COMMENTS TO THE FEDERAL TRADE COMMISSION

MOTOR VEHICLE ROUNDTABLES – PROJECT NUMBER P104811

BY

THE CENTER FOR RESPONSIBLE LENDING

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The Federal Trade Commission (FTC) Act makes unfair and deceptive acts and practices (UDAP) unlawful and empowers and directs the FTC to prevent such acts and practices through rule-making and enforcement.[1] The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank")[2] provided clear FTC jurisdiction over most auto dealers, particularly when entering into finance transactions with consumers, while freeing the FTC from the cumbersome procedural requirements that otherwise apply to FTC UDAP rule-makings.[3] In easing these requirements, Congress signaled its intent that the FTC use their rule-making authority to prevent UDAPs by auto dealers.[4]

We believe that the ability of automobile dealers to add to a consumer's interest rate for compensation when financing a vehicle for a consumer can and should be considered a UDAP. The effects of competition in the market should benefit the consumer, and should be based on true competitive forces instead of perverse incentives. The only effective way to ensure effective competition is to prohibit dealer compensation that varies based on the interest rate or other material terms of the loan other than the principal balance of the loan.

Background

Auto financing through the dealer is commonly referred to as "indirect financing," even though it is a credit transaction directly arranged by the dealer. In the vast majority of indirect automobile financing transactions, the dealer uses a retail installment sales contract. The retail installment sales contract treats the dealer as both the creditor and the seller, and as such the dealer enters into an agreement to both sell and finance a vehicle for the customer at a certain price, a certain interest rate, and a certain number of payments (along with other terms for the loan).

Typically, the dealer does not want to retain ownership of the retail installment sales contract and collect payments into the future. Most (if not all) dealers borrow funds to purchase inventory (called "floorplan financing" or "floorplanning") and must pay a portion of that loan back to the floorplan creditor upon the sale of each vehicle. Because of this, the dealer normally elects sell the retail installment sales contract to a third party, such as a finance company, bank, credit union or other investor.

To facilitate the process, the dealer routinely communicates with potential loan purchasers while negotiating the terms of the sale with the consumer. Potential third-party purchasers make most of the common terms and conditions available to dealers in regularly published rate sheets and in the conditions of authorized dealer agreements that

[1] 15 U.S.C. 45 *et seq.*
[2] Public Law 111 – 203 (not yet codified).
[3] *Id.* section 1029(d), 15 U.S.C. 2309.
[4] See Senate Banking Committee Report to the Restoring American Financial Stability Act, Report No. 111-176 (April 30, 2010). "As with mortgages, borrowers are simply unaware of the incentives pushing the auto dealers to charge buyers higher interest rates. Auto dealers have a history of abusive and discriminatory lending. However, despite the abuses in this sector, and the urgent need for better consumer protections, the federal government has not done enough to address these issues."

are entered into before purchasers agree to buy loans from the dealer. When a consumer applies for credit with the dealer, the dealer sends the consumer's financial information to one or several potential purchasers. Interested purchasers then respond to the dealer with offers to purchase that contract, specifying the interest rate and specific conditions and terms that purchaser will require.

The interest rate that the potential third-party purchaser is willing to accept to purchase the retail installment sales contract from the dealer is called the "buy rate". The third-party purchaser may give the dealer the opportunity to add compensation to the transaction, also called "dealer reserve" or "dealer participation". This form of compensation allows the dealer to add to the interest rate and keep some or all of the difference in net present value between the buy rate and the rate ultimately paid by the consumer. Some third party purchasers cap the amount of dealer interest rate markup, while others may allow unlimited markups. And, some third party purchasers offer a flat fee for compensation instead of the rate markup model.

The markup on car loans operates similarly to yield spread premiums that mortgage brokers used to charge on mortgage loans. As with yield spread premiums, the customer is typically unaware that the dealer will benefit financially if the customer pays a higher interest rate, or that the loan has a higher interest rate than the rate for which the borrower actually qualified. Like mortgage brokers, dealers routinely advertise that they use several sources to find financing. Such representations give consumers the false impression that the dealer is actually shopping on the consumer's behalf, rather than to maximize their own compensation.

In September 2010, the Federal Reserve Board (FRB) eliminated compensation for mortgage loan originators that varies based on the terms of the loan for residential mortgage loans other than compensation based on the principal balance of the loan, finding that system of compensation to be unfair within the meaning of the FTC Act. The FRB also concluded that disclosures alone would be insufficient to protect consumers from the substantial harm caused.[5] The FRB's findings in this context apply equally to dealer markups.

Dealer Markup of Interest Rates is an Unfair and Deceptive Practice

Dealer markup of interest rates squarely meets the elements of "unfairness" and "deception" under the FTC Act.

[5] The Federal Reserve acted pursuant to its authority under the Homeownership and Equity Protection Act (HOEPA), 15 U.S.C. section 1639(1)(2), to prohibit unfair and deceptive practices concerning residential mortgages. Noting that the Congressional Conference Report that accompanied the HOEPA legislation directed the Board to look to both the standards employed for interpreting state unfair and deceptive trade practices statutes, and the FTC Act, the Federal Reserve applied the UDAP standards set out in the FTC Act in determining that yield spread premiums were unfair. Regulation Z, Docket No. R-1366 Final Rule, Official Staff Commentary, Federal Register Vol. 75, No. 185, 58509, 58513 (Fri. Sept. 24, 2010) ("Federal Reserve Official Commentary on YSP Final Rule").

