

Date of Hearing: June 25, 2012

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Mike Eng, Chair

SB 956 (Lieu) – As Amended: May 21, 2012

SENATE VOTE: 24-12

SUBJECT: Buy-here-pay-here automobile sellers and lenders.

SUMMARY: Establishes the Buy-Here-Pay-Here (BHPH) Automobile Dealers Act. Specifically, this bill:

- 1) Defines a BHPA dealer as a seller that does the following:
  - a) Enters into a conditional sale or lease contract;
  - b) Does not routinely assign conditional sale contracts or lease contracts to an unaffiliated third-party finance or leasing source; and,
  - c) Collects payments on or otherwise services conditional sale contracts or lease contracts.
- 2) Requires BHPA dealers to be licensed under the California Finance Lenders Law (CFL).
- 3) Provides that an automobile dealer that meets the definition of BHPH to become licensed under the CFL within six months of meeting the definition.
- 4) Limits the annual percentage rate (APR) of a BHPH loan to no more than 17% plus the federal funds rate in effect at the time the contract was executed.
- 5) Provides that a BHPH conditional sale contract shall include the following notice in 8-point boldface type: “If you have a complaint concerning this buy-here-pay-here automobile dealer or the contract, you should try to resolve it with the dealer. Complaints concerning unfair or deceptive practices or methods by the dealer may be referred to the city attorney, the district attorney, an investigator for the Department of Motor Vehicles, or an investigator for the Department of Corporations, or any combination thereof. After this contract is signed, the dealer may not change the financing or payment terms unless you agree in writing to the change. You do not have to agree to any change, and it is an unfair or deceptive practice for the dealer to make a unilateral change. I have read and understand the terms of this notice.”
- 6) Prohibits a BHPH dealer from commencing repossession of a vehicle due to the borrower's failure to make a scheduled payment prior to the 11<sup>th</sup> day following the date on which that payment was due.
- 7) Provides that if a BHPH borrower pays the delinquent amount in full, the borrower shall be entitled to 45 days thereafter to pay the BHPH dealer the amount of any delinquency charges, penalty interest and fees arising out of the delinquency and commencement of repossession

proceedings.

- 8) Prohibits a BHPH from doing the following:
  - a) Repossessing a vehicle other than through engaging the services of a licensed repossession agency; or,
  - b) Charging a buyer fees or charges in excess of \$500 resulting from the commencement by the BHPH dealer of any action to repossess the vehicle.
- 9) Specifies that a seller is not a BHPH automobile dealer if the seller does both of the following:
  - a) Certifies 100% of seller's vehicles; and
  - b) Maintains an on-site service and repair facility that is licensed by the Bureau of Automotive Repair and employs a minimum of five master automobile technicians as certified by the National Institute for Automotive Service Excellence.

#### EXISTING LAW

- 1) Provides that under the Automobile Sales Finance Act (also known as the Rees-Levering Motor Vehicle Sales and Finance Act), sets forth various consumer protections relating to automobile conditional sales contracts, including, among other things, provisions relating to disclosure of fees, the terms of the contract, and repossession. (Civ. Code Sec. 2981 et seq.)
- 2) Provides for the CFLL, administered by the Department of Corporations (DOC), which authorizes the licensure of finance lenders, who may make secured and unsecured consumer and commercial loans (Financial Code Sections 22000 et seq.). The following are the key rules applied to consumer loans made pursuant to the CFLL:
  - a) CFLL licensees who make consumer loans under \$2,500 are capped at interest rates which range from 12% to 30% per year, depending on the unpaid balance of the loan (Sections 22303 and 22304). Administrative fees are capped at the lesser of 5% of the principal amount of the loan or \$50. An administrative fee of \$75 may be charged for loans of \$2,500 or more (Section 22305);
  - b) In addition to the requirements in “a” above, CFLL licensees who make consumer loans under \$5,000 are prohibited from imposing compound interest or charges (Section 22309); are limited in the amount of delinquency fees they may impose (Section 22320.5; delinquency fees are capped at a maximum of \$10 on loans 10 days or more delinquent and \$15 on loans 15 days or more delinquent); are required to prominently display their schedule of charges to borrowers (Section 22325); are prohibited from splitting loans with other licensees (Section 22327); are prohibited from requiring real property collateral (Section 22330), and are limited to a maximum loan term of 60 months plus 15 days (Section 22334);
  - c) In addition to the requirements in “a” and “b” above, CFLL licensees who make consumer loans under \$10,000 are limited in their ability to conduct other business activities on the premises where they make loans (Section 22154); must require loan payments to be paid in equal,

periodic installments (Section 22307); and must meet certain standards before they may sell various types of insurance to the borrower (Sections 22313 and 22314); and,

