NATIONAL AUTOMOBILE DEALERS ASSOCIATION
8400 Westpark Drive • McLean, Virginia 22102
703/821-7040 • 703/821-7041

Legal & Regulatory Group

March 30, 2012

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") released in the above captioned matter.[2] These comments supplement written comments that NADA submitted to the Commission in April 2011 and verbal comments that NADA representatives made during the FTC Roundtables in Detroit (April 12, 2011), San Antonio (August 2-3, 2011), and Washington, DC (November 17, 2011).

Our April 2011 comments discussed in detail several issues pertinent to the FTC's roundtables' initiative, including the appropriate basis for exercising the FTC's rulemaking authority under section 1029(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"),[3] an overview of dealer-assisted financing transactions, industry efforts to educate consumers about vehicle financing, and the extraordinary benefits that dealer-assisted financing provides to consumers.

[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] Pub. Law. 111-203 (July 21, 2010).

These supplemental comments reiterate several of those points and additionally focus on (i) the absence of a legislative directive to the Commission to take any action with regard to issues raised during the roundtables, (ii) essential findings that should be present before the Commission considers an unfair or deceptive acts or practices ("UDAP") rulemaking, (iii) the absence of information assembled during the roundtables that would support the consideration of a UDAP rulemaking as it relates to the two primary issues raised by consumer advocacy group representatives during the roundtables (spot delivery transactions and dealer participation), (iv) why consumer education is the most effective tool the Commission can employ to further the interests of consumers, and (v) a brief restatement of the compelling case for preserving the consumer benefits that stem from the dealer-assisted financing model that exists today. Appendix A of these comments explains why data offered by consumer advocacy groups to support their recommendations regarding dealer participation are distortive and completely unreliable, and it presents actual transactional data that underscores the competitiveness of dealer-assisted financing that is chosen by consumers.

I. Congress Did Not Direct the FTC to Initiate a UDAP Rulemaking.

In announcing that it would conduct public roundtables into consumer protection issues related to the sale and leasing of motor vehicles, the Commission stated that the purpose of this exercise was to inform itself of "what consumer protection issues, if any, exist that could be addressed through a possible rulemaking or other initiatives."[4] This exercise, the Commission noted, was in response to the authority it was granted in section 1029(d) of the Dodd-Frank Act to prescribe UDAP rules using procedures set forth in the Administrative Procedures Act ("APA"). Having concluded the scheduled roundtables, Commission staff has stated that it will now review the information that was presented and consider what, if any, future action in this area is warranted.

When reviewing this matter, it is important to recognize that, in enacting section 1029(d), Congress *authorized* the FTC to promulgate UDAP rules under the APA, but it did not *direct* it to do so. This is evident from the language in section 1029(d)(stating that the FTC "is authorized to prescribe" UDAP rules) and, equally significant, the absence of language in section 1029(d) that directs such activity. This grant of discretionary authority differs sharply from numerous other provisions in the Dodd-Frank Act that both *authorize and direct* an agency to engage in certain activity. *See, e.g.*, section 1411 (stating that the Board of Governors of the Federal Reserve ("FRB" or "Board") "shall" prescribe regulations to prohibit mortgage originators from engaging in several delineated practices), section 1076 (stating that the Consumer Financial Protection Bureau ("CFPB") "shall" conduct a study into reverse mortgage transactions not later than one year after the designated transfer date), section 1034 (stating that the CFPB "shall" develop reasonable procedures to respond to consumer complaints and inquiries), section 1028 (stating that the CFPB "shall" conduct a study into the use of pre-dispute arbitration agreements), and section 941 (stating, under the heading "Regulations Required," that the Securities and

[4] 76 Fed. Reg. at 14,015.

Exchange Commission ("SEC") and the federal banking agencies "shall" issue risk retention regulations not later than 270 days after the enactment of this section). Consequently, because there is not a statutory directive to promulgate UDAP rules or a statutory timeframe within which this must occur, the FTC may only exercise this authority at this time if the information it collected during the roundtables supports such action.

II. Essential Prerequisites to Considering a UDAP Rulemaking.

The jurisdictional standards for declaring an act or practice to be unfair are set forth in section 5 of the Federal Trade Commission Act ("FTC Act"),[5] while the Commission's view of its deception authority is set forth in the 1983 *FTC Policy Statement on Deception*.[6] However, before determining that a particular industry act or practice is ripe for consideration for a rulemaking under either of these standards, the Commission should, as discussed below, make several policy findings that are consistent with areas of importance that it repeatedly stressed during the roundtables and with sound public policy. These comments address whether those policy findings are present with regard to certain acts or practices that were raised during the roundtables and not whether the jurisdictional elements for a UDAP rulemaking have been satisfied. As discussed in section III below, we do not believe these essential policy findings are present with regard to any issue raised during the roundtables, and we therefore do not analyze whether the jurisdictional standards for a UDAP rulemaking have been satisfied. Should the Commission determine that the jurisdictional standards for declaring a particular act or practice to be unfair or deceptive may be present, we will address its determination at that time.

Sound public policy requires that the Commission proceed very cautiously when considering whether to initiate a UDAP rulemaking. Unlike a UDAP enforcement action that can be targeted at a business believed to have engaged in unfair or deceptive practices affecting consumers, a UDAP rule broadly applies to an entire industry and imposes new duties on numerous businesses for which there is no evidence of harmful activity towards consumers. Therefore, the effect of such a blunt instrument is to increase the regulatory burden and litigation exposure of *all* industry participants, including those who conduct their operations and treat their customers in an honest, straightforward, and professional manner.[7] This approach should only

---

[5] Section 5(n) of the Federal Trade Commission Act, 15 U.S.C. §45(n), states, in part: "The Commission shall have no authority under this section or section 57a of this title to declare unlawful an act or practice on the grounds that such act or practice is unfair unless the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition."

[6] The *FTC Policy Statement on Deception*, which is set forth in a letter dated October 14, 1983 from then-FTC Chairman James C. Miller III to then-U.S. House of Representatives Committee on Energy and Commerce Chairman John D. Dingell, states that deception consists of the following elements: (i) there must be a representation, omission, or practice that is likely to mislead the consumer, (ii) the act or practice must be considered from the perspective of the reasonable consumer, and (iii) the representation, omission, or practice must be material.

[7] The presence of ethical dealerships throughout the industry was recognized by roundtable panelists from all quarters, including consumer groups, military representatives, and public and private litigators. *See, e.g.*, the comments of Jack Gillis, Consumer Federation of America, at Panel 4 of the DC Roundtable ("Most dealers are

be considered under compelling circumstances, particularly since the Commission still retains the broad enforcement authority it requires to address harmful conduct affecting consumers.

Consequently, before the FTC considers whether to initiate a UDAP rule that would affect every one of America's over 17,000 franchised dealers and over 37,000 independent dealers, the record should conclusively support the existence of the following elements with regard to the act or practice under consideration -

1) that it causes *significant harm* to consumers,

2) that it is *prevalent* in the marketplace,

3) that it is supported by *current and reliable data*, and

4) that *inadequate remedies* exist under current law to address it.

These elements are consistent with areas of importance that the FTC repeatedly stressed throughout the roundtables' process and with efficient public policy. With regard to the first element, the Commission conducted an entire session on the topic during the DC Roundtable,[8] and it examined in most other roundtable sessions the extent to which numerous specified practices harm consumers.[9] With regard to the second element, the Commission has repeatedly inquired into whether the practices it is examining are prevalent within the industry.[10] Similarly, the Commission and its staff stressed the importance of the third element (the need for current and reliable data as opposed to anecdotal information) on multiple occasions before, during, and at the conclusion of the roundtables' process.[11]

---

trying to do the right thing, and they want to do the right thing….")("There are a lot of good dealers who believe in good sales practices…."), Greg Grzeskiewicz, Illinois Office of the Attorney General, at Panel 5 of the Detroit Roundtable ("One of the panelists said there are good dealers out there. There are good dealers. There are. I usually see the complaints that come in our office, but there are good dealers."), Ian Lyngklip, Ian Lyngklip & Associates, at Panel 4 of the DC Roundtable ("…we know that there are lots of good dealers out there doing good work…."), and Michael Wood, U.S. Army Headquarters, Installation Management Command, at Panel 1 of the San Antonio Roundtable ("And it's sad that the good dealerships are infected by the bad ones. The good ones don't receive the publicity that they deserve.").

