

Credit Acceptance: All Eyes on Mass AG Regarding Enforcement of Credit Acceptance and Subprime Auto Industry

Regulatory Update

Currently, the subprime auto sector, and Credit Acceptance Corporation in particular, are subject to investigation from a number of state attorneys general, but industry sources indicate that the Massachusetts Attorney General's likely enforcement against Credit Acceptance is particularly important because the expected oversight policies required of the company would lead to a reduction in the company's originations, collections and number of active dealers in the state.

The most likely outcome from the investigation is that the AG will settle with Credit Acceptance and enter into a consent decree that includes a range of provisions that would at a minimum curb Credit Acceptance's loan volume growth and collections in Massachusetts.

The biggest risk to Credit Acceptance from a Massachusetts AG settlement is that the settlement becomes a template for other states to use, mapping out a potential investigation and enforcement action against Credit Acceptance. Kathleen Engel, a national authority on consumer credit, law professor at Suffolk University and an advisor to federal and state agencies on various matters related to financing of loans, explained how states look to each other when it comes to enforcement:

"In cases the with the most egregious violations, states can help change practices across the county by entering into Assurances of Discontinuance that include a public recital of the allegations and the evidence that the state has against the wrongdoers. Other jurisdictions will then know the theory of the case and the evidence. It can be a template for other state regulators going forward with similar claims."

The potential for coordinated enforcement at the AG level going forward is very real, given that states are considering a broader task force on subprime auto policy. "There have been open discussions in state AG meetings about the need to form a mortgage-crisis-like multistate taskforce to focus on the auto lending and servicing market, particularly the subprime market," wrote Alan Wingfield, a partner at Troutman Sanders, in an article [posted](#) on the American Bar Association's businesslawtoday.org.

It's possible that an announcement related to the AG's investigation into Credit Acceptance comes before the November midterms, which would be roughly a year after the second CID was issued to the company. Massachusetts Attorney General Maura Healy, a popular Democratic incumbent, is running for reelection for her second term in a state that hasn't had a Republican AG since 1969. Even so, she has drawn two Republican challengers so far (the Republican primary is in September).

Besides Massachusetts, the Attorneys General of New York, Maryland and Mississippi are probing assorted business practices at Credit Acceptance, as are the FTC and the DOJ. So too, is the CFPB, but that risk has substantially lessened. In 2016, the company settled to resolve matters with the Attorney General of Kansas and last year with the New York Department of Consumer Affairs.

A spokesperson for the Massachusetts Attorney General's office said the investigation is ongoing but could not provide further comment or details. Credit Acceptance did not respond to a list of questions emailed to the company.

Closer Look at Massachusetts AG Process

In a recent [SEC filing](#), Credit Acceptance said the Massachusetts AG, which in 2014 began [probing](#) the company's loan origination and collection practices, has broadened the investigation to include [securitization activities](#). The AG is also seeking additional information through a second civil investigative demand, which Credit Acceptance received in November 2017. Credit Acceptance currently [acknowledged](#) seven ongoing federal and state investigations into various business practices at the company.

In the aftermath of the financial crisis, Massachusetts focused on unfair and deceptive practices under the state's consumer protection laws in the mortgage context, holding accountable originators, lenders and securitizers for alleged conduct that lead to consumers' inability to repay subprime loans. Under Martha Coakley, Healy's predecessor, the office was the first in the nation to investigate and hold securitization firms accountable for their role in the subprime mortgage crisis.

Many of those enforcement actions were the result of lengthy investigations by the Massachusetts AG working jointly with other states and regulatory agencies. Healy's office has an ongoing industry-wide review of securitization practices in the subprime auto market.

It is most likely that the staff of the Insurance and Financial Services Division (IFSD) at the AG's Office is handling the Credit Acceptance matter. Division chief Glenn Kaplan, who graduated from Harvard Law in 1990, is also an adjunct professor and lecturer at various law schools in the Boston area and teaches courses in consumer protection law, securities regulation, and antitrust.

Kaplan's enforcement practice includes a focus on lending, insurance products, and securitization relating to student loans, mortgages, and auto loans. For years, Kaplan worked alongside a key IFSD team member and fellow Harvard Law grad, Aaron Lamb, who unexpectedly passed away in December 11, 2016 at the age of 38. The resolution of the Santander Consumer USA case was dedicated to Lamb.

Ira Rheingold, Executive Director and General Counsel of the National Association of Consumer Advocates, explained the types of questions the Massachusetts AG is likely to ask during the Credit Acceptance probe:

“What is Credit Acceptance receiving from the dealer? So, here's the question you would find when you look at the borrower's loan application documents. Are the documents being doctored to fit the loan criteria or is there non-compliance with the underwriting standards to approve loans even though there's no ability to repay based on existing underwriting standards? Approving loans for borrowers you know are not going to be able to repay might be an unfair practice under the state's consumer protection laws.”

Closer Look at Potential Settlement Conditions

Below we provide a menu of potential conditions—targeting underwriting, origination, dealer oversight, collection and securitization—ranging from most significant to least significant, that could be pursued by the Massachusetts AG when it comes to a settlement. The items in this list are drawn from a recent settlement that Santander entered into with Credit Acceptance, from conversations with legal experts, and from findings from our own investigation into Credit Acceptance's business practices.