- d) Generally speaking, the terms of loans of \$10,000 or above are not restricted under the CFLL.
- 3) Authorizes the licensure of finance brokers under the CFLL, and defines a finance broker as any person who is engaged in the business of negotiating or performing any act as a broker in connection with loans made by a finance lender (Section 22004).
- 4) Imposes a 36% APR on consumer credit extended to members of the military and their dependents. (10 USC Sec. 987.)

FISCAL EFFECT: According to Senate Appropriations Committee Analysis all costs offset by license and assessment fees in the CFLL.

COMMENTS:

Need for the bill:

According to information provided by the author's office, the following expresses the need for SB 956:

Buy Here, Pay Here used car dealers are a largely unregulated industry within the used car industry that has taken advantage of a gap in regulations to prey on vulnerable populations. These abuses were documented in a fall 2011 investigative series by *The Los Angeles Times* that exposed the suspect business practices of these below-the-radar dealerships.

Buy Here, Pay here dealers differ from more traditional car sellers in that the dealers 'hold' the car loans, instead of selling/assigning it off to a third-party lender, such as a bank or finance company. This is often unknown by the car buyer.

The interest on loans associated with Buy Here, Pay Here dealerships is several times higher than the market rate for used car loans, and the dealers charge up to three times the Bluebook value of the vehicle. Many of the loans require customers to make substantial down payments and physically return to the dealership to make twice-monthly payments.

These dealers finance the sales of these usually road-worn vehicles at interest rates that forces customers to default at a 25-percent rate. When the customer defaults, the dealer repossesses the car and resells it to another customer – thus gaining yet another down payment and yet another predatory loan. Some vehicles have been sold, repossessed and re-sold as many as eight times, according to *The Times*.

There are a number of intriguing facts that speak to the questionable practices of BHPH dealerships:

- Buy Here, Pay Here dealerships sold 2.4 million automobiles in 2010, up from 1.3 million in 2000.

- Market research estimates there are up to 33,000 such lots nationwide, compared to 22,000 new car dealerships.
- Buy Here, Pay here dealerships make about \$80 billion in loans annually, according to the Federal Insurance Deposit Corp.
- Profit margins average about 40%, which doubles what new car dealerships typically earn according to a trade group, the National Alliance of Buy Here, Pay Here Dealers.
- Interest rates for loans from the dealerships can top 30%. Average rates at other used-car dealers for customers with good credit range from 5 to 8%, according to HSH Associates.
- About one in four buyers at Buy Here, Pay Here dealerships default.

Current law states that used car dealers offering BHPH loans are exempt from the laws associated with finance lenders and the protections applied for consumers. The Rees-Levering Automobile and Sales Act does apply to BHPH dealers yet these regulations treat all car dealers the same regardless if the dealer acts like a financial institution. Consequently, the consumers of BHPH dealers are suffering due to the lack of regulations that would otherwise protect them from dubious business practices.

SB 956 seeks to create consumer protections from the financial practices of BHPH dealers and to limit this business model that ratchets up profits by exploiting customers.

SB 956 has three major goals:

1. Impose first-ever regulations on used-car dealers offering BHPH loans by requiring them to obtain a California Finance Lender's license, which would provide customers with an array of protections. These protections include disclosures on the consumer's rights, interest rates and investigation agencies, as well as, prohibitions on false, misleading or deceptive statements and advertisements by dealers.
2. Limit BHPH used-car installment loans and leases to a maximum 17.25% APR, which would give California the strongest interest cap in the nation. Specifically, SB 956 limits the interest rate to 17% plus the federal funds rate. This would allow for fluctuations in the market to reasonably move the interest rate cap.
3. Change the way BHPH dealers are able to repossess vehicles to include a 10-day grace period, consumer protections typically offered by most car dealers. It would also make it easier for buyers to reinstate a repossessed car.