A. Unfairness

The FTC Act makes unlawful "unfair or deceptive acts or practices in or affecting commerce."[6] In making an unfairness determination, the FTC must work within the framework originally developed by the FTC and codified in section 5 of the Act, which establish these three elements of unfairness:

(1) An act or practice causes or is likely to cause substantial injury to consumers.
(2) The injury is not reasonably avoidable by consumers themselves.
(3) The injury is not outweighed by countervailing benefits to consumers or to competition.[7]

The Act permits the FTC to take public policy considerations into account, along with all other evidence it considers in determining unfairness, but provides that "[s]uch public policy considerations may not serve as a primary basis for such determination."[8]

(1) "Substantial injury"

As the FTC has noted, following U.S. Supreme Court precedent, "[u]njustified consumer injury is the primary focus of the FTC Act."[9] The "Commission is not concerned with trivial or merely speculative harms."[10] Rather, the injury must be "substantial." The FTC has noted, "In most cases a substantial injury involves monetary harm, as when sellers coerce consumers into purchasing unwanted goods or services".[11] Substantial injury can consist of a relatively small harm to a large number of consumers, or a greater harm to a smaller number of consumers.[12]

The cost to consumers from dealer interest rate markup is indeed substantial. CRL research estimates that consumers who bought cars in 2009 will pay an estimated $25.8 billion in interest over the lives of their loans that is attributed to dealer interest rate markups.[13] Lack of awareness about the dealer interest rate markup is also significant. A survey of North Carolina voters found that an overwhelming majority—79%—were unaware of the practice,[14] even though the dealer interest rate markup is the predominant form of compensation in the marketplace.

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[6] 15 U.S.C. 45 *et seq*.
[7] This standard was adopted by the FTC in 1980 (*see FTC Policy Statement on Unfairness* (Dec. 17, 1980)), available at http://www.ftc.gov/bcp/policystmt/ad-unfair.htm) and codified by Congress in 1994 as Section 5(n) of the FTC Act, at 15 U.S.C. sec. 45(n).
[8] 15 U.S.C. sec. 45(n).
[9] *FTC Policy Statement on Unfairness*.
[10] *Id.*
[11] *Id.*
[12] Sen. Rep. No. 130, 103d Cong. 2d Sess. 12 (1994), *reprinted in* 1994 U.S.C.C.A.N. 1776, 1787-88 (elaborating on the elements of unfairness when Congress enacted them in 1994).
[13] Delvin Davis and Joshua M. Frank, *Under the Hood, Auto Loan Interest Rate Hikes Inflate Consumer Costs and Loan Losses*, Center for Responsible Lending, April 19, 2011.
[14] Public Policy Poling Results of January 15-18, 2010 Survey of 494 North Carolina Voters at 3 (on file with CRL).

It is important to note that dealers routinely advertise that they work with multiple lenders, giving consumers the mistaken impression that the dealer is shopping on the consumer's behalf. Even the "Understanding Vehicle Finance" guide on the FTC website states that "the dealer's relationships with a variety of banks and finance companies means it can usually offer buyers a range of financing options."[15] This guide, however, does not clearly disclose the method of compensation for the dealer or the impact of that method of compensation on the choice of loans or loan cost. Rather, it hints that the interest rate "may be higher than the wholesale rate" and is negotiable.[16] It is this misunderstanding of the process that dealers perpetuate to discourage consumers from shopping loan rates among different lenders or dealers.

Moreover, dealers usually offer the consumer only one loan option. It is entirely within the dealer's discretion to determine which loan the dealer will show to the consumer. The dealer simply tells the consumer that the consumer has been approved for a loan at a certain APR. As such, the consumer has no ability to choose a loan product that may be less lucrative for the dealer but may be less expensive for the consumer. This form of compensation essentially rewards the dealer for convincing the consumer to pay a higher interest rate. This creates a perverse market incentive where the dealer's incentive is to sell the loan that provides the most compensation for the dealer, which by definition is not the loan that provides the most competitive rate for the consumer.

The FRB made similar findings in its rulemaking on yield spread premiums. In finding that mortgage broker yield spread premiums resulted in substantial injury, the FRB stated:

> When loan originators receive compensation based on a transaction's terms and conditions, they have an incentive to provide consumers loans with higher interest rates or other less favorable terms. Yield spread premiums, therefore, present a significant risk of economic injury to consumers. Currently, this injury is common because consumers typically are not aware of the practice or do not understand its implications, and thus cannot effectively limit the practice.[17]

The FRB found that because consumers do not effectively understand how yield spread premiums work, it has a significant impact on the consumer's ability to negotiate.

> Because consumers generally do not understand the yield spread premium mechanism, they are unable to engage in effective negotiation. Instead they are more likely to rely on the loan originator's advice, and, as a result, may receive a higher rate or other unfavorable terms solely because of the greater originator compensation. These consumers suffer substantial injury by incurring greater costs for mortgage credit than they would otherwise be required to pay.[18]

[15] http://ftc.gov/bcp/edu/pubs/consumer/autos/aut04.shtm
[16] Id.
[17] 75 Federal Register 58509, at 58515.
[18] Federal Reserve Official Commentary on YSP Final Rule at 58515.

A survey CRL conducted found that close to half of the borrowers surveyed did not negotiate the credit terms because they trusted the dealer to give them a good rate.[19] The same survey also found that consumers who trusted the dealer to find the best interest rate received, on average, an annual percentage rate two percentage points higher than their similarly situated peers.[20] Most consumers expect that the rate quoted is the rate, not a starting point for negotiations. Further, since the consumer cannot tell which portion of the rate is based on risk and which portion is compensation for the dealer, there is no effective means to negotiate the rate other than to compare multiple rates from multiple lenders. But, as we show in the next section, shopping between dealers is a time-consuming, ineffective protection against the practice of dealer markups.

A predominant financial incentive in the industry that serves to steer consumers into more expensive loans clearly creates substantial injury to consumers.

