>> Robert M. Ackerman: Good morning.

>> All: Good morning.

>> Robert M. Ackerman: My name is Bob Ackerman. I'm dean of Wayne State University Law School, and it is my pleasure to welcome you here this morning for what should be a very interesting round table. We are very, very pleased to be hosting the Federal Trade Commission. Indeed, we're very pleased that, this week, that there is a Federal Trade Commission and that it is operating. You know, here in Detroit, we've come not to take things for granted, whether it's the continued operation of the big three auto companies, the continued performances of our symphony, which just came back Saturday night after, oh, about a 7-month hiatus, or, for that matter, the operation of the federal government. So we're very pleased to have you all with us here. And of course, we think that Detroit is a very fitting place to hold a discussion of consumer-protection issues in motor-vehicle sales and financing. What you should also know is that our law school frequently serves as a convener of discussions on issues of public importance. This past semester, for example, we had three very interesting symposia on very different topics -- one, a symposium produced by our law review on the legal landscape 10 years after September 11th, a second one produced by our Program for International Legal Studies on the United States-Chinese economic relationship, and a third symposium just last week produced by our "Journal of Law and Society" on the school-to-prison pipeline. And so we enjoy being a forum for this sort of thing. We enjoy hosting lively debate -- lively and respectful debate on issues of current interest, and of course, this is such an issue. It's my pleasure to introduce David C. Vladeck, who is the director of the Federal Trade Commission's Bureau of Consumer Protection. While at the FTC, Professor Vladeck is on leave from Georgetown University Law Center, where he is, indeed, a professor of law, so he is very much in his familiar habitat here at the law school. He's taught courses in federal courts, government processes, civil procedure, First Amendment litigation, and has co-directed the Institute for Public Representation, a clinical law program at the law center, where he's handled a broad array of civil-rights, First Amendment, and regulatory litigation. In that sense, Georgetown

has something in common with Wayne Law in that we are the home of the Damon J. Keith Center for Civil Rights -- that's the source of the construction that you see at the west end of our facility here. Prior to joining the Georgetown faculty in 2002, Mr. Vladeck spent nearly 30 years with the Public Citizen Litigation Group, serving as its director from 1992 to 2002. He has handled a wide range of complex litigation, primarily in federal courts, has argued a number of First Amendment and civil-rights cases before the United States Supreme Court, and more than 60 cases before the federal courts of appeal and state courts of last resort. He's testified frequently before Congress, advised members of Congress on legal matters, and written on administrative law, preemption First Amendment, legal ethics, and access-to-justice issues. Mr. Vladeck received his undergraduate degree from New York University, his law degree from Columbia University School of Law, and an LLM from Georgetown University Law Center. In May 2008, the "Legal Times" of Washington recognized him as one of 30 champions of justice and one of the 90 greatest lawyers in Washington, D.C., over the past 30 years. It is our pleasure to welcome Professor David C. Vladeck.

>> David C. Vladeck: Thanks so much. [Applause] Good morning, everyone, and thank you, Dean Ackerman, for that kind introduction. And thank you again, Dean Ackerman and Wayne State University Law School, for hosting this event. It's sort of only fitting that we're here -- the Federal Trade Commission and this law school have very close ties. Our former general counsel Steve Calkins is a member of the law school faculty and is the associate vice president of the university. And a former FTC consumer-protection lawyer, John Rothchild, is a member of the law school's faculty and serves as the school's associate dean. So we think of Wayne State Law School as FTC Detroit, and we very much appreciate the university's hospitality. I'd really like to thank each of you for attending what we hope will be a spirited discussion about the consumer-protection issues in automobile financing in the United States. We've assembled a distinguished group of experts, and we are looking forward to hearing from them this afternoon -- this morning and this afternoon. We're also especially pleased at the turnout, given that, as of 11:00 p.m. on Friday, we had serious doubts we'd ever make to Detroit. So, why has the Federal Trade Commission convened this meeting? It's no secret America has a love affair with cars. There have been no divorces, to breakups, no flirtations with others. Our love affair with cars, which has been going strong for decades, is still rock solid. And the mobility brought about by car ownership is a key to

our nation's economic success. But cars are more than a symbol. In most of America, a car is a necessity. Without a car, a person may face difficulty finding a job, buying fresh food at reasonable prices, gaining access to healthcare, and even participating in the social and political life of America, from driving kids to soccer practice and Little League games to actually getting to the polls to vote. In short, motor vehicles are a valuable part of our lives. So it's only fitting that we begin our exploration of the consumer-protection issues in the sale and leasing of motor vehicles in Detroit, the Motor City, the heartland of America's auto industry. Now, for most consumers, the purchase of a car or truck is their most expensive financial transaction, except, perhaps, for the purchase of a home. And when purchasing a vehicle, many consumers use dealer-assisted financing. Now, financing at a dealership can provide substantial benefits to consumers. We understand that. But it also can be a complicated and, to the consumer, an opaque process. The round table's goal is to shed light on this process and to gain a deeper understanding of the consumer's experience when buying a car or truck. Now, our mission at the Federal Trade Commission is to ensure the consumers are not faced with unfair or deceptive acts or practices when buying or financing a car. That is our end. That is our mission. And we've brought numerous enforcement actions challenging, for instance, deceptive advertising by motor-vehicle dealers regarding the purchase, loan, or lease terms or cost, challenging deceptive advertising regarding add-on products, challenging auto-warranty issues through the Magnuson-Moss FTC Improvement Act, and challenging claims by auto-warranty robocallers. Just two summers ago, I think each person in this room received multiple robocalls about auto warranties. We've shut these people down. Now, as part of last year's Dodd-Frank Wall Street Reform and Consumer Protection Act, Congress gave the FTC increased authority over motor-vehicle dealers. As of July 1, 2011, the commission will have the power to promulgate rules applicable to most auto dealers. This round table is the first step in the process of gathering information about consumers' experience with motor-vehicle purchases and leases to see what regulatory or enforcement actions, if any, are needed. We are here to learn. The information obtained during this and future round tables will inform the Federal Trade Commission and help us determine the priority of the next possible steps to bolster consumer protection. And we have options -- increasing consumer and business education, bringing more enforcement cases, promulgating rules, or conducting other initiatives. Of course, the information we gather may also demonstrate that current enforcement efforts and existing regulations are sufficient to protect consumers. Again, we're here to learn. We're looking forward to hearing all points of view. As mentioned, this is the first of several round tables. Additional round tables will focus on issues we won't get to today, including the unique concerns faced by our service-men and -women when buying a car, whether consumers seeking to finance their purchases when buying a car faced discrimination under the Equal Credit Opportunity Act, and consumer issues associated with leasing a motor vehicle. I expect that today's round table will be an interesting and important first step in our listening tour. And without further ado, let me turn the microphone over to Joel Winston, who heads our Division of Financial Practices. Joel will moderate our first panel. Thank you so much.

>> Joel Winston: Good morning, everyone. If I could ask the panelists from the first panel to come forward. The first panel is entitled "Understanding the Motor Vehicle Sale and Credit Transaction, from Both Prime and Subprime Perspectives." This is more of a background to get us started, talk about how the process works, and then, with some of the later panels, we'll get into some of the more specific issues, in terms of the consumer's experience in buying and financing cars. I'm going to introduce the panelists, give you a short description of who they are. Their bios are in the packets for you, so you can see the details. I would ask the panelists to make sure you speak into the microphones when you speak. I guess the acoustics here are not perfect. But I'm sure, if you speak into the microphone, everyone will hear you. At the end, we're gonna try to save some time for questions. There -- A microphone -- There's a microphone here. I don't know if there's -- looks like there's nobody up there -- okay, nobody in the balcony. Also, there are question cards in your packets. If you prefer to ask a question anonymously, you can write it on the card and hand to one of the FTC people, and we'll be sure to get to your question. So, let's start. Let's see -- who do we have on the end there? I know Tom. Tom Hudson, at the far right, is partner at Hudson Cook, LLP, and chairs the firm. He has practiced consumer financial law -- financial services law since 1973, focusing on matters related to vehicle financing and leasing. Next, we have Tommy Moore, who is the president and a director and executive-committee member of the National Automotive Finance Association, a nonprofit trade group. He also serves as the chairman, president, and C.E.O. of First Investors Financial Services Group, one of the most successful and longest-running companies in the auto-finance industry. Next, we have JJ Hornblass, who is the executive editor and publisher of "Auto Finance News." In 2009, Mr. Hornblass formed the Auto Finance Council, comprised of automotive lending and leasing executives of companies responsible

