>> Chuck Harwood: Well, good morning, everyone. I'm very happy to see all of you here in Washington for the Federal Trade Commission's third roundtable. My name is Chuck Harwood. I'm the Deputy Director for the Bureau of Consumer Protection, and I want to welcome all of you. Also welcome to those of you joining us through our Webcast today. For many of us, motor vehicles play vital roles in our lives. And when it comes to buying or financing or leasing that car or truck or other set of wheels, the FTC's Bureau of Consumer Protection is committed to ensuring that consumers do not face unfair practices. In response to regulatory changes made by the Dodd-Frank Act, the FTC scheduled a series of public roundtables to hear about consumer-protection issues that may crop up when vehicles are purchased or financed or released. At our first roundtable in Detroit last April we discussed consumer experiences in buying a vehicle, focusing especially on prime and subprime consumer experiences, interest rates and markups, consumer privacy in connection with payment and locator devices, spot delivery, contract add-ons, and vehicle title problems following dealer bankruptcies. Our second roundtable, in a very hot San Antonio, Texas, in August focused on the experiences of military consumers when buying and selling motor vehicles and how this process may differ from the experiences of nonmilitary consumers. We also discussed consumers' financial literacy as well as fair lending issues that may be associated with dealer-assisted financing. Today, for our third roundtable, we will begin with two panels discussing automobile leasing, focusing on the nuts and bolts of how leases work, how they're used by consumers, and the consumer-protection issues associated with leasing. Today's other panels will look back at what we have learned from all three roundtables about consumer experiences with purchasing, financing, and leasing a motor vehicle. The panelists will discuss the need for consumer business education, which practices cause significant harm to consumers and the potential solutions for those practices and which practices, if any, are widespread. These panels will also explore what, if any, government action is appropriate. As our other two roundtables, the panels feature experts representing many points of view, including motor-vehicle dealers and other industry representatives, state regulators and consumer advocates. Many of these panelists have appeared in our previous roundtables and we're pleased these roundtables have developed into an ongoing discussion about this very important industry and the significant issues. I appreciate that all of you took the time and effort to be with us today, including some who have traveled many

miles to participate in these important discussions. The information that we gather from this series of roundtables will help us determine what, if any, future action would be appropriate. These actions could include specific enforcement initiatives, increased consumer and business education, promulgating rules, or other action. I hope that the panelists gathered here will have spirited discussions, and I urge everyone in the audience to ask questions of the panelists and to submit written comments via the FTC's Websites. We are especially interested in data and empirical information. The more evidence we can gather, the better we can protect consumers as they purchase, finance, and lease other vehicles. Finally, if you missed our two previous roundtables, the Website contains each one. And you can find it at www.ftc.gov. Which reminds me also to remind you, remind those of you in the room, that this event is being Webcast and recorded for viewing by the public. So what this means is, your image and anything you say or submit may be posted indefinitely at ftc.gov with one of the FTC's publicly available social-media sites. So you've been warned. We are grateful for your assistance today as we determine the road ahead. And I hope all of us find this roundtable useful, and I'd encourage you to enjoy it, and thank you again. [Applause]

>> Tom Kane: Thank you very much, Chuck. My name is Tom Kane, and I'm gonna moderate the first panel if we can call up the right screen. Let me call up my panelists -- Randall, John, and David. If I can click this to the right slide. So, as Chuck said, we're gonna start off with two panels about auto leasing. The first one is called "Understanding the Motor Vehicle Process." -- owner motor vehicle leasing process. And our focus will be on consumer auto leasing, as opposed to commercial auto leasing. We want to get that started. And we also want to talk mostly about the basics of leasing. For the most part, we'll leave the discussion problems of auto leasing to the next panel which is entitled "Misrepresentations and Other Consumer Protection Issues in Motor Vehicle Leasing." So now let me introduce our panelists. First, we have David Blassingame, who is legislative consultant to the National Vehicle Leasing Association. And he's a managing partner of Autoflex Leasing Incorporated. We have Randall McCathren, who is managing director of the Association of Consumer Vehicle Lessors. He's also president and general counsel of BLC Associates Incorporated. And our third panelist is John Van Alst, who is an attorney at the National Consumer Law Center. So, as with all sessions today, as the moderator, I'll ask questions of our panelists. Sometimes I'll ask one of you, and sometimes the group. And I'll invite follow-up

from the other panelists. If you want to comment, we ask that you raise your table tent or turn it on its side, and I'll call on you as soon as I can. And our goal is to have a lot of back-and-forth throughout the day. We also want to have, as Chuck said, as much hard data as possible. So, to the extent possible, if you can cite numbers, we'd really appreciate that. If you don't have the numbers at your fingertips, it would be a great if you would include them, and tell us that you would be able to include them, in any public comment that we hope you're gonna submit. And we want the comments in by January 31st. Unlike the other four panels, we'll start this one with an 8-to-10-minute Power Point presentation by Randall. We're doing this -- again, just for this session -- because even a basic understanding of consumer vehicle leasing requires that we know a number of terms. So Randall will cover all the key terms in 18 slides -- which actually 17 because the cover slide takes one. So after Randall's presentation, I'll ask John and David for short comments on the presentation and then move into the core of the panel and that's a conversation of about three general areas. The first area is a big picture look at consumer leasing -- consumer vehicle leasing. And that big picture will include differences between leasing and buying a vehicle, demographics of those consumers who choose to lease, current trends in leasing, who makes money from leasing, and which laws govern leasing. And the second big topic area will be a deeper look into the leasing process. So basically, we'll be going into more depth about the slides, the terms that Randall talks about in his presentation. Then the third and final topic area is the charges that consumers might have to pay at the end of a lease. And then we'll take questions from the audience for the last five minutes of our hour-long session. So now we'll get started with Randall's presentation. Get you started here. There you go. Thanks, Randall.