(2) <u>“Not reasonably avoidable”</u>

To be unfair under the FTC Act, the injury also must be one that consumers could not reasonably have avoided. The FTC explained the reason for this requirement: “Normally we expect the marketplace to be self-correcting. However, it has long been recognized that certain types of sales techniques may prevent consumers from effectively making their own decisions.” In such cases FTC action may be necessary to “halt some form of seller behavior that unreasonably creates or takes advantage of an obstacle to the free exercise of consumer decision-making.”[21]

(i) <u>Dealer interest rate markup is a hidden and market-distorting incentive</u>

As noted earlier, a survey found that close to half of the auto loan borrowers surveyed did not negotiate the credit terms because they trusted the dealer to give them a good rate.[22] The same survey also found that consumers who trusted the dealer to find the best interest rate received, on average, an annual percentage rate two percentage points higher than their similarly situated peers.[23] This shows that the current system causes sufficient confusion as to distort market choices. Again, as noted in the previous section, dealers routinely advertise that they are working with several lenders to secure financing. This leads the consumer to believe that the dealer is actually *shopping* among lenders to find the best rate for the consumer, when in fact the dealer is simply looking for the most profitable option for the dealer.

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[19] Survey was conducted through Macro International’s CARAVAN interviews and includes a sample size of 1,007 customers across the U.S., 81% of whom owned a car or truck as of Nov 2008. The primary findings are based on approximately a quarter of those respondents (sample size of 268) who reported using a loan financed through their car dealership. Survey on file with CRL.

[20] Id.

[21] *FTC Policy Statement on Unfairness*; *see also*, *Am. Fin. Svcs. Ass’n*, 767 F.2d at 976.

[22] CARAVAN survey.

[23] Id.

The trade associations for the dealers and some of the entities that purchase auto finance contracts further this misunderstanding. For instance, in comments submitted to the FTC, the American Financial Services Association (AFSA), states:

> Competition among prospective assignees helps keep dealers' costs low and benefits consumers by helping to make cost-effective financing available to them.[24]

A casual reader unaware of the dealer markup system could easily read that statement to mean that the financing is cost-effective for the borrower. In fact, it is cost-effective for the lender and the dealer, while the consumer may end up in the most expensive loan available because it provided the most compensation for the dealer.

The National Automobile Dealers Association (NADA) made similar claims in its comment:

> 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.[25]

What NADA leaves out in their analysis is while the opportunity exists to provide more competitive rates, the dealer maintains significant discretion over which of the various loan options available will be presented to the consumer. The dealer may simply choose the least cost-effective loan for the consumer. Because of the perverse incentive to sell the consumer on the highest interest rate possible, the possible benefits to the consumer of competition are easily negated.

There is also a lack of awareness about the practice. As noted in the previous section, surveys show that the vast majority of consumers are unaware of the practice of dealer markups. CRL-conducted surveys found that 79% of those surveyed were unaware that car dealers have the discretion to increase the interest rate as a means of compensation. Consumers are largely unaware of a significant incentive that works against the consumer's interest.

One finance company, Westlake Financial, in a recent advertisement for its finance services and web portal, offered to help dealers find the most profitable deal for them:

> "[R]esults are arranged in order of potential profit, thereby minimizing the time spent, and maximizing the profit made, on every Westlake deal."[26]

This advertisement illustrates all too well the effect of the dealer markup.

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[24] AFSA Comments to FTC, Motor Vehicle Roundtables Project Number P104811, March 28, 2011.
[25] NADA Comments to FTC, Motor Vehicle Roundtables Project Number P104811, April 11, 2011.
[26] See Appendix A.

The FRB found in its analysis of yield spread premiums that consumers were equally unaware of the incentive and its impact on the loan. This lack of awareness, along with the inability of consumers to determine the portion of the rate that is compensation for the mortgage originator, convinced the FRB to conclude that mortgage yield spread premiums create an injury that is not reasonably avoidable by consumers. The FRB found:

> [M]any consumers are unaware of creditor payments to loan originators, especially in the case of mortgage brokers, because they lack transparency. Although consumers may reasonably expect creditors to compensate their own employees, consumers do not know how the loan officer's compensation is structured or that loan officers can increase the creditor's interest rate or offer certain loan terms to increase their own compensation. Without this understanding, consumers cannot reasonably be expected to appreciate or avoid the risk of financial harm these arrangements represent.
>
> To guard against this practice, a consumer would have to know the lowest interest rate the creditor would have accepted, and ascertain that the offered interest rate includes a rate increase by the loan originator. Most consumers will not know the lowest rate the creditor would be willing to accept.[27]

The same is true in the auto lending context. There is no way for the consumer to determine which portion of the rate is devoted to dealer compensation. For that reason, the consumer has no meaningful ability to understand the compensation system on the rate, or whether the compensation paid to the dealer is reasonable.

(ii) <u>Shopping among dealers or lenders is an ineffective remedy</u>

The process through which a consumer can compare financing between dealers also should be considered. If a consumer applies for a loan through a bank, credit union or other financial services provider other than the dealer, the lender will usually approve the consumer for a loan before the consumer actually shops for the vehicle itself. The consumer may have an idea of what vehicle he or she wants, and the lender will verify the collateral before making the loan, but the process does not require shopping for a vehicle beforehand.

In order to compare financing agreements between dealers, the dealer requires the consumer to first choose a vehicle and then negotiate the purchase of that vehicle before discussing financing. If the consumer has a trade-in vehicle, the value of that vehicle has to be negotiated. The dealer will also attempt to sell the consumer on several add-on products. Only then will the consumer receive a finance offer the consumer can compare with the other offer.

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[27] 75 Federal Register 58509, at 58515.

One of these negotiations can take hours, so it may take a consumer several hours, if not days, of negotiating to obtain enough offers for a fair comparison. As such, consumers may decide out of expediency (or fear that the car will no longer be available in the case of a used car) to take the dealer's offer. Had the consumer known, however, that the dealer had a built-in incentive to increase the interest rate on the loan, the consumer may in turn have a greater incentive to shop the rate among dealers or get a loan directly from a lending institution. It is the combination of a lack of awareness of the true nature of the dealer's compensation, the dealer's claims that it is working with several lenders, and the amount of time it takes to make finance inquiries among dealers that cause consumer to trust that the rate the dealer is offering is a fair rate.