for 40% of auto finance in the U.S. And we have Chris Kukla, who is the senior counsel for government affairs at the Center for Responsible Lending in Durham, North Carolina. The CRL is a nonpartisan, nonprofit policy and research affiliate of Self-Help, a community development lender. Mr. Kukla works with lawmakers and advocates in other states on consumer-lending legislation. Next, John Van Alst, who's an attorney at the National Consumer Law Center and directs the Working Cars for Working Families Project. His focus includes auto fraud, deceptive-practices law, rural issues, warranty, and manufactured-home issues. And last but certainly not least, we have Dave Westcott, president of Westcott Buick GMC Suzuki in Burlington, North Carolina. Dave represents North Carolina's franchised new-car dealers on the National Automobile Dealer Association's board of directors. He's been a new-car dealer since 1981, and he currently serves as chairman of NADA's Dealership Operations Committee and is a member of the Industry Relations Committee. As you can see, we have a very distinguished panel here, with a lot of experience in these issues. And I'd like to start by asking a general question, and anyone who would like to respond, probably the easiest thing is to put your card up vertically, your name card, and then I'll know that you'd like to talk. And remember to speak into the microphones. So, again, we're gonna be talking about the basic sale and financing transaction -- how it works. So, as background, there are different kinds of auto dealers out there that have been talked about. And the question is, who can describe the different kinds of auto dealers, who they cater to, and how they differ in their operations? Anybody like to tackle that?

>> Dave Westcott: Different kinds -- you mean from a franchise standpoint?

>> Joel Winston: Yeah, mm-hmm.

>> Dave Westcott: Well, I think there's 32 manufacturers of automobiles. Obviously, the demographics of each of those are different. Segments are different, not only pricing-wise, but, also, who they may cater to, from that standpoint. So on that...

>> Joel Winston: Well, we have new-car dealers. We have used-car dealers. We have...dealers who finance -- dealers still finance.

>> Dave Westcott: Okay, you're breaking down dealers -- the term "dealer."

>> Joel Winston: Breaking down the organization.

>> Dave Westcott: Okay, obviously, there's new-car dealers. Let me clarify -- I'm not an attorney. I'm a car dealer, the... [Laughter] ...maybe the only car dealer in the room. But the flak jacket I have on is -- it's covering. But, certainly, there's a lot of used-car dealers. Number-wise, there's 17,000 new-car dealers. That number has come down drastically in the last these years, and as I said before, obviously, the demographics of those manufacturers are quite different. And in the used-car standpoint, I would say 100% of the new-car dealers also are used-car dealers, from that standpoint. And so, do we compete with used-car dealers? Certainly, on a fair basis.

>> John Van Alst: And...

>> Joel Winston: John?

>> John Van Alst: I was gonna say, I could add a little bit to that. I think there's, you know, a little bit more of a breakdown. There's obviously the independent dealers who aren't franchised. There's the franchise dealers. We have "buy here, pay here" dealerships, many of whom are associated or even owned by owners of franchise dealerships or other independent dealers. We've got large dealerships, or actually publicly traded entities. We've got smaller dealerships. There's a wide variety. Unfortunately, we see a lot of the same abuses and the same practices between each of these dealerships. There are some that are limited to just a particular type of dealership, but there are many that occur throughout.

>> Joel Winston: And how does the -- this is kind of a general question, but if anyone wants to free-associate -- how does the consumer's experience vary, depending on whether they're dealing with a franchise dealer versus an independent dealer versus a straight used-car dealer? Is the experience different in buying a car?

>> Thomas B. Hudson: Joel, I'll take a little bit of a stab at that. The legal documentation doesn't vary particularly. I think it's probably fair to say that the less creditworthy the buyer it, the more investigation, background determining whether the customer is actually employed by the person who says he's employed with, verifying credit information -- that sort of thing probably takes a bit longer at an independent dealer if the customer doesn't have very good credit or at a "buy here, pay here" dealership.

>> Joel Winston: Anyone else on that? Yeah, Chris.

>> Chris Kukla: I would just add to that that I -- you know, the different dealers are gonna have different experiences, as Tom said, you know, based on the creditworthiness of the borrower. So, obviously, many of these dealers cater to different populations, and so the experience is gonna be a little bit different because of the nature of the transaction. Certainly, the difference between going to a franchise dealer or even an independent dealer, where it's a fairly straightforward, you know, traditional sort of lending agreement -- the "buy here, pay here" dealers are gonna be very different in that. So those two situations are gonna feel very different to the consumer.

>> Joel Winston: Can you explain what a "buy here, pay here" dealer is?

>> Chris Kukla: I'll take a stab at it, and then I think other folks can probably add to it. I mean, a "buy here, pay here" dealer is generally one that, you know, sells used cars. The financing is done through that dealership. It is in some cases transferred -- the financing's transferred to a third party, but it's usually an affiliated third party. The payments are made at the dealership. There are, you know, steps taken to ensure that the payments are made, whether it's the same -- I know we have a whole panel on that, so I won't get too deep into that, but the payments are made at that dealership, as opposed to a different lending transaction, where you're going to either do it through the dealer or directly with a lender of your choosing, or you're gonna make monthly payments and it's gonna feel a little more traditional. The "buy here, pay here" dealers -- the payments are much more frequent, usually either a week or two-week basis, and there are pretty stiff -- you know, the collections process is much different.

>> Joel Winston: JJ.

>> JJ Hornblass: I just wanted to point out that -- the size or distribution of the marketplace. The auto-finance sector is probably about $800 billion of originations -- of outstandings -- excuse me. And "buy here, pay here" is maybe $100 billion of that. And the vast majority -- the vast majority of auto finance is what would be called "prime," where the credit score is over, let's say, 620 or so -- 630. So it's just important to kind of break down, you know, where -- what we're talking about where these sectors, I think, are -- you know, they are smaller, vis-à-vis the entire marketplace.

>> Joel Winston: The one thing I'd like to focus on as you're answering is the difference between the prime and the subprime consumers and how their experience differs. What's the qualification process like for the prime versus the subprime, and are there issues that come up with one group or another, in terms of consumer protection? Dave?

>> Dave Westcott: Well, can I clarify -- or not clarify -- add to the "buy here, pay here." I do "buy here, pay here." It's part of our dealership. The goal of it -- I guess the underlying goal is that we offer that service to people that are credit-challenged -- not bad people, just bad credit -- with the goal that they, eventually -- or they'll have some transportation to get to work, to get a job, to get back into mainstream automobile financing. And nothing's more gratifying to see that somebody has paid that vehicle off and then we then have been able to put them into conventional financing, whether it be subprime or prime financing, just as an added to that.

>> Joel Winston: Okay. Tommy.

>> Tommy.

>> Thomas A. Moore, Jr.: Yes. Speaking to the differentiation between the credit sectors -- prime -- we look at it from an industry perspective -- probably four categories -- prime, nonprime, subprime, and deep subprime. I think industry definitions from -- at least from a credit-bureau standpoint in segmenting those -- the prime sector would probably be 680 and up credit-bureau score -- the nonprime would be 620 to 679. Subprime would be 530 to 619. And then deep

subprime would be 530 and below. The differentiation that we see -- and my company really focuses on the nonprime/subprime sector -- is going to be -- when you go through the sales process, I don't think it's that much of a difference -- and I'm really speaking only to franchise dealers, as well. That's where our sweet spot is. There's not really that much differentiation in the sales process. I think that it starts to diverge once you get into the finance office. And with a prime customer, they've proven, with their credit-bureau score, they have the cash-flow means to pay their obligations, and it's a fairly straightforward, easy transaction. As you go down the credit spectrum, there is much more validation that needs to be done by the dealer before he purchases the retail installment sales contract. Certainly, the same goes as he sends an application to a sales finance company or bank or credit union to buy the paper -- the amount of documentation and validation that needs to be done as you go down the credit spectrum is much different than in the prime sector.

>> Joel Winston: Okay. John?

>> John Van Alst: I wanted to add -- I think there's an important point to be made here, that not all this is related to creditworthiness, and when we talk about prime and subprime and different lending models and different dealership models, unfortunately, this is much like my experience previously in the mortgage business, as well. We had a lot of basically subprime loans and whatnot being made to prime folk, and we've got, in my experience, a lot of people who don't understand, don't know their current credit score and other things, and wind up at a "buy here, pay here" dealership thinking they have no other alternative. I know we're gonna have a panel later on dealer markups, but we see a lot of folks who have really good credit but, unfortunately, wind up with very bad credit terms not based upon their creditworthiness, but just based upon sort of the opportunity. We have a really inefficient market here that lacks transparency and, unfortunately, has some perverse incentives to get people into loans that aren't in their best interests and don't always perform as well as they should because they're -- got a lot of built-in costs that needn't be there.