>> Randall McCathren: Thank you, Tom. What we're going to do is really just kind of define the basic terms that you run into in consumer leasing, make sure we all have a common understanding of those transactions and pieces of them and what we're referring to as we make various comments throughout. So first of all, it's the Federal Consumer Leasing Act and it's implementing Regulation M that define what a consumer lease is, and that is a lease of personal property -- here we're talking about vehicles -- to an individual, primarily for personal, family, or household purposes -- So that excludes commercial -- for a period of more than four months and a total contractual obligation of not more than the applicable threshold amount, which was increased by Dodd-Frank to $50,000 and is now going to be annually pegged to the Consumer Price Index. So under consumer lease, the

consumer merely acquires the right to possess and use the lease vehicle. The consumer does not acquire title -- which has a number of implications -- or any ownership interest in the leased vehicle unless they later exercise a purchase option. The lease may or may not convey the option to purchase the leased vehicle, although virtually all leases do. The basic terms -- lessee, lessor, and assignee -- the lessee is the consumer, who leases the vehicle, typically from a dealer. The lessor -- for our purposes -- is the dealer that leases the vehicle to the consumer. The assignee is the person or entity that purchases the lease agreement and the vehicle from the lessor. So the majority of consumer vehicle lease agreements are negotiated and entered into with franchise to new motor vehicle dealers. Then a large majority of those motor vehicle lease agreements and the underlying leased vehicle are sold by the dealership to unaffiliated assignees. The vehicle lease agreements then fall into two broad categories -- closed-end or open-end. The difference between open-end and closed-end is whether the risk of the residual deficiency at scheduled lease end is placed on the lessee -- the consumer -- or the lessor. A residual value deficiency is the amount by which the sale price, the fair market appraised value, of the vehicle scheduled lease end is less than its residual value. A residual value is the end-of-term value disclosed in the lease and used in determining the base monthly payment. An open-end lease places this residual value deficiency risk on the lessee -- consumer. For the reason that the cost could be open-ended, then, the scheduled lease-end liability is called open-ended. However, relatively few consumer lease agreements are open-end any longer. Closed-end lease places this residual value deficiency risk on the lessor, which is, for the most part, what we're gonna be talking about today. Because the lessee does not bear any residual value deficiency risk at scheduled lease end, it's sometimes called a walk-away lease. But I think you can assume, for the purposes of our discussion today, that we're talking about closed-end leases, unless someone makes a specific reference to an open-end transaction. Gross capitalized cost is the agreed-upon value of the leased vehicle -- which is the disclosed item in the lease -- plus any items that the consumer/lessee agrees to pay for over the lease term, such as official fees and taxes, service contracts, insurance, and any prior creditor lease balance. It's analogous to the total cash sale price, plus any amounts paid to others, in a retail installment sale transaction. Capitalized cost reduction is the sum of any net trade in allowance, rebate, noncash credit or cash payment that reduces the gross capitalized cost. It's analogous to the total down payment in a retail installment sale transaction. The adjusted capital cost is then the capitalized cost reduction subtracted from the gross capitalized cost. The adjusted capitalized cost is sometimes referred to as the beginning lease balance. It's the amount that is capitalized in the lease. It's analogous to the amount financed in a retail installment sale transaction. Residual value is the end-of-term value of the leased vehicle that's used in determining the base monthly payment. The residual value is the portion of the adjusted capitalized cost that is not paid or amortized over the lease term. It's deducted from adjusted capitalized cost, which was the beginning lease balance to determine the quote depreciation and any amortized amounts, which is the amount paid over the lease term. Depreciation and any amortized amounts is the vehicle's projected decline in value through normal use over the lease term, plus the cost of other items that are paid for over the lease term. It's the portion of the adjusted capitalized cost that's paid over the term. The residual value is the portion of the adjusted capital cost that is not paid over the lease term. So it's what you could think of as the ending balance. The rent charge is the portion of the total lease payments that is charged in addition to this depreciation and any amortized amounts. It's analogous to the finance charge in a consumer credit transaction. The base monthly payment is then the sum of those two -- the depreciation and any amortized amounts plus the rent charge divided by number of scheduled payments, which are usually made monthly. Monthly sales and use taxes and any other amounts paid monthly are then added to the base monthly payment to determine the total monthly payment. In a vehicle lease transaction, sales and use taxes are generally assessed on the base monthly payment, any capitalized cost, and, in some states, some or all of the adjusted capitalized cost as well. In most states, the sales use tax on the base monthly payment is paid monthly. In some states, however, the tax is due at the beginning of the lease. Security deposit is an amount that the consumer may be required to pay, usually at the beginning of the lease. It's applied to offset any amounts owed under the lease agreement at scheduled termination or upon default or early termination. Any remaining amount after being applied to amounts owed by the consumer is then refunded to the consumer. Excess-mileage and excess-wear charges -- the closed-end lessee is responsible for excess mileage and excess wear because the residual value of the vehicle used in calculating the base monthly payment assumes the vehicle is going to be returned with only allowed mileage and normal wear. The excess wear charge compensates the lessor for additional depreciation that occurs due to wear and damage that's beyond normal wear. Consumer lease agreements disclose the allowed mileage and standards for determining excess wear. Regulation M is the analogue to Regulation Z. It's the implementing regulation of the Consumer Leasing Act. Whoops.

>> Tom Kane: We're not quite at break. Thanks very much, Randall. Now I go here. Great. Thank you very much. John and David, do you have anything you want to add to Randall's presentation or any clarifications, briefly, knowing that we're gonna go into the process in more depth later? But do you have anything that you want to comment on?

>> John Van Alst: Sure. Yeah. Thank you, Tim. I think Randall has done a great job of trying to simplify what's a pretty complex area, and, you know, he's made it as simple as he can. It's still pretty difficult, I think, to understand -- at least it is for me. And I think it certainly is for consumers as well. And, to me, that's one of the big issues we face is how complex this area is. You know, even beyond some of the terms that Randall defined for us, we have a lot of lease agreements that are much more complex and they contain terms that aren't defined for the consumer. In fact, there was a case in the second circuit a while back that said the lessee was going to be charged the amount, if any, by which sum of the adjusted lease balance, as described in item 8, plus one base amount, item 3A, exceeds the declared value as determined in accordance with item 15. And you sit down. I mean, you have a hard time what if any your liability might be throughout the lease. They'll oftentimes make reference to different processes by which early termination charges will be defined, which are not defined within the agreements themselves. It can be a pretty complex area, and, to me, that's one of the big hurdles we face in trying to make this fair and transparent for consumers.

>> Tom Kane: Thanks, John.

>> David Blassingame: Actually, I don't have anything to add. I thought Randall did a great job preparing and explaining the basics of leasing. If we're gonna go into it in detail later, we'll just talk then.