Shopping among dealers or lenders also assumes that the consumer has multiple options between which the consumer can compare. For prime consumers, there are many brick-and-mortar institutions outside of the dealer from whom the consumer can receive credit offers. There are fewer, and in some case no, options for subprime consumers in their communities. The choice for those consumers is to either apply for a loan online from an entity the consumer likely has never heard of or through the dealer.

NADA states, in comments submitted to the FTC, that subprime consumers frequently have no option other than the dealer to secure credit to purchase a car:

> 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 from these consumers and dealers' access to multiple finance sources (including many that may not be located or advertised in the consumer's geographic area) strengthens their ability to do so. When dealers are able to secure financing for these consumers, it is often their sole means of securing the transportation they require for their employment and other family and household needs.[28]

If, for many subprime consumers, the dealer is the only means of securing financing, then the ability to shop among providers is either extremely limited or non-existent. As such, there is no counterweight to the dealer's discretion to increase the interest rate. The dealer knows that the consumer has few, if any, other options. Even if the dealer is acting unreasonably or unconscionably in the amount added to the interest rate, there is no way for the consumer to know since the amount of the interest rate markup is never disclosed. For this set of consumers in particular, the practice of dealer markup is unavoidable.

(iii) <u>Disclosure adds confusion and does not remove the perverse impact of the dealer's incentive, changing the disclosure will not remedy the harm</u>

[28] NADA Comments to FTC, Motor Vehicle Roundtables Project Number P104811, April 11, 2011.

In North Carolina, like in many states, dealers are required to conspicuously disclose on the purchase order, buyers order or on a separate form given to the consumer prior to closing the loan that "the dealer may receive a fee, commission, or other compensation for providing, procuring, or arranging financing for the retail purchase or lease of a motor vehicle, for which the customer may be responsible."[29]

This disclosure does not inform the consumer that, in fact, that compensation is paid through an increase in the interest rate. It does not disclose the manner by which the dealer may receive compensation, that the interest rate may be higher than what the third party purchaser may be willing to accept to purchase the contract, or the actual amount of the compensation.

A significant number of dealers use the model forms that Reynolds and Reynolds has developed. The Reynolds and Reynolds model form also leaves the consumer without a true sense of the nature of the transaction. The disclosure on financing reads:

> Customer may secure financing through Dealer or a financing entity of Customer's choosing and Customer may be able to obtain more favorable financing from third parties. The retail installment sales contract ("RISC") to be entered between Dealer and Customer, unless otherwise indicated in writing by Dealer, shall be immediately assigned by Dealer to a bank / finance company (at face value or greater) which shall then be the creditor to whom Customer shall be obligated under the RISC. Customer also understands that: (i) the annual percentage rate (APR) for the installment sale of an automobile may be negotiated, and (ii) Dealer may receive some portion of the finance charge or receive other compensation for providing the financing and selling other products and services.

Although the existing disclosures are entirely opaque, changing the disclosure to be clearer will not eliminate the harm of dealer markups, particularly for subprime consumers. Even if the dealer interest rate markup were disclosed, those buying cars would still have to complete the entire sales and financing process multiple times to compare rates. In the case of subprime consumers who may not have another option, the disclosure is meaningless. The only way to ensure avoidance of this practice is to require use of other compensation structures that are already in existence that do not provide the perverse incentives that dealer interest rate markups do.

The consumer also receives this disclosure when signing all of the forms at the end of the sales and finance process. While the consumer is technically given the form "before closing," the consumer does not have a meaningful opportunity to digest the practical impact of the conduct explained in the disclosure before signing the contract. Although the consumer has the right to take the documents home for review before signing, consumers do not typically avail themselves of that right nor do dealers make consumers aware of that option.

[29] N.C.G.S. § 20-101.2.

At its core, the issue is not the dealer's profit but, as the FRB concluded in its analysis of yield-spread premiums, whether the compensation system creates an inappropriate incentive. Representatives from NADA argue, in the FTC Roundtables on auto lending and in other contexts, that the dealer markup is no different than the difference between the retail price of a particular good and the wholesale price at which the retailer can purchase the good for sale. NADA stated that retailers do not have to disclose the profit margin on their goods, so neither should auto dealers in the finance context.

Loans are different than other commodities, however. A consumer can easily compare prices between goods because the prices are clearly identifiable. Two different consumers can both see from the price listed that a particular television will cost $400. The consumer does not have to provide personal financial information before learning the price.

It is extremely difficult for car buyers to compare loan terms. Lenders have the ability to price for risk, meaning that the lender can take into account the borrower's risk of repayment. As such, the consumer must submit a loan application and go through approval process in order to know what the price of that loan will be. The lender has significant discretion to set the price of credit for each consumer and the ability to keep the variables used in the loan approval and pricing process hidden.

Other compensation systems would still provide dealers with the ability to profit from offering financing while shifting the incentive from finding the loan with the most profit for the dealer to finding the loan that is the best deal for the consumer.

(3) "Not outweighed by countervailing benefit to consumers or competition"

The requirement that the injury to consumers not be outweighed by any offsetting consumer or competitive benefits reflects the recognition that "[m]ost business practices entail a mixture of economic and other costs and benefits for purchasers."[30] For this reason, the FTC will not find that a practice unfairly injures consumers "unless it is injurious in its net effects."[31] This consideration does not demand a quantified cost-benefit analysis—in some cases that "would be unnecessary; in other cases it may be impossible." Rather, it requires careful evaluation, taking into account available evidence.[32]

In fact, dealers already receive multiple forms of compensation. Dealers already receive flat fee compensation, such as compensation that is based on a fixed percentage of the amount financed or a fixed fee per loan. As such, changing the compensation system to a flat fee model would not cause disruption to the market. For instance, in loan programs where the auto manufacturers subsidize low or zero interest rate programs, dealers are compensated on a flat fee basis. Credit unions participating in the Credit Union Direct

[30] *FTC Policy Statement on Unfairness*.
[31] *Id.*
[32] Sen. Rep. No. 130, 103d Cong. 2d Sess. 12 (1994), *reprinted in* 1994 U.S.C.C.A.N. 1776, 1787-88 (elaborating on the elements of unfairness when Congress enacted them in 1994).