[8] Panel 4 of the DC Roundtable was entitled "Which Practices, If Any, Cause Significant Harm to Consumers, and What Are Potential Solutions?"

[9] In addition to the wide variety of topics discussed during each of the roundtables, the Notice contains 15 sets of questions into the affects of different practices on consumers.

[10] In the Notice, the Commission inquires into the prevalence of each practice for which it is seeking information. In addition, the Commission devoted Panel 5 of the DC Roundtable to the topic: "Which Practices, If Any, Are Widespread, and What Are Potential Solutions?"

[11] *See, e.g.*, the Commission's Statement under "Roundtable Goals and Topics for Comment" in the Notice: "Of particular interest is data and empirical evidence supporting comments provided in response to this request;" the comments of then-Associate Director of the FTC's Division of Financial Practices Joel Winston at Panel 1 of the Detroit Roundtable: "And just to emphasize, what we're going to be looking for throughout this session today and future sessions is as much empirical evidence as possible. We've all heard stories and anecdotes and individual cases where consumers were mistreated in one way or another. One of the real goals of this process is to find out how prevalent those practices are. So if there are any studies, any sort of empirical data – that's something we'd be

The final element, that rules should only be promulgated to address harmful conduct for which inadequate remedies exist under current law, merely states a truism that recognizes the lack of necessity of prohibiting the same conduct twice. There certainly is no public policy rationale for engaging in such a redundant exercise, and the Commission should not entertain rulemaking proposals that have this affect.[12]

III. The Information Assembled During the Roundtables Does Not Support the Consideration of a UDAP Rulemaking.

In light of the foregoing, it is essential that, prior to considering a UDAP rulemaking involving motor vehicle dealers, the FTC determine whether the information collected during the roundtables' process conclusively establishes the presence of each element specified above as it relates to an industry act or practice under consideration. As explained in greater detail below, none of the acts or practices that were discussed during the roundtables meets these essential elements.

The most salient allegations raised by consumer advocacy group representatives during the roundtables, which were mentioned throughout the Notice and were the subject of multiple roundtable panels, focused on conditional sales ("spot delivery") transactions and dealer participation in the interest rate consumers pay in a retail installment sale contract ("dealer participation"). These comments address the information collected during the roundtables on each of these topics. Should the Commission seek specific comment on other allegations that were also raised at the roundtables, we will respond to those issues at that time.

---

interested in seeing;" the comments of FTC Division of Financial Practices Attorney Carole Reynolds at Panel 4 of the Detroit Roundtable: "Does anyone have data on these practices occurring?;" the comments of FTC East Central Region Director John Miller Steiger at the conclusion of the Detroit Roundtable: "… And in order to get good useful answers, we need data. And I know you've heard that from us as a constant refrain, but we really do…;" the comments of FTC Division of Financial Practices Assistant Director Malini Mithal at Panel 1 of the San Antonio Roundtable: "To the extent we have any information about widespread practices, that would be helpful from the panelists" and "Has there been any kind of analysis of trends and complaints from military consumers or any kind of… statistics or any widespread practices that we have any information about?;" the comments of FTC Bureau of Consumer Protection Deputy Director Chuck Harwood at the beginning of the DC Roundtable: "We are especially interested in data and empirical information;" the comments of FTC Division of Financial Practices Attorney Robin Thurston at Panel 4 of the DC Roundtable: "And, again, if you have data or other indicators of how frequently these practices occur, that would be great;" and the comments of then-Acting Associate Director of the FTC's Division of Financial Practices Reilly Dolan at the conclusion of the DC Roundtable: "…We are looking at whatever data we can get. And I will continue to say, please give us hard facts and data. That's more persuasive than anecdotes."

[12] In addition to the lack of impact such an action would have, it also is imprudent from a resource allocation perspective. The importance of this consideration was recently recognized by the Commission in the *Memorandum of Understanding Between the Consumer Financial Protection Bureau and the Federal Trade Commission* (Jan. 20, 2012), where it stressed the need to "maximize efficiencies and resources," "minimize duplication of efforts," and "eliminate redundancies."

a. Conditional Sales Transactions

Consumer advocacy group representatives made numerous statements and allegations concerning conditional sales transactions during the roundtables and in supplemental written comments.[13] Although their comments focused on various aspects of these transactions, they generally drew a distinction between conditional sales agreements that do not cause harm to consumers and a subset of those transactions that are abusive and can harm consumers.[14] We address each of these in turn.

1. Conditional Sales Agreements

As stated in our April 2011 comments, the overwhelming majority of spot deliveries are approved by and assigned to a finance source on the terms submitted. This is preferred by the consumer, who seeks (and, indeed, may need) to take delivery of the vehicle after signing the retail installment sale contract and other documents related to the transaction, and it is preferred by the dealer, who benefits most when the transaction can be concluded to the customer's satisfaction and without the expenditure of additional time and other resources.[15]

Given the sheer volume of conditional sales transactions that are executed at automobile dealerships, situations will inevitably arise where the condition upon which the sale was made (i.e., the ability to secure financing on the terms submitted within the specified time) will not be satisfied and the parties must return to the *status quo ante* (where each party returns the consideration it provided to the other). The consumer typically is fully informed of this possibility when he or she takes delivery of the vehicle because (i) the dealer wishes to develop a lasting relationship with the customer and this effort is undermined when the customer's expectations are not fully met, and (ii) should the dealer need to enforce its contractual right to rescind the contract, it may only do so if the dealer has clearly disclosed to the consumer the conditional nature of the sale and the obligation of the parties should that condition not be met. Without such disclosure, the sale is not conditional and the consumer has no obligation to return the vehicle.[16] Dealers thus have every incentive to clearly disclose to the consumer the condition

[13] *See, e.g.,* "Comments to the Federal Trade Commission" by the Center for Responsible Lending, Consumer Federation of America, Consumers for Auto Reliability and Safety, National Association of Consumer Advocates, National Consumer Law Center (on behalf of its low income clients), and National Council of La Raza (Feb. 1, 2012)("Consumer Advocacy Groups' Comments").

[14] The Commission recognized this distinction in Footnote 16 of the Notice, as did several roundtable panelists. *See, e.g.*, the comments of Ian Lyngklip at Panel 4 (entitled "Spot Delivery") of the Detroit Roundtable ("… as a consumer advocate, I see the complaints, and I understand I don't see the deals that go properly. I don't see the deals where there are no problems.").

[15] There are significant administrative and hard costs associated with bringing a vehicle back into inventory and entering into a new retail installment sale contract with the customer. *See* the comments of Marc Cross, Jordan Ford, at Panel 1 of the San Antonio Roundtable ("At our store, if by close of business today we haven't sold 20 cars, new and used, we've lost ground because we are a big organization. So, I don't have time to sell it twice…. [I]t's not smart, it's not efficient, and it certainly doesn't promote … long-term customers....").

[16] *See* the comments of Michael Charapp, Charapp & Weiss, LLP, at Panel 4 of the Detroit Roundtable ("I simply want to respond to this point that Bill made, that he's never seen a conditional contract. If he's not seeing one, then it's not conditional….")("… when the consumer walks out the door … after signing all the paperwork, it's a done

upon which delivery is made and to ensure verbal statements made by its salespersons are consistent with these disclosures. State law does not permit them to act in a contrary manner although, as stated above, such issues usually do not arise as these transactions are routinely executed by the parties to their mutual satisfaction.

