Consumer Federation of America

THE HIDDEN MARKUP OF AUTO LOANS:

CONSUMER COSTS OF DEALER KICKBACKS AND INFLATED FINANCE CHARGES

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EXECUTIVE SUMMARY

An undisclosed but widely practiced markup of auto finance rates encouraged by the auto industry's captive finance companies and major banks at the time of the sale has cost consumers hundreds of millions and as much as one billion dollars annually. The subjective nature of these markups has also resulted in a well-documented trend of discrimination against African-American and Hispanic borrowers.

In an industry-wide practice, when car buyers arrange financing through auto dealers, lenders quote dealers a finance rate (or "buy" rate) at which a car buyer is approved for a loan based on his or her creditworthiness. Typically, the dealer adds a markup of several percentage points or more to the rate offered to the consumer, with the lender kicking back most of the markup to the dealer and retaining the remainder. In this secretive practice, neither the "buy" rate, the "finance markup charge", nor the "dealer reserve" (the kickback from the markup that the dealer receives) are ever disclosed to the borrower.

This report examines the impact of such hidden dealer kickbacks on American consumers, and their role in broader trends in consumer credit. Among the highlights of the report's findings:

1. Americans owed more than $500 billion in outstanding auto loans and paid close to $45 billion in interest on these auto loans annually, based on Federal Reserve data from the year 2001. This same data shows that African-Americans and Hispanics pay higher auto-finance interest rates than other borrowers.

2. Within these costs are hundreds of millions and as much as one billion dollars annually in auto loan debt caused by the secretive practice of finance markup charges and dealer kickbacks called "dealer reserve." Such undisclosed auto finance markup charges are an industry-wide practice affecting millions of consumers, with the average markup totaling over $1,000.

3. Finance markup charges impact a broad number of purchasers of both new and used cars. Virtually all of the top auto lenders in the industry have engaged in this practice, which was practically unknown to the American consumer until recently.

4. Studies of several of the auto industry's leading captive lenders suggest the extent of the practice of finance markup charges and their impact on consumers:

    - A study of General Motors Acceptance Corporation (GMAC), the nation's second largest auto lender, indicates the annual frequency that GMAC transactions received the markup was at least one in four (25.9%), and as high as 41.7 percent, costing at least $421.6 million in markup, according to a study of 1.5 million of the company's 6.2 million customers over the period January 1999 through April 2003.

    - A study of Ford Motor Credit Company (FMCC), the nation's largest auto lender, found that over 1.5 million customer records indicate a markup was incurred in the period November 1997 to December 2001, which amounts to a rate of markup of one in four (25.9%) of the 5.9 million records examined. A conservative estimate of added debt burden to consumers who financed through FMCC is hundreds of millions of dollars.[1]

[1] Another recent study found similar results. A sample of 855,989 transactions of Ford Motor Credit Company (FMCC), from the period January 1994 through September 2003, indicates the average annual frequency that FMCC transactions received the markup was approximately 32.9% (281,985 transactions). This amounted to charges of $323.1 million in dealer reserve charges in the sample transactions over the period examined. In transactions that

- A study of Nissan Motors Acceptance Corporation (NMAC), found that as many as fifty percent of customers were assessed the markup, costing consumers between $70 and $210 million, according to a study of over 310,000 NMAC borrowers covering the period March 1993 to September 2000.

5. Finance markup charges have led to racial disparities in auto lending, and cost African-Americans and Hispanics additional auto loan debt over other borrowers.

   - Discrepancies in finance rates between African-Americans and Hispanics and other consumers cannot be explained by differences in creditworthiness.
   - Such discrimination occurs in two ways. First, African-Americans and Hispanics are more likely to be assessed a finance markup charge. Second, the finance markup charges they face are on average higher than those faced by non-African-American and non-Hispanic consumers in similar credit categories.

   Studies of several of the auto industries leading captive lenders expose racial discrepancies in auto lending to African-American and Hispanic borrowers:

   - An analysis of FMCC lending shows that 30.9% of white customers received the markup, versus 48.5% of African-Americans. African-American borrowers on average pay more than 2 times the amount in subjective markup compared to whites: $684 versus $337, a difference of $347.

   - An analysis of GMAC lending shows that only 28.2% of white customers received a "subjective markup," versus 53.4% of African-Americans. Moreover, African-American borrowers on average pay more than 2½ times the amount in subjective markup compared to whites: $656 versus $244, a difference of $412. Such discrepancies exist across all credit tiers.