Lending (CUDL) program are not allowed to pay a commission of greater than 1% of the loan amount to the dealer. A flat fee model removes the incentive to steer consumers into more expensive loans to increase the profit to the dealer.

The 2011 National Automotive Finance Association survey of subprime finance sources shows that finance companies routinely offer compensation that is not based on increases in the interest rate. The survey showed that 46% of finance companies surveyed did not use the "dealer participation" system.[33] This survey makes clear that a transition to a flat fee model would not be disruptive nor eliminate dealer financing.

There is nothing to suggest that the "dealer reserve" or "dealer participation" model provides any benefit to consumers that other compensation forms would not provide. Dealer financing provides an additional option to consumers, and since the financing is done on site it may be more convenient for consumers. This form of financing would still be available even with a different compensation structure, since other forms of compensation currently exist in the marketplace. In fact, the other forms of compensation that remove the incentive for dealers to sell consumers on the most expensive loan available provide *more* benefits to consumers and to competition than the current system.

Accordingly, we believe dealer markups satisfy all the elements of unfairness under the FTC Act.

B. Deception

Deception is a species of unfairness.[34] An act or practice may be "unfair" without being "deceptive."[35] A violation of the FTC Act exists—and FTC rulemaking is proper—whether an act is unfair, or deceptive, or both. The FTC has set out the standards it applies in determining whether an act or practice is deceptive within the meaning of the Act.[36] Although these standards have not been codified, they have been applied by numerous courts.[37]

An act or practice is deceptive when:

(1) There is a representation or omission of information;

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[33] *2011 Below-Prime Automotive Financing Survey*, National Automotive Finance Association (2011).

[34] Final Rule Commentary on Unfair or Deceptive Acts or Practices with respect to Consumer Credit Cards, 74 Fed. Reg. 5498 (Jan. 29, 2009) ("Final Credit Card UDAP Rule") (citing *FTC Policy Statement on Deception* (Oct. 14, 1983), available at http://www.ftc.gov/bcp/policystmt/ad-decept.htm at 1-2).

[35] See, e.g., *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233, 244 n.5 (1972); *Orkin Exterminating Co. v. FTC*, 849 F.2d 1354, 1367 (11th Cir. 1988), cert. denied, 488 U.S. 1041 (1989); *Am. Fin. Svcs. Ass'n v. FTC*, 767 F.2d 957, 979-980 n. 27 and text (D.C. Cir. 1985); *Spiegel, Inc. v. FTC*, 540 F.2d 287, 293 n.8 (7th Cir. 1976).

[36] *FTC Policy Statement on Deception* (Oct. 14, 1983), available at http://www.ftc.gov/bcp/policystmt/ad-decept.htm.

[37] See, e.g., *FTC v. Tashman*, 318 F.3d 1273, 1277 (11th Cir. 2003); *FTC v. Gill*, 265 F.3d 944, 950 (9th Cir. 2001); *FTC v. QT, Inc.*, 448 F. Supp. 2d 908, 957 (N.D. Ill. 2006); *FTC v. Think Achievement*, 144 F. Supp. 2d 993, 1009 (N.D. Ind. 2000); *FTC v. Minuteman Press*, 53 F. Supp. 2d 248, 258 (E.D.N.Y. 1998).

(2) Which is likely to mislead consumers acting reasonably under the circumstances; and
(3) The information is material to consumers.[38]

A representation or omission is deceptive if the overall net effect is likely to mislead consumers.[39] The FTC conducts its own analysis to determine whether a representation or omission is likely to mislead consumers who are acting reasonably under the circumstances.[40] When evaluating the reasonableness of an interpretation, the FTC considers the sophistication and understanding of consumers in the group to whom the act or practice is targeted.[41] If a representation is susceptible to more than one reasonable interpretation, and if one such interpretation is misleading, then the representation is deceptive even if other, non-deceptive interpretations are possible.[42] A representation or omission is material if it is likely to affect the consumer's conduct or decision regarding a product or service.[43]

(1) Representation or omission of information

As stated earlier, dealers routinely advertise that they work with multiple lending sources to obtain financing. The surveys cited in previous sections show that many consumers trust the dealer to find a loan with the best terms. That trust is seemingly justified – the finance staff at the dealer has far more experience in the auto finance market than the consumer, and the dealer is purporting to shop among many loan options.

These dealer statements are part of an overall pattern in the auto financing process. Dealers also routinely refer to potential third-party purchasers of the finance contract as "the lender," despite the dealer being listed as the creditor in the transaction. The dealer often represents to the consumer that "the lender" has approved the consumer for financing, or that the financing fell through because "the lender" has turned the consumer down for financing.

These statements lead the consumer to believe that the dealer is not, in fact, involved in decisions related to the financing. These statements are designed to give consumers the false impression that the dealer is not in control of the financing process when, in fact, the dealer has the ability to accept or reject offers to purchase the financing contract and alter the interest rate for compensation. The dealer can also shape the loan terms, such as lengthening the loan term to make the loan seem more affordable.

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[38] *FTC Policy Statement on Deception* at 1-2.
[39] Final Credit Card UDAP Rule (citing *FTC v. Cyberspace.com*, 453 F.3d 1196, 1200 (9th Cir. 2006); *FTC v. Gill*, 265 F.3d 944, 956 (9th Cir. 2001); *Removatron Int'l Corp. v. FTC*, 884 F.2d 1489, 1497 (1st Cir. 1989)).
[40] *Id.* (citing See *FTC v. Kraft, Inc.*, 970 F.2d 311, 319 (7th Cir. 1992); *FTC v. QT, Inc.*, 448 F. Supp. 2d 908, 958 (N.D. Ill. 2006)).
[41] *Id.* (citing *FTC Policy Statement on Deception* at 3).
[42] *Id.*
[43] Final Credit Card UDAP Rule (citing *FTC Policy Statement on Deception* at 2, 6-7).