>> Joel Winston: Yeah, let me -- [Clears throat] Sorry. [Coughs] Let me ask you specifically, John or Chris or anyone else -- there have been allegations, certainly, in the mortgage market of consumers who could qualify for prime rates, but, instead, get into subprime loans and get a much

higher rate. Is there evidence of that occurring in the auto industry? I know that we will have a panel on that somewhat later, but just sort of in a big picture at this point, is there any significant incidence of people who would qualify for a prime auto loan being put into a subprime loan without realizing it? Want to start, John?

>> John Van Alst: Well, depending on what you're -- I mean, I guess look at, you know, the -- what your definition of a prime and a subprime loan is. I would look at more the terms of what you're actually getting. And certainly, in some of the work that we did in some class-action cases regarding dealer markups, we saw folks with very good creditworthiness who wound up with really high-interest loans based upon a high dealer markup of their loan, even though they should have qualified for a much better loan. We also see, you know, both anecdotally -- I don't know if there have been any studies, but, you know, I've talked to a fair number of consumers who have good credit, went into maybe a franchise dealership and were referred to the "buy here, pay here" down the road without even really much of a discussion -- perhaps, based upon the way they looked or something else. And I think sometimes we don't realize that there's a real amount of profit to be made at the sort of "buy here, pay here" model. It's not always necessarily, as I say, unfortunately, in the dealers' best interests to get them into this prime loan at good terms. It oftentimes, unfortunately, is in the dealers' best interests to get them in a different loan.

>> Joel Winston: And just to emphasize, what we're gonna be looking for throughout this session today and future sessions is as much empirical evidence as possible. We've all heard stories and anecdotes and individual cases where consumers were mistreated in one way or another. One of the real goals of this process is to find out how prevalent those practices are. So if there are any studies, any sort of empirical data -- that's something we'd be interested in seeing. JJ?

>> JJ Hornblass: Yeah, well, actually, we did conduct such a study and tried to look at the degree to which -- we did a study on various aspects of the financing process, and so, one aspect that we looked at was what you're alluding to, which is the degree to which consumers understand the financing process. And we found that, overwhelmingly, it was the case that they understood. To the degree where -- and this was a survey that we did of dealerships under no guise of -- you know, no specific guise for them to have any -- to not necessarily give us the straight skinny, I guess, and

it was, you know, 75%, 80% of consumers came in, had a very good understanding of the financing process, according to the study that we did. And even the remainder had a fairly good understanding of the process. You could look at that in a number of different ways. You know, from my standpoint, I think that the overwhelming percentage of consumers seem to be pretty okay with what's going on, and so, you know, I just wanted to share that with you.

>> Joel Winston: Chris, would you agree with that conclusion?

>> Chris Kukla: No. [Laughter] And interestingly enough, we actually did a survey ourselves of consumers. So, rather than talking to the dealers about whether the consumers understood the process, we actually asked 1,000 consumers whether they -- and we asked some very specific questions. And one of the questions we asked was, "Do you -- Did you know that the dealer has the ability to increase the interest rate above that, you know, for which the finance company will buy the paper?" And 85% of consumers surveyed said they did not. And that's even though, in North Carolina, it's disclosed on the risk that says, "We have the right to do this," and there are signs in the dealership and everything -- yet, still consumers pretty overwhelmingly were unaware that this process occurred. And when we asked, you know, "Do you support this process or not?" they overwhelmingly said no. Now, it was a fairly quick survey, so we did not get into, you know, the back and forth on it, but it was pretty clear that, at least, in terms of understanding that part of the process, the majority of consumers didn't understand that. There's one -- I wanted to just jump back to one point. And I agreed a lot with what John was saying earlier. And I think it's important to know -- you know, to note that, as you go down the credit-score ladder, the number of direct outlets available to those consumers changes pretty significantly. If you're a prime consumer, you have a number of direct outlets. You can go to your bank, your credit union -- you can go to a lot of different places who are gonna compete and fight over your business. As you start to go down the credit-score ladder, particularly when you get into these subprime and deep subprime categories, the number of lenders who will make direct loans to you, that you can walk into, you know, an office or storefront and actually talk to somebody about making a loan, are pretty small. And so the dealer becomes really, if not the only, one of the only options available to those customers to receive financing. And so the dealer has a significant amount of influence over the terms and the availability of that credit. And I thought I would just say, when we were talking

about data, I mean, one of the reasons we were able to look at the data of, you know, folks receiving prime or subprime loans based on their credit scores, is because there's widely available data in the mortgage market. We have a number of laws and a number of regulations that require pretty significant disclosure of data in that marketplace. For car lending, the data's not nearly as robust. We've certainly, you know -- and I don't want to steal my colleague's thunder at all, 'cause he's gonna present some of the research we have, but one of the things that we found is, actually, piecing together data takes some time and can be somewhat difficult and it also doesn't always shed light on the kinds of questions that we're raising here.

>> Joel Winston: Yeah, and I don't want to get too deeply into the dealer markup, 'cause, again, that'll be part of a later discussion. But it occurs to me that maybe there's a piece of background information that would be helpful. Is there any estimate out there of how many consumers actually, when they finance, finance through a dealership, versus those who have independent financing? What would the number be?

>> Dave Westcott: I think that would vary by dealer. I could probably speak -- in my case, it's probably 70% of the consumers will finance through us indirectly. Can I clarify a couple points?

>> Joel Winston: Sure.

>> Dave Westcott: You know, the -- I realize I'm speaking to the choir here, 'cause everybody here, or probably most everybody, has bought an automobile or truck at some point in time. The way you buy it today -- I'm talking -- clarifying the sales process a little bit -- the way you buy it today is are you very informed. You've gone on the Internet. You've looked. You've talked to people. 15 years ago, you probably went to 10 dealerships to check their cars out. So I guess my point on that issue is that consumers are much more informed not only of the car, but in the entire process that exists to buy an automobile. I probably disagree with John a little bit -- maybe not a little bit, maybe a lot -- relative to taking a prime customer and putting them in a subprime loan. There's no advantage to that -- or putting him into "buy here, pay here." In "buy here, pay here," the dealer is at total risk. If I could finance a customer in a prime loan or a subprime loan that is controlled by somebody else, what's the old -- a bird in the hand is better than -- so the -- And I

won't get into the wholesale rate that you talked about, but it is a wholesale rate, not available to the consumer, so just three points. Thank you.

>> Joel Winston: Yeah, does anyone have data or any information about dealer financing versus independent financing? Tom, did you?

>> Thomas B. Hudson: No, I don't think so. I think the number I heard down there, the 70-30 split between cash deals for dealers and finance deals for dealerships sounds about right to me, but I don't have any empirical data on that.

>> Joel Winston: Others?

>> John Van Alst: I've seen data -- both industry data and a couple of other groups that have studied, that have looked at the deals that are actually financed -- I think around 79% are financed at the dealerships, so the originations actually take place at the dealership.

>> Joel Winston: Yeah, and one thing that -- I want to give you all a chance to make your points. But one thing that I'm curious about is the extent to which there really is a competitive process, where -- does the consumer really go through price shopping when considering financing and auto? Do they go out to the credit union or an independent lender of some sort and get some quotes and then compare them to what the dealer is offering, or is it more often the situation where the consumer doesn't do any of that sort of homework -- simply goes into the dealership and takes whatever the dealer is offering? JJ?

>> JJ Hornblass: Yeah. This was kind of part of our initiative, as well. And we found that they do. They absolutely are negotiating over price -- the vast majority, and to the point where probably close to the fifth of them -- a fifth of consumers -- a fifth of -- excuse me -- dealerships are finding that there is always a price negotiation involved. So I think that the -- it seems, from the research that we've done, that, indeed, there is a fair -- a good amount of price shopping that's taking place.

>> Joel Winston: By price, do you mean price of the car or financing?

>> JJ Hornblass: Price of the rate.

>> Joel Winston: Price of the rate. Okay.

>> JJ Hornblass: And I think, if you also look at just the spread of rates that -- on a national basis, rates are -- on the auto side -- are very low. I mean, the spread to benchmark financing rates is within reason. You don't have -- You don't have an inflated average rate on the auto side, versus other asset classes, certainly. So the pricing, from what I've seen, is good for the consumer, and from the research, appears that consumers are shopping around. I don't know if David has a different perspective when folks come into his dealership, but in aggregate, that seems to be the case.