   - An examination of NMAC lending to African-American customers from March 1993 to September 2000 finds that 71.8% of African-American borrowers are charged a markup, compared to 46.7% of white borrowers. Moreover, African-American borrowers on average pay more than twice the amount in markup compared to whites: $970 versus $462, a difference of $508.

   - In lending by FMCC, according to 1.5 million records from the period November 1997 to December 2001, Hispanic borrowers paid on average roughly $266 in additional finance costs per loan over non-Hispanic borrowers. This resulted in Hispanic borrowers having been charged an additional $36.1 million in finance charges over what non-Hispanic borrowers paid over the sample period. Moreover, Hispanic borrowers with excellent credit appear to be the most adversely affected by receiving the largest markups.

   - A report derived from the study of NMAC lending, in which Hispanic NMAC customers living in Florida were sampled, concluded that 62.6% of Hispanic borrowers were charged a finance markup, compared to 46.6% of white borrowers. On average, Hispanic borrowers pay $305 more in finance markup compared to whites; $773 versus $468.

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received the markup, the average markup charge was approximately $1,145. (See: "Preliminary Report on the Racial Impact of FMCC's Finance Charge Markup Policy," in the matter of *Joyce Jones, et al. v. Ford Motor Credit Company (FMCC)*, No. 00 Civ. 8330, *U.S. District Court for the Southern District of New York*, prepared by Mark A. Cohen, Ph. D., January 9, 2004.)

ANNUAL COSTS OF AUTOMOBILE FINANCING TO AMERICANS

Americans owe more in auto loans than on any other type of consumer credit. The most reliable source of information on household finances is the Federal Reserve Board's Survey of Consumer Finances, which last was conducted in 2001. This survey reveals that 34 percent of all households had at least one auto loan, that the average value of these loans was nearly $15,000, and that as a result, Americans owed more than $500 billion on auto loans.

The Survey of Consumer Finances also reports that the average interest that the consumers paid on these loans was nearly 9 percent, yielding a total $45 billion paid in interest in 2001.

To whom did consumers owe these debts? Momentic Research reports that, in 2001, those with outstanding car loans owed nearly $450 billion to the 50 financial institutions with the largest "outstandings." Heading this list was Ford Motor Credit with $125 billion in outstandings and General Motors Acceptance Corporation with $73 billion in outstandings. Daimler Chrysler ($32 billion), J.P. Morgan Chase ($25.6 billion), and Toyota Financial ($18 billion) also held many auto loans.

TOP TEN COMPANIES IN AUTO FINANCE, 2001[2]:

Rank	Company	Loans Outstanding
1	Ford Motor Credit Co.	$124,700,000,000
2	General Motors Acceptance Corp.	73,416,770,963
3	DaimlerChrysler AG	32,146,567,600
4	Toyota Financial Services	18,009,000,000
5	J.P. Morgan Chase & Co.	25,667,000,000
6	American Honda Finance Corp.	11,163,396,264
7	Bank of America Corp.	10,447,000,000
8	Bank One Corp.	11,076,000,000
9	Wells Fargo & Co.	5,580,000,000
10	VW Credit Inc.	4,131,199,999

DISPARITIES IN AUTOMOBILE FINANCING FOR AFRICAN-AMERICANS AND HISPANICS

The data also show that the average annual rate of interest on vehicle loans for African-American and Hispanic households is higher than that of all other households:

- On new cars, African-Americans pay on average an annual rate of 9.01%, as compared to 7.38% for all other households.
- On used cars, African-Americans pay an average annual rate of 11.03%, as compared to 10.15% for all other households.
- Hispanics pay an average annual rate of 8.52% on new car loans, as compared to 7.38% for all other households.
- On used cars, Hispanics pay an average annual rate of 10.85%, as compared to 10.15% for all other households.

[2] Source: "Auto Finance Big Wheels 2002: A Ranking of the Nation's Top Car Financiers," a Momentic Research Special Report. Ranking order reflects total outstanding; dollar figure reflects loans outstanding but excludes leases outstanding.

To an extent, these rate differences reflect differences in creditworthiness. However, as data outlined in this report will indicate, these differences also reflect disparate treatment of African-American and Hispanic consumers.