The consumer is consistently led to believe that the dealer or the dealer representative is not in control of the lending process. This deception leads the consumer to accept the terms or price as offered. The consumer believes there is no reasonable way to change the price or terms because the person or entity the consumer believes is responsible is not there.

Further, the representation that the dealer has access to multiple sources of credit leads the consumer to believe that the dealer is using those connections to pursue the best deal for the consumer, not the most lucrative one for the lender. As the consumer is largely unaware that the dealer stands to gain if the consumer pays a higher interest rate, this reliance on the dealer to shop for the best deal is seemingly reasonable. As stated previously, the trade associations for the dealers and finance companies perpetuate this misunderstanding, leading consumers to believe that dealers are working in consumers' best interest when in fact the dealer is not.

What further affects these misrepresentations are the steps dealers take to ensure that consumers are unaware of the impact of the dealer interest rate markup on their loans. For instance, the North Carolina Automobile Dealers Association successfully backed legislation that expressly shields the dealer from any obligation to inform the consumer whether an interest rate markup exists on the loan or the amount of that markup.[44] As such, the dealer lobby in North Carolina ensured that a dealer may lawfully refuse to answer consumer questions about a practice that has significant impact on the cost of credit to the consumer.

(2) Likely to mislead consumers acting reasonably under the circumstances

A consumer, operating under the belief that a dealer is working with several lenders to obtain financing, may reasonably believe that the dealer is working to find the best deal for the consumer. The consumer may also reasonably believe that the dealer is not in control of the financing process even though the dealer has a vested interest in increasing, and the ability to increase, the interest rate of the loan. Again, survey data from consumers in auto lending transactions bears out many consumers' misplaced belief. Close to half of the borrowers surveyed did not negotiate the credit terms because they trusted the dealer to give them a good rate.[45] Consumers who trusted the dealer to find the best interest rate received, on average, an annual percentage rate two percentage points higher than their similarly situated peers.[46]

Clearly, a significant number of consumers are of the belief that the lender is working on the consumers' behalf. And, as stated previously, for many subprime consumers there is virtually no effective way for the consumer to shop among lenders to determine whether, in fact, the loan through the dealer is the best rate available.

(3) The information is material to consumers

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[44] N.C.G.S § 20-101.2(b).
[45] CARAVAN survey.
[46] Id.

The role of the dealer and the incentive structure under which the dealer is operating are very much material to consumers. A consumer would be likely to act much differently if the consumer knows that the dealer has significant discretion in setting the interest rate and other terms of the loan, and that the dealer has a significant incentive to choose the loan that provides the most compensation to the dealer, which may also be the most expensive for the consumer.

As consumers do not meaningfully understand the compensation system and dealers lead the consumer to believe that the dealer is finding the best deal possible, the consumer is likely to pay more for a loan than may be otherwise necessary. As stated earlier, consumers who purchased cars in 2009 will pay $25.8 billion in interest over the lives of their loans that will be used for dealer compensation for providing loans to consumers.[47]

Thus, while unfairness alone would suffice to support the FTC's regulation of markups as a UDAP, we believe that dealer interest rate markups are also deceptive within the meaning of the FTC Act.

C. Scope of Remedy

Once the FTC determines that a practice is unfair or deceptive, it has wide discretion to craft an appropriate remedy. As the D.C. Circuit noted, "The Commission is the expert body to determine what remedy is necessary to eliminate the unfair or deceptive trade practices which have been disclosed. It has wide latitude for judgment and the courts will not interfere except where the remedy selected has no reasonable relation to the unlawful practices found to exist."[48] The court in that case expressly rejected the argument the FTC could have relied on disclosures alone to remedy the harm, noting with approval the FTC's reasoning that disclosure alternatives would deal only partially with the problem but would not address the problem of consumers' limited incentives to search for better alternatives.

Similar reasoning applies here. As the Federal Reserve Board concluded in rejecting disclosures as an adequate remedy for the injury caused by yield spread premiums, disclosures would be inadequate to protect consumers from the unfairness associated with dealer markups.[49] The incentive for the dealer to find the most profitable loan possible and its possible effect on the loan cannot be effectively delivered via disclosure. The disclosure would have to describe the compensation system, the potential impact of the compensation on the loan, the fact that the dealer may not be presenting the consumer with the best or lowest-cost loan, that the dealer is not shopping on the consumer's behalf and that the dealer has discretion to alter the terms of the loan.

[47] *Under the Hood.*
[48] *Am. Fin. Svcs. Ass'n v. FTC*, 767 F.2d at 979 (upholding FTC rule prohibiting the taking of security interests in certain household goods and prohibiting pre-default wage garnishment agreements, and citing *Jacob Siegel Co. v. FTC*, 327 U.S. 608, 612-13 (1946)).
[49] 75 Federal Register 58509.

As with mortgage brokers, the customer frequently trusts the auto dealer to find the best terms available. Moreover, consumers have far less experience with auto purchases and financing than dealers do. The dealer has the ability to find the lowest-cost loan available but the compensation system incents the dealer to do otherwise. Consumers do not fully understand the incentives at work behind the scenes. The onus should not be placed on the consumer to become expert in the impact of dealer markups, their calculation, and how the system may or may not impact the loan. Rather, the FTC should bar auto dealers from marking up interest rates to ensure that incentives are aligned and that inappropriate incentives are prohibited.

The effects of competition in the market should actually reach the consumer, and should be based on true competitive forces instead of perverse incentives. The only effective way to ensure this is to prohibit dealer compensation that varies on the interest rate or other material terms of the loan other than the principal balance of the loan.

Given the FTC's well-recognized broad authority to craft a remedy for acts it determines to be unfair or deceptive, prohibiting this form of dealer compensation is well within the scope of FTC authority.