>> Tom Kane: Great. I appreciate it. Thanks. Yeah. Thanks very much, Randall. So, our first broad topic area is a big-picture look at consumer vehicle leasing. So, let me first ask David. What are the advantages to consumers of leasing versus buying?

>> David Blassingame: Well, A lot of people lease because they don't want to make a large initial investment in a vehicle, the down payment. The payments on a lease are less. It allows them to drive a car that is in warranty for either the majority of the time or all of the time that they have the car. It allows them not to be subject to market when it comes to resale value because all of the leasing that we do to consumers is closed-end leasing so that the end value is guaranteed. As we've seen in the last three years, big swings in the value of used cars. When gasoline went up the first time, the truck and S.U.V. market was basically decimated. People quit buying them. And if you were driving one and you had financed it, the trade-in value dropped thousands of dollars in just a couple of months. We dealt with people wanting to trade out of their agreements, their retail agreements, that were $8,000 and $10,000 upside down and only a year away from the end of the term, because the values of the car had dropped so much. So leasing -- if they'd leased those vehicles, they wouldn't have been subject to that market change. The lessor would have taken the loss, in this case, instead of the consumer. You know, it's sort of a win-win on a closed-end lease for a consumer because now we're in a situation where the residuals that were set during the first big downswing in business, the residuals were lowered a great deal. And so, now what we're seeing is that people that are in leases that are two years into four year leases that have actually got equity in their cars right now. So, at our company, personally, we have a big push to let people know where they stand in their cars because they can now, at the end of these leases, have equity. And they can get that back in the form of cash or place it toward another car. If they are upside down or if they owe more on the car, if the car is not worth the residual value, they simply turn it in. They don't take a loss. But if the car is worth more than the residual value, they can capture that equity that’s occurred.

>> Tom Kane: Great. Any other advantages to leasing for consumers?

>> Randall McCathren: Sure. First of all, vehicles have -- Different models, of course, have different depreciation rates, and it may be difficult for consumers to go out and shop and determine that. But because you only pay for the projected depreciation of the vehicle, it makes it much easier for consumers to comparison shop between vehicles and implicitly understand their rate of expected depreciation because that's the major component of monthly payment. As part of that end-of-term option, when you turn the car in, if you decide to do so as a consumer, you're

effectively getting a professional remarketing of the vehicle, which allows the residual values, even if they were generally forecast accurately to be higher than a consumer could get for a trade-in value, and, of course, the consumer is relieved of the difficulty and complexity of figuring out a fair trade-in value and then trying to negotiate that with different dealers. The residual values are set, you know, really, at a higher level than a consumer could negotiate, in general, because they are gonna be professionally remarketed through a competitive bid process, where literally hundreds of dealers are gonna be bidding on that vehicle.

>> Tom Kane: Let me interrupt for a second, if I could. I was thinking we would go no to more depth about the residual value later, but I think I'm realizing that to understand the advantages of leasing, we need to know just a little more about residual value. How does that play in to the benefits of higher residual value or versus lower residual value?

>> Randall McCathren: Right. In essence, closed-end leasing offers a fixed-price depreciation over the term. If you purchase and finance a vehicle or purchase with cash, for the length of time you own the vehicle, you don't know what amount of depreciation you're gonna pay is. It's an open-ended amount of depreciation. In a closed-end in lease, you're only paying for the expected depreciation down to the set residual value. So lessors compete by setting higher residual values, either because they believe they can remarket the car effectively, they believe this model's gonna hold its value will. So manufacturers, oftentimes, are very optimistic with setting residual values, or they may subsidize the lease to reduce the monthly payment by allocating their marketing money to increasing the residual value to offer the most attractive monthly payment compared to competitor models. So the consumer can get, oftentimes, the very highest future trade-in value, if you will. It's the analogue to a trade-in value by getting a lease that has the highest residual value, which means the lowest depreciation paid over the term.

>> Tom Kane: Thanks. John, do you have any thoughts about the advantages and disadvantages of leasing?

>> John Van Alst: I do. And some about the residual-value issue as well and whether or not that's a benefit to consumers, too. So I'll start off with the residual-value issue and talk more broadly

about buying versus leasing. As Randall pointed out, these residual-value calculations are oftentimes very high. In fact, there's a study that the Consumer Banker Association did a while back that found the lease terms were -- Typically, the disposition of the car at the end of the lease typically brought in about $1,920 less than the residual value in 1999, about $2,300 less in 2000, and about $2,400 less in 2001. So typically we see these residual values inflated above what the lessor can expect to receive when they sell the car. Randall pointed out how he thought that might be of an advantage to consumers. Unfortunately, for consumers that have early terminations, as we'll talk about later on when you calculate the penalty, the fee at early termination, that inflated residual value results in a higher cost to the consumer in terms ever figuring out the depreciation at that point. So it can really be a detriment to the consumer. More broadly, when we compare sort of buying and leasing, you know, there's a whole host of things that remain the same. I would say comparing financing to leasing, you know, 'cause most consumers, if they buy, they're gonna be financing. And, you know, all those sorts of things that we see in terms of add-ons and markups or dealer reserves and things like that, we see that in leasing as well. Those same sorts of problems. We do, however, see some differences. So, the FTC, in years past, did a wonderful thing with the FTC holder rule to basically say that any claims and defenses a consumer might have against the dealer that sold them the car and originally financed the car, they would have against the assignee of that paper as well. They did that partially in response to the fact that a lot of the retail installment sales contracts had these waivers in the contract saying you wouldn't be able to assert any of the claims and defenses against the dealer against the subsequent holder of the paper. We still see some of those attempts at waivers in lease agreements and unfortunately, because the FTC rule is somewhat ambiguous in its scope -- it's not clear it covers these consumer lease agreements -- it's difficult to make sure that you're preserving these claims and defenses against the lessor or the subsequent assignee, I guess. Similarly, the Mag-Moss rules are ambiguous as to whether or not they cover these lease agreements as well. I think the act itself is pretty clear that it would cover basically a consumer lessee, but unfortunately, the way the current rules are written interpreting Mag-Moss, it needs some clarification that this should also apply to consumer leases as well. So there are a number of different areas where we see a real difference as opposed to buying and financing or leasing a vehicle.

>> Tom Kane: Okay.