When analyzing whether conditional sales agreements meet the four elements cited above that are essential to the consideration of a UDAP rulemaking, it is readily apparent that a UDAP rulemaking concerning this topic is unwarranted. While conditional sales agreements are prevalent in the marketplace, none of the other elements are present. There is nothing to suggest that routine conditional sales agreements cause any harm to consumers, let alone significant harm. In addition, consumer advocacy groups do not appear to have produced *any* data demonstrating that conditional sales agreements cause significant harm to consumers despite the Commission's repeated calls for data on the topic since March 2011.[17] Further, with regard to remedies, there is no harm created by routine conditional sales agreements that needs to be addressed.

2. Abusive Spot Deliveries

In contrast to routine conditional sales agreements, the FTC has inquired into, and consumer advocacy group representatives have raised serious concerns about, spot delivery transactions involving bad faith by the dealer at the expense of the consumer. Although the particulars of the various fact patterns differ, the ones mentioned during the roundtables typically involve conduct such as (i) delivering a vehicle to a consumer based on the dealer's ability to assign a retail installment sale contract to a finance source knowing in advance that the contract cannot be assigned to a finance source on the terms stated in the contract, (ii) misleading the consumer about the conditional nature of the sale, (iii) failing to fulfill a contractual obligation to return the consumer's consideration when a condition subsequent related to financing the purchase has not been satisfied, (iv) in the case of a condition subsequent that has not been satisfied, misleading the consumer into believing that he or she is obligated to sign a different retail installment sale contract on terms that differ from those in the initial contract, and (v) repossessing a vehicle that was delivered to the consumer based on the dealer's inability to assign the retail installment sale contract to a finance source when such condition to the delivery of the vehicle was never disclosed to the consumer and the consumer never agreed to the condition.

These practices, and other variations of them, were condemned during the roundtables by consumer advocacy group and industry representatives alike, and they clearly should not be present in the marketplace. However, as explained below, attempting to address these practices

---

deal, unless there is a document or a provision in a contract, which makes it conditional on the dealer being able to assign the financing document to a lender. And so the document's there, that disclosure is made, and it's not hidden.").

[17] It is noteworthy that in the section of the Consumer Advocacy Groups' Comments concerning spot delivery agreements, no data is presented in support of their arguments even though other sections of their comments cite data that they contend support their recommendations.

via a “ban on the use of spot delivery agreements unless the condition is related to something other than assignment of the finance contract and is not subject to the dealer’s discretion”[18] or similar action is unwarranted, unnecessary, and would frustrate the legitimate demands and expectations of the parties to the contract.

Categorically, prohibiting the use of conditional sales agreements fails to meet the essential elements for considering a UDAP rulemaking that are outlined above. Whereas the first element (an act or practice that causes significant harm to consumers) may be present when any of these actions occur, these practices are not prevalent in the marketplace. In fact, as noted above, dealers routinely enter into retail installment sale contracts with consumers that are conditioned upon the willingness of a finance source to take assignment of the contract on the terms submitted, and finance sources typically take such assignment on those terms. It is the exception, not the rule, when abusive spot delivery practices occur. Regarding the second and third elements, we are not aware of any data offered by consumer advocacy group representatives or others that suggest such abusive behavior is prevalent in the marketplace. Despite the Commission’s repeated request for data and not anecdotes on this topic, the information presented by consumer advocacy group representatives during the roundtables was completely anecdotal. This does not minimize the seriousness of the allegations they raised, but it does highlight the fact that no credible evidence exists to suggest that the cases brought to their attention are representative of the millions of conditional deliveries that occur nationwide each year without any hint of problems for consumers.

Regarding the fourth element, consumers and state attorneys general possess an array of adequate remedies under state law to address abusive spot delivery practices. Aside from contractual rights that consumers possess, consumers and state attorneys general can bring an action under common law and/or their state UDAP statute if a business engages in deception, misrepresentations, wrongful repossession, or other harmful practices. These statutes typically provide for actual damages, statutory damages, exemplary damages, and attorneys fees. Depending on the fact pattern involved, abusive spot deliveries may also give rise to causes of action under the federal Truth In Lending Act, Consumer Leasing Act, Fair Credit Reporting Act, Fair Debt Collections Practices Act, and state laws including the Uniform Commercial Code and state retail installment sales acts. In addition, these violations can cause a dealer to (i) lose its license to sell motor vehicles, (ii) have its sales and services agreement with its manufacturer rescinded, and (iii) create adverse publicity that can be devastating to a business that is permanently located in a community.[19] The existence of these remedies clearly reveals that a Commission rulemaking in this area is unwarranted.

A Commission rulemaking in this area also should not be considered because the Commission currently may initiate a UDAP enforcement action against actors who engage in abusive spot deliveries. This allows the Commission to address this problem where it arises, and it sends a strong message to any other bad actors in the marketplace about the consequences of

[18] Consumer Advocacy Groups’ Comments at 7.
[19] This is more likely today than ever before with the ability of consumers to post “reviews” on the Internet.

continued unlawful behavior.[20] To simply default to a "ban on the use of spot delivery agreements…" or similar prescriptive action would be overly broad, it would create inefficiencies in the marketplace by unnecessarily delaying the overwhelming percentage of conditional deliveries that are properly executed, and it would frustrate legitimate consumer demand.

b. Dealer Participation

The other prominent area of attack from consumer advocacy group representatives during the roundtables involved dealer participation. The allegations generally maintained that dealer participation (i) represents an "overcharge" to consumers, and (ii) should be disallowed and replaced with a mandated fixed fee compensation scheme. We address each of these allegations in turn.

1. Overcharge Allegation

The overcharge allegation characterizes dealer participation as an unnecessary "extra" payment that consumers make to dealers in dealer-arranged financing transactions. It is based on the flawed premise that consumers "qualify" for the discounted buy rate at which finance companies are willing to purchase retail installment sale contracts from dealers. If this premise were correct, it would stand for the extraordinary proposition that consumers should receive financing at its wholesale rate (and thus forego paying any retail margin on the financing) notwithstanding the fact that (i) finance sources outsource to dealers, and dealers completely absorb, the retail distribution costs to deliver financing to consumers,[21] and (ii) finance sources

---

[20] The enforcement action the Commission announced on March 14, 2012 (*see* the FTC press release at http://ftc.gov/opa/2012/03/autoloans.shtm) with regard to alleged advertising violations at five automobile dealerships around the country is instructive. NADA widely disseminated the press release along with the Commission's new educational publication on the topic (*see* www.ftc.gov/bcp/edu/pubs/consumer/alerts/alt083.pdf) shortly after their release, and state and metro dealer associations also provided this information to their members. NADA and other dealer associations have reacted in a similar fashion in the past even as it relates to Commission actions that do not involve automobile dealers but that do involve fact patterns that may be relevant to automobile dealers. Consequently, the reach of these enforcement actions is far broader than only the respondents to these actions, which underscores the effectiveness of the enforcement remedy when it is fairly and judiciously applied. Other roundtable panelists similarly recognized the value of enforcement actions. *See, e.g.*, the comments of Jack Gillis at Panel 4 of the DC Roundtable ("… You don't have to go after every single dealer. Most dealers are trying to do the right thing, and they want to do the right thing, and they hire people like Tom [Hudson, Hudson Cook, LLP] to make sure they do the right thing. So a little bit of enforcement action, I think, can go a long way.").