#### Background:

BHPH dealerships differ from traditional auto finance, in that BHPH auto sales are constructed as installment plans, similar to rent-to-own stores, allowing dealers to establish their own standards and interest rates. In a traditional auto finance transaction, the purchase money is

provided by a third party lender not affiliated with the dealer. The dealer gets the purchase money for the car, and the borrower is then responsible to the lender for maintaining the loan. Loans under this common scenario are regulated under various federal laws including the Truth in Lending Act, Consumer Leasing Act, Equal Credit Opportunity Act and the Fair Credit Reporting Act. Again, BHPH transactions are structured as installment contracts, thus falling outside the scope of federal and state laws that govern loan transactions.

According to **Forbes**, *Subprime Auto Loans Grow as Lenders Charge a Premium*, subprime auto finance is growing business as investors purchased \$5.8 billion in asset backed securities (ABS) during the first quarter of 2012. Subprime loans accounted for 23% of new car loans, and 57% of used car loans in the first quarter of 2012. These numbers several percentage points from the same time last year. "Deep subprime" borrowers (those with scores below 550) paid an average 17.9% APR. In 2011, BHPH loans accounted for around 20% of the used auto loans.

BHPH automobile dealerships gained attention after the *Los Angeles Times* published a three-part series on these dealers in Fall 2011, which described the situation of Tiffany Lee:

Another buyer might have balked at the deal she was offered. Lee figured she had no choice. She put \$3,000 down and drove off in a 2007 Ford Fusion, agreeing to pay \$387 a month for four years. The interest rate: 20.7%, nearly triple the national average for a used-car loan.

In this little-known but fast-growing corner of the auto market, dealers command premium prices for road-worn vehicles and finance the sales at interest rates that can top 30%. In a kind of financial alchemy, they have found a way to turn clunkers into cash cows and make money off the least creditworthy customers: the millions of Americans who are stuck in low-paying jobs, saddled with debt and unable to qualify for conventional auto loans. . . .

Buy Here Pay Here lots sold nearly 2.4 million cars nationwide last year, up from 1.3 million a decade ago, according to CNW Marketing Research. CNW estimates that there are more than 33,000 such lots nationwide, compared with about 20,000 dealerships selling new cars. Buy Here Pay Here dealers make \$80 billion in loans every year, according to the Federal Deposit Insurance Corp. . . . Many of the lots require customers to return once or twice a month to make loan payments in cash – hence the term Buy Here Pay Here

A key reason for the industry's growth in tough times is that dealers can come out ahead whether or not customers keep up with their loan payments. About 1 in 4 buyers default. In the real estate and credit card industries, that would be bad news. In the world of Buy Here Pay Here, it's just another avenue for profit: The car can be repossessed and put back on the lot for sale in short order. A new buyer makes a down payment, takes on a high-interest loan and the cycle starts anew. Provided they don't get wrecked, these recycled vehicles just keep paying dividends. At some dealerships, cars have been sold and resold over and over -- three, four, even eight times apiece, motor vehicle records show.

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Aimee and Chris Cvitanov wound up on a Buy Here Pay Here lot after financial setbacks dented their credit rating.

Chris, 37, was severely burned in a car accident six years ago and hasn't worked regularly since. Aimee, 30, lost her job in the insurance industry in late 2009. The lease on their Chrysler 300 expired soon afterward, and she needed a car quickly to search for work.

More than a dozen conventional dealerships turned the couple down for a loan. Then they heard an ad on the radio for M.K. Auto Inc. near their suburban Sacramento home.

The Cvitanovs said a salesman collected information to check their credit and told them the only car they qualified for was a 2003 Mitsubishi Galant. It had been driven more than 100,000 miles.

The price was \$7,999, according to their sales contract -- double the Kelley Blue Book value at the time. The couple said they could manage a \$1,000 down payment, and the dealer offered to finance the rest at 25.99%. Their monthly payment would be nearly \$290.

The Cvitanovs said they signed the contract, reluctantly, after the dealer promised they could trade it in for something better if they kept up their payments for six months.

When the time came, they exchanged the Mitsubishi for a decade-old Mercedes-Benz E-Class with 80,000 miles, three previous owners and a repossession in its past.

At \$13,998, the price was about \$5,500 above Blue Book. The balance of the old loan was rolled into a new one, also with an interest rate of 25.99%, according to the new contract. Their payments climbed to \$498, stretched out into 2014.

By then, the total cost of the Mercedes with interest would be more than \$25,000.

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Bor Pha bought a 2004 Honda Odyssey with 70,000 miles from Yia's Auto Sales in Sacramento, a Buy Here Pay Here dealership that caters to the Central Valley's Hmong community.