>> Randall McCathren: If I could respond to John's point about early termination. Because I think it is a critical and often misunderstood area. It's good to see John citing the thousands of dollars that are typically received implicitly by the consumer in paying less depreciation over the term than if they financed that same vehicle. To say that those consumers who choose to terminate early are somehow disadvantaged or penalized because they don't keep the vehicle and make payments through the end of the term to get the benefit, they are simply being treated the same as if they had financed the vehicle. In other words, that closed-end protection only occurs at one point in time. The consumer isn't treated worse or penalized on early termination. They simply are liable for the difference between the amortized balance at that point as if it were a finance agreement and the value of the vehicle, realized value, whatever it sells for, at that point in time. So it's hard to see that as a detriment to the consumer. It's just that they haven't received the benefit that they could receive through their own volition if they fulfilled the remainder of the lease term.

>> Tom Kane: John, do you have a comment?

>> John Van Alst: I do. It can really be a detriment to the consumer because this is all being presented to the consumer initially -- these terms. And it's very confusing, anyway, for the consumer to understand what's going on. But the lessor can easily manipulate the terms, and we'll talk later on, I guess, more about rent amounts and residual values and whatnot. But they can do so to actually increase, inflate this residual value. In fact, there was a case -- Nissan Motor Acceptance case -- where they were systematically inflating residual values. They had this process where they, basically, looked at what they thought the estimated residual value would be and then, basically, inflated it intentionally, referring to it as the contract residual value, and didn't derive it from the empirical data that they had already looked at when they were initially internally looking at this. And so, they were intentionally doing this. And I can say, what winds up happening is the consumer sees sort of one set of terms when they're initially entering into the lease, but winds up coming back and biting them if, for any reason, there's an early termination of the lease. So it can harm consumers.

>> Tom Kane: Does the higher residual value benefit consumers who pay for the entire, who do not terminate early and harm those who do terminate early?

>> John Van Alst: Not necessarily. It could just harm those who terminate early and not benefit those who pay throughout, depending on how they set the rent amounts. So, I mean, you can basically move those numbers around, increase the amount of rent, inflate the residual value, basically, decrease the depreciation you're including in the calculation of the payments and then sort of compensate yourself as a lessor by increasing the rent, wind up getting the same amount, but get more when somebody terminates early.

>> Tom Kane: Okay. David, you want to comment, too?

>> David Blassingame: Yeah, a couple of things. And I don't speak legalese really good. I'm a car guy, so this is car-guy talk. Early termination -- there's a big, bold statement on the face of all Reg M leasing contracts that says early termination can cost you up to thousands of dollars. That's very clear. When we lease someone a car, we make sure they are fine with the term. We don't want to early term. If they need to, then, as Randall said, it's pretty well a wash because then you're just dealing with the market value of the car versus the payoff. If you had an inflated residual, you'd have a lower payment each month. Then you would be making up for that lower payment when you do early terminate. But it's pretty well a wash. It's just like you bought the car because you're still gonna be paying value of the vehicle versus the payoff. That's what you're gonna be looking at. I think that we have seen residual changes that have been very favorable to consumers throughout time until 2008. We then saw everyone pull residuals back, which is not as favorable to consumers. But now it's turned out that it is because they can simply capture the equity that they've built in their cars because the residuals were lower. We're starting to see increased residuals again, which is gonna swing payments in favor of consumers again as the market is returned.

>> Tom Kane: Any of you, do consumers understand the differences between leasing and buying when they're sitting in the dealer's office?

>> Randall McCathren: [Clears throat] Excuse me. I think they understand some of them. And, you know, depending on how much time the dealer has with the consumer and how much interest the consumer has, you know, the dealer may have time and consumer interest to walk through a lot of the lease agreement -- if not all the lease agreement -- and explain things like how gap coverage in case of an insurance loss, is generally covered in a lease, which is generally not covered in a finance agreement; how the sales tax works, which in most states is not paid up front; so over the term of the lease, generally, in most states are not gonna pay as much sales tax. And if you look at the net present value of paying sales tax monthly rather than incurring the full sales tax up front, it's an even bigger cost savings. And of course, the options at the end of the lease, which allows you to defer, in essence, the purchase of the vehicle, to know whether this is the right vehicle three, four, five years later -- Is it the one that you want to keep for 10 years, or have your family circumstances changed? Has this vehicle turned out to be not one that you want to keep forever but you're happy to return because of, you know, of some other reasons of dissatisfaction with it?

>> Tom Kane: Anybody else have any comments on whether consumers do understand?

>> John Van Alst: Well, I think -- First of all, we have to assume that most consumers don't understand the lease itself, much less the differences between leasing and buying. I was a little bit troubled, too. I think we're gonna have more discussion in the following panel about misrepresentations and whatnot. But Randall mentioned, you know, if you have a dealer who has time to explain these things. Unfortunately, what we all too typically see is dealers who don't explain these things correctly or maybe intentionally mislead consumers to understand the terms of the lease. And we've got to recall that this is, you know, very much analogous to the financing proposition, where it's the dealer, who's the original lessor, who's gonna be assigning and selling this lease paper later on to other entities, as Randall described earlier on. So, we've got this lessor oftentimes misrepresenting what's in the lease agreement in terms of how things will work if there is an early termination, how things will work at the end of the lease and things like that. So it's difficult for consumers to follow.

>> Randall McCathren: I would say that the lack of understanding of the differences and the benefits of leasing leads to much lower rates of leasing than would occur if less-educated, less-

sophisticated consumers sat down and really understood they could save thousands of dollars of depreciation of the vehicle, they could pay less sales tax, they could be covered for a gap loss if the vehicles and insurance loss, if they have the end-of-term options, they could capture any equity in the vehicle. If they understood all those things, we would find much more similar rates of leasing in less-educated, less-sophisticated consumers as we now find in luxury consumers and more-educated consumers that are taking more expensive vehicles. There's a relatively high correlation in choosing leasing among higher-end vehicles and higher-end consumers.

>> Tom Kane: That brings us so my next set of questions. Thank you very much. Didn't even plant the question. I want to talk about demographic differences between consumers who lease and those who buy. For example, let me start off with income bracket. Do people with higher incomes lease more than people with lower incomes? What would you say about the differences?