>> Thomas B. Hudson: I might be going a little bit astray here, but I thought it might be worthwhile dropping back just a little bit to describe some of the things that, at least, I think occur in the F&I office, and I would defer to the dealers either in the audience or on the panel to correct me, but often, I think people believe that a Ford Motor dealership finances only through Ford Motor Credit. Typically, as I understand it, a franchise dealership will have four or five or six or seven sources of prime credit and these or four additional sources of subprime credit and may also operate a "buy here, pay here" operation at the same time. So a single dealer is -- can end up financing through a large number of different organizations. The legal theories that arise from that are different from the ones that might arise if, for instance, the Ford dealer only financed through Ford Motor Credit.

>> Joel Winston: Tommy?

>> Thomas A. Moore, Jr.: Yes, I would agree with what Tom just said. Dropping back on to the survey that was done on, "Does the consumer understand the markup that the dealer is given?" you know, I look that as a wholesale rate. It's like going in and buying a pair of blue jeans. You don't know what the retailer paid for it, but what the consumer does understand, and we have a strong -- we have two customers when we finance a car -- the dealer and, ultimately, the consumer. And

there is a very strong process, audit process, interview process with the consumer that we go through before we decide to invest in that retail installment sales contract. And what we have found -- the disclosure on the retail installment sales contract is very clear -- the consumer understands exactly the rate that they paid for the car. And I think that that's what is the most important is, do they understand what rate they're paying? By understanding that, it gives them the ability to go to the market and be able to shop if they feel that they're paying an above-market rate.

>> Joel Winston: Chris.

>> Chris Kukla: I think there's a few things wrapped up in this. I think one important distinction, again, is that I think that when we talk about -- you need to understand or remember the difference between what it's like to be shopping as a prime customer versus a subprime customer and the amount of -- the number of options available to prime customers are much greater than those who are subprime. So if you have, you know, a lot of different lenders competing over your business, offering -- you know offering you competitive rate, then you're gonna have the opportunity to shop or you're gonna have the opportunity to actually have an effective bargaining transaction. If you only have a couple of different outlets bargaining over your business, then, you know, the price is gonna be different. The amount of data that you have is gonna be very different, as well. I would say, you know, I've heard this analogy a lot about, you know, the wholesale rate -- it's like going into the retailer and, you know, paying for blue jeans. It would -- I think it's -- I think the analogy's a little different. I think it would be as if you walked into the retailer and there was no price on the blue jeans. And when I walk in, it's a $20 pair of blue jeans, and when someone else walks in, they may be $25 for that pair of blue jeans. The fact is, is that the price is different, and that's understandably so because, in a credit transaction, it's different than a commodities transaction. The commodity transaction is, this is how much the good is worth to me -- this is how much I'm going to sell it for. When you're talking about financing, the interest rate is there to protect against risk, and, ultimately, the interest rate is supposed to compensate the lender for the risk that each individual person presents to that lender. I mean, there are certainly credit markets where that's not the case, where everybody pays the same rate, regardless of their credit score, but in this market, we have, you know, a system where that's how it works. I think where this falls apart a little bit -- and we saw this in the mortgage market -- is that when you build compensation into rate, it's

impossible for the consumer to know, "What part of my rate is actually my risk, versus what part of my rate is actually the compensation for the person providing me the service of providing the credit?" And so when you talk about this notion of the blue jeans, you know, there are two things put into this -- into this transaction -- one is the service that's provided and the other is the risk that you project. And if you're gonna charge different rates and you're gonna have different pieces on that, then I think -- we think that it makes much more sense to disclose what part of the rate is compensation or what part -- or divorce it altogether. And we -- you know, the market panel will certainly talk about the incentives to that -- having the ability to increase or decrease rate bring and what that can do and how it distorts the market. But I think that that's really where it gets down to is that, built into this is, even in the wholesale rate, is the service that's being provided, and the customer really doesn't have any real ability to know what they're paying for that service and whether it's worth the cost to them.

>> Joel Winston: Okay. I would like to move on in a minute because, again, this is gonna be handled in more depth in a later panel, but, John, do you want to say a few things?

>> John Van Alst: Well, I'll actually make an attempt to move us on a little bit, as well, 'cause I'm -- I'll save my remarks about the rate for later on, since there will be a panel about markups. But more broadly, I wanted to address -- I think it's an important issue -- this sort of lack of understanding where I think we got into the discussion about markups in the transaction. And it was -- I used to work at legal aid for a long time and saw lots and lots of folks who came in and didn't understand their purchase and sales agreement, the financing agreement of their car, and so they sat down and talked with me. Now, even I didn't know whether or not they had been marked up or, if so, how much. That wasn't evident on the face of the documents. But, inevitably, it was the case that consumers didn't know they had purchased an add-on. They didn't know other -- They didn't know there was an arbitration clause and their risk. They didn't know all these sorts of things. And it's not just my -- we actually did a brief survey of practicing attorneys, as well, and they're reporting, you know, 70-some percent of the time, consumers come in and didn't understand the transaction they entered into when they bought the car in the financing. And I think that's important, you know, that a lot of these abuses -- you know, not just the dealer markups, but other, as well -- even after the fact, the consumer doesn't know that it's even happened to them. So it's

difficult to, you know, in terms of trying to collect data, it's difficult to go to the consumer if they don't even know -- they don't understand what their, you know, gap insurance they bought that they didn't realize they were buying was. They didn't know when their car got marked up -- all those sorts of things. One other point I wanted to make, too, in response to David's, you know, what would be the advantage of sending a prime customer over to my "buy here, pay here" dealership -- obviously, if you've got somebody who has prime credit and is gonna make the payments and you can get them in a very high-cost loan, where you're the lender and gonna reap all the benefits, there's a huge benefit to getting a prime person who's gonna make all these payments where there really isn't much risk into the higher-cost loan, so...

>> Dave Westcott: Doesn't happen, though. Wanted to move on?

>> Joel Winston: [Laughs] Tommy had his card up.

>> Thomas A. Moore, Jr.: Yes. I wanted to go back on a couple things. The first is the comment that there's limited options in the nonprime/subprime space. I don't see that as being the case. There are hundreds of companies. I wish that was the case. Having played there, I'd have -- wouldn't have the competition that I have. There are hundreds of companies that play in this space. There are very large banks, credit unions, and sales-finance companies, as well as the captives. That are captive finance arms that play in this space, as well. If you go back 10 or 15 years, I would probably believe that was the case, but there are many options available to the dealer, as well as to the consumer in being able to finance nonprime and subprime loans. The other is I would respectfully disagree completely with the bringing in mortgage into the auto space. I see no correlation between the well-written mortgage debacle and what's happened in the auto space. We can do surveys. Surveys sometimes can be biased. The ultimate test, to me, is go back and look at all the securitizations that were done in the mortgage space. They blew up because of all of the bad tactics used. Go back and look at the auto space. Standard & Poor's has issued a report on this. They've all performed very well in very adverse economic conditions -- matter of fact, there were only two downgrades during this -- during the Great Recession in the auto space. It just did not have the same abuses and problems that the mortgage sector experienced.

>> Joel Winston: I think we can all agree that we're not gonna solve the mortgage crisis on this panel -- probably not on a future panel, either. [Laughter] But here's my question -- I've never actually financed a car. Every time I've bought a car, I paid cash, and I have no idea what happens in the F&I office. Dave, you can tell me what it's like?

>> David Westcott: I think, as we start talking about the sales process, again, that customer has picked out a car or -- and the salesman at that same point, they're gonna somewhat qualify the customer relative to -- during that conversation -- of where you work -- not necessarily what your pay is. When it's time to -- if they have acknowledged they want to finance it, the F&I manager or business manager, as we like to call them, is gonna interview that customer more. "What is your budget? What are you trying to do? How much money are you gonna put down? Is there a trade-in involved? Is -- Has anybody -- Have we appraised that car?" So, with all those factors together, we're gonna try to make a determination, and, likewise with his credit report, what his FICA is. If it's an "A" customer, we're gonna see that right away. Now, if he's going to -- we may be challenged if he's trying to buy a $60,000 vehicle and he's -- it could get a complicated -- become a complicated process, but we're gonna -- basically, if it's an "A" customer, we're gonna funnel his application to two, three, four banks. We may ask if he has a preference who he's dealt with, and then try to get a very competitive rate for him to finance. If it is less than that -- it's a subprime, as we talked about -- it's gonna vary 'cause -- to give you an example -- I looked the other day. We deal with 30 -- our dealership deals with 31 finance companies. Of those 31, there's only five brick-and-mortar in my town. So the rest of those are someplace else in the country. So we're able to facilitate getting financing for that customer that he could not get on his own. He wouldn't have that availability. And I'm not talking about "buy here, pay here," just on subprime. So from that standpoint, we're gonna qualify that customer and try to direct that application to that financial institution that maybe specializes in that. I mean, there's even finance companies that will specialize in people that have been bankrupt or in Chapter 13 or various categories along the line. So then that's the beginning of that process that we would do.

