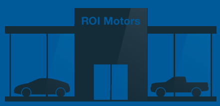
Dealertrack

# Compliance Guide

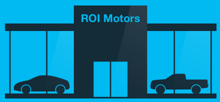
2016



# We have you covered.

**With Federal and State agencies taking aim at dealers and imposing more and more harsh penalties for compliance violations, it can feel like dealers are always under attack.**

**As your ally, we offer you this Guide to arm you with information to help you comply with current Federal rules and regulations, so you can better protect the future of your business.**



# Table of Contents

—
# What's New?

2015 was a difficult year for auto dealers in the compliance arena. Federal and state agencies took dead aim at dealers for compliance violations, frequently by bringing enforcement actions for practices which arguably are not expressly prohibited by agency rules or prior consent decrees. This "regulation by enforcement" occurs when regulators take general obligations and prohibitions and apply them in new and different ways. Previously announced agendas against auto dealers were also enhanced by new actions that brought with them large penalties and threats to established ways of doing business.

In 2015, the Consumer Financial Protection Bureau ("CFPB"), an independent federal agency created by the 2010 Dodd-Frank Act, increased its activity to enforce federal consumer credit protection laws into the area of indirect auto finance by furthering attempts to indirectly regulate auto dealers. While franchised auto dealers are not subject to the supervisory, enforcement, or rulemaking authority of the CFPB, the CFPB initially sought to indirectly regulate indirect auto finance practices in its March 2013 Indirect Auto Finance Guidance ("Guidance"). In 2015, these efforts continued in the aftermath of several 2014 consent decrees with national banks for alleged "disparate impact" credit discrimination in their portfolios that the CFPB claims resulted from the finance sources' "policy" of allowing dealers to markup buy rates. 2015 consent decrees capped dealer rate participation at 1.25% (125BP) for credit terms of up to 60 months and 1.0% (100BP) for credit terms greater than 60 months.

The Guidance concludes that dealer buy rate markups frequently discriminate against protected classes of persons under the Equal Credit Opportunity Act ("ECOA"), most notably minorities and women, and that finance sources that buy such paper and who are within the CFPB's jurisdiction can be liable for the resulting credit discrimination under a so-called "disparate impact" theory. "Disparate impact" occurs when a facially neutral policy such as a dealer marking up a "buy rate" results in a statistically significant disparity in the treatment of an ECOA protected class when compared to other customers whose credit profiles are similar but who are not in protected classes. Intent to discriminate is not necessary to find discrimination under this theory. The Guidance does not have the force of law but illustrates the CFPB's approach, i.e., that finance sources effectively monitor and police for discriminatory rate markups on purchased contracts or alternatively compensate dealers through flat fee pricing instead of dealer rate participation. In the aftermath of the Ally Bank consent decree in December 2013 and the 2014 supervisory resolutions, many large finance sources have sought to comply with the Guidance by requiring dealers to implement ECOA/Fair Lending policies and have begun to monitor buy rate markups on similarly qualified persons that could indicate a "disparate impact" on persons who are protected under the ECOA. A number of finance sources ceased doing business with dealers that they concluded were marking up buy rates in a manner disproportionately adverse to certain minorities, including women and Hispanics.

In July 2015, the CFPB and Department of Justice (DOJ) entered into a consent decree with Honda American Motor Finance Company ("Honda Finance") settling claims of credit discrimination. This consent decree required Honda Finance to cap dealer markups at 1.25% for contracts with terms up to 60 months and 1.00% for contracts in excess of 60 months and required Honda to pay $24 million in customer reimbursements, but no fines or civil money penalties. This followed a similar consent decree in May 2015 between the CFPB and the DOJ with Evergreen Bank Group, an indirect motorcycle financier. Honda Finance was given discretion to supplement dealer rate participation compensation with flat payments or performance incentives for dealers but not on a contract by contract basis. In fact, Honda Finance announced it would supplement dealer markups by 1% of the amount financed. Effectively, the settlement simply moved 100BP of dealer compensation from rate participation to a markup of the buy rate to compensate for the additional compensation to the dealer. Consumers will pay the extra compensation in the form of higher buy rates.

This settlement was made in the aftermath of a U.S. Supreme Court ruling in a case challenging the viability of a disparate impact claim under the Fair Housing Act ("FHA"). In that case, the Court ruled that a disparate impact cause of action exists under the FHA but did not address the Equal Credit Opportunity Act ("ECOA"), the law under which auto finance sources have been pursued and which contains materially different language than the relevant portions of the FHA. The Supreme Court also made it harder to bring a "disparate impact" case by ruling that statistical correlations were insufficient and there must be "robust causality" between the complained-of policy and negative terms impact on ECOA-protected classes (race, color, religion, national origin, sex, marital status, age, receipt of public assistance or prior pursuit of consumer protection laws). Nonetheless, the CFPB seemed energized by the Supreme Court's decision and increased pressure on finance sources to police dealers' markup practices. Whether the Honda Finance consent decree becomes a template for other captive and non-captive lenders remains to be seen. Fifth Third Bank, a non-captive lender, entered into a similar settlement with the CFPB and paid $18 million in consumer reimbursements with no fines or civil penalties on September 28, 2015.

In addition, the CFPB substantially expanded its authority over auto finance sources in August 2015, when it finalized a "larger participant" rule giving itself supervisory, enforcement, and rulemaking jurisdiction over approximately 34 non-bank auto finance sources collectively representing over 90% of the non-bank auto finance market. In this larger participant rule, the CFPB also asserted that consumer auto leasing falls within the definition of a covered consumer product or service. This despite the fact that the definition of "lease" under the Dodd-Frank Act only covers leases that are the functional equivalent of purchase finance arrangements. Consumer closed-end auto leases are not the functional equivalent of purchase finance arrangements, but no matter. It appears the CFPB is attempting to interpret the law to bring typical consumer closed-end auto leases within its jurisdiction.

In its examinations of large finance sources, the CFPB was also reported to be drilling down to obtain information about specific dealers for possible referral to the Federal

Trade Commission ("FTC"), the DOJ or State Attorneys General ("AGs") for possible law enforcement actions against the dealers. While no widespread movement to flat rate pricing occurred in 2015, our first chapter will discuss the credit discrimination issue and CFPB risks to dealers in more detail and suggest some best practices for dealers to address the issues raised by the CFPB. The affirmative entry of the CFPB into the area of indirect auto finance unquestionably changes many of the ways dealers will want to protect themselves from the other regulators with which the CFPB is sharing information from finance source examinations and investigations. It is also advisable for dealers to consider the CFPB's focus on transparency and fairness to consumers in all aspects of credit transactions.

The CFPB also indicated it was investigating aftermarket product sales for possible unfair, deceptive, or abusive acts and practices ("UDAAPs") that could violate the Dodd-Frank Act and also result in finance source liability for dealer activity. The CFPB brought a number of enforcement actions and entered into consent decrees involving aftermarket products in other consumer financing areas, such as credit cards and mortgages. It recovered $6.5 million from a bank and its service provider who had deceptively failed to properly disclose all the fees charged to participants in the companies' Military Installment Loans and Educational Services (MILES) auto loans program, and for misrepresenting the true cost and coverage of add-on products financed along with the auto loans. While auto dealers are not service providers for lenders and companies often agree to things in consent decrees that may not reflect their actual legal liability, this consent decree reflects the CFPB's interest in collateral areas of consumer auto finance, such as aftermarket product sales and financing. It is likely the CFPB will continue to use its "finance source as liable for dealer misconduct" theory in 2016. Transparency and consistency in aftermarket product selling should be a priority for 2016 as well.

The FTC was busy in 2015 as well as it continued its crackdown on allegedly deceptive motor vehicle dealer practices, especially advertising. It announced "Operation Ruse Control" as a follow-up to 2014's "Operation Steer Clear," a coast-to-coast review of dealer advertising and other potentially deceptive dealer practices in association with 32 law enforcement agencies. The FTC alone brought at least 14 enforcement actions and entered into 20-year consent decrees against each of the dealers involved who are located throughout the U.S. for advertising discounts and pricing that were not available to typical consumers. This makes a total of at least 32 deceptive advertising consent decrees the FTC has brought against dealers since 2012 with the FTC indicating that this is a priority area and more enforcement actions are in the works. Rebate stacking, where few, if any, consumers will qualify for all of the advertised rebates, was a particularly-cited violation along with failure to disclose Truth in Lending Act ("TILA") and Consumer Leasing Act ("CLA") triggered terms. If any of the dealers signing 20-year consent decrees are found by the FTC to again engage in any deceptive advertising (even if different from the advertising they were initially cited for), the FTC is likely to impose substantial penalties of up to $16,000 per advertising piece or online views of the deceptive advertising. In fact, it did so against two dealers who had entered consent decrees in 2012. One of these dealers—a 20-store group—was assessed fines and penalties of $360,000 for its repeat violation on an entirely different set of ads. The other dealer, a four-store group, was assessed an $80,000 penalty. State Attorneys General entered into hundreds of enforcement actions with dealers on advertising and other deceptive practices.

In another action brought by the U.S. Attorney and Department of Justice (DOJ), eight dealer employees of an Alabama dealership were sentenced to jail time for criminal violations in inflating consumer income and vehicle enhancements on credit applications submitted to national banks.

“Buying a car is a huge financial commitment, and people often calculate what they can pay down to the penny,” said Jessica Rich, Director of the FTC’s Bureau of Consumer Protection. “They should be able to depend on the dealers to provide truthful information, and they can depend on the FTC to enforce consumer protection laws on the lot.” The FTC described deceptive dealer advertising as a “significant problem.”

In another action, in 2013, the FTC warned 11 dealers in Arkansas that FTC staff inspections in Jonesboro, Arkansas found that eight dealers failed to display Buyer’s Guides on almost all used cars offered for sale, and three dealers failed to display the Guides on a significant number of used cars. Used Car Buyer’s Guides are required to be prominently displayed on any used car offered for sale. A year later, one of the dealers in Arkansas was still not affixing the Buyer’s Guides to used cars and the FTC entered into a 20-year consent decree requiring the posting of Buyer’s Guides and assessing fines and penalties of $88,000.

The FTC expressed its desire (although it did not require by regulation) that consumers be informed of and have the right to opt out of Internet tracking and online behavioral analytics. As the primary regulator for franchised auto dealers, the FTC is serious about using its authority to prevent unfair and deceptive acts and practices (“UDAPs”). The Dodd-Frank Act streamlined the process for the FTC to publish new UDAP rules against auto dealers. No longer does the FTC need to show that prohibited practices are “pervasive” in the auto industry before they can regulate them. Its new rulemaking authority no longer requires hearings or fact-finding studies and reports to Congress before new regulations can be adopted. The FTC is now able to issue regulations against auto dealers simply by proposing regulations, taking comments, and then issuing final regulations like most agencies under the federal Administrative Procedures Act. Nevertheless, the FTC seems to be following the lead of the CFPB and regulating by enforcement instead of by rule-writing. General standards of what “clear and conspicuous” require are used to bring enforcement actions against ads that the FTC believes do not adequately or clearly and conspicuously communicate required terms and otherwise have a tendency to mislead the consumer. In many of the FTC cases, no actual complaints were filed but the FTC only needs to find in its discretion that an advertisement “is likely to mislead” or “likely to cause substantial injury” to consumers to be actionable.