>> Randall McCathren: There is a relative high correlation between the cost of the vehicle. And we do know, with fairly great accuracy, because of the availability of information both from the Departments of Motor Vehicle and the credit bureaus. We do have very precise information on make, model for new vehicles that are leased. We have much less. And so that's pretty much a census, if you will, of how many individual vehicles are leased of every different price range and every different model. We know a lot less about the consumer characteristics income, education, et cetera, so that's when the survey and impressionistic data that you know luxury vehicles have higher credit scores and higher income, higher education characteristics generally than, you know, the subcompacts and the least expensive vehicles. You do have some models that have less lease penetration even though the more expensive full-sized pickups, for example, tend to have low lease rates even though these are often $30,000, $40,000 vehicles.

>> Tom Kane: Mm-hmm. So income -- we don't have hard numbers on income. Is that right? About leasing?

>> Randall McCathren: I haven't seen. I mean, perhaps someone in the audience -- and there's been some consumer survey work that I'm not aware of. But I haven't seen any really good

statistical information on income and education levels, although some of the federal agencies going back 15, 20 years did some survey work, but it's somewhat dated now.

>> Tom Kane: Okay. David, you want to say something about income specifically?

>> David Blassingame: Yeah. Well, that and the people that lease -- We're a leasing company, so that's why people come to us. But what we see are teachers, small-business owners, truck drivers, professional athletes -- which is another story -- doctors, politicians, policemen. Everyone leases. We've got every income bracket from -- Usually, the lowest we'll see is somewhere around $24,000 a year. I think average-wise income is around $50,000 to $60,000 a year for our average lessee. People lease luxury cars for cash-flow reasons also. If you have a $60,000 or $70,000 car and you're looking at a conventional five-year finance your payments are gonna be pretty steep. For the most part, luxury cars have good resell value, especially at three or four years. So there's a lot-lower payment on that vehicle. And it really doesn't matter who you are. A lot-lower payment is advantageous to you. So that's why we see a lot of luxury cars leased is because there's a huge payment advantage that, you know, it can be half the price of the retail payment to do a three or four year lease on that car.

>> Tom Kane: How about -- You want to say something, John?

>> John Van Alst: Just real quickly. I'm sure Randall and David know more about demographics 'cause of the information they can gather in their own work and whatnot. But I do think we see a real ebb and flow in leases, in particular to low-income families that I'm most concerned with. I think we see that across the credit spectrum in terms of auto finance, but specifically, with leases, I know when I talk to dealers and others, a lot of times they look at a 15% to 20% penetration rate in terms of leasing, but I think that really changes. We saw a lot of leases back in the '90s, and then it dissipated somewhat. I think we're seeing more leasing now. So I don't know where that gets us but this is something we see come and go in terms of low-income consumers, and while it might be sometimes a lesser amount, I think oftentimes we see a far greater amount of leasing in that area.

>> Tom Kane: Randall and David, are you seeing more low-income folks in the past five years, past two years?

>> David Blassingame: Not really. Leasing about 20% of the market right now. At a high, it was about 24%, 25% of the market. That was in late '90s, early 2000s. So there's been about a 5% decline with the last three years business.

>> Tom Kane: That's percentage of penetration rate. Okay. And the rest are folks who...

>> Randall McCathren: Small percentage of cash. Yeah. I think the difference -- I mean, I think there are two things going on. And this was cited. The used-car market because of dealer supply of used cars, due to 2008/2009, we had much lower new car sales than we have had historically creates a shortage of used cars two, three, four years later. So now we're still selling under trend line in terms of new car sales. So you have fewer used cars in the market, more demand for used cars, more drivers, more population -- even with a deferral, cars wear out, people have to replace them. So you have higher used-car values, which is the basis for establishing residual values today. So what we see is a bigger payment differential and a bigger cost savings per month between leasing and financing when you have periods of high residual value. So manufacturers advertise more. People have more consciousness of cost savings, they come in asking about a lease ad, dealers don't -- If you're not selling 17 million vehicles a year, you're selling 12 1/2, you have more time to explain how the transaction works and the finance versus the lease. So I think we're seeing, you know, more leasing. And we had, you know, several manufacturers come back from bankruptcy to be able to offer leasing which they couldn't do two, three years ago.

>> Tom Kane: John?

>> John Van Alst: Just a quick point Randall made me think of. I think part of what we see, too, as well -- The incentives that manufacturers provide, the same way they have these zero-percent financing, teasers for new-car sales financing, they do similar things with the leasing, oftentimes which involve that residual value as well. I have a lot of things about early-termination fees but we seem to keep coming back to this residual-value issue. But one of the ways in which manufacturers

oftentimes sort of encourage this leasing is to have inflated residual values that they'll offer to the assignee. In other words, they're gonna offer to take the car off their hands at this higher price than they'd be able to get for the car at the end of the lease, which certainly tempts the consumer into leasing. But then if, you know, somebody loses their job, has a medical issue -- all these sorts of other things, again, we get hit with that early termination -- a much higher charge. In other words, what would have been subsidized by the manufacturer through this incentive, suddenly all that burden falls on the consumer in the calculation of the early-termination fee?

>> Tom Kane: Let me ask, are there any other demographic differences between consumers and consumers who purchase finance cars, before we move on? One thing I was wondering about, what about credit scores? Are credit scores higher for those who lease or lower for those who lease? Yeah, David?

>> David Blassingame: Yeah. Our base credit score for a lease right now is 640 beacon, which is certainly not low, but below that there's no opportunity to lease, at least through any of the banks and lenders that I work with.

>> Randall McCathren: When you say "base," that's not the average.

>> David Blassingame: No, that's the lowest it can go. Our average beacon score for a lessee is between 700 and 720.

>> Tom Kane: Okay. How does that compare to consumers who purchase cars, finance a vehicles?

>> Randall McCathren: That would be about the same.

>> David Blassingame: Yeah. That's about the same.

>> Randall McCathren: Typical new car buyer is probably close to 720. I think David's point -- Really the only difference is the absence of, really, a subprime.

>> Tom Kane: That's what I was gonna ask you next. Is there a subprime leasing market?

>> Randall McCathren: Very, very rare to have leasing offered below 640, 620. The subprime market pretty much sticks with financing, and you see much less leasing in that credit tier. But above 640, 650, you know, lease programs pretty similar to finance programs, but we'll see -- You know, because of the higher penetration rates on luxury vehicles, you know, David's experience is probably a little bit different than the national experience of all leases because there's heavier concentration, you know, two to three times as high a rate of leasing on vehicles over $40,000 MSRP compared to under.