>> Joel Winston: And what information do you get from the consumer as part of that process?

>> David Westcott: As much as we can. I mean, obviously, you can tell a lot from a credit bureau -- FICA score. You're gonna get his employment, how long he's been employed, or the industry that he's been employed with, along -- what his current budget is. And that's key, not only -- I mean, the bank wants to know all that information, certainly, which they can pick up from the credit bureau and the application, 'cause they have to make that decision. We don't make the decision on the loan. And so then we have to fit it within the parameters that the bank sends us back -- he needs to be at $350 or $400 a month. Maybe we've picked -- Maybe that customer or we've picked out the wrong car for him. Maybe this car is too expensive for what he may qualify for. So we're at the mercy somewhat of listening to what that bank tells us and then trying to get that customer an automobile.

>> Joel Winston: But I assume that, while you don't make the decision on whether the person qualifies, you do make the decision on to whom you shop the applications, right? Based on the information you have, you think, "These are the four lenders who might be appropriate for this consumer"?

>> David Westcott: Right. Right. I mean, absolutely right. We can't send a 520 FICA score to a prime lender, 'cause it's a waste of time, so we're gonna specialize on who specializes with that type of customer.

>> Joel Winston: And if I'm in the F&I office and I'm providing this information, do you ever tell me what rate I can expect, or do you simply say, "I have to go shop your application and see what I can get”?

>> David Westcott: Until we have all that data, we can't give you that information. We don't know it. In today's market, it's changed greatly. In those -- You can get a lot of the subprime companies that today have plenty of money, okay, and -- but next month, they don't have that same availability of funds. And so you can't base your decision today on what occurred a month ago with that same finance. So until we have that data, I can't give you a rate of what your financing would be.

>> Joel Winston: Until you actually shop the applications, you can't?

>> Dave Westcott: I can't give a prime customer a rate. I mean, years ago, could you do that? Certainly. But not in today's world and today's market.

>> Joel Winston: John?

>> John Van Alst: Yeah, I wanted to add a little bit to the discussion about what goes on in the F&I office. I think it's important to remember that, depending on whose numbers you look at, different industry sources have now reported that the profit coming from the F&I is anywhere from mid-30s or whatever up to over 50% of the dealer profits now. And I think that's -- customers, unfortunately, in this process, when they've been negotiating and through the process of buying a car -- David pointed out there's a lot more information out there about the pricing of the car itself these days for customers who have the ability to go look online and have the time to go investigate, whether it's new or used car, to understand with a the price of a good car should be. They've just spent several hours negotiating that, and they kind of, at that point, think they're, you know, to some extent home free, wind up going in the back office, in the F&I office, and don't realize that that's actually where a large part, or even a majority of the dealership's profits are coming from, and that's yet another big negotiation they're about to enter into without even knowing that that's what they're going to do. I think, you know, there are a lot of different -- from the discussion about the dealer markups to -- you know, we're gonna have to talk later about add-ons and all these sorts of other things. I don't want to steal anybody's thunder or go into all of those, but I think that general idea of understanding that -- you know, I've even talked to some dealers privately who have said, "I'd rather compete on the price of the car -- you know, get people into a good car at a fair price, but I can't do it when the dealer down the street is making most of his profits from the F&I. He can undercut me on price, and he can definitely advertise lower than me on price because he knows he's gonna make all the profits over there." And it really builds this sort of inefficiency in the market -- both the car-sales market and the financing market, and there's really a disservice to consumers and, I think, truthfully, in the long run, even to honest dealers, who want to do this the right way.

>> Joel Winston: Chris?

>> Chris Kukla: I just -- I actually wanted to -- I agree with Tommy that there are -- there are a number of lenders that are out there making loans in the subprime space. I think the difference is, is how do you get them? And I think, for the majority of them, you get them through the dealer. It's not -- again, not walking into a store independently, walking and saying, "I want --" you know, "I'm looking for financing for this car," like you would if you went to your credit union or your bank. It's -- The dealer is the one that's ultimately the gatekeeper, and they're the ones sending it out to the different financing agencies. The dealer is the one who has an enormous amount of discretion to decide what loan they're gonna present to you at any given time. And so, even though there are -- you know, there may be a number of lenders who they're sending this out to, ultimately, it's the dealer who has the discretion to decide which loan they're gonna present to the customer. And so, even though there may be a number of different lenders out there, because of the different incentives and just because of the way it works, again, the dealer has this ability to present a loan option to a customer that -- there may have been other options that the customer may have preferred, but those aren't gonna be presented to that customer -- not generally.

>> Joel Winston: And why wouldn't the dealer want to present the applications to those lenders who he thinks would be most appropriate for the consumer?

>> Chris Kukla: No, I think -- I don't disagree that that's appropriate. I think you would -- you know, obviously, as Dave said, you know, you're not gonna send a subprime customer to a lender that only deals in prime customers. I mean, that's not gonna make sense. What I'm saying is, is that you may get back a number of different offers of, you know, loans that will be available to that customer. The customer is not gonna know what those offers are. The customer's gonna know the offer that's being presented to them from the dealer saying, "This is the offer that we think makes sense." So there is an enormous amount of discretion, and with that comes responsibility. And I think where -- you know, I totally understand the mortgage market and the car market have had very different outcomes, but we've seen very similar practices in the mortgage market and the car-lending market, and the practices that led to significant issues in the mortgage market are some of the same that are in the car market, and those are the ones that we're concerned with.

>> JJ Hornblass: I just wanted to touch on what Chris is saying, and that is that, yes, it's through the dealership, but if you think that these hundreds of even subprime lenders don't want to get into that dealership and compete, it's absolutely the case that they do. The competition to offer products is intense. And so it's not necessarily that -- I don't think -- I don't think it's necessarily a self-selecting process, meaning that I do think that there is a tremendous push on the part of lenders to infiltrate dealers, to offer their products, to be as competitive as possible. This is a competitive marketplace. So, you know, whether, in aggregate, that means that, you know, there's probably analysis that needs to be done on that, but I think the bottom line is, is that there's, from my standpoint, a tremendous amount of financing that is available. And I think, you know, to David, if David wanted to, I'm sure he's got finance companies that are calling on him all the time. So the opportunities available from a financing side, I think, are substantial.

>> Joel Winston: Hudson?

>> Thomas B. Hudson: Back to your comment, Joel, about anecdotal evidence, I have no doubt at all that John and Chris see abuses all the time, but it bears saying somewhere along here, I think, that dealers are small businessmen and sometimes not-so-small businessmen, when -- with multiple dealership operations. But they are in the business of selling cars and car-related services. And some of those car-related services are things like gap policies, debt-forgiveness policy, service contracts, sometimes credit life, sometimes other after-market sorts of things. Those are legitimate sales. Unlike some in the room, I actually occasionally finance a car, and I just went through a financing process about two months ago -- sat down at a dealership, my local Annapolis dealership, bought the car, and was presented with a menu of other things that could I buy if I wanted to, with a description of how each item on the menu would affect whatever payment I had. We call that a menu sale -- a straight menu sale -- very straightforward, as transparent as it could possibly be. The -- An assistant who works in our office, in case you think I got this kind of treatment because I'm the lawyer and could actually understand what I was looking at, my assistant, a week ago, went through exactly the same process. She said it was one of the most enjoyable days she had ever spent every buying anything. I think it bears saying that the huge majority of car dealers in the country are honest small businessmen trying to run their dealerships correctly.

>> Joel Winston: Tommy?

>> Thomas A. Moore, Jr.: Yeah, I'll just -- I'll add to that, as well, and talk a little bit about a couple of things behind the scenes. First of all, there is a host of options available to the consumer in the nonprime/subprime space. You can go out online. You can go and apply directly online. Most of the nonprime/subprime companies that offer indirect lending to dealers also offer direct loans to the consumer. There is an agreement between any finance company and the dealer -- it's referred to as the dealer agreement. I pulled mine out and read it, and I think it's pretty similar to most used in the industry. And there is a page and a half of warrants and reps that the dealer makes when he sells that retail installment sales contract to a bank, credit union, or sales finance company. Those warrants and reps include everything that the dealer had responsibility of doing, including the car, but it also goes beyond that and he's making warrants and reps to the information that the consumer provided, as well. And if any of those are breached, it results in a repurchase by the dealer. So this isn't a situation -- he's just a broker, and he sells it, and once he sells it, he collects a fee, and he's off the hook. The dealer makes extensive warrants and reps, as to the car, the information collected from the consumer -- employment, income -- as well as warrants and reps to the entire transaction was in compliance with both state and federal laws.