The FTC continued to emphasize data security and privacy in 2015, and has now entered into 53 consent decrees with companies that did not adequately safeguard customers’ non-public, personal information. The federal courts’ Third Circuit ruled that the FTC is the agency with primary administrative authority over privacy issues. The FTC also became far more specific on elements necessary to be included within a compliant Safeguards policy to protect consumer non-public personal information from both internal and external threats and issued new guidance on this subject. These consent decrees also generally last for 10-20 years, require periodic certification by a third-party of the company’s Safeguards and Information Disposal policies, and subject the company to continuous FTC oversight. Several consent decrees imposed fines and penalties as well. The FTC has also ruled that inadequate data security practices are an “unfair trade practice” under Section 5 of the FTC Act. Any violation of the consent decree is a violation of Section 5 and subjects the company to potential penalties of up to $16,000 per day.

State Attorneys General now have increased enforcement powers under the Dodd-Frank Act and will be able to enforce certain federal as well as state consumer protection laws and regulations against auto dealers. For example, the New York AG recovered $13.5 million from a dealer group for allegedly engaging in payment packing, i.e., including the cost of optional aftermarket items in vehicle prices and making deceptive statements about such products—especially credit repair and identity theft protection products—sold to customers.

Credit discrimination, deceptive advertising, privacy and safeguards, and unfair and deceptive acts and practices should generally remain the primary focus of the CFPB, FTC, and State AGs in 2016. All are closely investigating the sale of aftermarket products and it is likely that 2016 will bring UDAP actions against dealers for deception and a lack of transparency in these sales as well.

This is our 11th annual edition of the Dealertrack Compliance Guide. It is current as of January 1, 2016. To keep you current and compliant throughout the year, we urge you to regularly visit our dedicated compliance website, **http://blog.dealertrack.com/compliance** for new developments, best practices and tips to keep your dealership from being the next newspaper headline. Our website contains articles, blogs, webcasts and other material to help your business. We also host free bi-monthly webinars on current compliance topics. You can sign up for webinar invitations by sending an email to compliance@dealertrack.com. You can also access this Compliance Guide online at **complianceguide.dealertrack.com** where we will periodically update the Compliance Guide to reflect major developments.

This 2016 Compliance Guide focuses principally on federal, as opposed to state and local, laws and regulations. It is intended for informational purposes only. Many of the issues discussed in this Guide are new or emerging in our Congress, administrative agencies such as the CFPB and FTC, legislatures and courts. Since laws and regulations are always changing, this Compliance Guide may not always be completely up to date. You should always review your dealership's specific compliance and legal situations with your local attorney or compliance professional, as this Compliance Guide is not intended to be individual legal or compliance advice.

We always welcome dealer comments and feedback on how we can improve our Compliance Guides to better assist you. Please send your views and comments to Randy Henrick, Dealertrack's regulatory and compliance counsel, at randy.henrick@dealertrack.com. Randy Henrick is the author of this Compliance Guide and will be grateful for your input and respond directly to your questions.

**Dealertrack Technologies, Inc.**
Randy Henrick
January 1, 2016

—

Chapter One

—



# The CFPB's Attempts to Indirectly Regulate Indirect Auto Finance and Pursue Rate Markup Credit Discrimination

## Background

The Dodd-Frank Act limits CFPB supervisory authority (think of this as authority to audit a company at any time for any reason or no reason) to large banks and credit unions having assets in excess of $10 billion and all lenders engaged in mortgages, student loans, and payday lending. The CFPB can also regulate "larger participants" in markets for other consumer financial services by promulgating a rule identifying the criteria for such larger participants. They have done so several times by publishing rules to supervise credit bureaus and collection agencies with revenues in excess of $7 million and $10 million per year respectively, among other entities. In August 2015, the CFPB finalized a rule to obtain "larger participant" supervisory authority over non-bank auto finance companies that generate, refinance, or purchase 10,000 or more auto finance contracts and leases in a year. This rule covers approximately 34 captives and other non-bank finance companies that control over 90% of the non-bank consumer auto finance market.

The CFPB is also asserting that consumer auto leasing falls within the definition of a covered consumer product or service. This despite the fact that the definition of "lease" under the Dodd-Frank Act only covers leases that are the functional equivalent of purchase finance arrangements. Consumer closed-end auto leases are not the functional equivalent of purchase finance arrangements, but no matter. It appears the CFPB is attempting to interpret the law to bring typical consumer closed-end auto leases within its jurisdiction by including a new definition of "leases" within the "larger participant rule" for auto finance providers.

Section 1029 of the Dodd-Frank Act denies the CFPB supervisory, enforcement, or rulemaking authority over auto dealers who finance or lease and service vehicles, have repair facilities, and routinely sell their retail installment sales contracts and leases to unaffiliated third-party auto finance sources. So while the CFPB does have jurisdiction over buy-here-pay-here and certain independent dealers, it does not have any authority over most franchised dealers.

This absence of CFPB authority over dealers was no doubt a large factor in the CFPB's March 2013 Indirect Auto Finance Guidance ("Guidance") and subsequent enforcement actions against auto finance sources based on the alleged misconduct of all dealers. The Guidance provides that finance sources that purchase retail installment sale contracts from dealers (over whom the CFPB has no supervisory and enforcement authority to the extent they meet the criteria for exclusion) are liable for ECOA credit discrimination arising from a "policy" of permitting dealers to markup wholesale lender buy rates. The ECOA prohibits discrimination in any aspect of a credit discrimination to persons on the basis of: (1) race, color, religion, national origin, sex, marital status, or age (provided the applicant has the capacity to contract); (2) because all or part of the applicant's income derives from any public assistance program; or (3) because the applicant has in good faith exercised any right under the federal Consumer Credit Protection Act. The CFPB indicated in the Guidance that if a statistical analysis of a lender's portfolio (either dealer by dealer or the lender's portfolio in totality (the latter being so-called portfolio-level discrimination) shows that protected classes are paying disproportionally more for credit than others similarly situated, the lender will be liable for civil penalties and restitution. As a result, the Guidance directs lenders to monitor and police dealers for potential credit discrimination and to adopt policies and procedures concerning dealer compensation that will minimize the risk of credit discrimination. The Guidance indicates that flat fee pricing to dealers is its preferred solution, consistent with the Bureau's belief that disparate impact credit discrimination is caused by dealer discretion to markup buy rates. The CFPB has and will continue to investigate lenders' portfolio-level discrimination as well as their monitoring programs for dealer discretion. "Portfolio-level discrimination" is not possible to avoid since a lender purchases contracts from hundreds if not thousands of dealers, all of whom have their own independent markup policies. Only flats to all dealers would solve this pseudo-issue.

In December 2013, the CFPB settled a disparate impact case against Ally Bank for $98 million. Ally settled not because it believed the CFPB's legal theories had any credibility but because they needed to settle to obtain regulatory approval of an enhanced charter that protected other businesses. Two finance sources that adopted flat fees are also believed to have done so for collateral business reasons and both took hits in market share from eliminating rate participation. In September 2014, the CFPB entered into confidential settlements with several additional finance sources, and in July 2015, the CFPB settled with American Honda Finance Company ("Honda Finance") by allowing dealers to mark up Honda Finance's wholesale "buy" rates but only by 125 basis points (1.25%) on credit terms up to 60 months, and 100 basis points (1.0%) on credit terms in excess of 60 months. Since the majority of Honda Finance's financing consists of subvented rates (like 0% financing), the loss in market share from going along with the CFPB may not cost Honda significantly and they paid a very low amount by CFPB standards ($24 million in reimbursements and no fines and penalties) to settle. Honda Finance has the authority to pay dealers a supplemental non-discriminatory payment and indicated it would pay an additional 1% (100BP) on non-subvented deals. This arrangement will cause Honda Finance's buy rates to be higher which may price many subprime consumers out of the market.

Fifth Third Bank entered into a similar consent decree with the CFPB on September 28, 2015. It too agreed to cap buy rate markups at 125 basis points (1.25%) on credit terms up to 60 months and 100 basis points (1.00%) on credit terms in excess of 60 months. Fifth Third agreed to pay reimbursements of $18 million with no fines or penalties imposed by the CFPB. Like Honda Finance, Fifth Third will have the option to provide a non-discriminatory supplement to dealers. Like Honda Finance, a portion of Fifth Third's portfolio consists of direct two-party lending in its home state of Ohio and this portfolio and practice is not affected by the CFPB settlement either.

**The Fallacy of the CFPB's Guidance** - There are many questions about the legitimacy of the Guidance starting with its theory of credit discrimination. Under the language of ECOA, only intentional credit discrimination (called "disparate treatment") is specifically prohibited. But the CFPB takes the position that ECOA impliedly prohibits credit discrimination under a theory called "disparate impact" which is derived from employment discrimination laws and works as follows:

- Focus on a credit practice not discriminatory on its face (e.g., a minimum income requirement)
- Application of the practice has a disproportionately negative effect on a protected class (in this example, this could be women who do not make incomes as high as men)
- Burden then shifts to creditor to show the practice meets in a significant way, the legitimate goals of the business*
- If the creditor can so show, the burden then shifts to the regulator to show that the business goals can be met by means that are less disparate in their impact (e.g., substituting debt-to-income ratio for a minimum income requirement)*
- There is no requirement to show knowledge or intent to discriminate by the creditor in a "disparate impact" case.

* The CFPB completely skipped these elements in the Guidance and gave them only cursory mention in its 2014 Supervisory Highlights.

The Guidance claims that dealer buy rate markups are a neutral practice that has a disparate effect on women and minorities. Since a creditor can't collect demographic information on customers in auto finance transactions like it can with mortgages, the CFPB used "proxies" to try to determine who among similarly-qualified customers are in a protected class and who aren't. Proxies are ways to try to guess who is in a protected class based on names and geography. The white paper the CFPB released purporting to explain its proxy methodology only confused the issue further since it admitted it cannot identify with precision who is in and who is not in a protected class. It uses a proxy called the Bayesian Improved Surname Geocoding ("BISG") proxy which has been criticized by statisticians as overstating minorities and understating whites, a conclusion which the CFPB confirmed in its white paper.

The way the proxy works is combining residential information from the 2010 census tracts which can be possibly as large as a 5-digit zip code or as small as a city block. If 80% or more of the persons in a given census tract are in a protected minority class, then everyone in that census tract is presumed to be in the protected class as well. Persons of Hispanic or Asian origin are identified by a list of surnames derived from self-reported census data and women are identified by first names that are supposedly not ambiguous. Such proxies can only attempt to replicate reality and an AFSA-commissioned study conducted by Charles River Associates using 8.2 million RISCs and leases for customers who had taken out mortgages and thus whose race and ethnicity were known, showed the BISG was wildly inaccurate, finding significant bias and high error rates. The BISG proxy only identifies probabilities which, for black Americans, can be as high as 75% off. It also overstated disparities and the amount of alleged harm by failing to take into account non-discriminatory factors such as geography, new versus used, length of loan, down payment, trade-in vehicle, credit score and competitive factors such as meeting or beating a competing offer. According to the American Banker, internal CFPB memoranda confirm that the BISG proxy overstates discrimination but the CFPB views that result as better than understating it.