The price was \$13,000. The contract, handwritten in English, said she'd pay 12% interest on the loan. Pha said she trusted the dealer because he was a fellow Hmong and had sold her two cars in the past.

Late last year, she tried trading in the van at a different lot. The salesman looked at her contract with Yia's and determined that her monthly payment of \$326.43 reflected a 20.3% interest rate, not the much-lower listed rate. The higher rate would cost Pha an additional \$3,200 over the five-year term of the loan. (*A vicious cycle in the used-car business*, Los Angeles Times (Oct. 30, 2011).)

The *Los Angeles* series on BHPH also exposed that the high interest rates are not the only drain on the resources of customers. Typically, the cars purchased are high mileage, increasing the likelihood of expensive repairs on the part of the driver, adding to the overall costs of the vehicle. Not only are interest rates high on automobiles near the end of their life span, but the purchase price (on which the installment contract is based) is usually inflated far beyond its Blue Book value. In one case highlighted in the Times series one customer with a four year loan at 22% APR will end up paying four times the Blue Book value. These costs do not take into account the repairs that would be necessary for an older car over a 4 year period.

In further proof that Wall Street and private equity have an appetite for almost anything, subprime auto loans are packaged into securities and sold into secondary markets. Private equity firms have invested millions of dollars in BHPH lots. The attraction to these investors is the average profit on each car of 38%. In one part of the BHPH series featured in the *Los Angeles, Investors place big Bets on Buy Here Pay Here Used-Car Dealers*, provides this ironic background on the securitization of BHPH loans:

*Although they're backed mainly by installment contracts signed by people who can't even qualify for a credit card, most of these bonds have been rated investment grade. Many have received the highest rating: AAA.*

In conclusion, in considering the extent and solution to this problem one must consider that the interest charges are not the only consumer costs associated with these transactions. The *Los Angeles Times* series has exposed that frequently these cars start off the transaction marked-up well beyond Blue Book value, sometimes double or triple the value. Additionally, consumers that qualify for a BHPH loan are not given a loan amount for which they qualify and then shop around the car lot. Instead they appear to be steered to a particular automobile for which they qualify; a practice and idea far removed from a typical used or new car sale. Thus the interest rate is not the only borrower costs in these transactions. They are paying far above market rates for older used cars that will need costly maintenance and repairs, while paying interest rates exceeding 20%.

#### Key components:

In the simplest terms SB 956 does the following:

- 1) Requires BHPH dealers to be licensed under the CFLL.
- 2) Provides that the interest rate on a BHPH transaction shall not exceed 17% plus the federal funds rate.
- 3) Requires a borrower/buyer notice that outlines the borrower's rights and responsibilities.
- 4) Mandates the BHPH dealers use third party repossession agencies and that the charges resulting from a repossession shall not exceed \$500.

#### Arguments in support:

The following are a sample of arguments in support:

National Consumer Law Center writes,

Buy here pay here (BHPH) car dealerships target the most vulnerable consumers, those who believe, accurately or not, that they are not qualified to obtain financing elsewhere. The BHPH model includes the selling of older cars, often in poor condition, at high prices with financing at very high interest rates. These terms are in lieu of serious and effective underwriting to determine ability to repay the loan. The deals are structured so as to provide a high profit margin even at a high default rate. This expectation of high default rates become a self-fulfilling prophecy as consumers must make very high

payments for cars that often in poor or dangerous condition. The BHPH business model, through repossessing and reselling the same cars over and over again, is built to profit off the failure of loans to perform. Repossession leaves consumers without working cars needed for jobs, child care, and other essentials. Having lost the assets they used to buy the BHPH car, they are often unable to afford to buy replace vehicles.

California Reinvestment Coalition writes:

Low-income consumers rely on their vehicles to drive to work, and without a car, many low-income individuals are put at risk of losing their jobs, or leaving their children at home for longer hours because of their longer commute times. During these sluggish economic times, when low-income communities and communities of color are faced with disproportionate numbers of foreclosures and job losses, their vehicles are often the last asset that they have to their names. By overpricing these vehicles and using aggressive repossession techniques, this final asset is being pulled out from underneath the feet of the most vulnerable Californians.

Center for Responsible Lending writes:

As hard-working Californians continue to struggle with their finances in a tough economy, it is important that we protect families from abusive lending practices which can endanger their ability to keep their car, and therefore put them at risk of losing their job. SB 956 would address some of the abuses inherent in the "Buy Here Pay Here" model by requiring a 10-day grace period before a dealer can repossess a vehicle, limiting fees charged in connection with a repossession, capping interest rates and requiring licensing (and thus oversight) of "Buy Here Pay Here" dealers by the Department of Corporations.