Data on African-American and Hispanic household car loans provided in the 2001 Survey of Consumer Finance data collected by the Federal Reserve Board reveals the following:

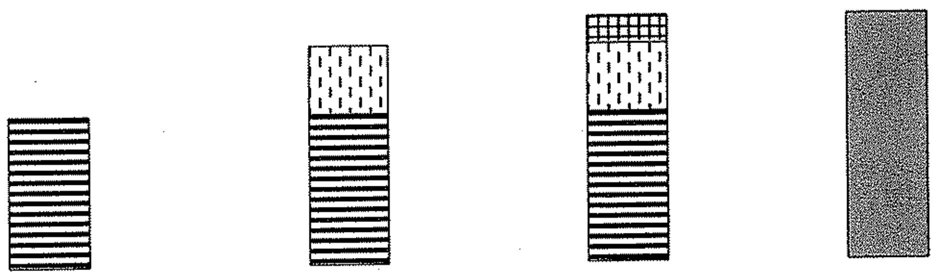
- 35% of African-American households held auto loans averaging a little more than $15,000 at an average interest rate of a little more than 10%, thus paying approximately $6 billion in interest annually.
- 30% of Hispanic households held auto loans averaging nearly $13,000 at an average interest rate of nearly 10%, thus paying approximately $4 billion in interest annually.

THE "SECRETIVE" PRACTICE OF MARKUP

When an auto dealer marks up a borrowers "buy rate" in a loan from an auto manufacturer's captive lending company or bank, the difference created by the finance markup charge comes out of the consumers pocket over the life of the loan, yielding a kickback to the dealer. The process of the markup and the kickback involves three steps. First, lenders authorize the auto dealer to markup the buy rate of auto loans. Second, the dealer adds a markup of percentage points on a car loan, when they assist a consumer in arranging an auto loan. Third, and finally, lenders pay a kickback to a dealer on a monthly basis representing most of the markup of all the loans the dealer has written for that lender.

For example, on a car purchased with a $26,153.00 loan, a 72-month term, an 8.5% buy rate, and an 11.5% loan rate, the total cost to a consumer is more than $36,000 dollars. These costs break out as follows:

Loan amount +	**Buy Rate:** +	**Markup:** =	**Total Cost:**
	(compounded)	(compounded)	(compounded)
$26,163.00	8.5%	3.0%	11.5%
	$7,326.78	$2,849.67	$36,339.45



The kickback from the markup ($2,849.67 in the example above) comes on top of a flat $50-$150 fee already paid by the lender to the dealer for preparing the paperwork.

Because the practice is not disclosed, people are not informed that they are being assessed a subjective charge, not related to their creditworthiness. Consumers who finance at the dealership are shown a document with a rate, but they are never told that the rate has been arbitrarily marked up by the dealer and that they could do better, given their creditworthiness. Similar practices in the home mortgage lending have been outlawed.

A former automotive dealership finance and insurance manager said of his experience in applying the markup that:

> "The standard industry practice is to prepare financing documents so that the customer is not alerted in any manner that the person with whom he is dealing has the ability to control the customer's price of credit. This allows the finance arranger to present himself as the ally of the customer, which further relaxes and disarms the customer. This type of pricing system is particularly successful when used in conjunction with the sale of an automobile, because the credit applicant's attention is naturally focused on the price of the automobile and/or the required monthly payment. The nature of the transaction creates the perfect opportunity for a dealer to obtain a large kickback from an unsuspecting customer by subjectively inflating their interest rate."[3]

MARKUP AS AN INDUSTRY-WIDE PRACTICE COSTING AMERICANS HUNDREDS OF MILLIONS AND AS MUCH AS ONE BILLION DOLLARS ANNUALLY

Undisclosed finance markup charges are an industry-wide practice, affecting millions of consumers costing hundreds of millions and as much as one billion dollars in markup charges annually. The typical markup is over a thousand dollars, but markups can cost consumers thousands of dollars over the life of a loan on purchases of both new and used cars.

A study by Vanderbilt University professor Mark Cohen released in September 2003, examined lending records of 1.5 million customers of General Motors Acceptance Corporation (GMAC), the nation's second largest lender, over the period January 1999 to April 2003.[4] The Cohen GMAC study found that the annual frequency of GMAC transactions that received the finance markup charge was at least one in four (25.9%), and as high as 41.7 percent.