The CFPB has not brought any finance source to court and the thinking here is that they won't because the U.S. Supreme Court has made the standard to win a disparate impact cause of action very high. The Court held that statistical correlations, which is all the CFPB has, are not enough to support a disparate impact claim. There must be a "robust causality" between a policy that is an "artificial, arbitrary, and unnecessary barrier" and the disparate impact. In 2012, the Supreme Court ruled that Wal-Mart allocating hiring decisions to local store managers that arguably had a disparate impact on women could not be imputed as a "policy" to Wal-Mart corporate. Independent auto dealers setting rates would probably not be imputed as a "policy" to a lender either. Finally, the ECOA's language does not even support a disparate impact theory based on the Supreme Court's 2015 Fair Housing Act decision. In a 5-4 decision, the Supreme Court held a phrase in the FHA "otherwise makes unavailable" refers to the consequences of an action rather than the actor's intent." No such language exists under ECOA which only prohibits intentional discrimination ("It shall be unlawful for any creditor to discriminate…"). The Supreme Court (as well as the Department of Justice) also affirmed that a legitimate business reason is a defense to a disparate impact case unless the CFPB can come up with an alternative practice that serves the same legitimate business interest. Making a profit was held by the Supreme Court to be a legitimate business interest.

Similarly, the notion of indirect auto finance sources as creditors liable for dealer credit discrimination seems to be inconsistent with the ECOA's Regulation B. Regulation B indicates that a lender "who in the ordinary course of business, regularly participates in a credit decision, including setting the terms of credit" can be responsible for a violation. But what involvement does a lender have in a spot delivery deal where the dealer sets all the terms of credit before the lender even learns about the transaction or sees the customer's credit application? Regulation B also provides specifically that a lender "is not a creditor regarding any violation… committed by another creditor unless the [lender] knew or had reasonable notice of the act, policy, or practice that constituted the violation before becoming involved in the credit transaction." Since disparate impact credit discrimination is not based on knowledge but is determined on the basis of statistical analyses done well after the fact, how can a lender be held liable under a disparate impact theory of liability as it would have no knowledge whatsoever of a dealer violation on an individual contract? A dealer is an independent business person, rate sheets are not loan commitments, and dealers don't act as agents for lenders in indirect auto finance. The CFPB tries to say the policy of compensating based on wholesale buy rate markups somehow provides the requisite knowledge or participation for the lender to be derivatively liable under Regulation B but it does not cite any authority for that proposition.

Finally, as noted above, there is no language in the ECOA that supports "disparate impact" or an "effects test" of liability. In 2005, the U.S. Supreme Court ruled that for an employment discrimination statute, Title VII of the Civil Rights Act, the authority for "disparate impact" came from the very language of the law, not a regulatory pronouncement that was not supported by the clear language of the statute. The same should be true under ECOA. No federal appeals court has validated a disparate impact claim under ECOA and the highly-respected D.C. Circuit has expressed doubt as to whether a disparate impact claim is viable under ECOA. The U.S. Supreme Court's decision under the Fair Housing Act relied on statutory language and Congressional history totally not present in ECOA. The focus on language addressing the consequences of an action ("or otherwise makes unavailable") rather than the actor's intent ("It shall be unlawful to discriminate") and Congressional history of amending the FHA in the face of nine Circuit Courts of Appeal finding the FHA supported disparate impact are not present with ECOA. No such language exists under ECOA and no Congressional history or Circuit Court decisions support a disparate impact theory under ECOA. It is apples and oranges.

Nonetheless, because of the Guidance and 2014 Supervisory Highlights repeating the CFPB's position and indicating finance sources had settled disparate impact claims on a confidential basis, many finance sources have taken action to follow the CFPB's direction to analyze, monitor, and take action against dealers whose rate markups to similarly-situated customers differ. Some lenders have also used "proxies" to try to identify members of protected classes and analyzed dealer rate markups to those customers versus similarly-qualified non-protected customers. No doubt many will use the CFPB BISG proxy software that has been discredited. Lenders have indicated they will monitor dealer rate markups for possible "disparate impact" findings and take appropriate action.

The CFPB has made clear its expectations of auto finance lenders to develop comprehensive Compliance Management Systems and to monitor dealers as well as to remediate for any disparate impact uncovered in its audits and reviews. Additionally, the CFPB indicated in the 2014 Supervisory Highlights as follows:

"Supervisory experience suggests that significantly limiting discretionary pricing adjustments—for example, imposing limits of 100 basis points, rather than the more common limits of 200 or 250 basis points—may reduce or even effectively eliminate pricing disparities. An institution that implements significant limits on discretionary pricing may find that it can significantly reduce certain compliance management activities, such as dealer-specific monitoring and discipline, to which the institution would otherwise need to devote significant attention and resources." Apparently the less quantitative discretion a lender allows to a dealer, the less comprehensive the activities it must take to monitor and police dealers. Hence the Honda Finance and Fifth Third Bank settlements.

To date, no lender has litigated with the CFPB on "disparate impact" discrimination under ECOA even though a lender doing so would have an excellent chance to win fairly quickly and get ECOA disparate impact as argued by the CFPB thrown out. Given the actions of lenders who are monitoring and evaluating dealer rate markup differentials on similarly-qualified customers, what courses of action represent best practices for dealers?

### A Dealer Strategy to Deal with the CFPB Guidance

First, all dealers should consider adopting, implementing, and monitoring compliance with an ECOA/Fair Lending policy that states unequivocally the dealership's policy to not discriminate in any aspect of a credit transaction. Training and monitoring transactions in which lender buy rates are marked up can be a part of the policy. One good practice developed originally by the Department of Justice in the two cases discussed at the end of this Chapter is to implement a consistent buy rate markup amount for all customers and negotiate the markup down only for significant non-discriminatory pre-identified legitimate business reasons that are documented in the deal jacket to demonstrate the legitimacy of the action should a lender or regulator audit the dealer's practices. This documentation should be a purely internal document and not something to give to the customer. It is documentation of your significant, nondiscriminatory business purpose to legitimize the lowering of a buy rate markup to one customer but not another. This approach is the foundation of the NADA-NAMAD-AIADA Fair Credit Compliance Policy and Program ("NADA Program") which closely tracks not only the approach of the Department of Justice but also provides a list of the specific reasons approved by the DOJ in the case settlements in which this policy was used by the DOJ to settle the two dealer disparate impact cases in 2007.

Examples of significant business reasons that justify differences in markups are many and you should consult with your counsel for legitimate business reasons applicable to your dealership. But using the seven reasons blessed by the Justice Department is the safest course of action. For example, if the customer has another offer of credit from a bank, credit union, or another dealer, meeting or beating that rate (your ECOA/Fair Lending policy should say whether you meet or beat and, if you beat, by how much) is a legitimate, non-discriminatory business practice. Document in the deal jacket the name of the other creditor and the terms of the competitive offer. You should be able to match or better it without being held to have committed credit discrimination.

Similarly, if a lender or manufacturer buys down a rate or an employee or promotional rate applies, those too are legitimate non-discriminatory business reasons and should be documented in the deal jacket. Lowering the buy rate markup as necessary to meet a customer's payment ability is another reason approved by the Justice Department that should be documented in the deal jacket. If the mark down is necessary to sell a vehicle that is aging in your inventory or the sale of which will generate a back-end incentive from the manufacturer, these too should be documented in the deal jacket as legitimate business justifications for the pricing that consumers receive. See the NADA-NAMAD-AIADA Rate Participation Certification Form published at the end of this Chapter for an example of how such a program would work. In each credit sale deal jacket, you will insert a form indicating either that you have utilized the dealership's standard rate markup (recommended to be 150 basis points or less) or indicating which of the seven legitimate business reasons approved by the Justice Department (or any others that you add upon advice of your attorney) as a justification for lowering the standard rate markup.

Dealertrack Compliance enables you to complete the Rate Participation Certification Form electronically and store it in a secure electronic deal jacket from which you can easily pull it up in the event of a lender or regulator audit. Doing this consistently on every credit sale deal is the best way to protect your dealership from a disparate impact claim from a lender, regulator, or plaintiff's lawyer.

Discuss other non-discriminatory business reasons with your local attorney that should support a rate markup differential as between two customers and make sure to document those reasons in every deal jacket when they come into play. The CFPB has informally indicated that an open-ended "other" reason is not acceptable because they believe such creates an opportunity for a dealer to discriminate on the fly and try to explain it after the fact. So a best practice is to develop an exclusive list of significant, non-discriminatory business reasons that justify deviating from the dealership's established buy rate markup policy. Then document from the list the factor that comes into play in a specific deal if you are not using the standard markup. And make sure your policy covers how much of a reduction each identified legitimate business reason will justify. You don't want to be accused of discrimination in the amount of the markup reduction.

When coupled with training, monitoring for rate deviations, and taking remedial action when none of the legitimate business reasons is identified, this practice best positions a dealer to be able to respond to a fair lending inquiry by a lender or regulator claiming "disparate impact" credit discrimination. It is important that you place a Rate Participation Certification Form in every deal jacket for every credit sale along with any supporting documentation as necessary indicating whether you applied the dealership's standard rate markup or used one of the pre-identified legitimate business reasons to justify a lower rate.

The Department of Justice affirmatively supported this approach during testimony at a CFPB field hearing on auto finance in Washington, DC on November 14, 2013. Steve Rosenberg, DOJ's Director of Enforcement, affirmatively stated the following:

"ECOA neither requires nor prohibits discretion in pricing. If you have discretion in pricing, you have a fair lending risk and need to manage around it. One way is to set limits on how much of an overage or dealer markup there can be… Identify when you can depart from the markup, identify what the justifications are. The one we hear most often is competition… Identify that as the reason, document it, keep it in your files and produce it" in an audit or regulatory review.

This is exactly what the NADA Program does in strict tandem with the Department of Justice's promulgation of this approach to manage the disparate impact risk in the two dealer disparate impact cases it settled in 2007.

While the Guidance and disparate impact credit discrimination under ECOA are rapidly-changing events, this seems to be the best way to set your dealership up to address the Guidance as it is being applied by lenders in the real world. Remember you also have the right to send your contracts to any of your lenders willing to approve the applicant. It is unlikely that many lenders will move to flat fee pricing as only two national lenders have done so. Both did so for other business reasons (to placate the CFPB or another regulator) and both have lost market share as a result. When a different lender attempted to go to flats a number of years back, it quickly lost volume and abandoned the practice. With over 1,900 lenders participating on Dealertrack, the likelihood of your finding lenders that continue rate participation is very high. Even a CFPB consent decree or regulatory resolution with a few large lenders should not eliminate rate participation in the market generally. There is no indication that any of the settling lenders are going to flats and Ally Bank has affirmatively stated its intention to not do so. Even the Honda Finance settlement shows that the CFPB has backed off its initial position that flats are the only permissible solution.

