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Legal & Regulatory Group

January 5, 2011

Via E-Mail

David C. Vladeck
Director
Bureau of Consumer Protection
Federal Trade Commission
600 Pennsylvania Avenue, NW
Washington, D.C. 20580

Re: Request for Written Clarification on Whether the Risk-Based Pricing Rule Applies to Certain Franchised Automobile Dealer Transactions

Dear Director Vladeck:

On behalf of the National Automobile Dealers Association ("NADA"),[1] we are writing to request that the Federal Trade Commission ("FTC" or "Commission") provide NADA with a written staff opinion stating whether the Duties of Creditors Regarding Risk-Based Pricing rule ("RBPR"), 16 CFR Part 640, require franchised automobile dealers to provide certain consumers with either a Risk-Based Pricing Notice ("RBPN") or a Credit Score Disclosure Exception Notice ("Exception Notice") in the circumstances described below.

I. Background

This request has arisen in connection with NADA's efforts to educate its members about their compliance responsibilities under the RBPR. As part of those efforts, NADA has coordinated with staff attorneys with the Commission and the Board of Governors of the Federal Reserve System (collectively, "the agencies") to ensure that franchised dealers obtain accurate and timely information concerning their duties and the agencies' compliance expectations under the RBPR. As is routinely the case when either or both agencies issue or amend a regulation affecting our members, the agencies' staff attorneys have provided valuable support to NADA's educational efforts.

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[1] NADA represents approximately 16,000 franchised dealers in all 50 states and the District of Columbia who (i) sell new and used cars and trucks; (ii) extend vehicle financing and leases to consumers that routinely are assigned to third-party finance sources; and (iii) engage in service, repair, and parts sales. Our members collectively employ approximately 1 million people nationwide. A significant number of our members are small businesses as defined by the Small Business Administration.

Notwithstanding this productive collaboration, the agencies' staff attorneys have recently expressed an informal position on a scope issue that we believe is inconsistent with section 311 of the FACT Act and the RBPR and, if unaltered, will prove burdensome and very costly to the many franchised dealers to whom it applies and who will rely upon it.

The specific issue concerns whether franchised dealers who are initial creditors must provide consumers with either a RBPN pursuant to 16 CFR §640.3(a) or an Exception Notice pursuant to 16 CFR §640.5(e)(1) in the following circumstances (which describe a three-party vehicle financing transaction) -

(i) the dealer sends a consumer application for vehicle financing ("credit application") to an unrelated finance source (e.g., captive or independent finance company, bank, or credit union) for its review;
(ii) the dealer neither orders nor otherwise obtains a consumer report from a consumer reporting agency ("CRA");
(iii) the finance source conducts underwriting on the credit application and, as part of that process, presumably (but not necessarily with the dealer's knowledge) obtains a consumer report from a CRA;
(iv) following its underwriting analysis, the finance source provides the dealer with an approval of the credit application and a wholesale buy rate at which it will purchase the credit contract from the dealer; and
(v) based on the finance source's agreement to purchase the credit contract, the dealer offers the consumer credit terms, including a retail financing rate ("APR"), and, if those terms are accepted by the consumer, enters into a credit contract with the consumer and then immediately assigns it to the finance source.

The agencies' staff attorneys have taken the informal position that the dealer in this fact pattern "uses a consumer report" (which, as delineated below, is one of the rule's scope requirements), even though it does not order or otherwise obtain a consumer report from a CRA. This position is apparently based on the *finance source's* use of a consumer report to conduct its underwriting, its subsequent communication to the dealer of its approval of the credit application and the wholesale buy rate at which it will purchase the credit contract from the dealer, and the dealer's use of that information to set the credit terms with the consumer (steps (iii) through (v) above). Under this interpretation, the finance source's use of a consumer report is imputed to the dealer notwithstanding the fact that, as explained below, the finance source's communication of this information to the dealer is not a consumer report under the Fair Credit Reporting Act ("FCRA").

The position of the agencies' staff attorneys on this issue appears to have evolved from their concern that a less expansive interpretation (i.e., that dealers do not use a consumer report when they neither order nor otherwise obtain a consumer report from a CRA) would result in many intended recipients of one of the two notices not receiving either notice since the RBPR's Rules of Construction place the responsibility to issue the notices solely on the initial creditor.[2]

[2] 16 C.F.R. §640.6(b).