A separate study by Dr. Cohen, released May 2001, examined over 310,000 records of Nissan Motors Acceptance Corporation (NMAC), the nation's fourteenth largest lender, from the period March 1993 through September 2000.[5] The Cohen NMAC study found over 159,000 customers received the markup, or approximately 1 out of every 2.[6]

A study by Dr. Richard P. Voith, an adjunct professor at the University of Pennsylvania's Wharton School, released in May 2002, examined lending records of Ford Motor Credit Company (FMCC), the nation's largest auto finance lender.[7] The Voith FMCC study found that the markup occurred in over 1.5 million customer records in the period November 1997 to December 2001, which amounts to a rate of markup of one in four (25.9%) out of a total 5.9 million records examined.

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[3] "Expert Report of Edward Ford, Jr.," in the matter of *Addie T. Coleman et al. vs. GMAC, U.S. District Court for the Middle District of Tennessee*, Case No. 3-98-0211, prepared by Edward Ford, Jr., August 21, 2003.
[4] "Report on the Racial Impact of GMAC's Finance Charge Markup Policy," in the matter of *Addie T. Coleman, et al. v. General Motors Acceptance Corporation (GMAC)*, prepared by Mark A. Cohen, Ph. D., August 29, 2003.
[5] "Final Report on Racial Impact of NMAC's Finance Charge Markup Policy," in the matter of *Robert F. and Betty T. Cason, et al. v. Nissan Motor Acceptance Corporation (NMAC)*, No. 3-98-0223, *U.S. District Court for the Middle District of Tennessee*, prepared by Mark A. Cohen, Ph. D., May 17, 2001.
[6] Data for this figure was derived from the study in which 310,718 NMAC records race coded as either African-American or white, from a total sample of over 1.09 million records. In the race coded records, 71.8% of African-Americans (approximately 42,393), and 46.7% of whites (approximately 117,531), respectively, received the markup.
[7] "Expert Report Analyzing the Disparate Impact Produced by Ford Motor Credit Company's Finance Charge Markup Policy," in the matter of *Rodriguez, et al. v. Ford Motor Credit Company* (No. 01 C 8526), *U.S. District Court for the Northern District of Illinois*, prepared by Richard P. Voith, Ph. D., May 28, 2002.

The conclusions of these recent studies offer a glimpse into the total impact of the finance markup charge. The Cohen GMAC study found that in a survey of 1.5 million customers of GMAC, over the period January 1999 to April 2003, a total of $421.6 million was paid in dealer reserve by GMAC customers, almost $100 million per year. GMAC represents a total of about 1/6th of the auto lending market, but this study looked at just 1.5 million of the company's more than 6.2 million customers, over a 52-month period.

The Cohen NMAC study determined that NMAC, which was the 14th largest lender in 2001, accounting for two percent of the market, assessed at least between $70 and $210 million, over the seven year period, March 1993 through September 2000.

Analysis of data in the Voith FMCC study supports a *conservative* estimate of hundreds of millions of dollars in consumer impact caused by the finance markup charge to FMCC customers. FMCC, the nation's largest lender, represents over one quarter (approximately 27.7%) of the auto-lending market. From data provided in this study, we determine that a conservative estimate of added debt burden to consumers who financed through FMCC was hundreds of millions of dollars, per year in the period studied.[8]

Although specific data is not available on every captive lender, given that the top nine of the top ten auto lenders, who collectively represent approximately seventy percent of U.S. auto-lending, according to 2001 statistics, have allowed finance markups at the dealership, the trend in the industry has affected millions of borrowers and has clearly cost American consumers hundreds of millions and as much as one billion dollars in markup charges annually.

Using two methods, based on conservative figures, we estimate annual markup charges to consumers of more than one billion dollars. Method one: The markup in FMCC loans amounts to approximately $400 million in annual charges, and GMAC approximately $100 million in annual charges. Together, these two companies represent approximately 44% of annual outstanding U.S. auto loans.[9] Given that the markup is an industry wide practice, if FMCC and GMAC together represent $500 million annually in the markup charge as 44% of the market, then 100% of the market would amount to approximately $1.1 billion.

A second method confirms this estimate: If Americans borrow approximately $600 billion in auto loans (2001 est.), and at least 1 in 3 loans take place through the dealer[10], and approximately 1 in 4 loans at the dealership receive the markup, then approximately $50 billion in car loans receive the markup ($600 billion X 1/3 X 1/4). As numerous studies indicate, the average markup is approximately 2.5 percent, then the net sum of markup charges amounts to $1.25 billion ($50 billion X 2.5%).