The CFPB is not the only federal agency seeking to enforce disparate impact credit discrimination against auto dealers. In September 2013, the U.S. Department of Justice ("DOJ") announced a $125,000 settlement with Union Auto Sales, Inc., a car dealership that formerly did business in Los Angeles, resolving allegations that it charged higher interest rate markups on financing to non-Asian customers—many of whom were Hispanic—than to similarly-situated Asian customers. Under the consent decree, if Union Auto Sales or its principal shareholder re-enter the business of car financing within the two-year duration of the consent decree, they will implement clear guidelines for setting dealer markup and pricing and establish appropriate fair lending training for their employees and officers. This settlement followed a DOJ consent decree with the lender who purchased the contracts. The DOJ drilled down to identify the dealership which supplied approximately 20% of the lender's contracts and apparently could produce no consistently legitimate business reason for Asian customers getting better rates than similarly qualified non-Asian customers. The CFPB has a Memorandum of Understanding ("MOU") in effect with the DOJ to share information on entities it believes may violate consumer protection laws such as the ECOA. The Union Auto Sales case came after the Federal Reserve Board had referred the lender to the DOJ following a Federal Reserve Board fair lending audit on the financial institution.

# Case Study

In 2007, the Department of Justice simultaneously filed complaints and consent decrees against two dealers in Philadelphia alleging that the dealerships had engaged in a pattern or practice of discriminating on a disparate impact basis against African-American customers by charging them higher dealer markups on auto financing, in violation of the Equal Credit Opportunity Act (ECOA). In the consent decree, the dealerships agreed to pay up to $457,731, plus interest, to African-American customers who were charged higher interest rates under this “disparate impact” theory.

In addition, the dealerships agreed to implement changes in the ways it set buy rate markups, including guidelines to ensure that the dealerships follow the same procedures for setting identical markups for all customers (the markup figures in effect became both a floor and a ceiling for all deals). The dealers agreed to charge a markup of 2.5% on deals of 60 months or less and 2.0% on deals longer than 60 months. Under the consent orders, only good faith, competitive factors consistent with ECOA could influence that process and justify a lower rate markup in a given transaction. The dealerships agreed also to provide enhanced equal credit opportunity training to officers and employees who set rates for automobile loans. Ongoing monitoring was also an important element of each consent decree.

The dealerships agreed to start all loan negotiations at these set markups and were restricted from lowering the markup except for “a good faith competitive reason that is consistent with ECOA.” The seven specific reasons cited in the consent decrees were the following:

- The lender’s restriction on rate markup being lower than the dealers’ standardized rate markup;
- A constraint on the customer’s ability to satisfy monthly payment requirements;
- An equal or more favorable offer from another dealer or lender;
- A special promotional offer extended to all customers on the same terms;
- The fact that the transaction was eligible for a captive’s or other lender’s subvented interest rates (a rate subsidized by either the lender or a third-party so that the interest rate the customer would pay is below the market rate that the customer otherwise would pay if fully marked up, such as a 0% APR program);
- The fact that the transaction was eligible for the dealership’s employee incentive program; and
- Documented inventory reduction considerations related to specific vehicles.

# Recommended Practices

1. Your Board of Directors or senior management group should adopt a dealerwide ECOA/Fair Lending policy and name a senior officer to be in charge of the policy if you have not already done so. The policy should state clearly the dealership's commitment to equal treatment and non-discrimination in all aspects of a credit transaction. Sales and F&I personnel who set prices or rates to consumers should be trained and tested regularly with respect to the policy. Monitor rate markups to ensure consistent application of the policy. Make the policy available to lenders who send you communications about fair lending issues and be prepared to show the affirmative steps your dealership takes to make fair lending a priority.

2. Like the Philadelphia dealerships, it is a good practice to begin all negotiations with a set rate markup amount both when quoting without customer credit (your first "pencil") and after submitting the customer's credit application to your lending sources. It is not recommended that you "size up" a customer and make an initial quote based on what you think the customer's negotiation skills are. Starting each customer with the same rate markup (and hopefully completing a large number of your deals at that figure or close to it) will provide good evidence of the absence of disparate impact pricing. It is critical that you monitor rate markups for similarly-qualified customers and if you observe material differences, speak with the dealership personnel involved and learn the reasons. Make redress to aggrieved customers if appropriate. Document your final rate markup on each credit sale deal – be it the standard rate markup or a lower rate based on the pre-existing list of legitimate business reasons – in the deal jacket using something like the NADA-NAMAD-AIADA Rate Participation Certification Form. Include supporting documentation if you are deviating from the standard rate markup. Doing this using an electronic service like Dealertrack Compliance will facilitate your ability to respond to auditors or inquiries from lenders or regulators.

3. The NADA Program adopts the seven reasons approved by the Justice Department in the 2007 settlements. Consult your attorney about a list of other significant, non-discriminatory, legitimate business reasons that can justify different pricing to similarly-qualified consumers. Use the list from the Philadelphia cases as a start although there may be other reasons that you and your attorney are in the best position to identify. Create a master list of qualified reasons to lower markup rates and limit your doing so to those reasons alone. Use a Rate Participation Certification Form or other document to indicate in each credit sale deal jacket whether you used the standard dealership markup rate or one of the pre-existing justifications for varying from the pre-established rate markup. This is an internal document only and should not be given to the customer. Every credit sale deal – whether or not it uses the standard markup or one of the pre-established justifications for deviating downwards from the standard rate markup – must be so documented in the deal jacket. This will be your best evidence in the event of a lender audit or regulatory inquiry and companies like Dealertrack can enable you to create the forms electronically which will make them easier to produce for an audit or review. If done properly, you will be able to show either that you treat all customers equally with the standard rate markup or that you had a legitimate business reason for reducing the standard markup which provides a defense to a disparate impact credit discrimination claim.

4. In the event you receive a notice or communication from a lender concerning fair lending, or a letter indicating the lender believes you have engaged in disparate impact credit discrimination, respond firmly by offering to show the lender your ECOA/Fair Lending policy, your deal jackets which show either the use of the standard markup or indicate the significant business justification for the rate reduction and the results and corresponding actions from your monitoring.

Challenge the lender’s finding and ask them to explain in detail how they claim to have identified persons in protected classes whether by using “proxies” or otherwise. Point out that they only get a small portion of your portfolio and cannot make such determinations from such a statistically insignificant sample.

## Additional Resources

Link page to recording of webinar and published slide materials of August 6, 2013 webinar on indirect auto finance presented by the Federal Reserve Board, the Consumer Financial Protection Bureau, and the U.S. Department of Justice
http://www.cfpbmonitor.com/2013/08/09/recording-of-agency-auto-fair-lending-webinar-available/

The CFPB’s Indirect Auto Finance Guidance and related materials:
http://www.consumerfinance.gov/pressreleases/consumer-financial-protection-bureau-to-hold-auto-lenders-accountable-for-illegal-discriminatory-markup/

2015 Fair Lending Report of the CFPB:
http://files.consumerfinance.gov/f/201504_cfpb_fair_lending_report.pdf

CFPB 2013 Auto Finance Guidance:
http://files.consumerfinance.gov/f/201303_cfpb_march_-Auto-Finance-Bulletin.pdf

NADA-NAMAD-AIADA Fair Credit Compliance Policy and Program:
https://www.nada.org/regulatory_affairs/faircreditlanding Dealer Participation Certification Form

# Example of a Dealer Participation Certification Form

Buyer(s) Name(s): JOHN SMITH

Assignee: XYZ BANK

Date: 08/27/2015

VIN: JH4TB2H26CC000000

Standard Dealer Participation Rate 2% Final Dealer Participation Rate 1.25%

If the Final Dealer Participation Rate does not equal the Standard Dealer Participation Rate, check the allowable deviation box below and fill in the corresponding blanks.

☐ Dealer participation limited by finance source

☐ Customer stated monthly payment constraint of $ ______ per month

X Customer stated competing offer by Town Local Credit Union (name) of 3.75%

☐ Customer qualified for Dealership Promotional Financing Campaign

☐ Customer qualified for subvened interest rate of

**Reviewer Certification**

I have reviewed the above information and supporting documentation and:

X certify that the Final Dealer Participation Rate complies with the ABC Dealer Fair Credit Compliance Program, or

☐ certify that I have initiated the corrective action noted below. % from __________________ (name)

☐ Customer qualified for dealership Employee Incentive Program

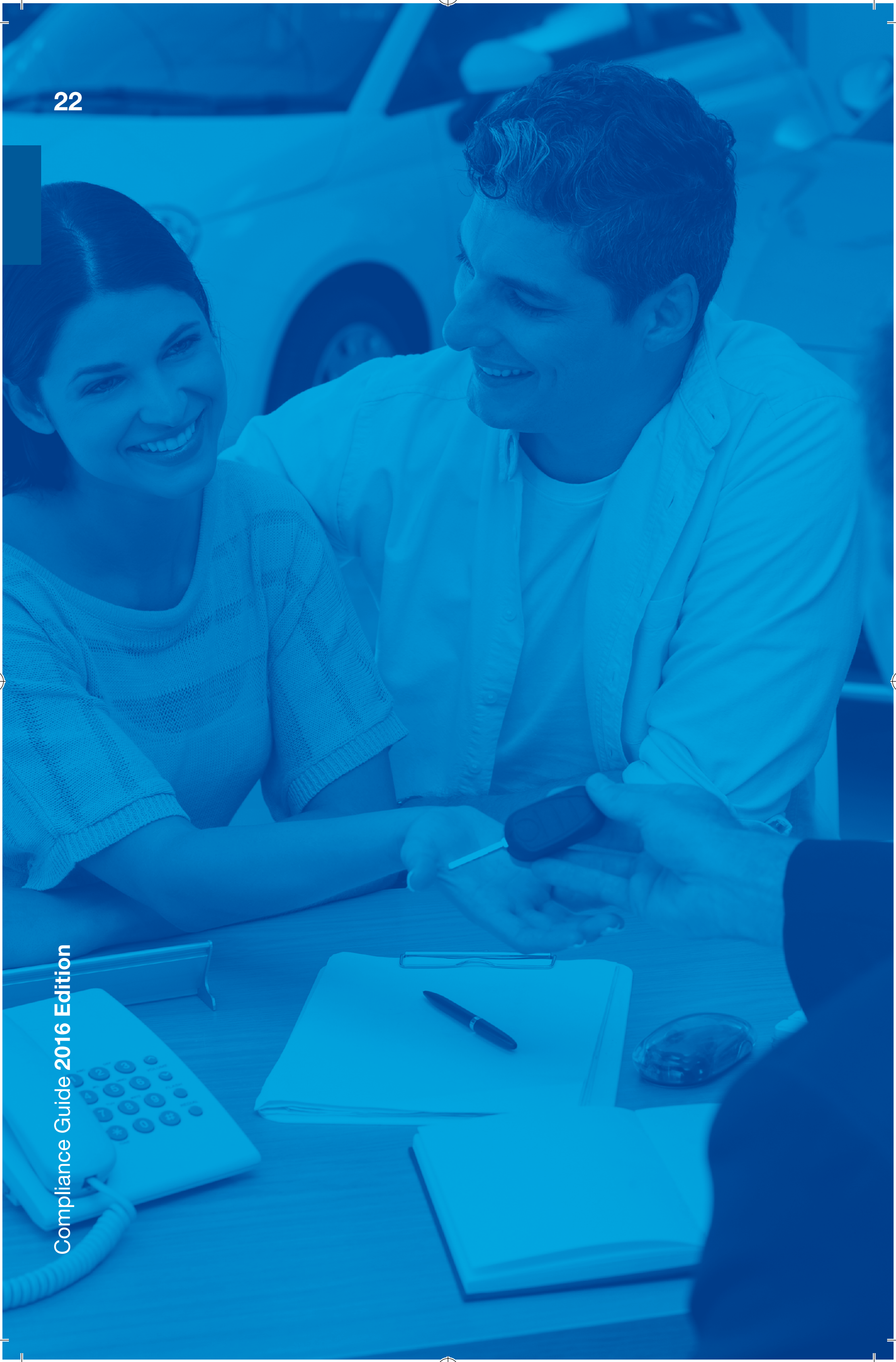
☐ Customer purchased a vehicle that satisfies the Dealership's predetermined inventory reduction

☐ Reduced the customer's interest rate to ____% or provided a refund to the customer in the amount of $____.

