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Legal & Regulatory Group

April 11, 2011

Via Web

Office of the Secretary
Federal Trade Commission
Room H-113 (Annex V)
600 Pennsylvania Avenue, NW
Washington, DC 20580

Re: Motor Vehicle Roundtables—Comment
Project No. P104811

Dear Secretary:

The National Automobile Dealers Association (NADA)¹ submits the following comments in response to the Notice entitled “Public Roundtables: Protecting Consumers in the Sale and Leasing of Motor Vehicles” (Notice) that the Federal Trade Commission (FTC or Commission) recently released in the above captioned matter.²

NADA has a long history of working with federal regulatory agencies, including the FTC, to promote franchised dealers’ compliance with federal statutes and regulations and to educate consumers about the vehicle financing process. Accordingly, NADA welcomes the opportunity to work with the Commission and members of the public to further promote these efforts in response to the FTC initiative announced in the Notice. However, NADA objects to the unbalanced and hostile view that the notice exhibits towards dealer-assisted financing³ and the extent to which it seeks to examine issues that are not germane to the underlying basis for the Notice, which is the authority the Commission will soon assume “to prescribe rules under Section 553 of the Administrative Procedures Act (APA) with respect to unfair or deceptive acts

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.

² 76 Fed. Reg. 14,014 – 14,017 (Mar. 15, 2011).

³ The fifteen sets of questions contained in the Notice consist largely of a series of leading questions that adopt pejorative terminology and suggest the answers they are seeking.

or practices [UDAP] by motor vehicle dealers.”⁴ Notwithstanding these concerns, in order to assist the Commission and the public in better understanding the mechanics of dealer-assisted financing and to help establish a facts-based record upon which the question of whether to engage in a UDAP rulemaking may be considered, NADA will provide in these comments an overview of optional dealer-assisted financing transactions and the compensation dealers receive as part of those transactions. This explanation will address several topics that will be discussed at the roundtable scheduled for April 12. NADA reserves the right to submit supplemental comments on the April 12 roundtable topics and to comment on additional topics that may be the subject of future roundtable discussions.

I. Appropriate Basis for Exercising UDAP Rulemaking Authority

a. Issues Relevant to the Exercise of the UDAP Rulemaking Function

The notice announcing the roundtable discussion seeks to “explore consumer protection issues pertaining to motor vehicle sales and leasing” and to determine “what consumer protection issues, if any, exist that could be addressed through a possible rulemaking or other initiative.”⁵ As noted above, the basis for this effort is the authority that section 1029(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)⁶ confers on the Commission to prescribe rules under the APA with respect to unfair or deceptive acts or practices by motor vehicle dealers. Section 1029(d) of the Dodd-Frank Act does not expand or otherwise address the authority the Commission already possesses under the Federal Trade Commission Act (FTC Act)⁷ to initiate enforcement action against unlawful behavior. Consequently, the Commission’s attempt to elicit information about activity that already is plainly prohibited by current law (e.g., engaging in credit discrimination in violation of the Equal Credit Opportunity Act⁸) will not aid it in determining whether to exercise the rulemaking authority set forth in section 1029(d) of the Dodd-Frank Act.

Because the Commission intends to conduct a series of roundtables that examine whether and how it should appropriately exercise its UDAP rulemaking authority as a result of the enactment of section 1029(d) of the Dodd-Frank Act, NADA recommends that the Commission tailor any subsequent information requests in this matter to the exercise of that function. These requests should necessarily focus on whether there exists in the marketplace areas of systemic abuse and harm to consumers for which inadequate remedies exist under current law.⁹

⁴ 76 Fed. Reg. at 14,014.

⁵ 76 Fed. Reg. at 14,014, 14,015.

⁶ Pub. Law. §§ 111-203 (July 21, 2010).

⁷ 15 U.S.C. § 45.

⁸ 76 Fed. Reg. at 14,016.

⁹ Notwithstanding our concern about the Commission’s attempt to gather information that cannot reasonably lead to the exercise of the APA rulemaking authority that gave rise to the Notice, the Commission appropriately inquires into whether each of the alleged practices with respect to which it is seeking information is “prevalent” within the industry as such a finding is essential to the proper exercise of that authority.

b. Record Upon Which UDAP Rulemaking Should be Based

Any attempt to determine whether such conditions exist should be grounded in facts and credible data and should reflect today's marketplace. It should not be based on anecdotal reports, conjecture, or recycled allegations of past conduct that do not reflect the current business model of franchised dealers. To that end, the Commission appropriately seeks "data and empirical evidence" relative to the issues it has raised. However, the notice does not mention the most direct source of relevant information available to the Commission, which is its *Consumer Sentinel Network Data Book for January – December 2010* (March 2011).¹⁰ This current and comprehensive compilation of consumer complaint data reveals that there are no systemic concerns with dealer-assisted financing.