However, this concern, while well-intentioned, cannot serve as a basis for imposing a regulatory duty on persons who fall outside the scope of the governing statute and regulation.

II. Analysis of Pertinent Law

a. Scope Provision

Determining whether dealers in the fact pattern we have presented are covered by the RBPR requires an analysis of the rule's scope provision. 16 CFR § 640.1(a)(1) defines the scope of the RBPR as follows –

> This part applies to any person that both –
>
> (i) Uses a consumer report in connection with an application for, or a grant, extension, or other provision of, credit to a consumer that is primarily for personal, family, or household purposes; and
>
> (ii) Based in whole or in part on the consumer report, grants, extends, or otherwise provides credit to the consumer on material terms that are materially less favorable than the most favorable terms available to a substantial proportion of consumers from or through that person.[3]

In its Paperwork Reduction Act burden analysis, the Commission summarizes these coverage requirements as applying to "[a]ny creditor that engages in risk-based pricing and uses a consumer report to set the terms on which credit is extended to consumers."[4] We address these two required elements of the scope provision in inverse order.

b. The Information Dealers Receive from the Finance Source is Excluded from the FCRA's Definition of a "Consumer Report"

The dealers about whom we are inquiring serve as the initial creditor in three-party financing transactions but do not order or otherwise obtain a consumer report as part of their business model. Consequently, they may only be found to be using a consumer report if they actually receive a consumer report from some other source.[5] The agencies' staff attorneys appear to have taken the position that the finance source's communication to the dealer of its approval of a consumer's credit application and the wholesale buy rate at which it will purchase the credit

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[3] This provision closely tracks the language of section 311 of the FACT Act, which states: "Subject to the rules prescribed as provided in paragraph (6), if any person uses a consumer report in connection with an application for, or a grant, extension, or other provision of, credit on material terms that are materially less favorable than the most favorable terms available to a substantial proportion of consumers from or through that person, based in whole or in part on a consumer report, the person shall provide an oral, written, or electronic notice to the consumer in the form and manner required by regulations prescribed in accordance with this subsection."

[4] 75 Fed. Reg. 2,724, 2,748 (Jan. 15, 2010).

[5] Any suggestion that dealers can somehow be found to be using a consumer report by virtue of the finance source's independent use of a consumer report that only the finance source obtains and has access to would require a tortured construction of the word "use" that would clearly depart from the plain meaning and purpose of section 311 of the FACT Act and the RBPR.

contract from the dealer is a consumer report which, if used by the dealer to set the credit terms with the consumer, brings the dealer within the scope of the RBPR. However, as explained below, this apparent assumption overlooks the fact that the finance source's communication of this information to the dealer is not a consumer report under the FCRA. Thus, the finance source's communication to the dealer in the fact pattern we have presented cannot serve as a basis for concluding that a dealer's use of that information constitutes use of a consumer report to set the credit terms, thereby requiring the dealer to issue either RBPNs or Exception Notices to consumers under the RBPR.

Section 603(d)(2)(C) excludes from the definition of a "consumer report" –

> any report in which a person who has been requested by a third party to make a specific extension of credit directly or indirectly to a consumer conveys his or her decision with respect to such request, if the third party advises the consumer of the name and address of the person to whom the request was made, and such person makes the disclosures to the consumer required under section 615 [§ 1681m].

The Commission provides the following interpretation of this provision in its Official Staff Commentary on the FCRA ("Commentary"):

> The exemption covers retailers' attempts to obtain credit for their individual customers from an outside source (such as a bank or a finance company). The communication by the financial institution of its decision whether to extend credit is not a "consumer report" *if* the retailer informs the customer of the name and address of the financial institution to which the application or contract is offered *and* the financial institution makes the disclosures required by section 615 of the Act. Such disclosures must be made only when there is a denial of, or increase in the charge for, credit or insurance….[6]

Consequently, as applied to the fact pattern we have presented, this provision directly and conclusively establishes that a finance source's communication to the dealer of the information specified above is not a consumer report provided the dealer informs the consumer "of the name and address of the financial institution to which the application or contract is offered."[7] Accordingly, dealers' receipt of this information from the finance source may not serve as the basis for concluding that dealers use consumer reports to set the credit terms with the consumer.

c. Dealers in the Fact Pattern We Have Presented Do Not Engage in Risk-Based Pricing

Even if the written staff opinion we have requested were to conclude that, notwithstanding section 603(d)(2)(C) of the FCRA, dealers still use a consumer report to set the credit terms in the fact pattern we have presented, the Commission's staff also would have to

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[6] FTC Official Staff Commentary, 16 CFR Part 600 (Appendix), § 603(d), item 7.
[7] Id.

find, as a prerequisite to concluding that these dealers fall within the RBPR's scope provision, that they engage in risk-based pricing.

