August 18, 2008

Office of the Secretary
Federal Trade Commission
Room H-135 (Annex M)
600 Pennsylvania Avenue, NW
Washington, D.C. 20580

Re: Fair Credit Reporting Act (FCRA)/Fair and Accurate Credit Transactions(FACT) Act Risk-Based Pricing Regulations, 16 CFR Parts 640 and 698

Dear Secretary:

This letter contains the comments of the National Independent Automobile Dealers Association ("NIADA") responding to the Notice of Proposed Rulemaking ("NPR") issued by the Federal Trade Commission ("FTC") and the Board of Governors of the Federal Reserve System ("Board") (hereinafter, "the agencies"). The NPR proposes to implement the risk-based pricing provisions in Section 311 of the Fair and Accurate Credit Transactions Act of 2003 ("FACT Act")(73 Fed. Reg. 28,966 – 29,021 (May 19, 2008); 73 Fed. Reg. 30,814 – 30,818 (May 29, 2008)).

NIADA represents over 20,000 used motor vehicle dealers from across the country and the District of Columbia who (i) sell and lease used motor vehicles, including passenger cars and trucks; (ii) assist consumers in obtaining financing through the use of retail installment sale contracts **conditioned upon the agreement that such contract will be assigned to a third-party finance source**; (iii) may serve as their own finance source in concluding transactions with consumers, often referred to as "buy-here, pay-here" and (iv) may engage in service and repair operations, and parts sales. NIADA's members collectively employ approximately one hundred fifty thousand (150,000) people nationwide.[1] The vast majority of the Association's members are small businesses as defined by the Small Business Administration. Accordingly, NIADA is particularly focused on regulatory changes that will increase the regulatory burden on small businesses.

While NIADA commends the agencies for attempting to create a workable regulatory scheme within this complex statutory mandate, we believe the proposed rules create a system that incorrectly applies the risk-based pricing notice requirements contained in Section 311 to persons, such as motor vehicle dealers involved in three-party financing, who do not engage in risk-based pricing. The corresponding increase in paperwork and administration will not only cost our small business members financially, it will also expose the dealers to potential legal action from the agencies or from consumers who will seek to make a violation of the Rule a violation of state Unfair and Deceptive Acts and Practices (UDAP) statutes.[2]

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[1] Additionally, of the almost forty-three million retail used motor vehicle transactions in 2007, independent dealers sold over thirteen million used motor vehicles, totaling one hundred thirteen billion dollars in gross sales. Manheim 2008 Used Car Market Report, citing data from CNW Marketing/Research, p. 35.

[2] While NIADA recognizes that the proposed rule does not provide for a private right of action, Federal Register/Vol. 73, p. 28970, many consumer protection statutes or related case decisions

In light of our stated position, NIADA believes that the Rule should be reworked to clarify that motor vehicle dealers engaged in third party financing transactions, as described above, are not subject to the rule requiring the issuance of any risk-based pricing or exception notice. However, should the agencies adopt a final rule that imposes the risk-based pricing requirements on dealers who do not engage in risk-based pricing, the agencies should retain the exception notices set forth in the proposed rule subject to certain modifications and clarifications. The agencies also should retain, subject to the same modifications and clarifications, the exception notices for dealers involved in two-party financing transactions who engage in risk-based pricing.

General overview of three-party financing

As a threshold matter, it is important to understand the respective functions typically performed by dealers and finance sources in three-party vehicle financing transactions.

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

Most finance transactions involving dealers include three parties – the consumer, the dealer, and the assignee-finance source -- and thus are commonly referred to as “three party paper” or “three-party financing.” In typical three party paper or three-party financing transactions, the consumer enters into a finance contract with the dealer **that is conditioned or contingent on a finance source’s willingness to take assignment of the finance contract from the dealer.** If the dealer cannot secure such an agreement from a finance source, then the finance contract is not consummated. This arrangement is necessary, as most dealers are not equipped to serve as their own finance source.