>> Tom Kane: I'm sorry. Move your mike a little closer, Randall. I don't think you're coming across as clearly as the others. John, you were gonna add something?

>> John Van Alst: Yes. So, I don't have any hard data that Randall and David might in terms of subprime leasing. I do know that it's something we consistently see. So I think it is going on. But I did want to add, in terms of sort of something we're seeing more and more of, especially in the low subprime market is a lot of buy here/pay here dealers that are doing rent-to-own. Now, many of those are not structured so that they would fall under the Consumer Leasing Act. But I think when we look at what consumer perception is, you know, they can look at the disclosures required under Reg M and see rent and whatnot and then they see the same sort of rent terms when they're doing the rent-to-own transaction at pay here/buy here place. And I there is a lot of confusion among consumers as to exactly what they're getting into. Also, some of these do structure them as leases because in some states, rent-to-own, motor vehicle rent-to-owns are actually prohibited, like Indiana and whatnot. And so we see some of these intentionally structuring their alternative sort of as a lease as opposed to a rent-to-own.

>> Tom Kane: Yeah, David, you want to --

>> David Blassingame: Speaking to what John just said, there were a number of independent dealers in Texas that tried to do a rent-to-own thing, and the Motor Vehicle Commission came in,

examined the documentation, determined that they were not, in fact, leases, that they were conditional sales, that they were not figured at an acceptable interest rate, and closed them down. So in Texas, we don't really have an issue.

>> Tom Kane: Thanks. Let me move on to some current trends in auto leasing. I think you've talked about some of them. Who's doing the most leasing? Is it dealers, other leasing companies? Who's doing the most leasing these days?

>> Randall McCathren: Well, dealers are doing the most leasing because they have the lion's share of the new-car sales market. I'll let David speak to independent leasing company volumes, but certainly, just the size of the new-car franchise dealer network -- 20,000 dealers across the country -- that's where most consumers are gonna end up going for a leased vehicle.

>> Tom Kane: David, can you tell us, how do independent leasing companies work? How is that different from a dealer or a franchise leasing company?

>> David Blassingame: Yeah. We're different in that we don't have a franchise agreement with the manufacturer. We lease all makes and models. When it comes to the actual lease documentation and the mechanics, it's exactly the same. We are going to, just as the dealer would, buy a vehicle. The dealer buys that from his franchised manufacturing company. He then leases that vehicle, which is exactly what we do. He then sells that lease contract and vehicle to whoever funded the lease and that's exactly what we do. Now, there are some independent lessors that actually hold all that paper themselves in which they would be buying a vehicle. Then they would be entering that into a lease agreement, and they would collect the payments. And then they would have the end responsibility of the value of the vehicle. That's how independent lessors work -- Either just like a dealer or they actually finance all of the leases themselves. Sometimes they sell those leases off in bulk to banks, but they still collect and they still have end value responsibility, and they take the credit risk on that also.

>> Tom Kane: What's the typical length of lease term these days, and how is it different from two years ago or five years ago? Is there a trend going on with the length of lease terms?

>> Randall McCathren: Well, there was a period of time when lease agreements, particularly offered by financial institutions, got to be very long -- 60-, 66-, even 72-month leases were not at all uncommon. In some markets, 66 months got to be the standard for bank leases. Banks have pretty much dropped out of the auto leasing market because of that residual risk that we've talked about, and the potential for literally hundreds of millions of dollars, if not billions of dollars, of losses that, essentially, the lessor shoulders rather than the consumer.

>> Tom Kane: The typical length, typical period is how long now?

>> Randall McCathren: The typical length has really been reduced to probably 42 months now. So there's probably an equal number of 36, 39 and 48.

>> Tom Kane: Great. And how often do consumers buy the vehicle at the end of the lease term, and, again, how is that trending?

>> Randall McCathren: Well, it does trend with the used-car market and whether there's a residual deficiency. Consumers are generally rational, and if they understand their vehicle is worth $15,000 and the residual value in their lease is $19,000, very few consumers are gonna pay $19,000 purchase option when the vehicle is only worth $15,000. So you're going to see, you know, turn in rates of 50%, 60%, 70%, 80% in periods where you have an average $3,000, $4,000, $5,000 loss at the end of the lease. In periods today, as David was alluding to, with some exceptions -- The used-car market always favor some segments over other segments due to gas prices, changes in technology, whatever, discontinued models. But in general, we're seeing equity where vehicles are worth more than the purchase-option price. So, again, consumers are either purchasing those or trading them to the dealer and allowing the dealer to purchase rather than, you know. So on that $19,000 residual, if the car is worth $22,000, very few consumers are just going turn that in and give the lessor the $3,000 gain. They're keep that gain for themselves -- either purchase that vehicle or trade it to a dealer who's buy it for $19,000 from the assignee.

>> Tom Kane: Okay. So, the percentage now of consumers who buy vehicles is?

>> Randall McCathren: I mean, I haven't seen any statistics. I would be making a wild guess, but I would say, you know, just substantially less than the 50%, 60% we've seen historically.

>> Tom Kane: David?

>> David Blassingame: Term has a lot who buys their cars and who doesn't. The shorter term, the less likely they are to actually buy the car. Three-year leases generally get turned back in. But if there is significant equity, I guess you could consider trading that car in as a purchase. Right now almost every one we've got in cars are trading those cars in early or a few months early or essentially trading them early and capturing the equity. So almost everything that we're getting back right now, they're trading out of earlier or they're buying.

>> Tom Kane: So, they're trading. What do you mean by "They're trading in"? I'm sorry.

>> David Blassingame: Well, if you trade in a car, you've essentially bought it, because at that point, the car's paid off. So when the value of the car is greater than residual value or greater than the payoff during the lease term, a lot of people choose to trade early, which essentially buys the car because it pays it off.

>> Tom Kane: Do you want to add something?

>> John Van Alst: Well, I was just gonna say that, you know, that's yet another example where we see these issues in terms of early-termination costs, where people are actually trading in early for some reason or another. And not only the issues that we'll cover later on in terms of the difficulties of determining early-termination cost, but it really winds up -- A lot of times you get dealers who try to sort of estimate what the amount's gonna be and wind up structuring a deal to purchase a new car. And then, oftentimes, we have real issues in what early termination fee actually is. And so that can raise real issues with this trade-in model as well.