[21] The FRB has long recognized the value of the retail financing functions performed by dealers. *See* 42 Fed. Reg. 19,121, 19,122 (Apr. 12, 1977)("The dealer's participation in the finance charge may serve as compensation for the work done in arranging financing and for the risk of loss which is shared with the lending institution. Therefore, the Board believes that, in many instances, the portion of the finance charge which represents the dealer's participation is not an amount the consumer could save by obtaining a direct loan from a lending institution."). Courts have also recognized the value of the retail financing functions performed by dealers. *See, e.g.,* Geller v. Onyx Acceptance Corp., 2001 WL 1711313 (Cal. Superior (Nov. 13, 2001)(No. 728614))("Car dealers typically assist the consumer in completing a credit application, obtain a credit bureau report on the consumer, including the consumer's 'credit score,' verify employment, obtain account, income, and other information regarding the consumer's credit application, and seek explanations for any credit problems the customer may have had. The dealer also prepares and

acknowledge that, if they had to erect a retail distribution network for the financing they provide, they would not be able to offer consumers the buy rate that they offer to dealers.[22]

In support of their overcharge allegation, consumer advocacy groups frequently cite their own April 2011 report entitled *Under the Hood: Auto Loan Interest Rate Hikes Inflate Consumer Costs and Loan Losses* (*"Under the Hood Report*").[23] Among many other dubious claims, the *Under the Hood Report* alleges that, in 2009, consumers collectively paid $25.8 Billion in dealer participation, which it characterizes, in its entirety, as "extra" interest payments that dealers charged to consumers.[24] The *Under the Hood Report* further alleges that this amount is a 20% increase from the $20.8 Billion that consumers paid for dealer participation in 2007. In September 2009 testimony before the U.S. House of Representatives Committee on Financial Services, a representative of the Center for Responsible Lending ("CRL") referred to the entire $20.8 Billion figure as a "dealer kickback,"[25] while another CRL representative similarly referred to this amount as a "dealer kickback" and "the $20.8 billion surcharge" in May 2009 testimony before a subcommittee of the U.S. House of Representative Committee on Energy and Commerce.[26]

The overcharge allegation suffers from four fatal flaws. First, from an analytical perspective, it is illogical because, as stated above, it assumes consumers qualify for the wholesale buy rate and thus ignores the fundamental concept that retail sales involve retail

---

provides the customer the required Truth-In-Lending and [California] Rees-Levering Act disclosures. On the average, a dealer's finance personnel spend approximately an hour with a customer negotiating the terms of indirect financing, obtaining the needed information from the customer, and preparing the contract for the customer's signature. Car dealers incur substantial costs in performing these retail services…. Car dealers are compensated for this effort through the price at which they sell their conditional sale contracts to finance companies. This price includes a 'dealer participation' from which the dealer pays its costs and potentially receives a profit….").

[22] *See, e.g.*, the comments of Peter Sheptak, World Omni Financial Corp., at Panel 2 of the Detroit Roundtable ("… if we were to become a direct lender, we would have to increase our staff and our costs significantly in order to provide the same type of financing to our customers, and that is because the dealers do a lot of the work and the dealers ultimately, under our dealer agreement, carry some of the risk in connection with the loan…"); and the comments of Randy Henrick, DealerTrack, at Panel 2 of the Detroit Roundtable ("I spoke this week with a number of our lender clients, and every one of them confirmed to me that the so-called buy rate… is almost invariably lower than the lender's direct cost of lending over to retail customers. This is certainly true in the used-car market. And that lenders frequently purchase indirect paper at rates lower than their direct retail rate….").

[23] The *Under the Hood Report* was prepared by Delvin Davis and Joshua M. Frank of the Center for Responsible Lending.

[24] *See* the "extra interest payments" calculation in Figure 3 of the *Under the Hood Report*, which includes the entire amount of dealer participation.

[25] *See* Testimony of Michael Calhoun, CRL, before the U.S. House of Representatives Committee on Financial Services: "Perspectives on the Consumer Financial Protection Agency" (Sep. 30, 2009), available at: http://www.responsiblelending.org/mortgage-lending/policy-legislation/congress/cfpa-calhoun-testimony.pdf.

[26] *See* Testimony of Kathleen Keest, on behalf of CRL, Consumer Federation of America, and National Consumer Law Center (on behalf of its low-income clients), before the U.S. House of Representatives Subcommittee on Commerce, Trade and Consumer Protection, Committee on Energy and Commerce, H.R. 2309: The Consumer Credit and Debt Protection Act (May 12, 2009), available at: http://www.responsiblelending.org/credit-cards/policy-legislation/congress/ftc-ccdp-testimony-5-12-2009-final.pdf.

margins.[27] Second it is based entirely on a single report – the *Under the Hood Report* – whose data are unrepresentative, flawed, and opaque, and whose analysis and methodology are similarly flawed, poorly explained, and impossible to replicate. (The numerous deficiencies in the *Under the Hood Report*, which Thomas Durkin, former Senior Economist at the FRB, correctly characterized as an "advocacy report,"[28] are explained in detail in Appendix A to these comments.) Third, the overcharge allegation is completely hollow because it fails to offer any data demonstrating that retail financing rates offered by dealers exceed retail financing rates offered by direct lenders to similarly situated customers.[29] Fourth, as explained in Appendix A, the overcharge allegation is contradicted by actual transactional data demonstrating that dealers offer consumers retail financing rates that, on average, are more competitive than the retail rates offered by direct lending sources.

Consequently, when analyzing whether including dealer participation in the interest rate charged to consumers meets the four essential elements for considering a UDAP rulemaking, it is apparent that a rulemaking on this topic is completely unwarranted. Dealer participation, while prevalent in the marketplace, does not harm consumers and there is no credible data to suggest otherwise. There is no need to examine the adequacy of remedies under current law as there is no harm that needs to be addressed.[30]

---

[27] Inexplicably, the overcharge allegation is directed solely at 3-party financing, and not 2-party financing, even though both involve retail margins.

[28] *See* the comments of Thomas Durkin at Panel 8 of the San Antonio Roundtable ("…advocacy reports tend to start with a conclusion, and then they try to marshal evidence and data and so forth to support this conclusion…. And they tend, unfortunately to ignore evidence that doesn't agree with that 'hypothesis' or conclusion. So, sometimes that leads to a lack of transparency in the work itself. And I think that unfortunately appears to be true in the CRL report…").

[29] A simple milk analogy illustrates this point. If Grocery Store A sells a gallon of milk for $3.75 and Grocery Stores B, C, and D charge $3.95, $4.00, and $4.05 respectively for the same gallon of milk, Grocery Store A can hardly be described as overcharging its customers regardless of the amount of its retail margin. Of course, such an analysis is possible only when comparing the respective prices charged by different businesses for the same product to similarly-situated customers (which is precisely what CRL provided in April 2008 in an attempt to demonstrate that yield spread premiums charged by mortgage brokers result in overcharges to subprime borrowers, see *Steered Wrong: Brokers, Borrowers, and Subprime Loans* ("*Steered Wrong Report*") – Executive Summary available at http://www.responsiblelending.org/mortgage-lending/research-analysis/steered-wrong-executive-summary.pdf). However, such a comparison between the financing rates offered to consumers by auto dealers and the financing rates offered to consumers by direct lenders is notably absent from the *Under the Hood Report*.