MARKUP IMPACTS AFRICAN-AMERICANS AND HISPANICS DISPARATELY

[8] Based on the findings of the Voith study, If the average FMCC markup is 2.78 points, and extra markup for Hispanics is 0.68 points, and the average cost of the extra markup for Hispanics is $266.00, then the total average cost for all markups is approximately $1087.00. Therefore, based on this average markup, the total markup charges to FMCC consumers would be $1.7 billion over the four year period studied, or an annual average charges of over $400 million.

[9] Source: Ibid., "Wheels," Momentic Research, 2002.

[10] This reflects a very conservative estimate. A recent estimate of the number of vehicles financed through the dealer comes from the New York State Banking Department. In 2001, they estimated that of the 17.7 million new vehicles expected to be sold in 1999, about half were financed, and 75% of this financing was arranged through car dealerships. If 75% of financing takes place through the dealer, and 1 in 4 is marked up, the total markup would be over $2.5 billion – more than double the most conservative estimates.

Discrepancies between finance rates of African-Americans and Hispanics and other borrowers, which are evident in data from Federal Reserve Board's Survey of Consumer Finances, cannot be fully explained by differences in creditworthiness. The Cohen GMAC and NMAC studies, the Voith Ford study, and other studies have demonstrated that the practice of markup in automobile credit pricing has led to discrimination against African-Americans and Hispanics.

The industry-wide practice of subjective auto finance markup has resulted in equally situated consumers of different races receiving different finance rates. Even when they have similar credit to others, African-Americans and Hispanics seeking to finance the purchase of a car are being disproportionately affected by finance markup fees. Such discrimination occurs in two ways. First, according to studies of individual finance company's data, African-Americans and Hispanics are more likely to be assessed a finance markup charge, and second, the finance markup charges they face are on average higher than those faced by non-African-American and non-Hispanic consumers in similar credit categories.

A recently released study produced by Dr. Cohen examined a sample of 855,989 transactions of Ford Motor Credit Company (FMCC), from the period January 1994 through September 2003, and found that African-American borrowers consistently pay a higher markup than similarly situated white Customers.[11] In particular:

- African-American borrowers on average pay more than 2 times the amount in subjective markup compared to whites: $684 versus $337, a difference of $347.
- African-American borrowers who receive a subjective markup are charged on average $1,412 compared to only $1,090 for whites, a difference of $322.
- Of the total of $323.1 million in subjective markups charged to this sample, $69.9 million, or 21.0% was paid by African-Americans, who make up only 11.6% of this customer base.
- 30.9% of white customers received the "subjective markup," vs. 48.5% of African-Americans.
- Over 13,122 FMCC customers in the sample were charged $3,000 or more in the markup. African-Americans make up 30.4% of those who were charged $3,000 or more, although they represent only 11.6% of the borrower pool.

Significant findings of racial discrimination nationwide are detailed in the Cohen GMAC study. Looking at GMAC loans in all 50 states and the District of Columbia over the period, January 1999 through April 2003, Dr. Cohen's study shows clear bias in both the number of African-Americans receiving finance markups on the interest rates and the size of those markups. It is important to note that customers' credit rating is controlled for in these conclusions – that is, African-Americans with identical credit rating to whites were being marked up more often and for more money on their loans.

The Cohen GMAC study documents the problems uncovered in its huge sample of over 1.5 million buyers. Among such problems are:

- African-American borrowers on average pay more than 2½ times the amount in subjective markup compared to whites: $656 versus $244, a difference of $412.
- African-American borrowers who receive a subjective markup are charged on average $1,229 compared to only $867 for whites, a difference of $362.
- A total of $421.6 million was paid in subjective markup by the 1.5 million GMAC borrowers who have been identified as either being African-American or white.

[11] *Ibid.* fn. 1. "Preliminary Report on the Racial Impact of FMCC's Finance Charge Markup Policy," in the matter of *Joyce Jones, et al. v. Ford Motor Credit Company (FMCC)*, prepared by Mark A. Cohen, Ph. D., January 9, 2004.

- Of a total of $421.6 million charged to GMAC borrowers in finance markup charges, $83.9 million, or 19.9% was paid by African-Americans, who make up only 8.5% of this customer base.
- Only 28.2% of white customers received any "subjective markup" at all, vs. 53.4% of African-Americans – and average markup charge for African-Americans was 2.69 times that of whites.
- Over 12,000 GMAC customers in the 1.5 million race-coded sample paid $3,000 or more in subjective markup. African-Americans make up 33.5% of those who pay $3,000 or more, although they represent only 8.5% of the borrower pool.
- African-Americans are less likely to get 0% or low interest promotional interest rates.