>> Joel Winston: Let me move on to a different topic -- we don't have much time left -- the issue of what's often called "negative equity." When a consumer comes in and is trading in a car and actually owes more on that car than it's worth, how does that title get cleared? Dave, do you want to describe the process?

>> David Westcott: Negative equity -- even though the word is "negative," it's not a dirty word. In today's environment, there is more negative equity. I would venture to say that most people in the room, if you have financed, probably 80% of you have negative equity in your car, obviously meaning that your payoff on your vehicle is higher than what your -- what the actual value is. So, in years past, when the entire market and the entire economy was much better, there was more flexibility with that when somebody came in. In today's banking world, the banks want to finance pure equity or less than -- if your car is $30,000, they don't want to finance $30,000, as a rule. So, when you have a customer that you've looked at their trade and said, "Yes, you do have negative

equity" -- and in a lot of cases, they know. I mean, on every Internet site, you can plug in a number today and put in what your payoff is, and it'll tell you what the value is. "So, Mr. Jones, you've got $5,000 of negative equity that you basically need to come up with cash." It is -- I think it's a Federal Reserve rule enforced by FTC that we have to declare to the customer that there is negative equity, so that customer has an option. They can come up with more money or some portion of it, even disclosed, can be put into the next loan. Are they gonna pay more on a monthly payment? Certainly. But that is their choice. But banks today are going to allow that to be much less -- much less than it was several years ago.

>> Joel Winston: Tom?

>> Thomas B. Hudson: I was gonna make the point -- after some litigation, I think it was the late '90s that the Federal Reserve Board amended Reg "Z" to require a certain type of disclosure for negative equity. And in -- Since Reg "M" was revised, there is also a requirement under Reg "M" that you disclose a prior credit or lease balance. That's in the Fed's model form.

>> Joel Winston: And what does that disclosure look like?

>> Thomas B. Hudson: It's a number -- simply a number -- the amount due on the car that's in excess of its value.

>> Joel Winston: So you believe it's basically a transparent process, that the consumer understands how much of the negative equity they owe and how they're gonna go about paying it?

>> Thomas B. Hudson: Well, the comment was made earlier, when we were talking about the things that consumers do and do not understand that are in retail installment sales contracts and leases. I think that very few consumers actually bother to read the documents at all. Many refuse to read them carefully. So there's sort of a limit to what disclosure can do. I think it is certainly there for any customer who wants to see it. And I think customers are generally aware of the values of their cars and are generally aware of the balances they owe, so I think they understand the concept of negative equity.

>> Joel Winston: Anyone have any concerns about consumer protection, whether this practice creates any problems for consumers?

>> Thomas A. Moore, Jr.: I'd clarify --

>> Dave Westcott: To answer that, as a dealer, you know, dealers have millions of dollars invested in their facility, in their community. And our reputation, our continued success, or staying in business, is our reputation. So a lot of the things that sometimes are implied -- it's our reputation. You know, if someone -- If, for some reason, there's a car loan that -- has it been said in the past we charge too much money, that customer can refinance it, okay? I mean, it isn't the end of the world. So, but we don't want to gain that reputation. CSI -- the manufacturers reward us for good CSI in contests and so forth. So it behooves us as dealers to have the best -- try to please you as a consumer as much as we can. And so...

>> Chris Kukla: Addressing the negative-equity piece for a second, I mean, we do have some significant concerns, even though, you know, the transparency may be there -- that the amount of negative equity is listed on the risk -- just exactly how -- borrowers do understand how it works. And I think it's also important to just, you know, remember that this is -- you know, it's not as though the negative-equity piece is the only piece of this transaction that's going on. And I think it's important to, you know, recognize that there's a pretty big confluence of transactions that are going on at the same time, all within a fairly short period. I mean, the home-buying process, which is where, you know, we got our start -- I mean, it's the actual purchase of the home, negotiated the sales price versus, then, the financing -- takes place over, you know, matter of days, weeks, if not months. You know, the car-buying process can often take place in an afternoon, even though that's the second largest purchase and, for some families, the largest purchase they're gonna make. The negotiation on the sales price, the negotiation on the trade-in, the negotiation on the financing all are occurring separately. They're all different transactions. They all require a different understanding of data, a different understanding of what's going into those particular products. And so when we get to, you know, negative equity, it's important to remember that it's not just -- you know, you're not just sitting there, going, "Oh, you have negative equity. Okay. Now we're done."

It's part of a larger transaction. And I think the concern we've got -- we have a couple concerns with it. You know, one is simply the effect on the borrower that you're basically rolling in what you had on your last car into your new ride, and you're basically, you know, driving one and paying for two, and that can have serious issues. And the notion that you can refinance out of it -- you can if your loan-to-value is low enough, but if your loan-to-value is too high, there are a number of lenders who will just say, "Thanks, but no thanks. We're not gonna refinance this." And I know it's changed somewhat in the recent times, but I wouldn't necessarily say that the way that, you know, auto financing is gonna work now and forever is based on what's happened right now. I think things will change -- you know, things will change. Things will go back -- you know, a number of things will go back to what they were before. And so, you know, make no mistake that that's -- I think dealing with what we're dealing with right now is a mistake in saying that's how it's always gonna be. But the other piece of it -- and we've taken a look at some of the ABS offerings, as well -- is that it's difficult from an ABS perspective to really know whether the negative equity is actually involved in the transaction or not.

>> Joel Winston: Let me ask you just to play devil's advocate a little bit. Suppose the consumer really doesn't understand that part of what they're paying on is from the prior loan, but doesn't the consumer basically look at the bottom line -- "This is what I owe overall. This is what -- These are what my monthly payments are going to be," and make a judgment on that basis, even if they don't understand that some piece of that is actually from a prior loan? Why is that material to consumers?

>> Chris Kukla: Because, I mean, it changes the overall cost of the vehicle, first of all, but I think it's also, I mean -- and this is a problem, you know -- I see it as sort of a problem is that, you know, people tend to shop based on monthly payment, not on overall price. So they look at, "What's the impact gonna be on my monthly payment? What can I afford?" And so understanding what all goes in to that transaction, what that means longer term, "How much more am I actually gonna be paying on that vehicle?" You know, if you're doing it on monthly payment, it's very difficult to, you know, to connect the dots on that. And so, having all these different pieces within the transaction just make it that much more complicated.

>> Joel Winston: Tommy?

>> Thomas A. Moore, Jr.: Yeah. First of all, it doesn't change the overall price of the car. The consumer has the option of not trading that car in and writing a check and paying it off themselves. On -- From the finance perspective, it's not -- finance companies will allow a small amount of negative equity to be rolled in. Finance companies impose upon any approvals that they have a maximum advance rate, and that maximum advance rate's generally based upon the wholesale value of the car or the invoice price of the car. And it will range anywhere from 110% on 120% of wholesale or invoice. So if the negative equity is a large number, they cannot roll that in. It also -- I think this is old news -- 10 years ago, there were problems with it, but Tom made -- quoted the dates of when it had to be a disclosed item. It's disclosed -- Virtually any time someone finances a car, it's gonna have negative equity in the beginning of the loan, and people were trading in cars every two years that were going to be upside down. The car is gonna depreciate faster than the loan amortizes, and they have the choice of not trading that car in, not buying a new car, or paying cash for that upside-down amount, or rolling it into the new car. It's disclosed, and the consumer understands it.

>> Joel Winston: John?

>> John Van Alst: I just wanted to talk a little bit about this idea of the transparency of the negative equity and a couple other issues, as well. You know, I think there is a lot of -- unfortunately, as Chris pointed out, there are so many deals going on at the same time that there's a lot of play in terms of what the negative equity is, depending on what the trade-in value you're being given and what the supposed value of the new car you're buying is. I mean, we have a lot of problems with a practice called "power booking," where there are reported add-ons and features of the car which aren't really there, which would increase its value if there were there. You know, there are -- at least, in some industry magazines that I read, there are discussions that there's an increase in the level of sort of fraud on the lender right now. And I think there's a lot of -- you know, I'll beat up on anybody. You know, I think dealers have problems, and lenders do things wrong. Even if we talk about repossessions, I'll tell you that, you know, consumers sometimes can

be very violent and harm repossession agents. But I think all of this is to go to look at what we can do systemically to change the rules, to change the enforcement, to put a stop to these bad practices.

