THE CAPITOL FORUM

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Credit Acceptance: A Closer Look at How Company Policies Create Incentives for Fraud at Dealerships

Company Policy Update

Credit Acceptance markets itself to dealers and customers on its ability to finance the purchase of a car to any borrower, no matter how likely that borrower is to default, so it can then securitize and sell its debt. To do so, the company pushes its dealers, both through incentives and explicitly, to increase the total amount financed in a way that often involves deceptive practices in sales and financing. In this article, we provide a recap of our series of articles on Credit Acceptance, and then examine one of the common consequences of the company's business model: fraud committed by dealers.

While the advances paid under the company's Portfolio program are appealing, the system is not lucrative for dealer-partners, and it is often difficult for dealers to operate with integrity and still make a lot of money through Credit Acceptance. As we have explained in previous articles, there are three ways the company encourages dealers to push up the size of the loan in order to profit:

- Company policy encourages dealers to inflate the car price, to a median 35% markup over their retail book value. Dealers are trained to then obscure actual car prices, advertising by monthly payment instead.

- The company sets the standard APR on its car loans at 22-24%, which is often near the legal limit. The CAPS dealer software penalizes dealers who negotiate the interest rate down by sharply reducing the advance.

- Selling add-on products in the form of vehicle service contracts and GAP insurance is very profitable and richly rewarded through commissions. As a result, these products, which are often complained about as being of little value, are sold aggressively.

Dealers who follow the above approach while trying to stay in compliance with the law can still have difficulty making money. Further, as company executives discussed on the third quarter earnings call, the company may cut the amount it advances dealers in times when its expected collection rate falls. In light of these pressures, dealers have to stretch the cost of the loan deal in every way possible in order to make a net profit off of the advance. Many dealers have responded to this incentive by violating the law in the following ways:

- Down payment and document fraud: Dealers may falsify a larger down payment or the borrower's proof of assets and income, both of which boost the advance by making the loan appear less risky.

- Add-on products: Some dealers may use a variety of deceptive tactics to make consumers buy the company's add-on products only for the customer to find that actually using the coverage is near impossible or the car is ineligible for coverage.

- Fake accounts: Some dealers have opened up loan accounts for consumers who specifically requested to pay in cash or opened up a second loan without consent.

- Conditional financing: Some dealers tell customers that enrolling in auto-debit or buying add-on products is a condition of obtaining financing.

- Selling lemons: Cars that are not worth the price paid, have been wrecked and rebuilt, or have hidden defects are the subject of many complaints, sometimes related to the above themes.

The Capitol Forum reviewed over a hundred lawsuits and complaints filed against Credit Acceptance. We separated the frequently occurring practices underlying the complaints into categories below. While we found multiple instances of each practice, not all practices may be widespread, and are against company policy. However, the fact that there are so many documented cases on recurring issues suggests that there are clear pathways to boost profit that may be incentivized by the company's system. This fact also suggests that the company may not be performing enough oversight of dealers' compliance practices or loan documentations.

An In-Depth Look at Fraud at Dealerships

Down Payment and Document Fraud. Down payment fraud is one type that is clearly tied to increasing the advance and appears to happen frequently; a source familiar with the company's dealer policies described it as "pretty rampant."

A dealer will enter a higher down payment into the deal in order to boost their advance in CAPS. The formula rewards a deal with a higher down payment because it indicates less repayment risk under the CAPS formula. So for example, a dealer might enter a $3,000 down payment into CAPS for a deal where the customer only pays a $1,500 down payment. Alternately, the dealer might tell the customer that they can pay part of the down payment on the spot and pay the rest at a later date, such as payday.

Document fraud is another response to incentives surrounding the advance, in that falsifying job or income information can change a customer's risk profile in a way that increases the advance. Either the dealer or the customer can carry it out, although the dealer's incentive to do so is greater: better risk scores lead to a better advance rate for the dealer, but generally not to more favorable loan terms for the borrower.

The source familiar with the company policy stated that document fraud is "not so common," but acknowledged that it does happen. The company performs routine audits to deal with this issue, including contacting customer to inquire about the down payment or other loan details. If caught, dealers may face a $10,000 fine, collected as a $100 deduction from their next 100 loan deals.