The usual three-party paper transaction begins with the consumer providing the dealer with a completed credit application authorizing the dealer to (i) obtain a copy of the consumer’s credit report, and (ii) submit the consumer’s credit application to finance

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interpreting such statutes provide that a violation of a federal consumer protection act also violates the state UDAP statute, exposing suppliers, like motor vehicle dealers, in individual or class actions, to rescission of the contract and extreme penalties such as double or treble damages and attorney fees.

Albeit uncommon, another variety of two-party financing occurs when a dealer arranges financing directly between the consumer and the finance source. When this occurs, the finance source (and not the dealer) acts as the initial creditor.

This process in commonly referred to as “spot financing.” A vehicle is delivered to a customer on the condition/contingency that financing must be obtained from a third party. If a third party does not approve the financing, then the proposed deal is cancelled. Spot delivery contracts account for a significant percentage of all new and used motor vehicle transactions annually.

sources with which the dealer has a contractual relationship to determine if a lender may be willing to take assignment of a contingent credit or spot delivery contract. **The dealer obtains the credit report, not for the purpose of extending credit, but to determine to which of its finance sources to send the credit application based on the finance source's lending guidelines.**

The finance sources receiving the credit application perform the task of underwriting to determine the credit risk presented by the credit applicant. As part of this process, the finance sources typically obtain their own credit report, which may be from a credit reporting agency different from the credit reporting agency used by the dealer. The finance sources' underwriting analyzes risk-based factors, such as loan-to-value and debt-to-income ratios, verification of employment, verification of residence, references and routine entries on the applicant's credit report (e.g., credit score, number of delinquent accounts, bankruptcy filings, etc.). If a finance source agrees to accept assignment of or buy a finance contract from the dealer, it will offer the dealer a wholesale buy rate that reflects the credit risk presented by the applicant.

The dealer does not engage in the costly underwriting process used by the finance source, but rather negotiates with the consumer to determine the amount of its retail margin on the financing it provides (similar to the manner that it negotiates the amount of the retail margin on the vehicle it provides). The dealer thus does not establish its retail margin (which, in
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As might be anticipated, the interests of NIADA and its 20,000 members intersect with those of the National Automobile Dealers Association (NADA) and its 19,000 members. After conferring with NADA counsel and staff, it is clear that many of the concerns expressed herein are virtually identical with those expressed by NADA. The following points are drawn from NADA's submission and have been endorsed by NIADA for inclusion with NIADA's foregoing comments.

Risk-based pricing requirements should apply to those who engage in risk-based pricing, not those who do not

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□ Dealers do not set or adjust dealer participation based on the risk of nonpayment by the consumer. As discussed above, this risk already is accounted for in the buy rate that is set by the finance source after the application of the finance source's underwriting process.

Given this backdrop, it is essential to determine the types of creditors Congress intended to issue risk-based pricing notices and who perform this function in the vehicle-financing context.

Congress intended for the Section 311 risk-based pricing notice requirements to only apply to persons who actually engage in risk-based pricing, not to anyone who happens to pull a credit report. This is evident from the language of Section 311 (which applies the new notice requirement to persons that grant, extend, or otherwise provide credit on material terms that are based in whole or in part on a credit report), the title of Section 311 ("Risk-Based Pricing Notice"), and the legislative history of Section 311.[] The agencies acknowledge this intent throughout the NPR. See, e.g., the scope provision at Proposed 16 C.F.R. section 640.1(a)(ii)(applying the new notice requirement to persons that grant, extend, or otherwise provide credit on material terms that are based in whole or part on a credit report);[] the NPR's Supplementary Information, 73 Fed. Reg. at 28,967 ("Section 311 of the FACT Act added a new section 615(h) to the FCRA to address risk-based pricing")("… The goals of this initial outreach were to get a broad sense of how risk-based pricing is used in practice, how information from consumer reports factors into risk-based pricing, …")("… the Agencies recognize that no single test or approach is likely to be feasible for … the many different credit products for which risk-based pricing is used"); and the agencies' description of the affected public in the NPR's Paperwork Reduction Act analysis, 73 Fed. Reg. at 28,987 (consisting of "[a]ny creditor that engages in risk-based pricing and uses a consumer report to set the terms on which credit is extended to consumers").