A brief analysis of the complaint data supports this unmistakable conclusion. The *Consumer Sentinel* database consists of over 1.3 million complaints that consumers presented to the Commission directly on its website or by telephone and indirectly through a multitude of sources, including 60 Better Business Bureaus located in 29 states and the District of Columbia, four state consumer protection agencies, and several other public and private organizations. The Commission's website even includes a designated portal (known as *Consumer Military Sentinel*) for members of the military to submit complaints. Despite these multiple avenues for consumers to present complaints to the Commission, only 1.18% of the complaints received were "auto related" and several of the subcategories of "auto related" complaints are completely unrelated to dealer-assisted financing.¹¹ Indeed, of the 1,339,265 complaints received during 2010, a mere 2,178 (0.16%) pertained to new automobile sales and only 5,936 (0.44%) pertained to used automobile sales. Because these two subcategories (new automobile sales and used automobile sales) contained complaints that (i) are very limited in number, (ii) may be unrelated to dealer-assisted financing, and (iii) have not been verified,¹² the data obtained by the Commission reveals quite clearly that any abuses which may have occurred in this area are isolated and most assuredly are not prevalent.¹³

II. Overview of Dealer-Assisted Financing

A proper assessment of consumer protection issues related to dealer-assisted financing requires a clear understanding of the process. To facilitate this understanding, we have set forth below a brief explanation of (i) the respective functions performed by dealers and their finance sources in dealer-assisted financing transactions, (ii) the components of the retail financing rate

¹⁰ Available at <http://ftc.gov/sentinel/reports/sentinel-annual-reports/sentinel-cy2010.pdf>.

¹¹ For example, "Auto: Gas" and "Auto: Parts & Repairs" are subcategories under "Auto Related Complaints."

¹² "The 2010 Consumer Sentinel Network Data Book is based on unverified complaints reported by consumers." *Consumer Sentinel Network Data Book for January – December 2010* (March 2011), at 3.

¹³ This conclusion is even more apparent when comparing the number of consumer complaints involving new automobile sales and used automobile sales to the high volume of vehicles sold. In 2010, franchised dealers sold or leased approximately 9 million new vehicles to consumers, while franchised and independent dealers collectively sold or leased approximately 20.9 million used vehicles to consumers. *NADA Industry Analysis*. According to this data, in 2010, consumers presented complaints directly or indirectly to the FTC in 0.024% of new vehicle deliveries and 0.028% of used vehicle deliveries.

that dealers offer to consumers, (iii) the general methods by which finance sources will compensate dealers for delivering financing to consumers, (iv) the nature of conditional sales contracts, and (v) the credit terms that dealer must disclose to consumers.

a. Respective Functions of Dealers and their Finance Sources

Most consumers who take delivery of a vehicle from a franchised automobile dealer will finance the purchase of the vehicle or enter into a lease agreement with the dealer. When the consumer makes arrangements to obtain financing for the purchase directly from a finance source (such as a bank, independent finance company, or credit union), the transaction is commonly referred to as “two-party financing” as the finance contract involves two parties -- the consumer and the finance source. Similarly, when the consumer obtains financing from a dealer that serves as its own finance source (often referred to as “buy-here, pay-here financing”), the transaction also is referred to as two-party financing as the finance contract in this instance similarly involves only two-parties -- the consumer and the dealer.¹⁴

Most finance transactions involving dealers include three parties -- the consumer, the dealer, and the assignee-finance source -- and thus are commonly referred to as “three-party financing.” In typical three-party financing transactions (also known as “dealer-assisted financing”), the consumer enters into a finance contract with the dealer that is conditioned on a finance source’s willingness to take assignment of the finance contract from the dealer. Most dealers have multiple finance sources to which they can assign credit and lease contracts. The assignment of credit and lease contracts from the dealer (the initial creditor) to the finance source (the assignee creditor) is conducted pursuant to a finance source-dealer agreement that sets forth each party’s contractual responsibilities. Dealer-assisted financing is completely optional to the consumer as the consumer is not required to obtain financing from the dealer in order to purchase the vehicle.

Dealer-assisted financing transactions involve the performance of distinct functions by the dealer and the finance source that match their respective capabilities and that are both essential to the delivery of financing to the consumer.