- Taken the following employee corrective action (describe):
- Criteria (describe how vehicle satisfies the criteria)
- Other (describe):

*I certify that the information above is true and correct to the best of my knowledge and that any deviation from the Standard Dealer Participation Rate was made in good faith and in a manner that is consistent with the requirements of the ABC Dealer Fair Credit Compliance Program.*

| | |
|---|---|
| ______________________ | 8/28/2015 |
| Signature | Date |
| ______________________ | 8/27/2015 |
| Signature | Date |
| Dave Wilson | ABC Dealer Fair Lending Officer |
| Printed Name | Date |
| Richard Harris | F&I Director |
| Printed Name | Date |



## Chapter Two



# Marketing and Advertising Vehicles and Credit Terms

## Background

This Chapter discusses laws, regulations, regulatory enforcement actions, and case decisions concerning marketing and advertising of vehicles and credit products as well as best practices to do so. Federal and state laws govern the methods and content of advertising and marketing in any medium of communication including the Internet and social media.

**Vehicle Advertising**

Since the 1960s, the FTC has exercised enforcement authority over false or misleading advertising and other wrongful activity under the authority of Section 5 of the FTC Act to prevent unfair and deceptive acts and practices ("UDAPs"). This law and its state counterparts are discussed in Chapter 5 (UDAPs). In 2014, the FTC revved up its enforcement of deceptive dealer advertising in "Operation Steer Clear," calling deceptive dealer advertising a "significant problem" and a "priority for the agency" with many more investigations in the pipeline. In 2015, the FTC took a larger step by partnering with 32 law enforcement agencies against deceptive dealer advertising and conduct in "Operation Ruse Control." Most legal challenges to advertising and marketing come within the ambit of deceptive acts or practices. For example, in June 2015, the FTC entered into a consent decree with two dealers for alleged deceptive advertising of the cost or available discounts for their vehicles. The FTC charged that the dealers violated the FTC Act by advertising discounts and prices that were not generally available to a typical consumer. Additionally, the FTC alleged that the dealer failed to make Truth in Lending Act ("TILA") and Consumer Leasing Act ("CLA") required "triggered" disclosures and misled consumers by indicating an advertisement was for "a purchase not a lease" when in fact the small disclosure below the ad indicated it was for a lease. One dealer was also charged with deceptive advertising of $0 at lease signing when in fact substantial fees of approximately $2000 were due at lease inception. Other FTC complaints charged that ads failed to disclose that "dealer discounts" and "Internet prices" required customers qualify for other discounts (e.g., military member, recent college graduate, etc.) and that even with these other discounts, the consumer would wind up paying a higher price for the vehicle than advertised. The FTC is aggressively challenging dealer advertising that does not conspicuously contain any qualifications to the prices advertised or indicate the vehicles to which the discount applies and does not apply.

Two dealers were hit for monetary fines and penalties for violating prior consent decrees from 2012 in which the dealers had advertised that they would pay off the consumer's trade-in vehicle, no matter how much the consumer owed. In fact, the dealers either financed the "negative equity" or required it to be paid off by the customer in cash. In December 2014, both dealers were charged to have violated the consent decree with different deceptive advertising, this being advertising low-cost headlines or banners while failing to conspicuously disclose material terms related to the low cost headlines such as needing to qualify for multiple rebates or making huge up-front payments, as well as failing to disclose triggered terms required by TILA or the CLA. One dealer group paid $360,000 in civil fines and the other paid $80,000.

The FTC looks at advertisements in totality from a "reasonable consumer: standard, meaning even if everything stated in the ad is correct, the ad may still be found to be deceptive. It does not require that any consumer complain of an ad. Most of the 10 enforcement actions in January 2014 when it began "Operation Steer Clear" consisted of FTC staffers trolling the Internet and uncovering these ads which it concluded were "likely to mislead" a consumer even if no consumer was actually misled.

The FTC announced a non-exclusive list of eight "to don'ts" in dealer advertising.

1. Deceptive pricing - An example being where the price does not include fees and charges other than tax, title and registration. In one case, a dealer lured prospective buyers onto the lot by advertising vehicles at a specific low price. But the advertised price was only after a $5,000 down payment, details of which were buried in a small-font footnote. The FTC complaint also mentioned that some of these ads involved a mix of Spanish and English.

2. Deceptive teaser payments - One dealer prominently advertised a new vehicle for $99 per payment, failing to disclose that after the first two payments, the payment amount increased to $525 for the remaining 70 months of the financing term.

3. Undisclosed balloon payments - Advertisements which state a low monthly payment without indicating a significant final "balloon" payment at the end of term are another example of deceptive advertising. A balloon payment is one that is more than two times the regular periodic payment. One dealer didn't disclose that buyers would owe a final balloon payment or the amount of the balloon—in this case over $10,000.

4. False $0 leasing payments - This is a particular area of concern with the FTC. All payments except tax, title and registration must be disclosed. If there are any fees or other charges due up front associated with a lease (such as an acquisition fee or doc fees), the FTC will consider a $0 down leasing payment ad to be deceptive.

5. Undisclosed lease payments - Similar to $0 down lease ads, if there are hidden payments, whether up front, during, or at the end of the lease term, the FTC will consider the ad misleading. Many states enhance this requirement by mandating that mileage limits and the cost for excess mileage use be included in the advertisement for a lease transaction as well.

6. Hidden rates - If a purchase or lease transaction contains the potential for a variable rate during the term, this must be prominently disclosed in the advertisement as well. In one case, the FTC charged that the dealer claimed to offer 0% for 60 months. But as it turned out, the rate only applied if people bought a new car for up to a certain dollar

amount—in one case, $12,000. If the car the consumer leased or purchased had a cost of say, $19,000, the buyer would have to pay a higher rate and that rate wasn't stated.

7. Bogus promotions or sweepstakes - One dealer mailed out scratch-off sweepstakes cards. Every card scratched off to be a winner yet no one was awarded a prize. The promotion was only intended to lure customers into the dealer's store and the FTC imposed a 20-year deceptive advertising consent decree for such deceptive advertising.

8. Failure to conspicuously advertise "triggered" terms under Truth in Lending, the Consumer Leasing Act, or Regulations Z or M - For a credit sale, if the amount of any payment, down payment, finance charge, or term is advertised, the ad must also advertise all of these plus the APR, using that term. For a lease, if the amount of any up-front payment, the amount of any lease payment, the lease term or backend lease payment (such as an open-ended lease) are advertised, then all of these terms plus the fact that the transaction is a lease and whether a security deposit is required must also be advertised. See "Credit Advertising" below for more detail on Truth in Lending and Consumer Leasing Act triggered terms.

All advertised terms must be "clear and conspicuous." The FTC has stated if a disclosure is not made clearly and conspicuously, it is the equivalent of not making the disclosure at all. In defining what constitutes "clear and conspicuous," the FTC announced the four P's: Prominence, Proximity, Placement, and Presentation.

**Prominence** - The type size and readability of any disclosures and qualifications. Minimum type size of 8 or 10 point is required by many state laws and the disclosures cannot be in a small footnote that bleeds into the background color of the ad. It must be readable by a reasonable consumer. Asterisks next to qualified terms should be at least 50% the size of the qualified term's print size.

**Proximity** - The disclosures must be located close to the terms being qualified. A small footnote at the bottom of the page or image is not sufficient. Neither is putting the disclosures on another page of a brochure or another page of a website not proximate to the qualified term.

**Placement** - This deals with location in the advertisement. Would a reasonable consumer's attention be likely to go there from the advertised terms? Small asterisks that may be unreadable next to the qualified term do not meet this standard.

**Presentation** - Language should be plain English and not dealer speak. It should not scroll across media or be of such detail and depth that the average consumer is not likely to read or understand it. It must be presented unambiguously and in short phrases. If in radio or audio media, it must be in a volume and cadence that a reasonable consumer can hear and understand.

The same rules for print and media advertising apply to online ads. Internet ads and social media ads must present disclosures necessary to keep an advertisement from being deceptive in a clear and conspicuous presentation in the device in which it is viewed. Proximity as close as possible to a qualified term has been cited by the FTC as a critical element. Generic statements such as "see below" are insufficient especially if the consumer must scroll to see it. Hyperlinks, if prominent and conspicuous and that link directly to the disclosures, can be used and named specifically to identify the information behind it. But hyperlinks cannot be used to communicate disclosures that are "an integral part of the claim." Again, generic statements such as "Disclaimer" or "more information" are not considered clear and conspicuous. To be clear and conspicuous, a disclosure must be prominent in the context of the media in which it will be displayed to a consumer such as on a smartphone or tablet since approximately 80% of consumers do Web browsing on these devices. Color, size and graphics can be used to make disclosures prominent and disclosures should not be buried in long paragraphs of scrolling text or footnotes or in unrelated pages like a website's terms of use. Elements of the ad that distract from the disclosure should also be considered and removed if necessary to ensure consumers are able to see and understand all the applicable terms and conditions. Pop-up disclosures do not comply because many consumers block pop-ups. A disclosure should be made in the same manner as the claim requiring the disclosure and may need to accompany each repetition of the claim each time it is presented. The language for disclosures should be clear, simple, and straightforward. The test for whether a disclosure is effective is the extent to which consumers can actually read, perceive and understand it. A dealer that ran a YouTube ad that ended with a scrolling page of 380 words of rapidly moving text on 33 lines of white paint against a black background was also subject to a 20-year enforcement consent decree.

The FTC is serious in its approach to dealer advertising. In September 2014, a senior Federal Trade Commission attorney in the commission's Division of Consumer Protection and Business Education, cautioned corporate executives that they can be held personally liable for false advertising and privacy violations tied to their businesses. In a case about a company falsely claiming to run a scan to identify compromising content on consumers' computers in order to sell a supposed fix, the Fourth Circuit Court of Appeals held one of the responsible officers could be personally liable for fines and penalties of $163 million. Eight dealer employees of a store in Birmingham, Alabama were sentenced to prison for falsifying income on credit applications and overstating vehicle enhancements (i.e., power booking).

