FEDERAL RESERVE SYSTEM

Docket No. OP-1158

Comments of the National Independent Automobile Dealers Association Directed to the Board of Governor's of the Federal Reserve System Regarding the Proposed Interpretation and Supervisory Guidance on Anti-Tying Restrictions of Section 106 of the Bank Holding Company Act Amendments of 1970.

The Federal Reserve Board (FRB) has requested public comment on its Official Interpretation of the Anti-Tying Restrictions in Section 106 of the Bank Holding Company Act Amendments of 1970 and related Supervisory Guidance. Section 106 generally prohibits a bank from conditioning the availability or price of one product on the requirement that the customer also obtain another product from the bank or an affiliate. The FRB's Proposed Interpretation of Section 106 is intended to provide banking organizations and their customers with a comprehensive guide to the special anti-tying restrictions. It describes the scope and purposes of Section 106, the elements of a tying arrangement prohibited by Section 106, and the statutory and regulatory exceptions to the prohibitions of Section 106.

The National Independent Automobile Dealers Association (NIADA) has represented the interests of independent motor vehicle dealers for over 50 years. The NIADA and its State Affiliate Associations represent more than 17,000 independent motor vehicle dealers located across the United States. In 2002, a record 43 million used motor vehicles were retailed generating more than $370 billion in revenues. Because vehicles are lasting longer (the average age of the vehicle on the road today is in excess 8.5 years old), projections of future used vehicle sale volumes suggest that the used vehicle market will maintain its 40-million-plus volume in the years to come.[1] The FRB's Proposed Interpretation of Section 106 may impact businesses engaged in the retail sale of motor vehicles because the sale of a motor vehicle is contingent upon a customer being able to obtain financing. The amount to be financed often includes not only the cost of the vehicle, but also the cost of other products and services sold by the dealership in connection with the sale of the vehicle.

Congress adopted Section 106 of the Act at the same time it expanded the ability of bank holding companies to engage in nonbanking activities under the Act. In doing so it expressed concern that banks might use their ability to offer bank products - credit in particular - n a coercive manner to gain a competitive advantage in markets for nonbanking products and services.[2] Therefore, Congress decided to impose special anti-tying restrictions on banks. The FRB's Interpretation of Section 106 clearly state that a bank is prohibited from imposing certain tying arrangements as well as certain reciprocity and exclusive dealing arrangements on their customers.[3]

"Exclusive dealing arrangements" are defined as "arrangements that require a customer not to obtain a product from a competitor of the bank or of an affiliate as a condition of the bank providing another product to the customer."[4] The exclusive dealing restriction generally prohibits a bank from conditioning the availability or price of a bank product (the desired product) on a requirement that the customer not obtain another product (the tied product) from a competitor of the bank or a competitor of an affiliate of the bank.[5] Stated another way, banks are prohibited from extending credit, leasing or selling any property or furnishing any service, or fixing or varying the consideration for any of the foregoing, on the condition or requirement that the customer "[n]ot obtain some additional credit,

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[1] The 2003 Used Car Market Report, Manheim Auctions, 1400 Lake Hearn Drive, NE, Atlanta, GA 30319-1464.
[2] See FRB Proposed Interpretation and Supervisory Guidance at 2 citing S. Rep. No. 1084, 91st Cong., 2d Sess. (1970)
[3] Id. at 6.
[4] Id. at 6, n. 14.
[5] Id. at 22 citing 12 U.S.C. 1972 (1)(E).

property or service from a competitor of the bank or of an affiliate of the bank, unless the condition is reasonably imposed in a credit transaction to ensure the soundness of the credit."[6]

The list of illustrations of the types of activities that banks are prohibited from engaging in includes "imposing a condition on a prospective borrower that requires the borrower to…[p]urchase an insurance product from the bank or an affiliate of the bank (a prohibited tie)" and "[r]efrain from obtaining insurance products or securities underwriting services from a competitor of the bank or from a competitor of an affiliate of the bank (a prohibited exclusive dealing arrangement)."[7] A bank is not prohibited from declining to provide credit or any other product to a customer, so long as the bank's decision is not based on the customer's failure to satisfy a condition or requirement prohibited by Section 106. The two essential elements that must be demonstrated to establish a tying arrangement by a bank are: (1) the arrangement must involve two or more separate products: the customer's desired product(s) and one or more separate tied products; and (2) the bank must force the customer to obtain (or provide) the tied product(s) from (or to) the bank or an affiliate in order to obtain the customer's desired product(s) from the bank.[8] It has recently been brought to the attention of NIADA and its State Affiliates that some banks may be forcing consumers to obtain "GAP" products from the bank in order to obtain financing from the bank for the purchase or lease of a motor vehicle.