Determining which persons perform this function in the vehicle financing context requires an understanding of what is meant by the term "risk-based pricing." The NPR provides the following description:

> Risk-based pricing refers to the practice of setting or adjusting the price or other terms of credit offered or extended to a particular consumer to reflect the risk of nonpayment by that consumer. Information from a consumer report is often used in evaluating the risk posed by the consumer. Creditors that engage in risk based pricing generally offer more favorable terms to consumers with good credit histories and less favorable terms to consumers with poor credit histories.

73 Fed. Reg. at 28,967.

The summary of testimony of Mr. Howard Beales, then FTC Director of the Bureau of Consumer Protection, before the Senate Committee on Banking, Housing, and Urban Affairs when the FACT Act was being considered, also is instructive. It describes risk-based pricing as "pricing based on quantitative analysis of data related to credit worthiness" and describes the changes risk-based pricing has brought to consumer reporting. It states, in pertinent part:

[] See H.R. Conf. Rep. No. 2622, 108th Cong., 1st Sess. 6 (Extension of Remarks by Hon. Michael G. Oxley)("This section established a new notice requirement for creditors that use consumer report information in connection with a risk-based credit underwriting process for new credit customers").

[] For ease of reference, these comments will refer only to the FTC sections of the proposed rule.

> Advancements in information technology and underwriting have moved credit markets far beyond the days where decisions with respect to eligibility were made on essentially a "pass-fail" basis. Today a consumer's credit risk is carefully calculated so that he is offered a particular rate or terms that closely match the risks his report suggests he poses. Because of the precision it affords creditors, risk-based pricing has made credit available to many more people. However, because the rates and terms are tied to the contents of credit reports, any negative inaccuracy can have an impact on the price a consumer pays for credit.

S. Rep. No. 108-166, at 7-8 (Oct. 17, 2003).

Applying this description to vehicle financing, highlights that dealers involved in three party paper or three-party financing transactions **do not engage in risk-based pricing.** They do not use a quantitative analysis, information technology, or an underwriting process to "set or adjust the price or other terms of credit offered or extended to a particular consumer to reflect the risk of nonpayment by that consumer." As explained above, risk-based pricing occurs when the finance source uses its underwriting process to establish its buy rate. The dealer does not, nor does it have any incentive to, duplicate the underwriting process employed by the finance source. Although dealers who offer buy-here, pay-here financing in two-party financing transactions need to consider the risk of non-payment in determining the credit terms they offer to consumers (as no other person performs this essential function), the same does not apply in three-party financing transactions where dealers will not consummate a finance contract with a consumer until a finance source that performs underwriting has agreed to take assignment of it.

Accordingly, if the risk-based pricing requirements are to have any meaning at all, they must be imposed only on persons who engage in risk-based pricing, not those who do not. The agencies' creation of a regulatory scheme, as set forth in the Proposed Rules

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The agencies assume the opposite in an example set forth in the NPR's Rules of Construction analysis where, in the context of a three-party financing transaction, they state that "the auto dealer and the financing source or assignee may conduct separate underwriting." 73 Fed. Reg. at 28,985.

In the Proposed Rules of Construction, the agencies place the responsibility for issuing the risk-based pricing notice or one of the exception notices exclusively on the dealer notwithstanding their own recognition that: "An intermediary's decision regarding where to shop a consumer's credit application generally occurs before the material terms are set. Thus, at the time the application is shopped to various creditors, it is too early in the process to perform the direct comparison of material terms required by the statute, even if a consumer report influenced the intermediary's decision regarding where to shop the consumer's credit application" (Emphasis added). 73 Fed. Reg. at 28,973. In addition to the fact that dealers engaged in three-party financing transactions do not engage in risk-based pricing, this recognition explains why the risk-based pricing notice requirements are inapplicable to them. If: (i) the risk-based pricing requirements apply only to persons who use a credit report to grant credit on certain material credit terms, Proposed section 640.1(a)(1)(ii); and (ii) the dealer uses the credit report to shop a consumer's credit report before the material terms are set (which is "too early in the process to perform the direct comparison of material terms required by the statute"), how can the dealer use the credit report to set the material terms required by the statute? Clearly, it is the finance source and not the dealer that performs the function giving rise to this duty.

of Construction, flips the imposition of this duty so that persons who do not engage in risk-based pricing must issue a risk-based pricing or exception notice, while those who engage in risk-based pricing are relieved of this obligation. The result is inconsistent with the statutory mandate and should be corrected by the agencies when issuing the final rule implementing Section 311.