State laws on unfair and deceptive acts and practices (UDAP laws) are often broader than Section 5 of the FTC Act and most State Attorneys General have guidelines for vehicle advertising in their state in both traditional and online media. For example, in New York, the Attorney General's Auto Dealer Advertising Guidelines prohibit selling an automobile for more than the advertised price, even if the advertised price has not been communicated to or seen by the buyer unless the ad specifically conditions obtaining of the automobile at the advertised price upon presentation or mention of the ad. If the vehicle is advertised without this conditional language, it cannot be sold at a price higher than the advertised price. Also if the advertisement includes the language requiring the buyer to mention or bring in the ad, then that vehicle cannot be sold at a price higher than the advertised price if the buyer mentions or produces the ad. The Ohio Attorney General also takes the position that advertised prices must be honored whether the customer sees them or not. Failing to do so is a violation of the Ohio Consumer Sales Practice Act regardless of what medium the advertisement appeared (Internet, newspaper, television, radio, etc.).

"Clear and conspicuous" is defined by the New York Attorney General to mean that "the statement, representation or term is so presented as to be readily apparent and understood by the person to whom it is being addressed. Factors to be considered for this purpose include, but are not limited to, size, color contrast, length,and crawl time.

It is a deceptive advertising practice in New York to "use one or more footnotes or asterisks which, alone, or in combination, contradict, confuse, materially modify, or unreasonably limit a principal message of the ad. So is the use of any print in type size so small as to be not easily readable. For the purpose of this guideline, any type size 10-point type or larger in print advertising is deemed easily readable.

State laws authorize Attorneys General as well as private plaintiffs to bring actions against auto dealers for deceptive advertising as occurred in a number of states during 2009's "Cash for Clunkers" promotion. More recently, Attorneys General around the country have obtained settlements in the range of $100,000 - $500,000 or more for deceptive or unfair advertising. Marketing and advertising of consumer products are ripe areas for Attorneys General looking to fill state coffers.

Advertising of vehicles should reflect only terms that are actually available. Advertising specials like repossessed vehicles, end-of-lease vehicles, or manufacturer closeouts must be literally true for the inventory of vehicles being sold. “Payment packing,” which consists of adding optional aftermarket products to the base price of a vehicle, is effectively unlawful under federal Truth in Lending and very likely to produce a deceptive or unfair trade practices claim from a consumer or regulator. The FTC has fined dealers who payment pack aftermarket items such as vehicle etching into the base vehicle price. A new vehicle should be sold only with the options installed by the manufacturer unless the customer chooses to purchase additional options from the dealer. Credit cannot be conditioned on the purchase of aftermarket items.

Attorneys General in Washington, Massachusetts, New York, Iowa and other states have brought actions and imposed fines in excess of $100,000 against dealers who engaged in deceptive advertising. When a regulator brings such an action, class actions and private lawsuits inevitably follow as well. A Brooklyn, NY, auto dealer was hit with over $500,000 in fines and restitution payments in a lawsuit brought by the New York Attorney General. The dealer engaged in dishonest sales practices, deceptive advertising, and offering phony contests that cheated customers, particularly elderly customers and non-English-speaking customers.

**Credit Advertising**

Federal Truth in Lending (“TILA”) and Regulation Z, and the Consumer Leasing Act and Regulation M contain advertising requirements relating to credit terms. Advertising certain “triggering terms” about credit (down payment, period of repayment, payment amount or finance charge in a credit sale) requires including other terms about the credit as well (in a credit sale, the down payment, terms of repayment, and the APR, labeled as such). For consumer leasing, if the ad includes the amount of any lease payment or the capitalized cost reduction or other payment due prior to or at lease signing, it must include the total amount due at lease signing, the number and amount of scheduled payments, and whether a security deposit is required. Advertising a payment amount is a triggering term for both credit sales and leasing. For these purposes, $0 down is not a triggering term for a credit sale, but it is a triggering term for a lease. A number of state laws also require lease advertisements to disclose mileage limits and the cost of excess mileage. In recent years, a number of new laws have been passed that restrict how and to whom a dealer can send marketing communications and advertising. Developing marketing lists and picking the media for communications is becoming a more complex task as described below.

The Consumer Financial Protection Bureau (CFPB) also published lender examination procedures in which it indicated it will be evaluating auto finance companies for fairly marketing and disclosing auto finance terms. The CFPB’s guidelines indicated concerns about consumers being misled about the benefits or terms of financial products. The CFPB is also looking to ensure that consumers understand the terms they are getting.

**Internet Marketing of Credit Terms and Prequalifying Customers**

Dealers can use their websites to market credit terms and prequalify customers even before taking a full credit application. Whether a prequalification is treated as merely an inquiry or a credit application depends on what you communicate to the consumer.

A consumer can securely provide personal information (e.g., name, address, birth date, Social Security number) over a secure webpage (an https page or by using encrypted data transfer) and give consent to access their credit report such as their credit score for prequalification purposes. If you respond by indicating the types of credit programs you offer for which the consumer may qualify and indicate how the consumer can submit a complete credit application, the prequalification process can be treated as an inquiry that does not trigger any Risk-based pricing or adverse action notice requirements. You can also communicate to the consumer that your dealership has many credit programs available and that you need additional information from the consumer to be able to prequalify them for one of the programs. Either way, suggest that the consumer come to the dealership or call your Internet sales manager.

If you respond that there are no programs for which the consumer can qualify, then you will be considered as having made a credit decision instead of treating it as an inquiry. In that case, you will need to send the consumer an adverse action notice. If you respond with information that indicates the consumer qualifies for specific financing, you have also made a credit decision and must provide the Risk-based pricing Credit Score Disclosure Notice.

If you give the customer specific credit terms for various programs you offer, be sure to give the other terms that are "triggered" under TILA or CLA advertising rules. So if you give a monthly payment amount and term, you must also indicate the down payment and the APR for a credit sale. If you give a lease payment and lease term, you must indicate all sums due at or prior to lease signing, whether any security deposit is required, and in certain states, the mileage limitations and the charge per mile for going over the limit. Most frequently, the triggering term will be the payment amount. If you advertise a payment amount (or any of the other triggering terms), you must be certain to clearly and conspicuously disclose the triggered terms in both credit sales and leases.

**Prescreening**

You can also "prescreen" a list of leads or even a single lead under the Fair Credit Reporting Act ("FCRA"). Prescreening is governed by the FCRA and involves giving a credit bureau a list of credit criteria for the credit bureau to produce a list of consumers meeting the criteria. Dealers are then required to make a "firm offer of credit" to these consumers, provided the consumers continue to meet the prescreen criteria. The FCRA requires specific "clear and conspicuous" disclosures that must be included in the prescreen mailing, including conspicuously disclosing to the consumer how to opt out of further prescreening.

Case law has challenged auto dealer prescreening activity. Several cases have found FCRA violations where the terms and conditions of the prescreen offers (APR, minimum amount of credit, length of contract, method of computing interest) were not clearly stated or the offers were of such limited amount (promised credit of only several hundred dollars for auto financing) as to have no appreciable value to the consumer. Recent cases have been somewhat more liberal in requiring fewer details concerning the specific terms of the credit offer pending a full review of the consumer's credit file, but if the consumer accepts the prescreen offer and continues to meet the prescreening selection criteria, the dealer must provide the credit described in the offer. Courts have permitted consumers alleging violation of the FCRA based on prescreening abuses to bring class action lawsuits. Prescreening is only for making firm offers of credit; it cannot be used for marketing purposes.

A wrinkle on prescreening is "trigger leads." Trigger leads are sold by credit bureaus that prescreen customers, but the credit bureaus do not communicate the consumer's name and contact information (usually a cell phone number) to the prescreen client until another auto dealer pulls the customer's credit report. At that point, the prescreen client (typically a lender or another auto dealer in partnership with the lender) will call the customer on the customer's cell phone and attempt to induce them away from the original dealership that pulled the credit report. They will do this often by claiming to offer better purchase or financing terms on the vehicle or aftermarket products. Some customers literally have been called on their cell phones while still in the original dealer's F&I office.

Trigger leads have been approved by the FTC for consumers seeking mortgage financing. However, neither the FTC nor any court has approved trigger leads for indirect auto finance, and trigger leads in the mortgage context are prohibited in a number of states including Connecticut, Kansas, and Kentucky.

Prescreening differs from preapproval inquiries in that a consumer who passes the prescreen criteria must receive a firm offer of credit. Persons who do not pass the prescreen criteria do not need to receive adverse action notices unless they otherwise affirmatively apply for credit and are declined.

**Social Media Advertising**

Another area of advertising and customer communications is social media, being sites such as Facebook.com, YouTube.com, LinkedIn.com, Twitter, and others. These sites have gained increasing popularity – Facebook has over 213 million active users in the U.S. and Canada each calendar quarter. Social media sites offer dealers a new way to connect with consumers through consumers' principal means of staying in touch with friends, colleagues, and companies with whom they have an interest or a relationship. All of the advertising laws and regulations described in this Chapter apply to advertising in all media, including social media.

In March 2013, the FTC issued an update to its "Dot Com Disclosures" guide to advertisers on making effective online disclosures. In doing so, the FTC emphasized that consumer protection laws apply equally to all advertising, regardless of the medium used, and include social media even where there is limited space. Disclosures required to avoid deception or otherwise comply with the law must be presented in a clear and conspicuous manner and space constraints in social media do not relieve you of your obligations to make clear and conspicuous disclosures. You need to understand how your ads—including any disclosures required—will actually display in the medium or media in which they appear. Make them responsive and adaptive to the devices they can be viewed on. This is especially important since it has been estimated that consumers use a cell phone or tablet approximately 80% of the time to surf the Web. The FTC warned that if you cannot make a required disclosure conspicuous in a particular medium (e.g., Twitter), then you should not run the ad in that medium. For example, disclosures on your website or in social media may be sufficiently clear and conspicuous when your site is viewed on a desktop but may not be sufficiently clear and conspicuous when viewed on a mobile browser such as a smartphone or tablet. With the explosive growth of social media and the need for careful drafting to avoid FTC scrutiny, this is a rapidly-changing area of the law and you should consult with your attorney concerning social media advertising. Regulators actively monitor social media. The FTC entered into five consent decrees in March 2012 with dealers for deceptive advertising and the majority of the 10 consent decrees entered into in January 2014 involved social media as well. The ads came to the FTC's attention as a result of FTC staffers searching the Internet and finding the offending ads on sites such as YouTube.com. There were no consumer complaints nor any evidence that any consumer was deceived. The CFPB is also very savvy in monitoring social media sites and has indicated it does so to identify complaints against companies for the purpose of bringing enforcement proceedings.

If your dealership plans to open its own social media site, or if your employees access and use such sites, it is a good practice to adopt a Social Media Policy. Such a policy needs to balance the dealership's right to protect its image and confidential information against the employee's protected speech, such as speech intended to organize labor unions or engage in concerted activity. Some guidelines for a Social Media Policy are to define social media broadly to include all social networking sites, blogs, photo or video sharing sites and chat rooms. Make it clear that the dealership is monitoring employees' social media usage on the dealer's site and from dealer-issued PCs and mobile devices, and encourage employees to be responsible and vigilant with their own personal pages. You should identify with specificity categories of prohibited topics such as dealership financial or pricing data, customer information and a catch-all of "other confidential information." Prohibit disparaging comments about the dealership, customers, other employees, and offensive or legally actionable statements. Employees posting on an auto-related site need to make clear that their postings are their own and not those of the dealership and you should identify restrictions for using social media during company time. The policy should list consequences for violations, including termination of employment, and identify a person at the dealership responsible for social media and whom an employee can consult about the Social Media Policy or a prospective posting, prior to their posting it. However, you need to be careful that your social media policy does not violate federal labor laws by prohibiting "concerted activities" by employees such as discussing job terms and conditions. The National Labor Relations Board (NLRB) struck down a social media policy in October 2012 that contained unqualified prohibitions on making disparaging comments and restricting all communication with the media as violating Section 7 of the National Labor Relations Act, the section that protects employees' rights to engage in concerted activities. From an employment perspective, you should consider how your social media policy handles employees' negative posts or, more importantly, the leak of sensitive information. Employers should consider having procedures in place to investigate and address potentially damaging posts. While certain laws, e.g. the National Labor Relations Act, may protect employees for negative comments on the Internet, not all employee posts are protected. Employers should be prepared to act on those that are not – particularly if the posts contain confidential information.