The finance source serves as the source of funds and conducts underwriting to assess the consumer’s creditworthiness. The underwriting consists of the use of highly sophisticated, proprietary systems to analyze risk-based factors related to the consumer’s credit application such as loan-to-value and debt-to-income ratios, verification of employment, and routine entries on the applicant’s credit report (e.g., credit score, number of delinquent accounts, bankruptcy filings, etc.). The finance source also services the finance contract after the finance source takes assignment of it. The finance source’s in-depth analysis of the consumer’s creditworthiness, provision of funds, and servicing of the finance contract are functions that most franchised dealers are unable to perform.

¹⁴ Albeit less common, another variety of two-party financing occurs when the dealer arranges financing directly between the consumer and the finance source.

The dealer serves as the retail distribution outlet for the financing. The dealer advertises to and establishes relationships with prospective vehicle purchasers, takes their applications for financing, and sends the applications to one or more finance sources to which the dealer assigns credit and lease contracts. The dealer routinely gathers supplemental documentation from the consumer, as required by the finance source, to consummate the transaction. The dealer prepares all of the transactional documents and executes many forms and functions required by federal and state law (e.g., the initial creditor is solely responsible for providing Truth In Lending Act disclosures and Risk-Based Pricing or Credit Score Disclosure Exception Notices). The dealer also must employ and train the persons who perform these functions and must assume all of the retail costs inherent in the delivery of a product to market (e.g., building costs, utilities, computers, telephones, copying machines, and insurance). If dealers did not perform these functions and assume these costs, this burden would fall on the finance source and would affect the rates at which it could offer financing to consumers.

b. Explanation of the Components of the Rate Offered to the Consumer

The retail rate that is offered to the consumer in dealer-assisted financing transactions (also known as the “annual percentage rate” or “APR”) reflects the separate functions performed by the finance source, in its capacity as the credit underwriter, source of the funds, and servicer of the finance contract, and the dealer, in its capacity as the retail distributor of the finance product. It consists of a wholesale rate (known as the “buy rate”) that is established by the finance source and a retail margin (known as “dealer participation”) that is established by the dealer. The buy rate includes the risk premium, along with the finance source’s costs of funds, loan production and servicing costs, and a return on investment on its costs. The dealer participation consists of the dealer’s loan distribution costs and a return on investment on its costs.

The wholesale and retail elements of the retail rate outlined above exist in every automobile finance contract, whether they are divided between two parties (as in the case of dealer-assisted financing) or they are handled by a single party (as in the case of a direct loan from a bank or credit union). The amount charged by the dealer cannot be avoided by seeking financing directly from the dealer’s finance sources as, in the absence of the function performed by the dealer, the finance source would be required to erect a retail distribution network for its products that would prevent it from being able to offer, on a sustained basis, financing to consumers at the wholesale buy rate that it provides to the dealer. Nor can the amount charged by dealers be avoided by seeking financing directly from a bank or credit union as each must build its retail distribution costs into its pricing structure. Consequently, it should come as no surprise that dealer-assisted financing, which must compete with these alternative finance sources in an intensely competitive market,¹⁵ is chosen by millions of consumers each year.

¹⁵ The Federal Deposit Insurance Corporation has noted that “[t]he competition for automobile finance products is intense.” “Supervisory Insights: The Changing Landscape of Indirect Automobile Lending,” available at www.fdic.gov/regulations/examinations/supervisory/insights/sisum05/article04_auto_lending.html.

c. Payment of Dealer Participation

The amount of dealer participation typically is determined by negotiation between the dealer and the consumer in much the same way that the dealer's retail margin is established in a vehicle sale. It is based on factors such as the extent to which the dealer can offer a competitive rate, its desire to sell a particular vehicle, and its efforts to develop and maintain customer loyalty. Dealer participation may not exceed contractual rate caps that finance sources routinely establish in finance source-dealer agreements. However, because of intense rate competition among finance sources, dealer participation usually is well below the contractual rate cap amount.

Finance sources typically pay dealer participation to dealers through one of three means. Under the first, the finance source that takes assignment of the retail installment sales contract pays to the dealer every month the dealer participation portion of the monthly payment that the consumer remits to the finance source. If the consumer defaults or prepays, dealers do not receive the unearned portion of the dealer participation.

Under the second approach, in order to enhance the dealer's cash flow position, the finance source-assignee pays to the dealer the dealer participation in a lump sum at the beginning of the contract and discounts the amount to present value. If the consumer defaults or prepays, dealers must refund to the finance source the unearned portion of the dealer participation.