More specifically, the agencies should clarify that persons who do not engage in "the practice of setting or adjusting the price or other terms of credit offered or extended to a particular consumer to reflect the risk of nonpayment by that consumer" fall outside the scope of the risk-based pricing rules and thus are not required to issue a risk-based pricing notice or any of the exception notices set forth in the risk-based pricing rules. In addition, to assist dealers in the application of this clarification, the agencies should state that this clarification applies to dealers engaged in three-party financing who obtain credit reports but do not determine the amount of dealer participation based on the risk of nonpayment by the consumer.

In addition, the agencies should clarify that persons who do not obtain a credit report from a credit reporting agency before consummation of a transaction similarly are not required to issue a risk-based pricing notice or any of the exception notices set forth in the risk-based pricing rules.

Assuming arguendo that the final rule retains the imposition of risk-based pricing requirements on persons that do not engage in risk-based pricing and continue to require motor vehicle dealers, as an original creditor, to perform this duty, the agencies should retain the exception notices subject to certain modifications and clarifications

Assuming the agencies conclude that imposition of the risk-based pricing requirements on motor vehicle dealers who engage in three party paper or three-party financing is consistent with the statutory mandate, the agencies should retain the exceptions set forth at Proposed sections 640.5(e) and (f). Regardless of the agencies' determination regarding the application of section 311 to three-party paper, they should retain these exceptions for dealers engaged in two-party financing who provide buy-here, pay-here

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Proposed section 640.6(b).

We recognize the perceived convenience of placing the risk-based pricing requirements on a single entity that has direct contact with the consumer before the transaction is consummated (which obviously is not convenient to that entity), but considerations of convenience are irrelevant if the arrangement is inconsistent with the language and purpose of the statutory obligation.

As the agencies acknowledge, the Credit Score Disclosure Notice only applies to persons who are "otherwise subject to the risk-based pricing notice requirement." 73 Fed. Reg at 28,990.

For a recent example of a joint final rule where the FTC and the Board, along with other federal agencies, clarified that a FACT Act requirement may not apply to certain entities, see Footnote 24 of the Supplementary Information to the Identity Theft Red Flags and Address Discrepancies Under the Fair and Accurate Credit Transactions Act of 2003; Final Rule, 72 Fed. Reg. 63,718, 63,724 (Nov. 9, 2007)("The Agencies anticipate that some financial institutions and creditors, such as various creditors regulated by the FTC that solely engage in business-to-business transactions, will be able to determine that they do not need to develop and implement a[n] [Identity Theft Prevention] Program").

See Proposed section 640.1(a)(1)(i), which sets forth that one of the conditions for the risk-based pricing requirements to apply is that the person "uses a consumer report" in connection with a grant, extension, or other provision of consumer credit.

financing. Retaining these exceptions, which permits persons to "provide this notice to all consumers in connection with loans that are not secured by real property, without performing a comparison of the terms offered to different consumers," 73 Fed. Reg. at 28,982, is essential to creating a regulatory scheme with which dealers can comply and with which consumers can receive meaningful information.

Because the exceptions permit dealers to forego having to issue risk-based pricing notices, we will not elaborate on the shortcomings of the methods set forth in Proposed section 640.3(b) for identifying the subset of credit customers to whom risk-based pricing notices must be delivered.