A word about Facebook. A dealer has two options to advertise on Facebook. Place an advertisement on its posting page or buy an advertisement that appears in the column adjacent to the posting pages. Always use the latter option of buying Facebook ads. This is because Facebook has an algorithm that distributes some or all of your postings to some or all of the users who "like" your page. If you post an ad, many users will only receive a part of it, possibly the part without the necessary disclosures. This will constitute unfair or deceptive advertising on your part, not Facebook's. Purchased ads on Facebook are always shown in their entirety.

**Sweepstakes**

Sweepstakes or "games of chance" contests present additional challenges and are regulated principally by state laws. To avoid being an illegal lottery under state law, a sweepstakes must not contain one of three elements: a prize, an element of chance, or the giving of a consideration to enter. The easiest element to eliminate is the giving of a consideration to enter. To do this, a sweepstakes must give consumers the right to enter without making a purchase such as by mailing in a postcard. A dealer in Florida was cited by the State for running a sweepstakes only open to consumers who purchased or leased vehicles. Some states (e.g., New York and Florida) require bonding for certain consumer sweepstakes. Make sure the rules are clear about the prizes; ways to enter; the duration of the sweepstakes; when and how the winners will be determined; and name the dealership as the sponsor of the sweepstakes. Disclose the odds of winning, or state the odds depend on the number of entries received. Federal law requires that you prominently indicate in mailings and in sweepstakes rules that no purchase is necessary and making a purchase will not improve your chances of winning a prize, among other things. The sponsor of the sweepstakes and their contact information must also be disclosed and there must be a notification system that allows the consumer to have their name removed within 60 days from mailing lists of the sweepstakes provider. IRS tax reporting is required for certain winners depending on the value of the prizes. Consider getting advice from a competent attorney or agency familiar with the laws of the states where the sweepstakes or contest promotion will be conducted. For example, Florida requires a state filing along with a bond in certain situations for any consumer sweepstakes offering prizes totaling more than $5,000, and advertisements must contain the full material rules for the sweepstakes.

## Important Laws and Regulations

**Laws Regulating Telemarketing, Email and Faxing** – Federal and state laws govern contacting consumers by telephone, fax, or email. The FTC and a number of states maintain "Do-Not-Call" lists prohibiting telemarketing calls to the listed numbers, which include both land lines and cell numbers. Scrub telemarketing lists against both the FTC's National Do Not Call Registry and applicable state do-not-call lists. Additionally, dealers are required to keep their own company list of customers who indicate that they do not want to be contacted by telephone, fax, or email and their names must be deleted from marketing lists as well. If you share customer information with affiliates or third parties, make sure to scrub from the shared lists any customers who have opted out of being contacted in any medium of expression.

As background, the federal Telephone Consumer Protection Act ("TCPA") and the Telemarketing Sales and Consumer Fraud and Abuse Prevention Act ("Telemarketing Act") restrict the use of telephonic equipment to contact consumers and the use of fax machines to send unsolicited advertisements. The Junk Fax Prevention Act of 2005 also restricts fax advertising.

The FTC also regulates use of phone numbers for various purposes principally through its Telemarketing Sales Rule published pursuant to the Telemarketing Act. Among other things, the Telemarketing Sales Rule prohibits making pre-recorded telephone marketing calls to any phone number unless the recipient has provided a prior express written consent to receive such calls at the indicated phone number. An established business relationship with the consumer is no longer sufficient for pre-recorded telemarketing. Even with consents, all pre-recorded calls must include an automated interactive opt-out mechanism to disconnect at the outset of the call by means of a key-press or voice-activated mechanism, as well as a toll-free number to limit further calls. If the customer opts out at any time during the call, then the pre-recorded message must immediately terminate and disconnect from the consumer's phone.

The Telemarketing Sales Rule can be enforced by the FTC, state Attorneys General or via consumer lawsuits, including class actions. States also have laws that restrict the right to make calls to cell phones, fax numbers and for telemarketing and other purposes.

The federal CAN-SPAM Act of 2003 and the Junk Fax Prevention Act of 2005 also require that each email and fax transmission conspicuously gives the consumer a way to opt out of receiving further communications in that medium. Faxes and emails also must contain information about the sender, the fact that the communication is an advertisement, and other specific language.

Fax advertisements require either the customer's prior written consent to receive fax advertising or an "existing business relationship," which generally means the prior purchase of a product or service from the sender. Fax communications must contain on the first page a toll-free telephone number, fax number, website or email address for the recipient to opt out of future fax advertisements.

Commercial email messages having a primary purpose to advertise or promote a product are also subject to additional restrictions. In addition to providing opt-out rights, all commercial email must accurately identify the sender in the FROM line and have truthful SUBJECT lines that are not misleading. They must identify the email as an advertisement. The Federal Communications Commission ("FCC") prohibits advertising emails or text messages to be sent to a wireless device such as a cell phone without the recipient's express prior written consent which consent must designate the cell phone number to which it applies and contain the phrase "I understand that this consent is not a condition of purchase or credit." Transaction or relationship messages, such as informing a customer of a warranty or recall notice, are permitted based on your pre-existing relationship and the customer giving you their cell phone number. But such messages should not contain any language that could be construed as marketing or a solicitation. An example is a text message informing a customer that their serviced vehicle is ready for pickup. Such a message will violate the law if it includes additional advertising components such as recommending a scheduled maintenance appointment, unless the customer has consented in writing to receive such messages and such consent includes the phrase listed in this paragraph.

The FTC's Telemarketing Sales Rule requires certain disclosures to be made in telemarketing and prohibits deceptive and abusive telemarketing acts or practices, such as misrepresentations, repeated calling, or processing payments before all required disclosures are made. Material information (information that would likely affect a person's choice of goods or services) must be made truthfully and in a clear and conspicuous manner before the consumer pays for the goods. The FTC has described "clear and conspicuous" for this purpose as "in a way that a consumer will notice and understand." The goal is that the disclosures be communicated as effectively as the sales message. Among the required disclosures in telemarketing sales are telling consumers the total costs of the products or services; any restrictions, limitations or conditions to purchase; the seller's refund policy; full details of any "negative option" features whereby the consumer's failure to act accepts the offer; and any sweepstakes information.

The Telemarketing Sales Rule also requires dealers to delete from telemarketing programs consumers whose phone numbers are on the National Do Not Call Registry unless an exception applies such as a "prior business relationship" with the consumer. The Telemarketing Sales Rule also requires a prompt disclosure of the seller, that the purpose of the call is to sell goods or services, and the Rule restricts time of calling and abandonment rates.

The 2008 amendments to the Telemarketing Sales Rule imposed additional restrictions. Dealers now need the customer's prior signed consent to use an auto dialer or make a pre-recorded marketing call to any phone number, and that call must give the consumer a way to immediately terminate the call and opt out by pressing a key or using a voice-activated mechanism, as well as giving a toll-free number to limit further calls. For cell phones, text messages are considered calls and require the consumer's prior written consent for calls or text messages to that designated cell phone number as well. For this reason, it would be unlawful to send a consumer a text message requesting their consent for future text messages, even if they respond affirmatively.

The FCC also regulates telemarketing under the TCPA. Under amendments to its rules that took effect in 2013, and a series of rulings issued in June 2015, a prior express written consent is required for all pre-recorded or artificial voice calls to both cell lines and residential lines as well as for the use of automatic telephone dialing systems or auto dialers to make marketing calls and send texts to cell phones. As noted above, the consent must state that it is not being given to purchase any goods or services. Customers can withdraw their consent "through any reasonable means" including orally, at any time. Auto dialers are any device that "has the capacity" to dial or store numbers without human intervention no matter how it is used. Even if the machine is being used to make calls manually, if the device has the capability of autodialing or the capability of being enhanced to become an auto dialer, it will be considered an auto dialer and the call treated as if it were made by an auto dialer, even if dialed manually even on a device not configured to be an auto dialer. When asked for an example of a device that is not an auto dialer, the FCC responded that a rotary dial phone is not an auto dialer. The “called party” means the current phone subscriber or the customary user of the cell phone. As a result, you can be held strictly liable for a call to a reassigned cell number, regardless of whether the original subscriber had previously provided his or her consent. There is a limited exception. For cell numbers that are reassigned, you are allowed one and only one call to the cell number to try to determine if it is reassigned, even if no one answers the call. This one call exception covers your affiliates and subsidiaries as well.

"Consumers have the right to choose whether they want marketing calls and texts to their cell phones," Travis LeBlanc, the FCC's enforcement bureau chief said in serving notice on a bank that it could not require consent to marketing calls to cell phones as a requirement for its online banking service.

Pre-recorded telephone calls must also have an automated up-front opt-out mechanism and no more than 3% of outbound calls in a campaign may be abandoned (calls are considered abandoned when a connection to a live agent is not made within two seconds of answering). Abandoned calls must give the opt-out mechanism as well. As noted above, the written signed consent must be sufficient to show the consumer received “clear and conspicuous” notice of the consequences of giving their consent to receive telemarketing calls; unambiguously consented to receive calls to the exact phone number stated in the signed consent; and that the customer did not give the signed consent as a condition to purchase or receive any goods or services. And remember the consumer can withdraw their consent at any time by any reasonable means including orally. Note that this heightened prior written consent requirement applies to pre-recorded and artificial voice calls made to residential phones as well as calls and text messages to cell phones.

The changes are important because the TCPA provides for unlimited strict liability of $500 - $1,500 per call or text message made without obtaining proper advance written consent. Numerous class actions have been filed under the TCPA in large part because of the absence of any cap on class action damages. In August 2015, the FCC issued a $2.96 million fine against a Florida travel club for making unsolicited, pre-recorded advertising calls to consumers. The identified violation was for 185 automated calls—that’s $16,000 per call.

Some states also give consumers three-day cancellation rights for telemarketing sales and a number of states have tougher telemarketing sales rules than the FTC and FCC. Examples include Texas, New Jersey, Arizona, Louisiana, and Wyoming.