>> Tom Kane: Okay. So, get off these current trends after I ask two quick questions which are what percentage of consumers -- Do we know what percentage of consumers terminate early? Do we know what percentage of consumers re-lease, choose to go to lease another car?

>> David Blassingame: You know, from personal experience, we've got about a 70% retention rate. About 70% of the people that we lease cars to lease another car. The other 30% either turn the car back in or choose to purchase the car and drive it for a longer period of time.

>> Tom Kane: Is that your company?

>> David Blassingame: Just my company.

>> Tom Kane: Your company. Do you know anything about your association? Do you have numbers like that?

>> David Blassingame: No, not really. Many members of our association are lessors themselves. They hold the paper themselves. They structure their deals differently than the vast majority much leases, which are done by new-car dealers. Don't have figures.

>> Tom Kane: Okay. Thanks. So who makes money from leasing? Is leasing profitable for dealers? And if so, how do they make money?

>> Randall McCathren: Well, obviously, it's similar in that they sell the contract -- whether it's a retail-installment sale contract or a lease contract to a third-party assignee. So whatever markup they have in the vehicle would be analogous whether it's an installment sale or a lease. So that part is very similar.

>> Tom Kane: Anybody else want to add anything about how --

>> David Blassingame: Yeah, I think -- Who makes money from a lease? Leasing companies do. Auto manufacturers do. Auto dealers do. All their employees do, if you consider that one in five

cars is leased right now. Lenders make money off the leases because they charge interest -- all of their employees. Auto manufacturers, if you again consider one in five cars is leased -- all the manufacturers make money off leasing, including all their employees, the assembly people. All of their suppliers make money off leasing.

>> Tom Kane: Do manufacturers -- Would they prefer to sell cars outright or would they prefer to lease their cars?

>> Randall McCathren: You know, that is a very interesting question, and the strategy and thinking of manufacturers has changed over time. There was a period because first leasing has higher brand loyalty than selling the vehicle, and it has higher dealer loyalty than selling the vehicle and higher customer satisfaction than selling the vehicle. So, when you have those three things working for you -- Leasing brings more customers back to the manufacturer, more customers back to the dealer, and customers are more satisfied with the vehicle, not just with the "finance versus lease" transaction. But they're more satisfied with the vehicle. That's word-of-mouth advertising. Nothing is better. You can see why the manufacturers put a lot of their subsidy marketing dollars behind leasing. However, in downturn periods, where there's this residual deficiency that the manufacturer is shouldering, if you will, when the vehicle is returned at the end of the lease, you know, their profit model may project that 50% of cars are coming back, and all of a sudden, end 80% of them are coming back, and their losses are bigger than they had expected. So manufacturers have really tuned in to trying to set -- and when you have a high number of vehicles being returned of the same make/model at the same time, then you have an oversupply in the used-car market, which can't absorb it, and so then the prices are depressed even further, where if the consumer owns the vehicle and the price is depressed, they'll tend to just hold on to it for another six months or a year, and you don't have the same flow of vehicles coming into the used-car market, you don't have the same oversupply, glut, depressing the used car price. So the manufacturers have wanted to kind of really watch the number of leased vehicles and when they're gonna be coming back into the used-car market, and try to make sure that the supply doesn't overwhelm demand so that their used-car values stay strong which is to their benefit in both selling and leasing new cars.

>> Tom Kane: Okay. Thanks. John? You had something?

>> John Van Alst: I just want to add to the long list that David gave. You know, I want to emphasize dealers and other parties make money off of these as they do financing -- all the sorts -- add-ons that can be packed on, and regular financing can be in leases as well. So we see those sorts of things. The payments basically to the dealer when they're selling to the assignee in terms of dealer reserve and whatnot -- All those sorts of things go on in the lease transaction the same as we see in finance.

>> Tom Kane: Great. Thanks. Let's move now into digging further into the leasing process. And we'll move through this quickly because we want to talk about the charges that consumers might have to pay at the end of a lease. I want to get to early termination, excessive wear and tear and other charges. So, first, consumer comes in and wants to lease a car. What's the first thing that happens? Something about an agreed-upon value of the vehicle is my understanding, right?

>> Randall McCathren: Right. Generally, the consumer will negotiate an agreed-upon value of the vehicle, unless they're responding to an advertisement that has kind of pre-set terms. And they may respond to either a dealer ad or an ad by the dealer that's essentially a manufacturer special, if you will.

>> Tom Kane: Okay. If there's no advertised amount, is there negotiating room?

>> Randall McCathren: Right. So there's a negotiation for the value of the vehicle.

>> Tom Kane: Okay. How does that get started? A sticker price on the side of the car? How does it work?

>> Randall McCathren: I mean, here, we're talking about new vehicles, since more than 95% of leases are on new vehicles, let's exclude used for the moment So you have an MSRP, a manufacturer's suggested retail price, that has to be listed on a window sticker or on the side of the vehicle. So that's usually the starting point for the price negotiation.

>> Tom Kane: Do consumers generally negotiate this amount?

>> Randall McCathren: Oh! Absolutely. Consumers are better informed, and there's more information on the Internet as to average prices that are being paid in their area, what the dealer cost of the vehicle is. You know, the tools available to consumers for price shopping and price comparison are so much more powerful than they were 10, 15, 20 years ago before the Internet became such a powerful tool for people.

>> Tom Kane: Sure. Yeah, John?

>> JOHN VAN My experience has been completely experience. In 13 years, I've never talked to a consumer who negotiated on the price of the vehicle. They don't think the price of the vehicle has anything to go them. They think they are making a monthly lease payment. And so, I've never talked to a consumer who said they did anything to negotiate the vehicle at the time that they were leasing.

>> Tom Kane: Okay, David, you want to add something?

>> David Blassingame: Everyone that we talk to negotiates. They negotiate the value of the car, they negotiate for mileage, they negotiate for term, they negotiate for up-front charges, they even negotiate for residual values because sometimes they have specific needs for residual values. And as far as where right and wrong or where good and bad is, pretty well everyone that we deal with has talked to a lot of new-car dealers as well as us before they make a final decision. I get a lot of -- I guess we probably get a thousand a month or so -- of inquiries over e-mail. And it's very common for them to ask for the cap cost, the implicit rate, the residual value, the number of miles. It's gotten to be -- it's an everyday deal. And everyone out there can calculate a lease now because you can go to any of a hundred Websites and find a lease calculator. So if you throw the numbers in, it will tell you exactly where you are in the deal. And all of our customers, I think, avail themselves of that.