APPENDIX A

Westlake

FINANCIAL SERVICES®

Westlake Financial Services is a leader in subprime auto finance, helping dealerships grow for over 20 years. Based in Southern California, Westlake originates indirect retail installment contracts through a network of over 10,000 new and used-car dealerships in the United States.

Westlake's Buy Program™ is available online 24/7 through Nowcom Corporation's DealerCenter® website or via Route One®. With the program's wizard-driven approach to structuring deals, getting an instant approval is fast and efficient. By simply inputting the customer's down payment and desired monthly payment, the Deal Wizard will analyze the customer's credit and automatically structure an approval for every qualifying vehicle on the dealer's lot. The results are arranged in order of potential profit, thereby minimizing the time spent, and maximizing the profit made, on every Westlake deal.

To learn more about Westlake Financial Services and the Buy Program™ software, visit www.westlakefinancial.com or call 1 (888) 8-YES-YES.

www.subprimenews.com 17

APPENDIX B

FADA

PERF HERE ALL PARTS

UNISET | The Reynolds and Reynolds Company | UNISET

In accordance with Rule 15C-18.006(5), Florida Administrative Code, disclosure of the Electronic Filing System Service Fee is to be displayed in a conspicuous manner on the Buyer's Order. The format of this document may vary among dealerships.

RETAIL BUYER'S ORDER

DATE

CUSTOMER	DOB	CO-CUSTOMER	DOB
ADDRESS		ADDRESS	
CITY STATE ZIP		CITY STATE ZIP	
E-MAIL		E-MAIL	
HOME PHONE / WORK PHONE / COUNTY		HOME PHONE / WORK PHONE / COUNTY	
STOCK NO. / YEAR / NEW / USED / DEMO / EXECUTIVE		MILEAGE / COLOR / SALESPERSON 1	
VIN / MAKE		MODEL / BODY / SALESPERSON 2	

2ND PROOF

NEW / DEMO AND EXECUTIVE VEHICLE DISCLOSURE

This new, demonstrator or executive Vehicle is sold AS-IS and WITH ALL FAULTS. **Dealer hereby expressly disclaims all warranties**, either express or implied, including any implied warranties of merchantability or fitness for a particular purpose and neither assumes nor authorizes any other person to assume for it any liability in connection with the sale of the Vehicle. The only warranties applying to this Vehicle are those offered by the Manufacturer. The Manufacturer's warranty is not affected by Dealer's disclaimer of warranties. The Customer hereby acknowledges that Dealer has made available "warranty Pre-Sale Information" as disclosed in the Warranty Binders pursuant to the Magnuson-Moss Warranty Act.

Customer: ____________ Customer: ____________

USED VEHICLE DISCLOSURE

This used Vehicle has been previously driven by others and Dealer has not made any representation regarding the Vehicle's history. Customer acknowledges that no representation has been made by any agent of Dealer: (i) regarding the history, condition, prior repair or maintenance, safety system or suitability of the Vehicle; or (ii) that it has or has not ever sustained damages prior to this Order, nor does Dealer have the obligation to make any such disclosure. Customer understands that s/he may retain a third-party to provide information regarding the Vehicle's history and that Dealer encourages Customer to do so. Customer may also make arrangements to have the Vehicle inspected by a person of Customer's own choosing. Customer further acknowledges that Customer has test driven this Vehicle and it meets Customer's satisfaction or Customer has been offered an opportunity to do so, and has declined. Except as otherwise set forth on the window form (Buyer's Guide), this Vehicle is sold "AS IS and WITH ALL FAULTS," without any warranty and **Dealer hereby expressly disclaims all warranties**, either express or implied, including any implied warranty of merchantability or fitness for a particular purpose, and neither assumes nor authorizes any person to assume for it any liability in connection with the sale of the Vehicle. The information you see on the window form for this Vehicle is part of this contract/order. Information on the window form overrides any contrary provisions in the contract/order of sale. The Manufacturer warranty, if any, has been fully explained. If the Vehicle is designated as a certified vehicle, that indicates that it has qualified for a limited extension of the Manufacturer's original warranty as set forth on the Buyer's Guide. The certified designation does not alter or modify any of the above disclaimers and waivers, nor does it create a Dealer warranty. It also does not mean that the Vehicle, like all used vehicles, will not suffer mechanical breakdowns, nor need maintenance due to wear and tear.

The Vehicle was previously a ____________ (enter short-term rental, taxicab, police vehicle, manufacturer buy-back, rebuilt, glider kit, replica or flood vehicle)

Customer: ____________ Customer: ____________

THIS VEHICLE WAS DELIVERED TO A PREVIOUS PURCHASER.

Customer: ____________ Customer: ____________

GUÍA PARA COMPRADORES DE VEHÍCULOS USADOS. LA INFORMACIÓN QUE VE EN EL FORMULARIO DE LA VENTANILLA PARA ESTE VEHÍCULO FORMA PARTE DEL PRESENTE CONTRATO. LA INFORMACIÓN DEL FORMULARIO DE LA VENTANILLA DEJA SIN EFECTO TODA DISPOSICIÓN EN CONTRARIO CONTENIDA EN EL CONTRATO DE VENTA.

