THE CAPITOL FORUM January 6, 2016

Auto Financing: Update on Credit Acceptance Investigation; Fair Lending, Deceptive Add-ons, Aggressive Debt Collection and Repossession Are Likely Areas of Focus in State Inquiries

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State Investigation Update

Credit Acceptance Corporation has now revealed that two state attorneys general are investigating its business practices - in addition to the DOJ - with the company receiving a civil investigative demand from the Attorney General of Massachusetts on December 4, 2014, and a subpoena from the Attorney General of New York on September 18, 2015. These come as part of a number of investigations targeting the company's lending, collection, and fair-lending practices.

Per Credit Acceptance's disclosure, one of its subpoenas came from the NY Attorney General's Civil Rights Bureau, an office whose work includes protecting "access to fair housing and lending opportunities." As such, a violation of fair lending laws is almost certain to be a primary area of investigation for the New York AG. However, given the purview of both attorneys general over consumer protection issues, the reported unfair and deceptive business practices of Credit Acceptance are very likely to be in focus as well.

To get a better understanding of what issues the attorneys general may be investigating as they probe Credit Acceptance, we spoke with consumer advocates in Massachusetts and New York about the harms consumers in their states are experiencing and what state consumer protection laws may apply. In compiling this article, we interviewed a range of sources including an attorney from the non-profit New York Legal Assistance Group in Manhattan, an attorney from the National Consumer Law Center in Boston, and a former Assistant Attorney General of Massachusetts.

Harms to consumers. Based on conversations with consumer advocates in Massachusettes and NY, we expect that the AGs are focused on the following harms:

- Debt collection: Advocates report various abusive debt collection tactics either by Credit Acceptance or its vendors.
- Repossession and sale practices: Auctions or sales of repossessed vehicles may not be commercially reasonable, resulting in low sale prices and high remaining debt for consumers.
- Deceptive add-ons: Vehicle service and service products are packaged into loans in a way that obscures to the consumer their true cost and value. In some cases, such as GAP insurance, consumers are unable to get value out of them and rack up more debt.

Potential remedies. Both attorneys general will be likely to push for a number of conduct-based remedies that may address the harms above. The source also noted that for this purpose, the Massachusetts Attorney General tends to prefer settlements, which can often resolve the case sooner and can include provisions not available in a

court judgment. With a settlement, the AG can order conduct changes that may not be well suited to an injunction, such as specific conduct changes and ongoing monitoring:

- Behavioral restrictions: These may range from general bans of UDAP conduct to specific restrictions on advertising and representations.

- Audits: These are usually ordered at an interval of every two to three years.

- Reporting obligations: Similar to audits, these involve regular productions of information or documents to show compliance.

- Continuing training obligations for employees: These are common where unlawful conduct involved sales or customer service staff, such as in the state mortgage settlements.

- Appointment of a monitor to oversee corrective action: Both the monitor and its contract must be approved by the AG as part of the settlement.

If the office of the attorney general cannot reach agreement or urgent action is needed, it will file a lawsuit, and may sometimes seek an injunction depending on the urgency of the harm.

Investigation Timing

According to a former attorney from the Massachusetts AG, the timing of investigations and enforcement actions is uncertain because it may revolve around numerous factors such as the legal issues involved, the need for intensive requests such as oral testimony, and effectiveness of settlement negotiations. However, for actions that have been made public, state investigations appear to move at a faster pace than federal ones. The Massachusetts Attorney General investigation and settlement with Santander may provide a useful frame of reference, since it dealt with a similar business: the AG reportedly issued a subpoena to Santander in December 2014 and then settled claims related to the interest rates of its auto loans in November 2015. Credit Acceptance received its subpoenas from Massachusetts in December 2014 and from New York in September 2015. While timing is uncertain for the reasons explained above, the time elapsed since the investigation commenced in Massachusetts could mean that stakeholders should expect a resolution in the coming months.

Credit Acceptance's Practices: Harmful Debt Practices During Collection and Repossession

According to John Van Alst, an attorney with the National Consumer Law Center in Boston, problems with Credit Acceptance's treatment of defaulted loans include "a whole range of things from sales of repossessed vehicles that aren't commercially reasonable to violations of state or federal debt collection statutes." He added "there's a whole bunch of other things which you could see with anybody collecting debt, but it seems to be more egregious or happen more often with Credit Acceptance." He also stated that abusive collection practices such as deceptive legal threats and harassing phone calls seem to happen "quite a bit."

Advocates from both states reported aggressive and potentially unlawful actions surrounding the repossession and sale of vehicles of borrowers in default. One issue most notable for its financial harm to defaulted borrowers is the alleged failure of auto lenders to hold a commercially reasonable sale of the repossessed car. A sale is

considered not commercially reasonable when a car is sold by the lender for much less than what would be considered a reasonable value. Commercially unreasonable sales often leave the car buyer with a huge debt since the cash from the sale does not significantly cut into the amount owed. Further, as a result of these types of sales, collection efforts will continue and the defaulted balance will continue to grow even after the car has been sold. Advocates also reported other instances of processing error to the detriment of borrowers, such as the company not properly applying a customer's GAP insurance, which covers the shortfall between the remaining balance on a loan and the insurance payout in cases where a borrower's car was totaled in an accident.

Legal options for AGs: Strong laws give Massachusetts more powerful tools. As we have explained in previous reports, Credit Acceptance is subject to the CFPB's UDAP authority, which it has already used to apply the principles of the federal Fair Debt Collection Practices Act (FDCPA) to original creditors. The FDCPA only applies to third-party debt buyers, although the CFPB may soon extend its reach to primary creditors through rulemaking.