Prohibit securitization of Massachusetts loans that are unfair under state law. The Santander settlement obligated the company screen Massachusetts loans to prevent the securitization of those loans that violate the laws of the Commonwealth for “reasons not limited to unfair or deceptive dealer conduct and the associated risk that the borrower will be unable to repay the loan.”

Additionally, the settlement required Santander to identify and repurchase those loans that are securitized in the future that do not comply with MA law. Should the AG impose this requirement on Credit Acceptance, it is likely to have a negative impact on the number of active dealers and origination volume in Massachusetts since the company will be less inclined to accept assignment of noncompliant loans.

Strengthen underwriting. The AG could require all newly originated Massachusetts loans be audited for compliance with the company’s underwriting guidelines and ensure that noncompliant loans are not securitized. A Credit Acceptance Program Set Up manual for dealers reviewed by *The Capitol Forum* details minimum requirements to qualify for a loan; 15% down payment, minimum monthly gross income of \$800, evidence of physical damage insurance, proof of residence and a valid driver’s license or other valid governmental issued identification.

According to regulatory filings, the company’s Dealer Service Center processes loan applications which includes tasks such as assessing the adequacy of documentation, compliance with underwriting and legal guidelines, verifying employment and residence. The AG is likely to be probing to what extent Credit Acceptance is examining the accuracy of information on loan applications to ensure that dealers are complying with the company’s guidelines and that borrowers are able to repay the loans.

Require proof of income on certain loans. If Credit Acceptance has determined specific dealers engage in problematic practices such as income inflation, sales price inflation, adding unwanted ancillary products or originating especially risky loans, then the AG could require that proof of income and other loan application procedures be upheld for those dealers without exception, as it did in the Santander settlement.

Tighten dealer oversight. The AG could require Credit Acceptance perform Massachusetts dealer audits and take corrective action on those that reveal problematic business practices.

In the Santander settlement, the AG found Santander had weak dealer oversight policies and a high bar for measuring suspect dealer practices. Examples the AG found are insufficient attention paid to dealers unless more than half of the verified loans in a dealer audit indicated income inflation and income inflation was considered only when the inflation was at least \$500 or \$1,000 per month.

The company continued to purchase loans even when dealer audits showed “Santander was able to verify a significant percentage, approximately 40%, of income inflation loans by asking the borrowers about their income. Where borrowers self-identified that their reported incomes were false, this was an indication that the false information derived from the dealer.” A crackdown on dealers is likely to cut into both the number of active dealers and originations.

Scrutinize new dealers’ loan performance sooner. Should the AG require closer monitoring of new dealers and the performance of the loans they assign to the company, it will likely impact the company’s growth strategy.

Not until a dealer has partnered with the company for at least six months and has assigned a minimum of 25 loans does Credit Acceptance base a dealer's risk level on their loan performance, according to a dealer manual. According to the 10-K, new dealer loan volume averaged 13 loans in 2017, indicating that most dealers won't be rated for almost two years under the company's current criteria.

Sever ties with noncompliant dealers. The AG is likely to require Credit Acceptance to heighten its audit and documentation procedures for dealers that the company has identified as having problematic performance. Dealers who originate loans that are unfair and unaffordable under Massachusetts law could be forced from Credit Acceptance's program.

The company has set guidelines and a monitoring mechanism already in place. The company rates its established dealers monthly on a risk assessment scale. The worse the rating the lower the dealer is paid for each loan assignment. The company also has a list of best practices outlined in a dealer manual. The best practices direct dealers to maintain or improve their dealer rating by such acts as writing affordable deals, watching for fraudulent documents, and verifying the accuracy of all customer information.

Adjust credit approval system. The AG could require the company to adjust their credit approval system (CAPS) for MA loans to ban bypassing certain fields as was required by the AG of Santander for certain problematic dealers.

Waive deficiency balances. As part of the settlement agreement with the AG, Santander had to waive any deficiency amounts and other post-default charges due from borrowers for loans that were originated by certain dealers known to Santander to be engaging in problematic practices.

Halt loan collections on certain loans. A requirement to waive deficiency balances would bring a halt to collections on deceptive loans, which would likely hit Credit Acceptance hard since its forecasted collection rate incorporates an aggressive strategy of customer pursuit for decades collecting through court judgments, wage garnishment, bank account levies, and interception of tax refunds.

Make loan docs available to the AG. According to Engel, "the AG could require that the company routinely make all its loan documents available to the state to review to make sure that the company is not engaging in ongoing wrongdoing." Under the settlement with Massachusetts, Santander is required to create, maintain and provide to the state upon request all records to demonstrate compliance with its obligations.

Ensure that investors do not suffer loss. The AG could also require the company ensure that investors in certain securitized loans do not suffer a loss of principal in case of borrower default, as was required in the Santander settlement. Credit Acceptance's securitization disclosures warn investors that the loans may be delinquent, in default or that the borrowers may be in bankruptcy.

Fines. Santander was fined \$22 million; \$16 million for consumer relief and \$6 million to the Commonwealth for facilitating unfair and unaffordable loans by certain dealers over the time period from 2009 to 2014.