Under the third approach, the finance source-assignee pays to the dealer the dealer participation in a lump sum at the beginning of the contract and (i) discounts the amount to present value (as in the second approach) and (ii) further reduces the amount in exchange for the finance source's agreement to assume the dealer's risk of losing the unearned portion of the dealer participation if default or prepayment occurs more than 90 days after the dealer assigns the contract to the finance source. Under this approach, the finance source's retention of a portion of the dealer participation (typically around 25%) is consideration for its reduction of the dealer's loss exposure.¹⁶ Significantly, a finance source's selection of one of the foregoing payment approaches over the others does not impact the cost of credit to the consumer.

d. Conditional Sales Agreements

Many dealer-assisted financing transactions involve conditional sales agreements. These agreements (which are sometimes referred to as "spot deliveries") generally occur when consumers and dealers agree to the credit terms of a transaction and the consumer takes delivery of a vehicle pending approval of the credit terms by a finance source that agrees to take assignment of the credit contract. Although technological improvements have reduced the length

¹⁶ To be sure, dealers retain significant risk after assigning the contract to the finance source even when the risk of losing the unearned portion of the dealer participation is shifted to the finance source in the event of default or prepayment. Finance source-dealer agreements typically require dealers to repurchase credit contracts if they breach or are unable to fulfill any one of several representations and warranties contained in the agreements. When this occurs, dealers risk losing the entire amount of the consumer's credit obligation.

of time from the vehicle delivery to the credit approval, time is still required to perform various functions such as verifying entries on the consumer's credit application. Most conditional sales contracts provide that if financing is not secured on the stated terms within a short period of time (e.g., five or ten days), then the parties return to the *status quo ante* (i.e., the consumer returns the delivered vehicle and the dealer returns any consideration provided by the consumer such as a down payment or trade-in vehicle).

The overwhelming majority of spot deliveries are approved by and assigned to a finance source on the terms submitted. However, situations do occur where financing is not secured within the specified period and the parties must either return to the *status quo ante* or agree to alternative financing terms that will be approved by a finance source. Contrary to what is suggested in the Notice,¹⁷ dealers do not prefer these situations and actually have significant incentives to avoid them.

When the parties return to the *status quo ante*, the dealer ends up with a vehicle that has been driven and incurred mileage (thus affecting its marketability), a customer who is disappointed (thus affecting the dealer's ability to establish a relationship with a "Customer for Life"¹⁸), and employees such as salespersons and finance managers who have expended time and effort with nothing to show for it. Moreover, when the parties agree to alternative financing terms that are approved by a finance source, the dealer ends up delivering the vehicle but typically on terms that do not increase the dealer participation. In fact, to secure financing for the consumer, the dealer often must reduce the dealer participation in order to meet the lending parameters of the alternative finance source. Therefore, even in instances where the alternative financing terms are less favorable to the consumer, it is unlikely that those new terms redound to the dealer's benefit. Dealers simply do not have a market incentive to extend the financing process.¹⁹

e. Disclosure of Credit Terms

The federal Truth In Lending Act (TILA) and its implementing regulation (Regulation Z) govern the advertising and disclosure of the cost of credit. In addition to mandating the proper disclosure of credit terms such as the amount financed, the finance charge, and the APR, it also addresses the proper disclosure of a variety of other items such as premiums for credit life, credit disability, and guaranteed automobile protection (GAP) insurance and certain charges related to the credit transaction.²⁰ Regulation Z also requires the disclosure of negative equity (i.e., the amount by which a lien on a trade-in vehicle exceeds its value) and specifies the allowable

¹⁷ 76 Fed. Reg. at 14,015 (Footnote 16).

¹⁸ It has been estimated that the average consumer will spend \$517,000 during his or her lifetime on the purchase of dealership products and services (e.g., vehicles, parts, and vehicle maintenance and repairs). See CARL SEWELL, CUSTOMERS FOR LIFE 193-95 (Crown 3d ed. 2002).

¹⁹ The suggestion in the Notice that fraud may occur in certain spot deliveries does not contribute to the exercise of the Commission's UDAP rulemaking function. Ample federal and state remedies already exist to combat fraud in any type of business transaction.