>> Dave Westcott: What's power booking? I didn't mean to interrupt you, but...

>> John Van Alst: Well, it's --

>> Dave Westcott: I'm new to this, but...

>> John Van Alst: Well, okay. I'm glad to hear it. [Laughter] It's when a dealer is reporting to a lender that there are features or options or other attributes of a car which would increase the car's value, but they aren't really there -- saying the car has a moon roof, leather seats, and whatever else -- lo and behold, the car doesn't actually have those things. Now, the lender, thinking that it does, has been willing to lend a larger amount, and that's where we get in this whole discussion of what the actual negative equity is. In addition to rolling over negative equity from the trade-in, there's, you know, what's the real value of the car you're buying? But I say all of that simply to say that, as Chris pointed out, there are all these transactions going on at the same time, and it's difficult for the consumer to sort them all out, and I think that's why we need to look at sort of what we can do systemically to try to address a lot of these.

>> Joel Winston: Let me follow up on that. And, again, I think there will be more discussion of this later on. But, so, what's the solution? Is it more disclosures? Is it better disclosures? Is it rules of what should be allowed and what shouldn't be allowed? You know, what...

>> John Van Alst: I agree with Tom that I don't think disclosure's necessarily gonna effectively work. I mean, right now, we have a lot of -- a lot of valuable disclosures, which, unfortunately, either the consumer doesn't see or doesn't read, you know. I had experienced this when I was back in North Carolina, where the consumer will --

>> Dave Westcott: Careful. Careful, now.

>> John Van Alst: I was there for a long time. We didn't go to Westcott Buick, or that I -- that I know of. But go and try to go to a dealership and get your truth-in-lending disclosure before you've actually signed your risk and see if they'll let you walk out of the dealership with it, as they're supposed to, to consider your credit option, and they wouldn't -- they wouldn't let you go out and sit down and think about the terms you were getting. I don't think there's one answer. I've actually -- I've put out a paper a couple years ago called "Fueling Fair Practices" with a number of solutions that would address a lot of these problems. I think there are a number of different answers, depending on which practices we're talking about. But I think, ultimately, we've got to do a lot to try to make the process -- stop these sort of incentives to give people, you know, the profit from doing the wrong thing. We've got to make sure that the dealers' incentives line up as best we can with the consumers' incentives, so that the dealer's not better off putting a consumer in a transaction that's bad for the consumer or bad for the lender. You know, we'll talk later on about markups. I think there's a great disparity of interest between the lenders and the dealers in these. You know, I mean, the dealer-marked-up loans perform worse. They're more likely to default. They really aren't in the lenders' interests, but as was pointed out earlier, there's a lot of competition among lenders to try to get dealers to offer their loans, and so they have to put these things out. I think the best -- we can make sure that the incentives line up to better protect consumers and dealers and everybody else, the better off we are.

>> Joel Winston: Okay, but let me focus just for a moment on negative equity. Suppose you do have a situation -- the consumer comes in. They owe more on the trade-in than it's worth. Absent disclosures, which -- apparently, there are disclosures -- maybe they could be better. But if that isn't the solu-- "What is the problem, and what is the solution?" I guess, is the question. If it's not telling consumers more or better about this situation, what would be -- what should be done? Dave, do you want to...

>> David Westcott: Well, in practicality, today, that consumer that comes in with that huge amount of negative equity, that we tell him he needs $5,000, $10,000 down, or it has to be put in the next loan, he isn't going to get the loan. The bottom line is, you know, this market's gone from $17 million to $12 million -- well, not only the financial end, but that consumer can't trade now. He -- The bank is not going to approve it. He can't handle that payment, okay? So he's going to

have to, rather than trade in every three, four years -- he may have to go six or seven years before he can trade or is in an equity position. So that's one. You know, even the power trading -- I'm not trying to make fun --

>> John Van Alst: Power booking.

>> Dave Westcott: Power whatever -- it sounds illegal to me, okay? [Laughter]

>> John Van Alst: It is.

>> Dave Westcott: There are already rules on the books, and things are illegal. So, you asked what to do. That is illegal, you know? I mean, if somebody practices that, put them in jail -- I mean, whatever the rules are.

>> I wish we could.

>> Dave Westcott: But adding more layers of regulation, obviously, from my standpoint, would not be the appropriate way.

>> Joel Winston: Chris?

>> Chris Kukla: Well, perhaps it's not layers, but, certainly, you know, maybe we have to look at whether or not the rules that exist actually are effectively deterring the practices that are going on. So you can say, "Power booking sounds illegal," but if it's still going -- you know, if it's going on, you know, somewhat unabated, then it shows that either the enforcement's lacking or there's the ability -- the ability to actually enforce those rules is difficult enough that it doesn't happen. I mean, I would say in the negative-equity context, I think, in a straight-up deal, if you have someone who comes in with negative equity and everyone's playing straight on the price of the car and the add-ons and all that stuff and then you get a loan-to-value ratio that's too high and, you know, the dealer knows no lender's going to will accept this loan-to-value ratio, then, you know, if that happens, then great. What we see, however, is not necessarily that straight-up transaction.

Somebody wants to make the deal work. And, you know, the dealer/owner may say, "It's my reputation on the line," but the F&I manager -- I mean, they're concerned about your reputation, but only to the degree that it, you know, helps the F&I manager to make money. If someone needs to make the deal work, there are a number of different ways that you can squeeze things around to make the negative equity, you know, pop into it.

>> Joel Winston: Are you saying that people are being -- consumers are induced into loans that they really can't afford? Is that the concern?

>> Chris Kukla: That may be -- I mean, that may be part of it, I think, and I think that is a part of it. I think the other piece of it, though, is that, you know, is, you know, that if someone wants to get that negative equity into the loan badly enough, there's a way to do that. And what ends up happening is what you said -- is that you now have this pretty significant portion of this car loan that is negative equity from the previous vehicle. It kind of starts to go in cycles. We're talking about, you know, this notion that people come in and trading in their cars every two years, that it's this, you know, transaction that they're wanting to get into. If you're talking about someone who's buying -- you know, who has to buy a cheap used car because that's all that they can afford and it's an eight-year-old car with 100,000 miles on it that breaks down in a year and a half or two years, they're not going into that dealership because they're, you know, looking to get the next, the new Cadillac. They're getting in because they need that transportation. And they've got negative equity rolled into it, and their choice is either they take the bus, if they have one, or they buy the car. And so I think we're looking at these transactions -- I mean, we -- You know, we see a very different client. You know, the folks that we talk to, the folks that we serve tend to be people -- tend to be a clientele that's very different. It's not someone who's coming in and just willingly buying the latest new model. These are folks who are trying to buy cars for transportation because, in most of the places, you know -- David knows this well -- in most of North Carolina, there is no public transportation. If they have it, it'll take you three hours to get to work. These are folks who are trying to get transportation to get around. They're not buying -- This is not a luxury purchase. This is a survival purchase. And so when you add in all these other practices that can go on, what negative equity may be appropriate for certain consumers, but for -- there's a pretty good,

substantial number of them for whom it's not. And yet, the deal can still be structured the same way. That's the concern that we have.

>> Joel Winston: Okay. We have about 10 minutes left. So, if there are people who have questions or comments, if you could go up to the microphone, and we'll get you on. In the meantime, a couple of you -- JJ, you had some...

>> JJ Hornblass: Oh, yes. I just wanted to say, first of all, I'm very sympathetic to the plight that Chris described for certain Americans vis-à-vis their car. It's sort of the reality of our transportation system and certainly is problematic for many Americans and deserves to be addressed in great sincerity. Vis-à-vis this issue, though, I did want to make a point related to something else that Chris said in terms of making the deal work. And I just wanted to point out that we are coming off one of the greatest financial calamities in our nation's history. And if you think that this notion is lost on lenders, you're -- it's -- you're wrong. The degree to which this circumstance has made lenders risk-adverse is substantial. So, when you're talking about negative equity, for example, it does boil down, as Tommy said, to the advance rate, and that is a number that I think it behooves all of us to watch. It's a mark of risk and risk appetite among lenders. Sure, it's totally possible that risk appetites could balloon among lenders, meaning that their underwriting guidelines could erode substantially. I think that is highly unlikely -- certainly not in the near term. I can't see it in the medium term. Even in the long term, it would be remarkable to me if you saw lenders completely, you know, throw up their hands and allow underwriting to just get out of hand. The experience over the last few years has been so substantial within auto finance, within consumer credit, within banking, that this notion of risk discipline is sort of ingrained on every lender's mind, and I think you see that in practice, as well. So I just wanted to point that out.

