundtable on

I am interested in the actions that the Commission has taken, or plans to take, to address the issues uncovered during the roundtable sessions and through the comment period. It is my understanding that the Commission seems to have received direct information and public comments about the damage caused by dealer markups and yo-yo schemes, and that the FTC has taken the important step of taking some enforcement action related to deceptive car dealership ads[26]. However, the FTC has not taken other public steps to curb other unfair or deceptive practices by car dealers. I therefore urge the Commission to initiate a full inquiry to determine whether the practices described above violate the FTC Act. If it finds that they do, I would urge the Commission to take appropriate actions against any persons acting unlawfully, and, as appropriate, initiate a rulemaking to ensure that these practices are prohibited or constrained going forward. Ultimately, Americans should have a right to expect that a car dealer who promises them a good deal on a car loan will actually keep that promise and will not attempt to renegotiate a contract after the consumer has been allowed to drive off with a car.

Additionally, in order to better understand both the practice of dealer markups and yo-yo schemes, I request that you respond to the following questions.

1) Does the Commission have any data on how many car dealerships are using either one of these practices, including the average amount of money a car dealer makes on a dealer markup? If so, please provide me with this data.
2) Has the Commission ever engaged in an enforcement action against a car dealership regarding a dealer markup or yo-yo scheme? If so, please provide details about that enforcement action, including information about any fines or damages the dealership was required to pay.
3) Please describe in detail any plans the Commission currently has to regulate motor vehicle financing, including specific benchmarks for finalizing regulations on this subject.
4) Does the Commission have data about the percentage of contracts between car buyers and car dealers that explicitly state that the car dealer will receive a piece of the dealer markup or that the dealer has the right to make use of a yo-yo scheme? If so, please provide me with this data.
5) Under the terms of the Stark Law (42 U.S.C. § 1395nn), physicians are not allowed to refer customers to an entity for health services in which the physician has an ownership

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November 17, 2011, page 1, available at http://www.ftc.gov/bcp/workshops/motorvehicles/dc_Sess3.pdf; Transcript of Session Four of Third Roundtable on November 17, 2011, page 18, available at http://www.ftc.gov/bcp/workshops/motorvehicles/dc_Sess4.pdf.

[25] Delvin Davis, "Deal or No Deal: How Yo-Yo Scams Rig the Game Against Car Buyers," *Center for Responsible* Lending, page 1, available at http://ftc.gov/os/comments/motorvehicleroundtable/00104-82860.pdf. Center for Responsible Lending, Consumer Federation of America, Consumers for Auto Reliability and Safety, National Association of Consumer Advocates, National Consumer Law Center (on Behalf of Its Low Income Clients), and National Council of La Raza, "Comments to the Federal Trade Commission – Motor Vehicle Roundtables," February 1, 2012, available at http://www.consumerfed.org/news/456.

[26] "FTC Takes Action to Stop Deceptive Car Dealership Ads," Federal Trade Commission, March 14, 2012, available at http://ftc.gov/opa/2012/03/autoloans.shtm.

interest (or cannot do so absent notification in some circumstances). This prohibition exists so that physicians may not directly profit off their own referrals. Does the Commission have any data indicating that some car dealers may be referring customers to specific third-party financing entities in which the car dealer has an ownership interest or contractually stands to profit from such referral? If so, please provide me with that data.

6) Does the Commission agree that one component of a policy designed to ensure that yo-yo schemes and dealer markups do not constitute unfair or deceptive trade practices would be to provide disclosure to customers that these practices are occurring via a written notice on a single sheet of paper in an easily readable type?

Thank you for your attention to this important matter. Please have your staff contact Justin Slaughter or Michal Freedhoff of my staff at 202-224-2472 with any questions. I request that you respond to this letter by November 14, 2013.

Sincerely,

Edward J. Markey

Edward J. Markey
United States Senator