Massachusetts has its own debt collection practices law, which also applies to original creditors like Credit Acceptance. The Massachusetts statute is similar to the FDCPA but has much stricter provisions on how many times creditors can communicate with debtors (two per week). It also allows higher levels of damages because a violation is also a per se violation of the Massachusetts Consumer Protection Act. New York has a state debt collection law as well, but it does not apply to original creditors. Regarding repossession practices, both states have the tools to investigate and punish a company's failures to sell in a commercially reasonable manner.

Both states have adopted the relevant part of the Uniform Commercial Code that requires creditors to dispose of repossessed collateral in a commercially reasonable manner. Stakeholders should note that the fact that a car has been sold for a low price does not necessarily make the sale commercially unreasonable; this is a determination usually made by a court based on a variety of factors. The Massachusetts Attorney General has the ability to enforce the provisions of the statute, which provide for both monetary and criminal penalties (§21), and just like the state debt collection law, triggers a per se violation of the state consumer protection act. New York has adopted the UCC's Commercially Reasonable Sale requirements as well at NY Code Section 9-610, although New York's statute is less clear on public enforcement and penalties.

A Closer Look at Add-on Products

Both advocates explained that they see issues with Credit Acceptance's ancillary products, which add to the overall cost of loans. Our sources explained that these products are sold often with confusing, rushed, or otherwise aggressive sales pitches. Both advocates mentioned they worked with clients who signed up for warranties or vehicle service contracts that the clients did not fully understand. GAP Insurance is also offered in a way that may be deceptive about consumer choice, actual value, or both. This type of insurance policy may pay the difference between the balance of the loan on the vehicle and what the auto insurance company pays if the car is considered a covered total loss. While gap insurance is a widely offered optional insurance product, the NCLC attorney reported that some consumers did not know that they were purchasing it until they saw a bill, while others were persuaded at the dealership. As mentioned above, consumers were often unable to avail themselves of the benefits of their coverage, such when as the company would pursue them for a deficiency even when they had GAP coverage.

Advocates from both states described deceptive tactics that may be used at the dealership to induce consumers to sign up for these add-ons. Shanna Tallarico, an attorney with New York Legal Assistance group, explained how

at the dealership, buyers can be rushed through the sales process into signing a contract. "They get people fixated on something that seems feasible, like the monthly obligation," instead of the total cost. The contract then shows the total cost, with extras, but it is presented to the consumer very quickly at the time of signing. Van Alst of NCLC explained a tactic that may be used to roll the add-on products into the cost of the loan, known as "menu selling": car buyers will be presented with several menus of products and services that come with the car financing, such as those mentioned above. However, the consumers don't realize that they do not have to buy any of them, or that the prices for the individual services could be negotiable, so they end up paying more than necessary.

Legal options for AGs: States can look to federal case law for guidance. As we have explained in previous reporting on autos and other consumer credit, both federal and state regulators will continue to regulate ancillary products, which are often suspect with regulators as they can raise UDAP issues. Add-on products are especially likely to be deceptive when lenders package them into loans without giving consumers transparency or choice, or when they do not deliver the value promised to consumers. Both New York and Massachusetts have UDAP statutes, often known as state FTC acts. Massachusetts General Law Ch. 93A broadly prohibits unfair and deceptive practices, allows for both public and private enforcement, and allows for consumer restitution, civil penalties, and equitable relief, such as injunctions. New York General Business Law § 349 has similar provisions and allows for enforcement by the Attorney General, with enforcement by private suits for deceptive acts only. Additionally, Massachusetts' statute specifically instructs that interpretations by the FTC and federal courts be used as guidance by state enforcers and courts.

Narrative from a low-income client quantifies harm to consumers. We spoke with Tallarico about one client's particularly negative experience with a vehicle loan from Credit Acceptance. This consumer's particular story ties together all of the issues mentioned above with a large amount of monetary harm that would not have been avoidable without the intervention of an attorney. While regulators need to use complaint numbers and other quantitative measures to decide how much harm a company is causing consumers, individual narratives of harm to consumers can serve as tools for regulators in investigations and to support the allegations in their enforcement suits.

In 2008, the client went to a used auto dealer in the New York area to shop for a car and bought a 2001 Ford Expedition. He paid a down payment of $6,000, and the dealer financed the rest of the purchase price through Credit Acceptance at 20.49% interest. The client did not recall any credit check or verification of his ability to repay, but the total cost of his loan was over $17,000, including the interest and fees. Also included was a warranty package the client did not understand; according to Tallarico, "he really didn't know anything about the financial product he was getting himself into." After making payments as agreed for months, the client lost one of his jobs and eventually fell behind and defaulted on his loan. His car was repossessed and sold at a private sale for $1,800, leaving only $900 towards the principal after auction fees. As Tallarico explained, this represented a $13,000 loss on cash value of the car at the time of purchase.

In 2010, Credit Acceptance sued Tallarico's client for the remainder due on his contract, which was almost $10,000. After a series of procedural motions and oppositions, during which the amount sought by Credit Acceptance grew to $12,000, for which the company sought a default judgment. At this point, the client finally found New York Legal Assistance Group and retained Tallarico as his attorney. When Tallarico was able to get the case to trial in order to contest the amount owed, Credit Acceptance chose not to pursue the case further, which left the client free of the remaining debt. For what reason the company chose not to pursue the $12,000

case is unclear, but it suggests that the company may rely on a lack of procedural scrutiny or challenges to its collection process.