[30] During the roundtables, CRL representatives retreated from the organization's earlier claims in publicly-released reports and the Congressional testimony cited above, *see* Footnote 26, that the entire amount of dealer participation constitutes "extra interest" to consumers and a "kickback" to the dealer. *See* the comments of Christopher Kukla, CRL, at Panel 8 of the San Antonio Roundtable ("…I don't think there's any disagreement that the dealer – if the dealer is working to arrange the financing, that the dealer should get compensated…. Nobody has said dealers should not get compensated for the work that they do…."). If there is no disagreement that "the dealer should get compensated" for arranging financing, then there should also be no disagreement that it is a complete distortion to characterize the entire amount of dealer participation as "extra interest," a "kickback," and a "surcharge." Unfortunately, this distortion is not confined to prior reports and congressional testimony. Notwithstanding CRL's present acknowledgement that at least some portion of dealer participation is legitimately earned by dealers, it *currently* maintains on its website (as of the date of these comments) an "Auto Dealer Markup Calculator" that appears to erroneously identify every penny of dealer participation as, among other mischaracterizations, an

2. Fixed Fee Compensation Scheme

Having completely failed to demonstrate that dealer participation constitutes an overcharge to consumers, consumer advocacy group representatives now focus almost exclusively on how (not whether) compensation should be earned by dealers for arranging financing for consumers. On this question, they generally allege that dealer participation (i) is unfair to consumers, (ii) "disproportionately affect[s] minority borrowers," and (iii) creates a "perverse incentive to steer consumers into more expensive loans."[31] They then attempt to analogize auto dealers to mortgage brokers and argue that the FRB's decision to address this set of issues in the mortgage industry by eliminating yield spread premiums ("YSPs") is an appropriate action for the FTC to take with regard to dealer participation.[32]

As explained below, this proposed action would be flawed because the premises upon which it is based (unfairness, disparate impact, and steering) are incorrect, and it would actually operate against the interests of consumers by weakening the intense competition that currently exists among dealers and between dealers and direct lending sources. This, in turn, would result in a higher cost of credit to consumers.[33] In addition, the factual underpinnings for the FRB's action against YSPs are not present with regard to dealer participation.

A. Unfairness Allegation

The allegation that dealer participation is "routinely applied unfairly"[34] apparently stems from the belief that because the amount of dealer participation may differ from consumer to consumer, it is somehow inherently unfair. This allegation is problematic for two primary reasons. First, price negotiability is present throughout the retail sector of the U.S. economy and the notion that one particular manifestation of it should be eliminated by agency action, in the absence of a demonstrable showing of harm to consumers or a specific directive from Congress (neither of which is present with regard to dealer participation), is an extraordinary and ill-advised proposition. Second, as explained below, the allegation fails to consider the overwhelming benefits that price negotiability provides to millions of consumers every year.

Price negotiability provides consumers with the ability to drive down the cost of credit for vehicle purchases. The way in which they do this is quite simple and occurs in the marketplace every day. There is an array of creditors that compete intensely to provide financing

---

"overcharge paid by the consumer." *See* http://www.responsiblelending.org/other-consumer-loans/auto-financing/tools-resources/auto-dealer-markup-calculator.html.

31 Consumer Advocacy Groups' Comments at 4-7.

32 Id.

33 Because of the adverse affect this proposed remedy would have on competition, if it were ever considered by the Commission, it should be reviewed by the Bureau of Competition and the Bureau of Economics, as well as the Bureau of Consumer Protection.

34 Consumer Advocacy Groups' Comments at 5.

to consumers.[35] This competition exists across the credit spectrum and includes the subprime market.[36] Creditors exist both in the consumer's community (e.g., auto dealers, community banks, local branches of regional and national banks, and local credit unions) and on the Internet (e.g., regional and national banks, independent finance companies, and larger credit unions). If each creditor is limited to offering consumers a non-negotiable cost of credit, the least expensive credit that the consumer can secure is the lowest posted offer that is made available to that consumer. However, if the creditor can negotiate the cost of credit, the consumer can (and routinely does) ask the creditor whether it can beat the most competitive credit offer that the consumer can secure elsewhere. That creditor, which, in the case of an auto dealer, is seeking to serve the consumer's full range of vehicle needs (known as the "customer for life" concept), can then exercise the discretion it possesses to reduce its own earnings in order to offer credit terms to the consumer that are more competitive than any other credit terms that are available to that consumer. This can (and frequently does) result in significant savings to the consumer that would not be possible if dealer compensation could only be in the form of "a flat fee from the loan purchaser or a fee based on a percentage of the amount financed."[37]

Moreover, the mere presence of price negotiability, even if it is utilized by only some market participants, disciplines the prices at which *all* market participants offer credit to consumers. This is due to the fact that every provider of credit is aware that consumers actively shop for credit and that there are competitors who have the ability to meet or beat the rates they offer to consumers. Accordingly, all providers of credit must price their products in a way that will remain competitive throughout the credit shopping process. This dynamic limits the earnings of credit providers (including dealers[38]) while producing corresponding savings to consumers. Such a model, which produces significant downward pressures across the board on

---

[35] *See* the comments of Randy Henrick at Panel 2 of the Detroit Roundtable ("…There are thousands of lenders. We have 1,000 in our system alone. There are 18[,0]00 auto dealers. They're all competing with each other….").

[36] *See* the comments of Chris Choate, General Motors Financial Company, at Panel 8 of the San Antonio Roundtable ("… in the subprime space… there's an enormous amount of competition…."); and the comments of Thomas Moore, National Automotive Finance Association/First Investors Financial Services, at Panel 1 of the Detroit Roundtable ("I want to [respond to] a couple things. The first is the comment that there's limited options in the nonprime/subprime space. I don't see that as being the case. There are hundreds of companies. I wish that was the case. Having played there, [I…] wouldn't have the competition that I have. There are hundreds of companies that play in this space. There are very large banks, credit unions, and sales-finance companies, as well as the captives. There are captive finance arms that play in this space, as well. If you go back 10 or 15 years, I would probably believe that was the case, but there are many options available to the dealer as well as to the consumer in being able to finance nonprime and subprime loans…."). In fact, creditors must consider not only competition that arises on the front end of a transaction, but also competition that arises after the transaction is consummated. *See* the comments of Chris Choate at Panel 8 of the San Antonio Roundtable ("…there is a competitive force kind of after the fact. There are re-fi opportunities out there. There are some lenders that engage even more specifically in the subprime segment in attempting to basically pick off recently originated loans and re-fi those down to a lower rate….").

[37] Consumer Advocacy Groups' Comments at 6-7.

[38] *See* the Comments of Randy Henrick at Panel 2 of the Detroit Roundtable ("… I had one lender tell me that up to 10% of its indirect-lending portfolio may be at rates lower than what it quotes as the buy rate. That's because of the intense competition among dealers to win business. Many dealers will buy down rates to get the deal.").

the pricing of consumer credit, should not be disturbed by an ill-conceived rule that would reduce these pressures by eliminating the bargaining power of consumers.[39]

B. Disparate Impact Allegation

The allegation that dealer participation disproportionately affects minority borrowers is similarly unfounded and completely unsupported by current and reliable data. While conflicting evidence was presented during class action litigation in this arena in the past, we are not aware of any data, nor did anything surface during the roundtable discussions, suggesting that this is prevalent in today's marketplace. If problems were to occur in this area, consumers and the government can avail themselves of the full range of remedies available under the Equal Credit Opportunity Act.[40]

C. Steering Allegation

The allegation that dealer participation creates a "perverse incentive to steer consumers into more expensive loans" is illogical and similarly unsupported by market data. It rests on the extraordinary proposition that "[t]he ability of the dealer to add to the interest rate for its own gain creates a perverse incentive for the dealer to push the consumer into the most favorable loan for the dealer rather than the loan that provides the lowest-cost for the consumer."[41] This suggests that the essential and ubiquitous retailer practice of adding a retail margin to the wholesale price at which it obtains its products and to do so for its "own gain" is somehow unusual and problematic. This suggestion reflects a complete lack of understanding of basic realities of the marketplace.

As stated repeatedly during the roundtables,[42] retailers cannot, on a sustained basis, forego adding a retail margin to the products they deliver to consumers. The retail margin allows retailers to recoup their retail distribution costs and earn a return on investment on those costs. This is true of department stores, grocery stores, dry cleaners, auto dealers, and every other category of retailers in the country. This includes direct lenders, who similarly incur retail distribution costs and seek to recoup, and earn a return on investment on, those costs by offering

---

[39] A simple example illustrates these downward pricing pressures. Assume a consumer is offered financing from four different finance sources and the most competitive rate it can secure is a 4.9% APR over a 60-month term. Further assume that the dealer from whom the consumer purchases the vehicle has discretion to limit its retail margin and, in an effort to secure the consumer's business, offers the consumer a 4.4% APR over the same term. If the consumer accepts this offer and purchases a used vehicle with an amount financed of $15,000, the consumer will save $205.20 over the 60-month term. If the consumer accepts this offer and purchases a new vehicle with an amount financed of $25,000, the consumer will save $342 over the 60-month term. Under either scenario, the consumer obtains significant savings that is made possible by the dealer's ability to limit the amount of its retail margin. Other creditors are aware of this dynamic and must price their products accordingly to attract the consumer's business.