However, in general, dealers engaged in three-party financing cannot avail themselves of the proposed methods because: (i) in the case of the Credit Score Proxy Method, Proposed section 640.3(b)(1), dealers do not "set the material terms of credit granted, extended, or otherwise provided to a consumer, based in whole or part on a credit score," Proposed section 640.3(b)(1)(i)(as discussed above, this function is performed by the assignee-finance source); and (ii) in the case of the Tiered Pricing Method, Proposed section 640.3(b)(2), dealers do not "set the material terms of credit granted, extended, or otherwise provided to a consumer by placing the consumer within one of a discrete number of pricing tiers, based in whole or in part on a consumer report." Proposed section 640.3(b)(2)(i). In addition, given the multiple variables that exist in the vehicle financing arena, these methods would, in many cases, fail to identify consumers who receive materially less favorable credit terms than a dealer's other credit customers based on information contained in the consumers' credit reports. The dealers' need to move certain inventory, and other non-risk factors often create situations where consumers receive less favorable credit terms than other consumers with a weaker credit standing.

These methods aside, dealers do not maintain the necessary technology systems to conduct their own direct comparison of "the material terms offered to each consumer and the material terms offered to other consumers in similar types of transactions." Proposed section 640.3(b).[] Consequently, the only meaningful way dealers can alert consumers "to the existence of negative information on their consumer reports," 73 Fed. Reg. at 28,967, is to provide standard credit report information to all of their credit customers as provided in the exceptions. This provides consumers with useful information while providing dealers with a viable compliance mechanism.

Notwithstanding NIADA's general support for the creation of these exceptions, we believe there are several issues pertaining to them that require modification or clarification. Accordingly, we request the agencies address the issues below in the final rule implementing Section 311.

Application of the notice requirement to leasing

The statute and the proposed rule address extensions of credit and make no reference to leasing. Although the definition of "credit" at Proposed section 640.2(d) does not include leasing, in order to preclude the possibility of a contrary interpretation, we request the agencies state in the final rule that persons covered by the regulation are not

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[] The agencies correctly recognize that "[i]t may not be operationally feasible for many persons subject to the rule to make such comparisons between consumers…." 73 Fed. Reg. at 28,968.

required to deliver either a risk-based pricing notice or an exception notice to consumers with whom they enter into a lease agreement.

Timing of the notice

The exceptions appear to require persons to deliver the required notice only to consumers who will consummate a credit transaction as opposed to those who apply for credit but then withdraw their credit application or otherwise do not consummate the credit transaction. See, e.g., Proposed section 640.5(e)(1)(applying the Credit Score Disclosure Exception to “an extension of credit”); Proposed sections 640.5(e)(3) and (f)(4)(generally permitting the exception notices to be provided “at or before consummation of the transaction”). However, the language in the timing provisions, Proposed sections 640.5(e)(3) and (f)(4), could be interpreted to require delivery of the notice as soon as the person is capable of delivering it as it requires delivery “as soon as reasonably practical after the credit score has been obtained, but in any event at or before consummation of a transaction in the case of closed-end credit….” (Emphasis added). To remove any possibility that the timing requirement could be interpreted in this manner, we request the agencies establish in the final rule a safe harbor stating that the timing requirement is satisfied if delivery occurs “at or before consummation of the transaction.”

Range of credit scores, bar graph, and date the credit score is created

It is essential that the final rules clarify that persons who provide the Credit Score Disclosure Notice are only required to provide the range of possible credit scores, the distribution of credit scores in the form of a bar graph (or the alternative statement of how the consumer’s credit score compares to the scores of other consumers), and the date the credit score was created, Proposed sections 640.5(e)(1)(ii)(E), (F), and (G) respectively, if the information is provided to the person in the form it must appear in the notice by the credit reporting agency from which the person obtained the score. In other words, the agencies should state that persons making the disclosure have no independent obligation to locate, produce, or purchase this information but should merely serve as a pass through for it. If the bar graph will not be made available on a cost-free basis to persons who must deliver the notice, then those persons should not be required to include it in the notice. To do otherwise would impose a considerable burden on persons providing the notice that would outweigh any corresponding benefit to the consumer.

For the reasons noted by the agencies in the NPR, we do not believe persons relying on the Credit Score Disclosure Exception should also have to include in the notice the “key factors” affecting the credit score. See discussion at 73 Fed. Reg. at 28,983.