The comments we submitted to the Commission in response to the proposed RBPR (see attachment) detail why dealers engaged in three-party financing transactions do not engage in risk-based pricing. Rather than restating those arguments here, we incorporate them by reference. We also request the opportunity to further address this discrete issue if the written staff opinion we have requested concludes that dealers in the fact pattern above meet the other required element of the scope provision (i.e., they use a consumer report to set the credit terms).

It is important to note that the only statement in the agencies' Summary of the Final Rules relating to whether dealers engage in risk-based pricing is premised on dealers having obtained a consumer report from a CRA to determine to which of their multiple finance sources they will send the consumer's credit application.[8] Neither the RBPR nor the Summary of the Final Rules address the notion that dealers who do not obtain or review a consumer report from a CRA could possibly be construed to engage in risk-based pricing. Consequently, any subsequent statement on this issue by FTC staff should not rely on the agencies' inapposite statements in the Summary of the Final Rules.

III. Burden Imposed by the Interpretation of the Agencies' Staff Attorneys

The reliance of dealers on these informal statements by the agencies' staff attorneys has begun, and will continue, to impose a considerable burden on dealers who are initial creditors in vehicle financing transactions but do not order or otherwise obtain consumer reports as part of their business model. The only viable RBPR compliance mechanism for these businesses is to issue an Exception Notice,[9] and the cost of doing so is considerable. The RBPR generally requires that an Exception Notice be provided to all consumer credit applicants for whom a credit score is available,[10] and the only means of obtaining the information necessary to complete the Exception Notice is to purchase from a CRA a consumer report for each of the dealer's consumer credit applicants. When considering the large number of consumer credit applications that dealers typically receive, this can cost dealers several thousand dollars per year and potentially well over $10,000. The imposition of such a financial cost is considerable for any business, but will be particularly burdensome to many small dealerships as, relative to their larger counterparts, they are more likely not to order consumer reports as part of their business model.[11]

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[8] The Agencies state, in part: "[A]n automobile dealer's use of a consumer report to determine which third-party financing source is likely to purchase the retail installment sales contract and at what 'buy rate,' and to set the [APR] based in part on the 'buy rate," is conduct that fits squarely within the description of risk-based pricing in… the final rules." 75 Fed. Reg. at 2,730.

[9] Because this group of dealers does not order or otherwise obtain consumer reports and typically does not engage in tiered pricing, neither of the methods described in 16 CFR § 640.3(b) for determining which consumers must receive a RBPN provides these businesses with a practical means of complying with the rule without ordering a consumer report (nor is this group, or dealers generally, able to determine required RBPN recipients under the direct comparison method).

[10] 16 CFR § 640.5(e)(1)(i).

[11] Separate from the financial burden this creates is concern about requiring small businesses to obtain sensitive consumer information for which they otherwise do not have a business need. Clearly, the Commission's identity theft prevention goals set forth in its rule mandating the Disposal of Consumer Report Information and Records, 16 CFR Part 682, and its rule requiring Standards for Safeguarding Customer Information, 16 CFR Part 314, are not

IV. Request

In light of the foregoing, NADA believes it is essential, and accordingly requests, that FTC staff immediately provide to NADA a written opinion stating whether automobile dealers who act in a manner consistent with the fact pattern we have presented fall within the scope of section 311 of the FACT Act and the RBPR and therefore must issue either RBPNs or Exception Notices as required by the RBPR. NADA also requests an opportunity to meet with you concerning this matter at the earliest possible opportunity.

Thank you for considering our request. Please direct your response, and any inquiries for additional information, to Paul Metrey at (703) 821-7040 or pmetrey@nada.org.

Sincerely,

[Original Signed]

Andrew D. Koblenz
Vice President
Legal & Regulatory Affairs

[Original Signed]

Paul D. Metrey
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Cc: Sandra F. Braunstein
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furthered by an interpretation that dealers must purchase consumer reports for the sole purpose of complying with the RBPR.