Following numerous statistical tests, the study concluded that the disparate impact against African-Americans could not be explained by creditworthiness or other legitimate business factors.

In Dr. Cohen's NMAC study, it is determined that African-American borrowers consistently pay a higher finance markup charge on average than similarly situated white customers. Specifically, the study concluded:

- 71.8% of African-American borrowers are charged a markup, compared to 46.7% of white borrowers.
- African-American borrowers on average pay more than twice the amount in markup compared to whites: $970 versus $462, a difference of $508.
- The average dealer markup for African-American customers was $1,351, as opposed to $989 for whites a difference of $362.
- These results are highly statistically significant.
- Accounting for the fact that NMAC's discretionary finance charge policy allows dealers to move customers across different rate categories results in even larger estimates of the disparate impact on African-American customers.
- These findings are consistent across 33 states where sufficient data exists to draw statistical inferences.

In the same study, Dr. Cohen also estimated the total monetary revenue NMAC obtained from African-American customers under its discretionary finance markup charges policy to be between $70 and $210 million in the period March 1993 to September 2000. This wide range of estimates is primarily due to differences in legal standards and definitions.[12]

Hispanic auto borrowers have been impacted as well, based on studies of FMCC and NMAC lending. The Voith FMCC study finds that Hispanic borrowers pay an average of roughly $266 in additional finance costs per loan over non-Hispanic borrowers. This resulted in Hispanic borrowers having been charged an additional $36.1 million in finance charges over what non-

[12] Cohen provided various estimates, using different methodologies. These estimates are: $210.5 million if NMAC is to disgorge all markups from African-American customers; $108.0 million if NMAC is to disgorge all excess markups paid by African-American customers based on a comparison of the average markup paid by African-Americans versus the average amount paid by whites; $139.5 million if NMAC is to disgorge all excess markups paid by African-American customers who paid more than the average amount paid by white customers; $149.3 million in NMAC is to disgorge all excess markups (including negative markups) paid by African-American customers based on a comparison of the average markup paid by African-Americans versus the average amount paid by whites; $193.7 million if NMAC is to disgorge all excess markups (including "negative" markups, in which preferential rates below the buy rate are offered to customers) paid by African-American customers who paid more than the average amount paid by white customers. Several estimates based on regression analyses that control for factors such as the length of the loan term and amount financed provided two sets of figures: between $68.9-$79.8 million if negative markups are excluded, and $88.8-94.0 million if negative markups are included.

Hispanic borrowers would have paid over the sample period. Moreover, Hispanic borrowers with excellent credit appear to be the most adversely affected

In October 2002, Dr. Cohen released an additional study in which 56,422 NMAC transactions in Florida from March 1993 to September 2000 were examined.[13] In this report, Dr. Cohen found that Hispanic borrowers in Florida consistently pay more in finance markup than similarly situated white customers. In particular:

- The study found that 62.6% of Hispanic borrowers were charged a finance markup, compared to 46.6% of white borrowers.
- On average, Hispanic borrowers in Florida pay $300 more in finance markup compared to whites.
- 62.6% of Hispanic borrowers are charged a finance markup, compared to 46.6% of white borrowers.
- Hispanic borrowers on average pay three hundred dollars more in finance markup compared to whites: $773 versus $468, a difference of $305.
- Hispanic borrowers who receive a finance markup are charged on average $1,234 compared to $1,003 for whites, a difference of $231.
- The most creditworthy Hispanic borrowers are the most adversely impacted.

THE INDUSTRY'S RESPONSE

The industry maintains that dealers should be compensated for their efforts in arranging loans. But, faced with growing criticism, the industry is also beginning to recognize the problem of finance markup charges.[14] In response, some lenders have undertaken self-imposed caps of three percent (3%) on the dealer authority to impose finance markup charge. Such caps are a step in the right direction and do eliminate opportunities for the most extreme cases of abuse.