TRADE-IN 1

☐ Private Trade ☐ Lease Walk Away

Year	Make	Model	Color
VIN		Mileage	
1st Lien to:		Amount	Good Thru
2nd Lien to:		Amount	Good Thru
Authorized by:			

TRADE-IN 2

☐ Private Trade ☐ Lease Walk Away

Year	Make	Model	Color
VIN		Mileage	
1st Lien to:		Amount	Good Thru
2nd Lien to:		Amount	Good Thru
Authorized by:			

Unless specifically identified by Customer in writing and signed by the parties, Customer represents and warrants the following regarding the Trade-In: (i) it was not involved in an accident; (ii) has not incurred any body or major engine repair(s); and (iii) it was not previously a police vehicle, a taxicab, a short-term lease (for less than 12 months), also referred to as a rental vehicle, a flood damaged, frame damaged, salvaged or a rebuilt vehicle. Subject to the terms and conditions of this Order, Customer authorizes Dealer to immediately sell the Trade-In whether or not the Financing Approvals have been obtained. Customer agrees that in the event any inquiry reveals any undisclosed lien on the Trade-In, and/or the actual pay-off for the disclosed lien on the Trade-In exceeds the Customer's statement of pay-off, Customer will cause such previously unknown lien(s) and/or the understated amount of the disclosed lien(s) to be satisfied within 72 hours of Dealer's notice to Customer in writing. If the vehicle(s) listed is a Lease Walk Away, Customer understands that Dealer's agreement to take possession of it is for convenience only and Dealer assumes no responsibility for its condition or any other obligation of Customer with respect to that lease, such as remaining payments, excess miles or damage to vehicle, unless otherwise indicated in writing and signed by Dealer.

Customer: ____________ Customer: ____________

ARBITRATION AND LIMITATION ACKNOWLEDGEMENTS

The parties agree to submit all claims to binding arbitration as set forth in paragraph H on the reverse side. Customer has read and understands paragraph H. In a dispute between the parties, Customer shall not be entitled to recover from Dealer any special damages, consequential damages, damages to property, damages for loss of use, loss of time, loss of profits, or income, or any other incidental damages, including, but not limited to vehicle rental charges. This Order is not evidence of any cash payment. Cash payments are evidenced by a separate receipt document. The Deposit will serve to hold the Vehicle from sale to another for 24 hours from this date.

Customer: ____________ Customer: ____________

PURCHASE INFORMATION

Cash Price of Vehicle	
Accessories	
Subtotal	
Less Pre-owned Allowance &/or Discount	
Net Difference	
Predelivery Service Fee	
Electronic Registration Filing Fee These charges represent costs and profit to the dealer for items such as inspecting, cleaning, and adjusting vehicles and preparing documents related to the sale.	
Lead Acid Battery Fee	
Florida New Tire Fee ($1.00 per tire)	
Subtotal	
Sales Tax ___%	
County Tax	
Lemon Law – Warranty Enforcement Act (New cars only)	
Florida Title, Registration and License Fees (New ___ Trans ___)	
Trade Pay-off / Balance on Prior Lease	
Subtotal	
Motor Vehicle Service Contract	
Vehicle Maintenance Agreement	
Sales Tax on Other Benefits	
GRAND TOTAL	
Rebate	
Cash (Receipt # ________)	
Total Cash Down	
BALANCE DUE ON DELIVERY	

FINANCING NEGOTIATION / APPROVAL

Customer may secure financing through Dealer or a financing entity of Customer's choosing and Customer may be able to obtain more favorable financing from third parties. The retail installment sales contract ("RISC") to be entered between Dealer and Customer, unless otherwise indicated in writing by Dealer, shall be immediately assigned by Dealer to a bank / finance company (at face value or greater) which shall then be the creditor to whom Customer shall be obligated under the RISC. Customer also understands that: (i) the annual percentage rate (APR) for the installment sale of an automobile may be negotiated, and (ii) Dealer may receive some portion of the finance charge or receive other compensation for providing the financing and selling other products and services. Dealer may terminate this Order if Dealer cannot obtain credit approval for Customer or if Dealer is unable to sell the RISC to a financial institution on terms of no less than face value (these acts shall be collectively referred to as "Financing Approvals"). Dealer's right of termination cannot be waived unless in writing. Financing Approvals are not typically obtained at the time of the Vehicle's delivery and are beyond Dealer's control. *Should Customer take delivery of the Vehicle prior to Dealer's obtaining the Financing Approvals, Customer understands and acknowledges that pending the Financing Approvals, delivery of the Vehicle to Customer serves as a convenience to Customer only and Customer does not have, nor will acquire, any rights or interests in the Vehicle by such delivery except Dealer's permission to use it, which permission can be revoked, requiring the Vehicle's immediate return to Dealer in the same condition as it existed when delivered to Customer.* Additionally, the obtaining of the Financing Approvals is a condition subsequent to the enforcement and validity of the RISC, which, at Dealer's option, shall be deemed null and void if such condition subsequent is not met. If the RISC contains a "Seller's Right to Cancel" provision or other provision that substantially addresses the substance of the Financing Approvals, and that provision is duly completed and executed, then the condition subsequent described in this section shall not apply. If the RISC does not contain a "Seller's Right to Cancel" provision or other provision that substantially addresses the substance of the Financing Approvals, or if it contains such a provision, but it is not duly completed and executed or is designated in some manner as inapplicable, then this section in this Order shall apply, govern and control.

Customer: ____________ Customer: ____________

DO NOT SIGN BELOW UNTIL YOU HAVE READ AND UNDERSTOOD ALL OF THE TERMS AND CONDITIONS CONTAINED ON THE FRONT AND REVERSE OF THIS ORDER. BY SIGNING BELOW, YOU ACKNOWLEDGE THAT EXCEPT AS OTHERWISE ACKNOWLEDGED IN WRITING, THIS REPRESENTS THE ENTIRE ORDER AND THAT YOU HAVE NOT RELIED ON ANY ORAL REPRESENTATION, PROMISE OR AGREEMENT NOT CONTAINED WITHIN THIS WRITTEN ORDER. THIS ORDER IS NOT BINDING UNTIL EXECUTED BY DEALER'S MANAGER. CUSTOMER REPRESENTS AND WARRANTS THAT ALL INFORMATION PROVIDED TO DEALER IN CONNECTION WITH THIS TRANSACTION IS COMPLETE AND ACCURATE. CUSTOMER HAS READ, UNDERSTANDS AND ACCEPTS ALL PROVISIONS OF THIS ORDER AND THE WARRANTY STATEMENT.