>> Joel Winston: Tom Hudson, you'd had your card up.

>> Thomas A. Moore, Jr.: Yeah. If the things that Chris discussed -- power booking, negative equity -- if all those things happened, we would see it in our loan pools. There is a strong correlation between the customer experience and loan performance. We also have two customers -- a dealer and a consumer. Before every loan is booked and virtually every company in the

nonprime/subprime space -- before we book a loan, there is a -- not an interview with the dealer -- an interview with the customer, and we go through the particulars of the loan. "How much money did you put down? What is your rate? What is your trade-in? How much did they give you for the trade-in? What is your employment? What is your income? Are you satisfied?" Even one of the questions I have on our questionnaire -- "Would you refer this dealer to one of your friends?" And if we find problems there, we don't fund the loan.

>> Did you car have...

>> Thomas A. Moore, Jr.: "Did your car have a moon roof?" [Laughter] We ask -- the equipment -- we ask those questions. So if those things are happening, they're not getting financed. And it's not only to protect the consumer, but it's also to protect us as an investor in that loan to make sure that we get the performance out of it. So our interest is very aligned with that of the consumer, and we have found in 23 years' worth of data, there's a very, very strong correlation between the customer experience and loan performance. And a little bit on what JJ said -- it's not just things have tightened up. Even if you look through the heighth of the credit boom, these loans performed very well. The auto space, by and large, had responsible lending. It was not -- It did not go astray, like in the mortgage industry, and I think the pools speak for themselves as to the case.

>> JJ Hornblass: Like I said, I was pointing out, even on the margin...

>> Thomas A. Moore, Jr.: Yes.

>> JJ Hornblass: Even on the margin, I don't think you see -- there's so little appetite to even move the dial a little bit on underwriting now. I mean, I think that that's just the perspective that lenders have coming out of the crisis.

>> Thomas A. Moore, Jr.: Maybe more disclosures -- that is one side of a retail installment sales contract, and it's front and back.

>> Joel Winston: Well, maybe we can all agree that more disclosures is probably not the answer to anything. [Laughter] We have a question. If you could identify yourself and who you're with...

>> Bill Brauch: Yes, I'm Bill Brauch. I'm director of Consumer Protection Division at the Iowa Attorney General's Office. We see a number of ads, particularly by franchise dealers -- "We'll pay off your trade, no matter what you owe." And of course, what, in reality happens is it's simply a matter of rolling it in, the negative equity, and the consumer...but the dealer doesn't pay anything. For John and Chris, are we seeing ads like that across the country? And for the industry folks, is there any circumstance under which that's a legitimate advertisement?

>> Joel Winston: Who would like to start?

>> Chris Kukla: I'll say -- I mean, I -- Certainly, I see it in the "News" -- you know, the Raleigh "News & Observer" all the time. So, I mean, I -- you know, as far as the proliferation of the ads, yeah, I mean, I think, you know, depending on how the deal's transacted is gonna depend on whether it's appropriate or not. But, I mean, I've often told folks in the presentations that I do that, if you see that advertisement, you know, run, 'cause, generally, that -- you know, it's all gonna get rolled into your loan. I mean, it's not gonna get paid off -- it'll get "paid off," but you're gonna be doing the paying off.

>> Dave Westcott: If they don't pay it off -- I guess we're going back to this program -- that's illegal, you know? I mean, they have to pay that car off. So, is it a little edgy? Certainly. You've not seen my ads that way.

>> Joel Winston: Tommy.

>> Thomas B. Hudson: Bill, it seems to me the one thing you'd have to take a look at is whether or not that dealer ever turned away anybody unable to finance their negative equity. If they did, that advertisement's simply false, and it seems to me that the A.G.'s office could bring an action for a false advertisement. I don't know why that's not already illegal.

>> Thomas A. Moore, Jr.: From an industry perspective, that's a big claim. I don't know how they could finance that in, with the caps that lenders are going to put on the amount that they would advance.

>> Joel Winston: Another question.

>> Paul Machin: I'm Paul Machin. I'm the regional sales director for DealerTrack in the Northeast. I represent -- actually, we support 14,000 stores. Walk in every day -- matters dealing specifically with this. I think we're talking about four different entities, and it's important to separate what we're talking about. We're talking about lenders, who have a vested interest. We're talking about the dealer, who has a significant vested interest. We have the consumer, which, for the most part, is very apathetic about most things that go on in their life, especially as it relates to financing. They don't take the time to really understand what the consequences are. They're about -- They're a Burger King society. They want it right now. And then we're talking about the business manager, who's actually in F&I, who's structuring the deal. So, within those four entities, where is the breakdown that you guys are looking for a solution? First, I think we need better education with our business managers. Kind of like Series 6, Series 7, some series strong licensing that needs to be done, both in matters of financing and in compliance, specifically to run the numbers in the F&I. The second thing is that there needs to be accountability from -- Mr. Westcott, been in your store. Great -- Great-run store, where you have people who have been there for a long time -- you have accountability. When you go a dealership and your F&I manager has been changed several times, your manager's been changed several times, there's a lot of challenges there. It's not the condition of the dealer -- it's more or less the condition of the market. And finally, when you talk about the consumer, I want you to introduce to you Mr. and Mrs. Treadwater. It's a new consumer. Used to be -- you said 619 was subprime. That's deep subprime now in a lot of cases. Most people today -- Mr. And Mrs. Treadwater used to be a 720. Since the credit scale has been changed, they're now a 619. But their mentality is they're still a 720. So they're coming in. The Internet is a very great parity on the consumer-buying process, and that consumer's coming in and challenging Mr. Westcotts and other dealers and saying, "You know, this is what I want," but they don't understand they can't get that anymore. So we need a much more -- transparency, as far as explaining to the customer, kind of like what you got, Mr. Hudson, on the menu presentation. So I think it's

important -- we need to separate what we need to go after, instead of just going after one individual party.

>> Joel Winston: Thank you. And can I ask just one quick question? The F&I folks -- are they paid on -- how are they -- are they paid a straight salary, or do they get...

>> Dave Westcott: I'm sure that goes all across the board -- I'm sure. It's some portion of salary and what they perform -- that office. Or a lot of cases -- and I won't get into specifics -- but a lot of cases, it's on the total sales department, also.

>> Joel Winston: Tom.

>> Thomas B. Hudson: In terms of customer understanding of the business and, for that matter, dealer understanding of the business, I spend a lot of time in front of dealer groups talking about compliance issues. And you go to the dealer association meetings and you hear them talking about loans and lenders, and you've heard nothing today except references to loans and lenders. In the typical dealer-financing transaction, there are no loans, and there are no lenders. There are retail installment sellers -- those are the dealers. They are retail installment sellers. They are engaging in credit sale of goods -- in exchange for their goods, they accept a promise to pay over time. They then assign that promise to pay over time, which is usually called a retail installment sales contract, to a bank or sales finance company. And you may think that's just pointy-headed lawyer differentiation between the transactions, and to a certain extent I guess it is, because, at the end of the day, they end up looking a great deal alike, but it really matters. It matters under state laws, which regulate these transactions differently -- loan transactions and retail installment sale transactions -- and it matters under federal law -- the disclosures are different for retail installment sales than they are for loan transactions. There is a document available out in the lobby -- if you didn't pick it up on the way in, you ought to get it on the way out. It's called "Understanding Vehicle Finance." It's a combined product of NADA and AFSA, the American Financial Services Association, and it has the FTC seal of approval on the back. They reviewed it before it was printed. It's not copyrighted. NADA legal staff has told me several times before that anyone can go on the Web, their site, pull it down, and print it. We tell dealers to hand it out to consumers all

the time, and we think it's a wonderful training piece for new employees for dealerships. But, you know, for the rest of the conference, maybe we could forget about loans and lenders.

>> Joel Winston: Okay, John, I'll give you the last word if you can keep it short.

>> John Van Alst: Oh, wow, that's a heavy --

>> Joel Winston: It's pretty tough -- I know. [Laughter]

>> Make it good.

>> John Van Alst: I actually just wanted to reiterate or support what was said in terms of turnover within the F&I department -- I think that's been a been longstanding problem in the broader dealership world, that there seems to be -- I don't really understand why personally, but there seems to be, in particular, in that part of the dealership, a lot of turnover. So having sort of consistency in people who understand and can shepherd consumers through the process effectively -- perhaps that might be something of a deficiency there.

>> Joel Winston: Thank you. We're almost exactly on time, which is amazing. We really appreciate all of you for coming and having this terrific discussion. And we're gonna take a break for 15 minutes. Be back at 10:15. [Applause]

>> Very good.