Consumers have filed cases against Credit Acceptance and their dealer-partners alleging practices of document forgery and fraud that result in deceptive vehicle price increases and inflation of the loan terms. Some suits accuse dealerships of affixing customers' signatures on paper and electronic documents and, in one case we reviewed, fraudulently altered a consumer's mother's bank statement to include the mother as an unwitting co-signer to fabricate a combined household income. When loan documents are forged it is also likely that the required truth-in-lending loan disclosures are not provided, a further violation of consumer lending law.

Unfair and Deceptive Tactics in Selling Add-ons. In our review of the CFPB database complaints filed against Credit Acceptance, we covered consumer harms stemming from the sale and use of two add-on products; vehicle service contracts (VSC) and GAP insurance. Abusive practices alleged in lawsuits against Credit Acceptance closely match the grievances aired in the CFPB complaints, including conditioning financing of the vehicle on the purchase of a service contract and difficulty using and cancelling the VSC.

In one case, a consumer was sold a "rebuilt" vehicle with a branded title (which commonly comes with vehicles that have been wrecked and rebuilt), which was not disclosed to her at the time of purchase. She was also sold a useless GAP policy, which was added to her financing deal. As she later found out when she went to make a claim, the GAP policy specifically exempted branded titles on rebuilt vehicles. She filed a lawsuit against Credit Acceptance, the dealership, and other defendants.

As Credit Acceptance often does when sued by consumers, it successfully asked the court to enforce its contracts' arbitration clause, which moves the case out of court into private arbitration. In some cases, especially where fake accounts are opened or forgery of the consumer's signature on the RISC is alleged, the attempt to enforce the arbitration clause is either not pursued by the company or may be less likely to be granted by the court.

Fake Accounts. Some lawsuits contain serious allegations of financial fraud committed on the part of dealerships which falsified retail installment sales contracts (RISC) on behalf of consumers and assigned them to lenders. In one case, the consumer had paid cash for the vehicle and did not find out about the Credit Acceptance debt until noticing it much later on his credit report. Numerous attempts to remove the account from the credit report were unsuccessful; both the credit reporting agencies and Credit Acceptance failed to investigate and act upon his disputes, forcing the consumer to file a lawsuit.

In another case, a consumer found that the car he financed through Credit Acceptance had mechanical issues within one week of purchase. After numerous contacts with the dealer and with Credit Acceptance to try to resolve the issues, the consumer learned that a RISC on the same vehicle had been opened by the dealer with different financing terms. His first and last names were reversed, signature forged and the fake RISC was assigned to another indirect auto finance company, United Auto Acceptance, which likely funded the loan. A title was issued to the consumer showing that two liens were recorded. Credit Acceptance did release its lien soon after realizing its dealer-partner had created double RISCs on the same vehicle and sold both into the stream of commerce.

Bait and Switch Sales Price and Financing Terms. Actions are filed against Credit Acceptance and their dealer-partners after consumers realize that the terms of their loans were surreptitiously changed to their detriment without notice or authorization. These lawsuits, like the others, commonly describe unroadworthy vehicles that ceased functioning within days or weeks of purchase. In terms of state commercial law, these were unmerchantable cars that never should have been sold or financed to consumers.

TILA claims are common in these suits along with allegations such as inflation of the vehicle sales price. When these consumers start contacting the dealerships and Credit Acceptance about the mechanical problems, they learn that they were deceived into worse financing terms than originally agreed and are stuck with a lemon vehicle.

Conditioning Financing on Enrolling in Auto-Debit. Creditors often prefer to enroll borrowers in auto debit for monthly bill payment, even going so far as to offer rewards like interest rate discounts or other inducements, but consumers are free to choose how to pay their bills.

In Issac v Credit Acceptance, the consumer sued the company and the dealership for conditioning auto financing on the requirement that he enroll in monthly auto-debit for payment, a violation of the Electronic Fund Transfer Act and the CFPB's Regulation E. Providing bank account information to Credit Acceptance carries an added risk to consumers considering the company's high default rate and business practice of using bank account garnishment after debt collection lawsuits.

Lemon Vehicles. Defective vehicles are also a common reason consumers turn to the courts after purchasing a used, high-mileage vehicle that they come to discover is not roadworthy soon after purchase. The majority of the lawsuits filed by consumers against Credit Acceptance and their partner dealerships, include these charges, either as stand-alone allegations, or in addition to claims of other unfair, deceptive, and abusive acts and practices.