However, capped finance markup charges remain unfair to consumers and are an inadequate solution to the problem of compensating dealers.[15]

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[13] "Impact of NMAC's Credit Pricing Policy on Hispanic Borrowers," in the matter of *Robert F. and Betty T. Cason, Et Al. v. Nissan Motor Acceptance Corporation (NMAC)*, Case No. 3-98-0223, *U.S. District Court for the Eastern District of Tennessee*, prepared by Mark Cohen, Ph. D., October, 17, 2002.

[14] Pressures on the industry against the markup have included introduction of a ballot initiative in California that would outlaw the practice. In addition, in the last several years, most major auto lenders have been sued by minority consumers on the basis that these markups have led to discrimination. In 2003, a class-action federal discrimination lawsuit against Nissan Motor Acceptance Corporation (NMAC) was settled when NMAC agreed, among other things, to institute a credit pre-approval program offering no markup to 675,000 African-American and Hispanic buyers over five years, to inform car buyers that interest rates may be negotiable, and to provide funding for a consumer education campaign.

[15] Dealers cannot make the argument that they would not be compensated for aiding customers in getting finance without the dealer reserve kickback. Dealers often are paid some fee by the captive finance companies, usually around $150 for setting up finance. Moreover, in 0% loans, which have become more prevalent in recent years, lenders compensate the dealers with a flat payment -- in the $100 to $150 range -- for doing the paper work of helping to arrange financing.

There is other evidence that auto dealers are learning that there are clear alternatives to the markup and they are learning that they can live without them. For example, Toyota's "Scion Solutions," offered online to purchasers of the Toyota Scion, provides disclosure of the buy rate. This may be the first completely transparent financing program by an auto manufacturer's captive lending company, albeit it applies only to one model. Also, as recently reported in *Automotive News*, credit unions increasingly forbid markups AND auto dealers are increasingly working with credit unions – a practice resisted by auto dealers in the past. In another example, Carmax claims to simply not allow the finance markup charge, and allows customers to view the credit approval process right on the computer screen.

It is notable that all of this is happening without dealer revolt. In these examples, dealers are instead being compensated with a flat fee, not FMC.

First, dealer compensation should not be determined by the arbitrary mark up of loan rates for unaware customers or the amount or length of a loan. Rather, the rates should be based on the creditworthiness of the borrowers.

Secondly, even at three percent or lower, a capped markup remains undisclosed to consumers, and markups at this rate can typically run over a thousand dollars per loan. Moreover, the subjective nature of the dealer markup leaves open the possibility that minority borrowers will continue to be affected differently than non-minority borrowers.

Finally, the caps are a flawed solution because they do not provide any remedy to consumers who have already been gouged by the most excessive abuses in the finance markup charge and who are continuing to pay on existing marked up loans.

RECOMMENDATIONS

Markup is an unfair practice to all consumers and it has also caused disparities in the credit pricing of African-Americans and Hispanics who finance car purchases. We are encouraged that the automobile industry has indicated they recognize this problem. However, the industry has not taken sufficient steps to address it. No solution will be complete unless it includes the following:

A. Disclosure of the markup percentage and dollar costs.
B. Flat fees that are a one-time charge paid to dealers for placing a loan that do not fluctuate and are not based on the loan amount *or* the term of the loan.
C. Remedy programs for those already negatively impacted.
D. Support for a consumer education program designed to give consumers a clear understanding of the automotive finance process, and awareness of any remedy programs to redress those affected by markup policies.

Recent steps, such as the caps on auto finance rates, are signs that the industry has been moving away from the worst forms of gouging that finance markup charges have enabled. But if more appropriate steps are not taken, it may be necessary for consumer groups and other interested parties to continue to seek remedy through other means. These include legislative, regulatory and judicial options.[16] These would be in addition to a broad consumer education campaign to educate consumers on the benefits of acquiring auto finance through sources that do not engage in the unfair, undisclosed practice of the finance markup charge.

ADVICE TO CONSUMERS

In order to avoid being a victim of finance markup charges at the car dealer, consumers are urged to check with their bank or credit union before seeking auto financing from a car dealer.

After selecting a car model, car buyers should call their bank or credit union for a rate quote. Then compare it to the dealer's quote. It is essential here that the buyer, not the dealer, make the call to the buyer's financial institution.

If the dealer offers zero percent financing, they will not give consumers a rebate on the sale price. Car buyers should ask their bank or credit union whether it makes sense to take the rebate and finance the purchase at the regular rate. Then compare their calculations with those of the dealer.

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[16] For example, in California a ballot initiative has been introduced that would outlaw the markup.