Persons that obtain a credit score from more than one credit reporting agency

Although the proposed rule addresses the receipt of more than one credit score in the context of the Credit Score Proxy Method, Proposed section 640.3(b)(1)(ii)(D), it does not address the receipt of more than one credit score in the context of the Credit Score

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 Allowing persons who must issue the notice to serve only as a pass through for the contextual information also avoids them having to determine the frequency with which the information must be updated.

Disclosure Exception. Because some dealers obtain more than one credit score and are unable to comply with the risk-based pricing requirements set forth at Proposed section 640.3, it is essential that the agencies clarify in the final rule these persons' disclosure responsibilities under the Credit Score Disclosure Exception. It also is essential that the Model Form at Appendix B-4 provides these persons with a simple and clear means to make the disclosures required under the Credit Score Disclosure Exception. For example, if dealers who use more than one credit score are required to disclose each credit score obtained, will they also be required to disclose the range of credit scores that relate to each disclosed credit score? Similarly, will such dealers be required to disclose a bar graph for each disclosed credit score? Such an approach would increase the burden on persons making the disclosures and also would likely generate confusion among consumers who receive them. To avoid these deficiencies, we suggest the final rule permit persons who obtain more than one credit score and wish to utilize the Credit Score Disclosure Exception to disclose only one of the scores and the additional information that provides context to it (e.g., the credit score range).

Persons that obtain a credit report but do not order a credit score

The NPR states that "a creditor that does not use a credit score in its credit evaluation process is permitted to rely on [the Credit Score Disclosure Exception] by purchasing and providing to the consumer a credit score and associated information it obtains from an entity regularly engaged in the business of selling credit scores." 73 Fed. Reg. at 28,982. Although uncommon, some dealers involved in three-party financing may order a credit report without a credit score. The agencies should excuse these dealers from the Section 311 notice requirement as requiring them to purchase a credit score every time a Credit Score Disclosure Notice is required would unnecessarily increase their burden and compliance costs and would overlook the fact that the finance source can provide the credit score it obtains to the consumer.

Other Issues

NIADA supports the agencies' determination that the risk-based pricing notice requirements should not apply to persons who use credit reports in connection with the provision of credit for business purposes for the reasons set forth by the agencies in the NPR. See 73 Fed. Reg. at 28,970.

Implementation Period

If the agencies conclude that dealers engaged in three-party financing must issue risk-based pricing or the exception notices, it is essential that they provide states with different notice requirements sufficient time to amend their laws to conform to the new federal standard. Because state legislative sessions may last for a full calendar year and it may not be possible to obtain conforming legislation during the current legislative session, we urge the agencies to establish a final compliance date that is at least 12 months after the date the final rule is published in the Federal Register. This period also is necessary to provide persons subject to these requirements sufficient time to produce the required notices and train their employees on the new notification requirements.

See, e.g., Cal. Veh. Code § 11713.20, which requires dealers to disclose the consumer's credit score but with different information contained in the notice.

Conclusion

NIADA appreciates the time and effort the agencies have devoted in trying to develop a workable regulatory scheme under Section 311. To that end, we believe the exception notices provide our members with a viable compliance mechanism provided the agencies can effectively clarify the implementation issues noted above. Nevertheless, as a threshold matter, we do not believe the agencies can overlook the fundament flaw in the proposed rule, which is its application of the risk-based pricing requirements to persons, such as dealers engaged in three-party financing transactions, who quite simply do not engage in risk-based pricing and do not use the credit report to establish the amount of dealer participation. Nor do we believe the perceived convenience of having the dealer, instead of the finance source, issue the risk-based pricing notice or one of the exception notices is a permissible scheme where the dealer does not engage in the activity that gives rise to the underlying statutory duty. We strongly urge the agencies to reconsider this critical issue and the approach they have taken in the Proposed Rules of Construction.

NIADA would like to thank the FTC for the opportunity to comment with respect to this matter. Any questions regarding NIADA's comments and the position taken herein may be directed to NIADA's General Counsel, Keith Whann of the Law Firm Whann & Associates located at 6300 Frantz Road, Dublin, Ohio 43017, (614) 764-7440 or via e-mail to whannassoc@rrohio.com.