[40] *See* 15 U.S.C. §1691E.

[41] Consumer Advocacy Groups' Comments at 6.

[42] *See, e.g.*, the comments of Andrew Koblenz, NADA, at Panel 2 of the Detroit Roundtable and Panel 8 of the San Antonio Roundtable; and the comments of Paul Metrey, NADA, at Panel 5 of the DC Roundtable.

a retail rate to consumers. If any category of businesses were unable to earn a return on investment on their costs (i.e., obtain "gain"), they would move their capital investment to other products and services that would provide this opportunity. Far from protecting consumers, the resulting departure of market participants would harm consumers by weakening the competition that disciplines the prices at which credit and other products are offered to them. Consequently, defining "steering" as the act of seeking "gain" on the products that a business offers to its customers is an illogical indictment of all retailers (and, indeed, all businesses), including both direct and indirect retailers that offer vehicle financing to consumers.

In addition to attacking "gain," the Consumer Advocacy Groups' steering allegation maintains that the dealer's ability "to add to the interest rate for its own gain" leads to "reverse competition," whereby lenders compete for dealers' business by "offering larger and larger interest rate kickbacks, compensation, and incentives," which "drives prices to consumers up rather than down."[43] Here again, these groups fail to provide any credible data supporting their allegation (which, in this context, would consist of demonstrating a causal connection between transactions involving dealer participation and above-market interest rates paid by dealer customers).[44]

Aside from the lack of supporting data, the allegation that dealers steer consumers to higher cost loans is perplexing because the incentive of dealers is just the opposite. It is axiomatic that retailers and other businesses are incentivized to reduce their costs so as to increase their earnings. Consequently, when dealers are paid dealer participation, it is in their interest to assign retail installment sale contracts to the finance source which offers the lowest wholesale buy rate (similar to direct and indirect lenders' efforts to seek the lowest available cost of funds). Dealers and other retailers do not have a market incentive, and indeed would act against their own economic interest, to sell high wholesale cost products to consumers.[45]

Therefore, in order for the steering allegation to be in any way plausible, its proponents must identify, and establish the presence of, intervening factors that distort the ordinary market incentives of dealers (i.e., they must identify, and establish the presence of, factors that create a "market failure"). However, as explained below, the consumer advocacy groups fail to identify (let alone establish) the existence of any factors that indicate a market failure exists with the dealer-assisted financing model.

---

[43] Consumer Advocacy Groups' Comments at 6.

[44] As noted in Footnote 29, the absence of such a comparison as it relates to dealer participation is in striking contrast to the comparison CRL offered in its *Steered Wrong Report* to demonstrate overcharges that result from YSPs charged by mortgage brokers to subprime consumers.

[45] As Judge Posner noted in Hoffman v. Grossinger Motor Corp., 218 F.3d 680, 682 (7th Cir. (Ill.), Jun. 20, 2000)), in the context of used vehicle pricing, "generally the lower a company's costs the lower its profit-maximizing price…."

D. Attempt to Link Dealer Participation to YSPs

The attempt by consumer advocacy group representatives' to identify intervening factors that might distort market forces that protect consumers consisted merely of (i) identifying the factors in mortgage originations that prompted the FRB to prohibit YSPs in those transactions and (ii) arguing that the same factors exist with dealer participation and thus serve as a basis for similarly prohibiting dealer participation. However, as highlighted below, the factual underpinnings that prompted the FRB's action with regard to mortgage originations clearly are not present with dealer participation and therefore fail to support similar action towards it.

<u>Difference 1</u> *The "market failure" that prompted wide ranging calls to reexamine mortgage originations never occurred with dealer-assisted financing transactions.*

In 2008, CRL noted that "the dismal performance of subprime mortgages today has put brokers and their actual practices under increased scrutiny."[46] This dismal performance was not replicated with subprime financing that involved dealer participation in 2008 or at any time during the credit crisis. This is because auto finance sources, whether direct or indirect, conduct underwriting which recognizes that their loan collateral will rapidly depreciate in value and, therefore, the repayment of the finance obligation will largely depend on the repayment ability of the borrower (and not speculation that the collateral will increase in value). Although this and other responsible lending models can be expected to experience some strain during periods of high unemployment, they nevertheless have historically performed exceedingly well, even during economic downturns (including the recent credit crisis). This strong performance is particularly evident with regard to auto asset-backed securities ("ABS") issuances, which are heavily relied upon as a source of capital by indirect finance sources that finance exclusively through auto dealers.[47]

---

[46] *Steered Wrong Report*, at 2.

[47] *See* the comments of the "Vehicle ABS Sponsors" (consisting of 16 finance companies, including all captive finance companies of major automobile and motorcycle manufacturers, leading independent automobile finance companies, and the leading issuer of ABS backed by medium and heavy duty trucks) to the Office of the Comptroller of the Currency, SEC, FRB, Federal Housing Finance Agency, Federal Deposit Insurance Corporation, and Department of Housing and Urban Development, dated August 1, 2011 ("Some members of our group have been issuing ABS backed by retail loans, leases and floorplan loans backed by vehicles for over 25 years. During that time, the performance of the ABS we have issued has been exemplary. We can state positively that every matured term Vehicle ABS —including non-investment grade Vehicle ABS — that has been issued by any Vehicle ABS Sponsor has repaid all principal and interest in full. We expect the same will be true for all currently outstanding term Vehicle ABS that we have issued. We consider this performance to be noteworthy, given the period of time over which Vehicle ABS issuance has occurred and the varying economic conditions during that period. Our ABS have demonstrated excellent performance on a sustained basis…. None of the Vehicle ABS we have issued has missed any payments."), available at: http://www.federalreserve.gov/SECRS/2011/November/20111102/R-1411/R-1411_080111_86962_501862745997_1.pdf.

Difference 2 *Congress directed the FRB to prohibit YSPs in mortgage originations but took no similar action with regard to dealer participation in dealer-assisted financing transactions.*

In addition to the dramatically different performance of dealer-assisted financing transactions vis-à-vis mortgage originations during the recent credit crisis, Congress' action towards the two compensation methods also significantly differed.

Congress directed the FRB in the Home Ownership and Equity Protection Act of 1994 to provide special disclosures and certain substantive protections to consumers, and to prohibit unfair and deceptive acts or practices, in connection with mortgages.[48] Congress also explicitly directed the Board in Subtitle B of Title 14 of the Dodd-Frank Act to prescribe regulations that, among many other restrictions, would prohibit mortgage originators from charging YSPs. Congress did not, on either occasion, direct any agency to address dealer participation notwithstanding the fact that, when the Dodd-Frank Act was enacted, there was legislation pending before Congress that would have directed the FTC to consider issuing rules to "establish limits on the compensation motor vehicle dealers may accept or solicit based on the interest rate, annual percentage rate, or the amount financed with respect to the sale of a motor vehicle…."[49] Congress' explicit directive to the FRB to prohibit YSPs and its corresponding absence of a directive to prohibit dealer participation (or to even study it), when both issues were before it, reflects Congress' determination that prescriptive action was only necessary to address the compensation methods involved in mortgage originations.