#### Arguments in opposition:

The following is a sample of arguments in opposition:

National Independent Automobile Dealers Association writes:

Limiting interest rates buy-here-pay-here lenders can charge at the fed-rate plus seventeen percent will cause those who provide this highly specialized financial service to deep sub-prime auto buyers to discontinue in the line of businesses, which will in turn cause a dramatic decrease in sales tax revenues for the state, county and municipal budgets. According to the California Board of Equalization, used car sales generated nearly \$468 million in sales tax in calendar 2011. Initial projections upon this bill's passage show a drop of sales tax revenue between \$234 million and \$337 million. This will cause catastrophic ripples that will be felt by consumers, businesses and state, county and local governments who depend on sales tax revenues to provide basic constituent services.

If the goal of this legislation is consumer protection, singling out and requiring only one segment of retailers in the auto industry to cap their interest rates while allowing others to charge rates substantially higher than the proposed rate cap in SB 956 is an unnecessary handicap on their businesses. This proposed rate cap will not prevent those who are not



defined as buy-here, pay here dealers to continue arranging financing and booking car loans for consumers through subprime lenders that will charge interest rates in excess of twenty-one percent and much higher. For example, CapitalOne Auto Finance perpetually books sub-prime and deep sub-prime auto loans on used vehicles sold "AS-IS" through franchise dealers at rates in excess of twenty one percent interest.

Amendments:

Page 4, lines 24-27 contains language that specifies that notwithstanding section 22250 of the Financial Code, that a BHPH contract shall comply with the sections referenced in section 22250. Section 22250 is the provision of the CFLL that exempts transactions of \$10,000 or more from certain requirements, and transactions of \$5000 or more from other requirements. The language on page 4, lines 24-27 is intended to say that in spite of this limitation in the CFLL, that these provisions would apply to BHPH contracts. In order for this to be clear, staff recommends the following amendment.

- 1) Notwithstanding Section 22250 of the Financial Code, a conditional sale contract or a lease contract entered into by a buy-here-pay-here automobile dealer shall be subject to sections 22154, 22155, 22307, 22313, 22314, 22315, 22752, 22201, 22202, 22300, 22305, 22306, 22307(a), 22309, 22320.5, 22322, 22323, 22325, 22326, 22327, 22400, and 22751 to the provisions referenced in Section 22250 of the Financial Code.

Related Pending Legislation:

AB 1447 (Feuer) would prohibit a person selling or leasing a motor vehicle under a conditional sale contract to require a buyer to make payments, other than the down payment, in person and would require the seller to display the vehicle's sale price on the vehicle. The bill would also prohibit the seller from calling a buyer's references after the sale of the vehicle and would prohibit a seller from tracking the vehicle using Global Positioning System (GPS) technology and from disabling the vehicle with ignition override technology. (Senate Judiciary)

AB 1534 (Wieckowski) would require a used car dealer to affix a label on a vehicle that states the reasonable market value of the vehicle and other specified information. The bill would also require the dealer to give a prospective purchaser any information obtained from a nationally recognized pricing guide that the dealer used to determine the reasonable market value of the vehicle. This bill is currently set for hearing in the Assembly Judiciary Committee on April 24, 2012. (Senate Judiciary)

REGISTERED SUPPORT / OPPOSITION:

Support

American Federation of State, County and Municipal Employees (AFSCME)  
California Immigrant Policy Center  
California Reinvestment Coalition (CRC)  
Center for Responsible Lending (CRL)  
Consumer Attorneys of California  
Consumer Federation of California  
Consumers for Auto Reliability and Safety

El Segundo Chamber of Commerce's Government & Military Affairs (GMA)  
LAX Coastal Area Chamber of Commerce  
National Consumer Law Center  
Silicon Valley Community Foundation  
Torrance Area Chamber of Commerce

Opposition

Antelope Valley Board of Trade  
Antelope Valley Chamber of Commerce  
Antelope Valley Hispanic Chamber of Commerce  
Coalition to Protect our Freedom to Drive  
D&H Motors  
Independent Automobile Dealers Association of California  
Independent Automobile Dealers Association of California  
Leedom Group  
National Alliance of Buy Here, Pay Here Dealers (NABD)  
National Independent Automobile Dealers Association

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