>> Tom Kane: Okay. So, what we're going to do is work quickly towards, basically, the amount, the monthly payment that a consumer pays for their lease. And so, there are all these different amounts, different terms that Randall talked about. So the gross capitalized cost is that agreed-upon value of the vehicle plus items the consumer agrees to pay for over the lease term, such as service contracts, insurance, prior credit, or lease balance. And then there's something called the capitalized cost reduction, and what's the capitalized cost reduction?

>> Randall McCathren: Well, that's the analogue to down payment.

>> Tom Kane: Okay. Okay. And how is this determined and can consumers negotiate this?

>> Randall McCathren: Well, yes. And, you know, it's how much cash the consumer has put into transaction. It's gonna reduce the depreciation and amortized amounts they pay over the term. So, just like in a finance deal, the more money you put up-front, the less you pay over the term, the lower your monthly payment's gonna be. There may be a cash rebate from the manufacturer, from the dealer. There may be some, you know -- There may be a trade-in, which would be, if there's trade-in equity, that's treated as a capitalized cost reduction as well.

>> Tom Kane: Okay. And then you subtract capitalized gross reduction from the gross capitalized cost to come up with the adjusted capitalized cost. And, Randall, you said this is analogous to the amount financed in a retail installment transaction. The next thing to be determined is the oft-mentioned residual value. It's a portion of the adjusted capitalized cost that is not paid or amortized over the lease term. Is that right?

>> Randall McCathren: Right. So, it’s the end point if you think of the transaction as amortizing an initial balance, which is that adjusted capitalized cost down to an end point instead of amortizing it down to zero. So it's what you're paying the balance down to, over the term, you know, through the monthly payments.

>> Tom Kane: Mm-hmm. And, then, so, again, how is the residual value set? Who sets it, and can consumers negotiate this?

>> Randall McCathren: Well, it's part art, part science. Whoever is going to own the lease, the assignee, generally is going to set the residual value that they will purchase a contract with. So if the dealer end up writing a residual value of $20,000 on a lease agreement but no assignee is willing to buy the vehicle with that $20,000, they're only, you know, willing to buy it with an $18,000 residual, then the dealer would get paid less. You know, that $2,000 would generally be subtracted from what the dealer can sell the lease for. So the dealer, generally, is going to look carefully at different assignees and see what residual value they're setting and what, you know, implicit lease rate they're using, and, you know, use the terms that they know they can sell the lease to an assignee.

>> Tom Kane: Okay. Now, we subtract the residual from the adjusted capitalized cost to determine the depreciation and any amortized amounts sway. That's a real mouthful. And, then, in addition to the depreciation and any amortized amounts, another large portion of the amount that a consumer has to pay over the course of the lease term is their rent charge. So, you analogized the rent charge to a finance charge in a consumer-credit transaction. John, what is the rent charge?

>> John Van Alst: Well, it is. I think he's right. It's analogous to the finance change and the consumer credit transaction. Where we really run into trouble, I think, if we only got three minutes left, to me, it's that early termination, the termination of what the consumer's gonna owe, the termination of the lease if it's early. And we've already talked about the problems with the residual value. There are a lot of other things that arise too. These are horribly complicated sort of formulas that are being used. Unfortunately, Reg M says that it's okay for them to be complex that basically only an expert can understand. They'll just refer to whether they're gonna use the "constant yield" method or "adjusted lease balance" method, without sort of explaining those. The consumer can ask for those to be defined, but they don't know typically they can do that. And even if they are, they have a really hard time understanding what in the world's going on. We see assignees typically -- Maybe not typically, but very often, unfortunately, not even using those. We have those incredibly complex sort of formulas within the lease agreement, but, then, if there's a change and there's a new lease agreement where, if it's sold to a different assignee, they'll use their own formula instead of applying what's in the lease agreement, as they ought to. We see them do

things such as -- You know, Randall mentioned how sort of the adjusted capitalized cost would really be equivalent to the amount financed in a normal sales transaction. We'll see them put this dealer reserve and other things like that into that capitalized cost as opposed to in the rent which is analogous to the finance charge. At early termination, that means that the consumer is oftentimes responsible for those amounts rather than -- I mean, if you really look at it, very simply, at early termination, you have this depreciating asset, and the depreciation's greater at the beginning. But unfortunately, the rent's higher at the beginning, and so you have this real short fall at the front half. And the effort is to determine, basically, how much depreciation the consumer should be liable for at early termination. But instead what we see is, through the use of -- You know, there's basically a fire sale when you turn the car in early rather than if it's a normal turn-in at the end of the lease term, they've either had this high residual value set because they know they can sell it back to the manufacturer or whatever other reason they've done it. But then, there aren't, unfortunately, sufficient protections to ensure there's a fair value. You know, if you look at Reg M -- it doesn't anticipate that the car is to be sold at early termination. It could simply be released to somebody else. The courtroom can request a third-party appraisal. But, there again, consumers don't know to do this. And the lessees -- It's on their time if they do, and so there are a lot of problems with figuring out this early termination amount.

>> Tom Kane: Okay. Great.

>> Randall McCathren: If I could make comment --

>> Tom Kane: Actually, I need to -- It turns out, I need to wrap it up. But I appreciate all the time you guys have given us, and I will just ask for one more question about excessive wear and tear, wear-and-use charges. How do those -- How are those determined and, you know, generally those -- John, what do you think about those, and then Randall -- How are they determined?

>> John Van Alst: The problem, I think, that we oftentimes see is there, again, this difficulty in assessing whether or not there has been reasonable wear and tear. Another problem we run is, a lot of times, you know, they turn in the car, the person taking the car says, "Oh, this looks great" and all that. And then a month later, or even after, you hear you're gonna be assessed this amount for

this wear and tear and things like that. And so we see a lot of problems both in the method of determining and also when the consumer finds out and what they're told by whom. But I know there will be another panel talking about some of those issues as well.

>> Tom Kane: Okay. Great. Thank you all very much. And we’ll now take a break until 10:00. [Applause] Thank you.