Difference 3 *The FRB's decision to prohibit YSPs followed FRB testing of mortgage broker disclosures on consumers, while no such testing has been conducted that supports the need to prohibit or otherwise restrict dealer participation.*

Unlike mortgage originations, no consumer testing has been conducted that supports the need to take any action concerning dealer participation. In fact, the Board actually examined dealer participation in 1977 and rejected calls to require dealers to disclose the existence or amount of dealer participation. The Board took this action after concluding that (i) neither disclosure would be beneficial to consumers, and (ii) "conversely, the addition of another disclosure requirement to Regulation Z would result in more complex disclosure statements and could lead to confusion or misunderstanding by consumers."[50] Consequently, the consumer advocacy groups' attempt to apply the Board's findings concerning the entirely separate mortgage originator compensation scheme to dealer participation, when the Board has actually examined the topic of dealer participation and arrived at an entirely different conclusion, is misplaced.

---

[48] 15 U.S.C. §1639.

[49] *See* H.R. 2309, 111th Cong., 1st Sess., §2(b)(2)(C)(2009). Section 2(d) would have required the Commission to commence rulemaking determined to be necessary within 6 months of the date of the bill's enactment.

[50] 42 Fed. Reg. 19,125-126 (Apr. 12, 1977).

<u>Difference 4</u> *The FRB's findings concerning why market forces do not adequately protect consumers who pay YSPs in mortgage originations are plainly inapplicable to consumers who pay dealer participation in dealer-assisted financing transactions.*

The FRB identified the presence of several factors in mortgage originations involving YSPs which, it noted, can distort the disciplinary effect that competition otherwise would have on the cost of credit in those transactions. These include (i) the likelihood that consumers will not shop for the most affordable mortgage rate available because they believe the mortgage originator is working on their behalf and will perform this function for them, (ii) the facilitation of this mistaken belief by "the common broker practice"[51] of imposing a charge directly on consumers which can lead them to "reasonably believe that the fee they pay is the originator's sole compensation"[52] and that the broker therefore is working on their behalf, (iii) the presence of alternative forms of compensation to the originator, such as prepayment penalties, that distort the consumer's understanding of the costs involved in the transaction, and (iv) the overall complexity of the transaction which hinders consumers' ability to engage in effective cost comparisons.

As explained below, none of these factors apply to the dealer-assisted financing model and, thus, they cannot serve as a basis to conclude that a "market failure" is present with dealer-assisted financing transactions that "prevents the forces of supply and demand from maximizing benefits and minimizing costs"[53] that would support the imposition of governmental constraints on the dealer-assisted financing model.

Consumers do not select dealers to serve their vehicle financing needs in the same way that they select mortgage brokers to serve their home financing needs. The range of products and services that dealers offer to consumers is much broader than just financing, and consumers reasonably understand that, when they visit dealerships and agree to purchase their products and services, dealers will receive compensation for these items. Consumers understand that dealers' products are optional, which is plainly apparent when consumers routinely inquire into whether dealers can meet or beat competing offers that they have received from direct lenders and other dealers. In addition, dealers typically do not receive a direct payment from consumers for arranging dealer-assisted financing that is separate from the dealer participation they earn. Consequently, unlike the Board's findings concerning consumer payments to mortgage brokers, there is no direct payment that would lead a consumer to reasonably believe that the dealer is working on the consumer's behalf or that the APR is non-negotiable.[54]

---

[51] 75 Fed. Reg. 58,509, 58,511 (Sep. 24, 2010).
[52] 75 Fed. Reg. at 58,515.
[53] 75 Fed. Reg. at 58,513.
[54] There are other notable differences in how auto dealers and mortgage brokers interact with their customer base. For example, as mentioned above and in our April 2011 comments, auto dealers earn their income from the sale of several products and services, including the vehicle, financing, products to protect the customer's investment, parts, and service. They operate in their local communities and cannot survive without the business of repeat customers. Consequently, auto dealers' long-term interests in creating a "customer for life" outweigh whatever short-term gain might accompany the sale of financing on terms that are unfavorable to the consumer.

Regarding other forms of compensation, such as prepayment penalties, that might distort the consumer's understanding of the financing costs involved in the transaction, these simply are not present in the dealer-assisted financing model. And, with regard to the complexity of the transaction, dealer-assisted financing transactions are very different from mortgage originations. The former do not involve introductory rates, adjustable rates, or any other feature that could change the consumer's monthly payment during the term of the contract. Nor does the structure of subprime retail installment sale contracts differ from the structure of other retail installment sale contracts.[55]

The much more simple and predictable dealer-assisted financing process facilitates comparison shopping by consumers and eliminates surprises that might arise after the transaction is consummated. As the FRB noted in its dealer participation rulemaking:

> The Board feels that disclosure of the total finance charge, the annual percentage rate and the periodic payment, all required by the Truth In Lending Act and Regulation Z, together with the widespread advertisement of credit terms, have afforded and continue to afford consumers the most important information with which to comparison shop for credit.[56]

Of course, as noted above and in Appendix A to these comments, consumers engage in extensive comparison shopping that has produced an intensely competitive market and, with consumers' increased access to information via the Internet,[57] this positive dynamic is even greater today than it was when the FRB made this finding.[58]

---

[55] The *Steered Wrong Report* contains, in part, the following statements in support of its call for a prohibition against YSPs: (i) "subprime loans tend to be much more complex than the fixed-rate mortgages that have long dominated the prime market, making their costs more difficult for borrowers to compare;"(ii) "because so many subprime mortgages come with short-term introductory rates that rise substantially when they adjust, the cost disparities become more pronounced after the first four years of a loan," and (iii) "In the subprime market, lenders usually will pay the maximum YSP only if a loan contains a prepayment penalty. The penalty ensures that the lender will recoup their YSP payment either through excess interest collected over time or from the penalty fee, should a borrower refinance to avoid those interest costs." None of these features exist in the dealer-assisted financing model.

[56] 42 Fed. Reg. at 19,125.

[57] A simple search on google.com of the term "auto loan" identifies and provides links to numerous finance sources.

[58] The court in Geller expanded on this positive dynamic: "Market forces, competition, and the dealer's own long-term interest in maintaining a customer base, impose important constraints on the contract rate and amount of dealer participation. If the dealer quotes too high a contract price or interest rate, the car buyer is likely to find a better deal from another car dealer and/or seek financing from direct lenders willing to make a direct loan at a lower rate. Too high a contract rate may induce a buyer to quickly refinance the car through a direct lender at a lower interest rate. Depending on its arrangement with the auto finance company, the dealer may have to refund its entire dealer participation when the car is refinanced in this manner. The dealer's own long-term interest in keeping its customers satisfied (or likely to return for future car purchases), curbs the dealer's desire for a quick profit through a higher contract rate and dealer participation payment. It is in the auto finance company's interest to keep dealer participation payments low. The higher the participation payment, the higher the finance company's initial investment in the contract and the greater the risk that it will not recoup the investment due to early refinance and payoff. As a result of these factors, dealer participation payments' average spread between the contract rate and buy rate is two percent or less for the industry as a whole, and less than one percent on contracts that Onyx purchases.

In light of the foregoing, it is clear that the factual circumstances surrounding dealer-assisted financing transactions are very different from those involved in mortgage originations and the conditions the FRB found that created a "market failure" with the latter plainly do not exist with the former. Consequently, the consumer advocacy groups' attempt to draw a parallel between the two in order to support its call for imposing the FRB's YSP restrictions on dealer participation is without merit.

* * *

When analyzing whether the price negotiability of dealer participation meets the four essential elements for considering a UDAP rulemaking, it is apparent that there is no basis for further action by the Commission. Although price negotiability is a widespread practice, there has been no showing that price negotiability significantly harms consumers (indeed, it is clear that price negotiability in the auto sector provides considerable benefits to consumers). The lone publicly-available data analysis that has been offered on this topic (CRL's *Under the Hood Report*) cites relatively current data but, as Appendix A conclusively demonstrates, it is not credible for numerous reasons and it is contradicted by actual transactional data. Regarding the adequacy of remedies, there is no abuse for which remedies are necessary.