Arrangements whereby banks finance the purchase or lease of a motor vehicle and provide a GAP product involves two separate and distinct products: the loan to purchase or lease a motor vehicle (the customer's desired product) and the Guaranteed Automobile Protection (GAP) product (the tied product). When an individual finances the purchase/lease of a motor vehicle, he is typically required to maintain physical damage insurance that meets the requirements of the lender to protect the collateral. In many cases, because motor vehicles are depreciating assets, the fair market value of the vehicle will be less than the balance outstanding on the loan/lease. An option available to consumers is to purchase a GAP product.

When a consumer purchases a GAP product in connection with the sale and financing of a motor vehicle, the supplier of the GAP product (whether it be a bank, third party supplier or insurance company) enters into an agreement with the consumer to pay the difference between the coverage provided under the consumer's primary insurance policy and the outstanding balance owed on the vehicle should it be declared a total loss due to an accident or theft. Depending upon state law and the amount of risk the supplier of the GAP product desires to assume, the supplier has the option of establishing a reserve account to pay future claims or to obtain insurance from a licensed insurance company in order to allocate some of the supplier's risk. In either case, if the amount owed by a consumer on a finance or lease contract exceeds the amount of a property damage settlement, the GAP product relieves him from having to pay the difference between the amount owed and the settlement amount because the supplier/administrator of the GAP product is obligated to pay the difference to the bank.

These GAP products are not "traditional" bank products. Motor vehicle dealers have sold GAP products offered by third party vendors for years. Additionally, long before these products became popular in the context of motor vehicle sales transactions, rental companies began selling a collision/damage waiver product that protects customers in the event that a rental vehicle is damaged and the customer's insurance does not cover the entire amount of loss. Despite this fact, it has become increasingly common for some banks to mandate that consumers who are approved for financing and desire to purchase a GAP product must purchase the bank's GAP product. The bank will not finance the transaction directly or accept assignment of a retail installment sales

[6] Id. at 6.
[7] Id.; See also at 10, n. 22.
[8] Id. at 9.

contract/lease agreement from a motor vehicle dealership if the amount to be financed includes the cost of any third party supplier's GAP product.

In other words, some banks have begun using their ability to provide financing for a motor vehicle transaction as leverage to force consumers to purchase the bank's GAP product even though the GAP product offered by the bank may cost more and offer the same or less benefits to the consumer than other GAP products made available at the dealership through third party suppliers. In many cases, these individual consumers, as well as the motor vehicle dealerships, have less bargaining power and are more susceptible to subtle pressure by a bank that mandates they sell and purchase the GAP product offered by the bank. If this activity were permitted to occur, third party suppliers of GAP products that have traditionally competed with banks would be at a competitive disadvantage, if not put out of business altogether, thereby having a negative financial impact on motor vehicle dealerships and consumers alike.

NIADA agrees with and supports the FRB's Proposed Interpretation and Supervisory Guidance on Anti-Tying Restrictions of Section 106 of the Bank Holding Company Act Amendments of 1970. The Proposed Interpretation and Supervisory Guidance clarify that while banks have an interest in establishing standards for acceptable products and services offered in connection with a transaction financed by the bank, as they often do with respect to service contracts and credit life and disability insurance policies, they are not permitted to mandate that consumers wishing to purchase optional products, such as the GAP product, not obtain the product from a competitor of the bank or of an affiliate of the bank as a condition of the bank providing financing for the purchase or lease of a motor vehicle.[9]

NIADA would like to thank the Board of Governors of the Federal Reserve Board for the opportunity to comment with respect to the Proposed Rule. Any questions the Board of Governors has regarding NIADA's comments and the position taken herein may be directed to NIADA's Legal Counsel, Keith E. Whann or Deanna L. Stockamp, of the Law Firm Whann & Associates, LLC located at 6300 Frantz Road, Dublin, Ohio 43017.

[9] Id. at 18 ("A bank, however, may not require a customer seeking an auto loan form the bank to purchase automobile insurance from the bank or from an insurance agency affiliate of the bank. Although the desired product (an auto loan) in this case is a traditional bank product, the tied product (automobile insurance) is not and, accordingly, the traditional bank product exceptions are not available for this transaction"); See also at 21, n. 55 ('the exceptions permit a bank to condition the availability of secured credit on a requirement that the customer obtain insurance, for the benefit of the bank, that protects the value of the bank's security interest in the collateral securing the loan…The bank, however, may not require that the customer obtain the insurance from the bank or an affiliate of the bank.")