²⁰ 12 C.F.R. § 226.4.

methods for its disclosure.²¹ Dealers currently must comply with the full range of disclosure requirements imposed by TILA and Regulation Z and, when conducting lease transactions, by the Federal Consumer Leasing Act (FCLA) and its implementing regulation (Regulation M), and a violation of either statute subjects them to private rights of action and administrative enforcement by the Commission and the attorney general of their state. After the Designated Transfer Date, dealers will remain subject to the TILA and FCLA rulemaking authority of the Board of Governors of the Federal Reserve (Board).²²

III. Industry Efforts to Educate Consumers about Vehicle Financing

When analyzing consumer protection issues involving dealer-assisted financing, it is important to recognize industry's efforts to enhance consumer understanding of vehicle financing and to make available useful resources to support this process. In addition to the individual educational efforts of numerous creditors and creditor organizations, the AWARE (Americans Well-Informed on Automobile Retailing Economics) Coalition²³ hosts a website at www.autofinancing101.org that provides consumers with a wide range of information on specific vehicle financing and leasing topics. Examples include a comprehensive teaching kit entitled *The Auto Financing Roadmap – A Guide for Teaching Auto Financing In Your Community*, a brochure entitled *What You Need to Know About Auto Financing*, an auto financing *Wallet Card*, and a series of articles on topics such as credit reports and negotiating vehicle financing. These and other resources can be found at AWARE's *Auto Financing 101 Learning Suite*, which also includes the Board's *Keys to Vehicle Leasing* (to which NADA and several other private and public organizations assisted in the preparation) and the brochure entitled *Understanding Vehicle Financing*, which was prepared by the AFSA Educational Foundation and NADA in cooperation with the FTC.

This collective outreach, coupled with consumers' increased access to and use of the vast amount of information available to them on the Internet, has helped consumers better understand and benefit from financing options that are available to them.²⁴ It also has coincided with a significant push within the industry to frequently and thoroughly train dealership employees on ethics, regulatory compliance, and the value of transparency and professionalism.²⁵

²¹ 12 C.F.R. Supplement I (Official Staff Commentary), § 226.2(a)(18)(3).

²² Section 1029(c) of the Dodd Frank Act. In addition to dealers' compliance responsibilities under TILA and FCLA, dealers must comply with an array of federal laws governing their finance operations such as the Equal Credit Opportunity Act, the Fair Credit Reporting Act (including the numerous amendments contained in the Fair and Accurate Credit Transactions Act of 2003), the Gramm Leach Bliley Act, and the FTC Act. Dealers also must comply with the many federal statutes and rules governing their non-financial operations and with the full range of consumer protection requirements imposed by their state.

²³ The membership of AWARE includes the American Financial Services Association (AFSA), NADA, the National Association of Minority Automobile Dealers, the American International Automobile Dealers Association, and auto dealers and finance companies.

²⁴ For a brief explanation of this progress, see AWARE's *Auto Financing: A Historical Perspective* at www.autofinancing101.org/fast_facts/Financing.pdf and *Fast Facts* at www.autofinancing101.org/fast_facts/index.cfm.

²⁵ FTC staff is aware of, and has participated in, many of these training efforts.

These efforts and trends have contributed towards an environment that, in 2011, has prevented the type of systemic concerns with dealer-assisted financing that would warrant the exercise of the Commission's UDAP rulemaking authority.

IV. The Benefits of Dealer-Assisted Financing

It is not enough simply to recognize the absence of systemic concerns with dealer-assisted financing. A fair assessment of dealer-assisted financing also requires a recognition of the extraordinary benefits it provides to millions of consumers across the credit spectrum.

One of these benefits is the access that most dealers have to multiple finance sources from which the dealer can seek competitive and affordable financing for consumers. Dealers' access to captive and independent finance companies, banks, and credit unions frequently results in dealers being able to offer more competitive credit terms to consumers than consumers can secure on their own. Even when dealer-assisted financing is not selected by consumers, its mere presence helps to create an intensely competitive market that significantly disciplines the rates that other finance sources will offer to consumers.

Another critically important benefit is dealers' enhanced ability to secure financing for the millions of Americans who are unable to obtain it on their own. Many of these "unbanked" consumers are responsible borrowers but elements of their credit profile prevent them, particularly in the current credit environment, from being able to secure financing directly from banks and credit unions. Dealers work in earnest to obtain financing for these consumers and dealers' access to multiple finance sources (including many that may not be located or advertise in the consumer's geographic area) strengthens their ability to do so. When dealers are able to secure financing for these consumers, it often is their sole means of securing the transportation they require for their employment and other family and household needs.

Consequently, it is essential that the Commission approach issues pertaining to dealer-assisted financing in a balanced fashion and that it carefully consider the effects that any subsequent Commission action may have on this efficient and consumer-friendly vehicle financing model.

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Thank you for the opportunity to comment in this matter. Please contact the undersigned if we can provide you with additional information that would aid the Commission in its consideration of these issues.

Sincerely,

[original signed]

Andrew D. Koblenz
Vice President
Legal & Regulatory Affairs

[original signed]

Paul D. Metrey
Chief Regulatory Counsel
Financial Services, Privacy, and Tax