IV. Consumer Education Is the Most Effective Tool the FTC Can Employ to Further the Interests of Consumers.

At the outset of the roundtables, FTC Bureau of Consumer Protection Director David Vladeck identified the purpose of the roundtables as follows:

> …We are here to learn. The information obtained at this and future round tables will inform the Federal Trade Commission and help us determine the priority of the next possible steps to bolster consumer protection. And we have options – increasing consumer and business education, bringing more enforcement cases, promulgating rules, or conducting other initiatives. Of course, the information we gather may also demonstrate that current enforcement efforts and existing regulations are sufficient to protect consumers….[59]

Quite appropriately, Director Vladeck identified consumer and business education as a prominent and discrete consumer protection option available to the Commission, and the Commission prudently included several sessions on this topic during the roundtables.[60]

The foregoing are indicative of an increasingly competitive market for auto finance." Geller, *supra* Footnote 21, at 3-4.

[59] Statement of David Vladeck at the opening of the Detroit Roundtable.

[60] The San Antonio Roundtable included three panels on financial literacy ("Financial Literacy and Capability for Military Consumers," "Special Programs to Enhance Consumers' Financial Literacy," and "Financial Literacy and

Consumer education provides enormous opportunities to address consumer protection concerns that were raised during the roundtables. As explained below, the opportunity to strengthen the financial literacy of consumers presents itself at numerous stages and many resources exist to facilitate this effort. In addition, the success of collaborative educational efforts between government and private organizations in the past should be further pursued to leverage the expertise of each and to present their educational content in a coordinated fashion.

There is an array of resources that have been developed to support educating consumers from their youth until the time in which they make purchasing decisions. Examples of youth-based programs include Junior Achievement, which has created a broad, nationwide network that provides K-12 programs to foster work-readiness, entrepreneurship, and financial literacy skills,[61] and the American Financial Services Association ("AFSA") Educational Foundation's Money Skills initiative, which provides a free, online, comprehensive course known as "MoneySKILL" that educates high school students on money management fundamentals in the content areas of income, expenses, saving and investing, and credit and insurance.[62] Another positive example of a broad-based educational initiative is the Jump$tart Coalition for Personal Financial Literacy, which advances financial literacy among Pre-K to college students through a national coalition, 49 affiliated state coalitions, and their local partners from corporate, non-profit, academic, government, and other sectors.[63]

Several government agencies have similarly promoted this process and developed educational material to enhance financial literacy. These efforts were enhanced by the FACT Act's creation of the Financial Literacy and Education Commission ("FLEC"),[64] which consists of the Department of the Treasury, the FTC, and 18 other federal agencies and is charged with developing and overseeing a national strategy for financial literacy and education.[65]

Numerous government and private organizations have also developed extensive tools to promote understanding among consumers specifically about the vehicle financing process, including those developed by the AWARE ("Americans Well-informed on Automobile Retailing Economics") Coalition at www.autofinancing101.org.[66] These groups have also worked together on several occasions to produce effective and widely disseminated educational publications for consumers. Examples include the FRB's *Keys to Vehicle Leasing* (of 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 (and which is available in both Spanish and English).

New Approaches for Auto Sales and Financing"), while the DC Roundtable included one panel on the topic ("Consumer and Business Education: What, If Anything, Is Needed and What Works?").

[61] *See* http://www.ja.org/.

[62] *See* http://www.afsaonline.org/financial_literacy/moneyskill.cfm and http://www.moneyskill.org/.

[63] *See* http://www.jumpstart.org/.

[64] *See* Title V of the Fair and Accurate Credit Transactions Act of 2003, Pub. Law 108-159 (Dec. 4, 2003).

[65] *See* http://www.mymoney.gov/.

[66] Several of the resources developed by AWARE are identified in our April 2011 comments to the FTC.

Such collaborative efforts, which leverage the resources, expertise, and broad distribution network of multiple organizations, offer enormous potential for further progress in this area.[67]

Another area that offers similar potential is social media. Several roundtable panelists noted how Facebook, web applications, and other technology present excellent opportunities to reach younger consumers who may be less familiar with the financing process.[68] This largely untapped and emerging resource can be used both to educate consumers and direct them to the reservoir of information that has been provided through more traditional information channels.

In addition to educational programs designed to reach young consumers, the array of resources presently available to vehicle shoppers, and the educational opportunities provided by social media, there are a number of federal and state disclosures that provide additional educational information to consumers who are engaged in the purchasing process. Examples of federally-mandated financial disclosures include the privacy notice, the risk-based pricing notice or credit score disclosure exception notice, and adverse action notices (in the case of a credit denial). There are also the Truth In Lending Act disclosures set forth in Regulation Z which, the FRB correctly noted, "together with the widespread advertisement of credit terms, have afforded and continue to afford consumers the most important information with which to comparison shop for credit."[69]

The success of these ongoing efforts to educate consumers is apparent in the marketplace. Consumers today have access to extensive information that is available at the click of a button. This has contributed to an intensely competitive vehicle financing market that has, both literally and figuratively, put consumers in the driver's seat in securing affordable credit. The opportunities that lay ahead with social media and with further public and private collaboration will only enhance this favorable condition.

The widespread, thorough, and ongoing efforts to educate consumers, as facilitated by the Internet and new technology, have provided, and continue to provide, consumers with more protection than can be achieved through the issuance of UDAP rules. The latter, by their nature, are imprecise (and thus overly broad) and end up imposing unnecessary and completely avoidable costs on honest small businesses.[70] Contrarily, consumer education is unobtrusive, it can be tailored to target audiences, it can be reinforced at multiple stages, and it can continue to

---

[67] Such efforts are also consistent with the goals of the FLEC. *See* FLEC's *Promoting Financial Success in the United States: National Strategy for Financial Literacy (2011)*("… [The FLEC framework] also establishes concrete goals that the non-profit, government, and private sectors can and should work together to increase financial literacy and improve financial decision making by individual Americans and their families as they pursue personal financial objectives."), available at http://www.treasury.gov/resource-center/financial-education/Documents/NationalStrategyBook_12310%20(2).pdf .

[68] *See, e.g.*, the comments of Pam McClelland, Office of Service Member Affairs, CFPB, and Michael Wood at Panel 5 of the San Antonio Roundtable; and the comments of Susie Irvine, AFSA Educational Foundation, at Panel 6 of the San Antonio Roundtable.

[69] 42 Fed. Reg. at 19,125.

[70] As noted above, the imposition of such costs is unnecessary as the Commission can address unfair or deceptive acts or practices by individual actors in a targeted fashion through the use of its UDAP enforcement authority.

foster the intense competition that provides immense benefits to consumers in the vehicle financing market. The Commission should thus regard consumer education as the most effective consumer protection tool that it possesses in today's market (and it is essential that the Commission recognize that it is today's market -- and not yesterday's market -- that it is overseeing).[71]

V. The Compelling Case for Preserving the Consumer Benefits that Stem from the Dealer-Assisted Financing Model.

We closed our April 2011 comments to the Commission with a brief summary of the extraordinary benefits that optional dealer-assisted financing provides to consumers across the credit spectrum. We restate that brief summary here and note that nothing that was presented during the entire roundtables' process undermines the clear and compelling case for preserving this consumer-friendly financing model:

> 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

[71] It is also important that the Commission recognize the magnitude of the market it is overseeing. In 2011, franchised dealers sold or leased approximately10.6 million new vehicles to consumers, while franchised and independent dealers collectively sold or leased approximately 22 million used vehicles to consumers. *NADA Industry Analysis*. Consequently, when considering anecdotal reports of problems encountered in the marketplace, it is essential that the reports be kept in perspective.

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.

* * *

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,

Andrew D. Koblenz
Vice President
Legal & Regulatory Affairs

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