In 2012, the Consumer Financial Protection Bureau (CFPB) issued two $200 million consent decrees against credit card companies for deceptive telemarketing of credit protection aftermarket products, and the CFPB made clear that the requirements of those consent decrees apply to other creditors as well. Among other things, when telemarketing products, a dealer must state promptly the purpose of the call; clearly disclose, prior to purchase, the cost of the product; disclose prior to purchase all material conditions, benefits and restrictions relating to the product; disclose clearly that the purchase of the product is voluntary and not required; make all legally required disclosures in a clear manner and at reasonable speed and cadence so the consumer can understand them; and after disclosures are read, require the customer to acknowledge the purchase is voluntary and that the customer affirmatively requests or consents to purchase the product. If the product has a cancellation or refund policy, the dealer must disclose the policy and give the phone number to cancel and the time in which to get a refund. The customer's purchase and means of payment must also be disclosed and confirmed. If paying by credit card, the customer must give the full credit card number for payment to the sales representative.

## Advertising Laws and Regulations

**FTC Used Car Rule** – The FTC Used Car Rule requires auto dealers to prominently and conspicuously post a "Buyer's Guide" to keep in plain view on all used vehicles offered for sale. The notice must be placed on the vehicle before the used vehicle is offered for sale. The Used Car Rule defines a "used car" as any car that has been driven more than necessary to move it or for road testing prior to delivery to a consumer. This would include many "demo" models used for customer test drives. The Buyer's Guide must disclose whether the vehicle is being sold "as is" or with a warranty. If it is sold with a warranty, the Buyer's Guide must state the general terms of the warranty, including whether it is full or limited; the specific systems covered (engine, transmission, etc.); a list of parts or systems not covered if necessary for clarity (e.g., a battery); what percentage of repair costs the dealer will pay under the warranty; an explanation of how the customer gets warranty service; and who to see about complaints. State law governs the legal requirements for disclaiming warranties.

The Buyer's Guide must also tell consumers that oral promises are difficult to enforce and to get all promises in writing, the major mechanical and electrical systems on the car that are covered by the warranty, the major problem areas that consumers should look for, and to ask to have the car inspected by an independent mechanic before they buy. If a used car transaction is negotiated in Spanish, the dealer must post a Spanish language Buyer's Guide. The Buyer's Guide becomes part of the sales contract and the disclosures cannot be contradicted orally or in writing. In addition to the Buyer's Guide, the dealer must provide a separate warranty document unless the dealer is not selling the used vehicle with its own warranty. A dealer who sells a car with only the remaining manufacturer's warranty, if that still applies, may simply state that clearly on the Buyer's Guide. The Buyer's Guide is not a warranty document.

The FTC is actively monitoring dealers' compliance with the Used Car Rule. In 2013, the FTC issued warnings to 11 dealers in Arkansas after FTC staff inspections in Jonesboro, Arkansas found that eight dealers failed to display Buyer's Guides on almost all used cars offered for sale, and three dealers failed to display the guides on a significant number of used cars. The warnings reiterated the need for posting the Guides on all cars and indicated that further violations could be considered an unfair or deceptive practice under Section 5 of the FTC Act. A year later, the FTC returned to the dealerships and found one of them that was still not displaying Used Car Buyer's Guides on all cars. The FTC filed a lawsuit against the dealer and its principals in the U.S. District Court for the Eastern District of Arkansas and the dealer and its principals settled the case by agreeing to pay $90,000 in civil penalties and submit compliance reports to the FTC for 10 years.

The Used Car Rule applies in all states except Maine and Wisconsin, both of which have enacted their own state law provisions for required notices that require additional disclosures for used car sales in these states.

**Magnuson-Moss Warranty Act ("MMWA")** – This is a federal law that requires manufacturers and sellers to disclose information about warranties given with the sale of a product. A warranty is a statement or representation, express or implied, about the character or quality of the goods sold. Express warranties result from statements or affirmations made about a product that the buyer relies upon in deciding to purchase. The MMWA covers written express warranties. Implied warranties derive from state law and automatically attach to the vehicle from the sale, such as an implied warranty of merchantability, which is a promise the vehicle will perform in a manner fit for its usual and ordinary purposes.

The MMWA requires any warranty to be clearly and conspicuously labeled as "full" or "limited" and be described in a single, easy-to-read document and to state any qualifications to the warranty (such as the consumer performing scheduled maintenance) with the full warranty terms available. At minimum, the document must describe who is making the warranty; when the warranty begins and ends; what is covered and what is not; what the warrantor will do if there is a problem; and how the consumer can obtain warranty service. It must also indicate that the consumer may have additional rights under state law and contain the following specific disclosures: "This warranty gives you specific legal rights, and you may also have other rights which vary from state to state. Some states do not allow limitations on how long an implied warranty lasts, so the above limitation may not apply to you." If a dealer sells the customer its own service contract within 90 days of the vehicle sale (as opposed to the consumer purchasing a service contract from a third-party), the dealer cannot disclaim any implied warranties but the duration of implied warranties can be limited under certain circumstances.

A common misconception concerns the concept of an "extended warranty" versus a service contract. For a new car, a warranty is included in the vehicle price and it provides the customer a right from the manufacturer to obtain certain repair services that must be adequately described under MMWA. Manufacturer warranties do not cover aftermarket products such as dealer-added equipment. Some vehicle manufacturers permit transfer of unexpired warranties to subsequent purchasers, and state laws restrict or limit any charges that can be imposed for doing so. Used car dealers can also provide warranties for the vehicles they sell, but a dealer cannot charge a customer for a warranty; it must be included in the cost of the vehicle. If the customer pays separately for additional coverage, that is a "service contract." Third parties also sell service contracts.

Some states require implied warranties in any vehicle sale. Other states permit "as is" sales of used cars. Used car warranties and the availability of a manufacturer's warranty must be disclosed in the Used Car Buyer's Guide discussed earlier in this Chapter.

An "extended warranty" is somewhat of a misnomer. Any product that provides for repair or servicing of the vehicle after the original manufacturer's (or seller's) warranty expires and for which the customer pays an additional charge is a "service contract," not an extended warranty. Service contracts can be sold directly by the dealer or by a third-party. They do not extend the manufacturer's warranty obligation, but give the consumer a contractual right against the seller of the service contract in the event of a breakdown or service need. Under MMWA and state law, a consumer's legal rights and remedies will be different for warranties and service contracts.

In 2015, President Obama signed the E-Warranty Act which does away with a requirement that has been on the books since passage of the Magnuson-Moss Warranty Act of 1975, which compelled manufacturers to include warranty terms on a single printed document on or within packaging of products costing more than $15. The E-Warranty Act now permits, but does not compel, manufacturers to avoid the requirement by directing consumers to their websites to find the terms and conditions of their consumer warranties. Vehicle manufacturers who elect to post warranty information online will be required to include the URL where consumers can find warranty terms on the product itself, on the product's packaging or in the product manual. Manufacturers also will be required to include a phone number, mailing address or other non-Internet based method of obtaining warranty terms. The law requires that the manufacturer's website include warranty terms in a clear and conspicuous manner.

Manufacturers will still be required to make warranty terms available to consumers at the point of sale prior to purchase, but the E-Warranty Act provides that manufacturers may meet this requirement by providing electronic access at the point of sale. However, the law requires enactment of revisions to FTC rules and regulations and the FTC has one year from final enactment of the law to revise its current warranty rules and regulations to comply with the E-Warranty Act.

**FTC Warranty Rules** – Two additional FTC rules, the Consumer Product Warranty Rule ("Warranty Rule") and the Rule Governing Pre-Sale Availability of Written Warranty Terms ("Pre-Sale Availability Rule"), specify language for warranties, require that warranties be displayed in close proximity to the vehicle and the full warranty terms be made available to consumers upon request before they buy. State laws, such as the California and Minnesota Car Buyer's Bill of Rights, provide minimum requirements for dealers to be able to use the term "certified" (or any similar term) in connection with a used car sale, and require other warranty and used car disclosures as well.

**FTC Endorsement and Testimonial Guidelines** – The FTC has issued revised guidelines on the use of endorsers and testimonial ads. In summary, the endorser must disclose if they are being compensated by the advertiser and a consumer endorsement is an implied representation that the endorser's experience is representative of what other consumers will generally experience. Actual consumers must be distinguished from actors, who must be prominently and conspicuously disclosed as such. The FTC requires that all statements by endorsers must be true and substantiated. The FTC has stated, "Consumer endorsements themselves are not competent and reliable scientific evidence."

**Other Advertising Guidelines** – The FTC and many state Attorneys General and Motor Vehicle Departments have published additional advertising guidelines for dealers in their states as well. One example concerns the use of the word "free" in advertising. The FTC prohibits use of the word "free" in reference to any item in connection with the sale of any other product or service that is usually sold at a price arrived through bargaining as distinguished from a fixed or set price. A classic example is the sale of an automobile. According to the FTC, nothing is "free" when the sale price is derived through bargaining. Also, the FTC will not permit use of the word "free" for a product or service if consumers have to spend money to get the item or scroll through numerous pages of "optional" offers or make applications for credit or other services. The FTC cautions: "all such [free] offers must be made with extreme care so as to avoid any possibility that consumers will be misled or deceived." A dealer can indicate that a particular product or service is "included" in the purchase price.

With respect to online advertising and social media, the FTC has adopted a "clear and conspicuous" standard to online advertising disclosures, and reiterated the applicability of the four P's listed above to determine whether the advertising was deceptive or misleading: (1) prominence; (2) presentation; (3) placement; and (4) proximity. Deceptive advertising takes many forms, especially when it comes to auto dealers. Prominent headlines or body copy cannot be contradicted or materially modified by small-type-size footnotes or disclosures not located close to the qualified statement or where a consumer would be expected to look for it such as by having to scroll for the disclosure. A good rule of thumb is that a footnote or online disclosure should be in plain English and can explain but not contradict, confuse, materially modify, or unreasonably limit the principal message. The footnote's explanation should be on the same page or document where it is first referenced in the text and in a conspicuous type size of at least 10-12 points as a best practice. Pop-up disclosures are not considered clear and conspicuous by the FTC. Statements such as "repossession sale," "fleet liquidation," or other unusual sale circumstances must be true in fact. If a vehicle is advertised at "factory invoice" or similar term, the terms must represent the dealer's ultimate total vehicle cost, including any holdbacks or manufacturer incentives. "See dealer for details" is not considered by the FTC to be a meaningful disclosure. Dealers need to ensure that every statement in an advertisement is truthful.

**State Advertising Laws and Regulations**

Almost all states have laws specifically prohibiting misleading advertising. An example is Florida, which prohibits any statement known or which could have been ascertained to be untrue or misleading and which was made with the intent or purpose of selling goods or services. Mississippi lists a series of phrases that are deemed to be untrue including "everybody financed," "no credit rejected," "name your own monthly payments," and a statement that no other dealer gives a greater allowance for trade-ins.

Florida's law gives consumers a right to sue for misleading advertising and specifically provides that a consumer can recover attorney's fees and punitive damages. So does New Jersey, which allows for recovery of treble damages "in addition to any other appropriate legal or equitable relief." An Arkansas Motor Vehicle Commission Rule imposes upon auto dealers "primary responsibility for truthful and non-deceptive advertising" and includes 20 pages of detailed rules for auto dealer advertising. Any advertising rule violation is automatically considered to be a violation of Arkansas law. Louisiana's Motor Vehicle Commission specifically prohibits using any abbreviations in dealer advertising that are not commonly understood and lists FTB, A/R, TOP, POF and DOC as examples. Connecticut regulations give 31 different examples of deceptive dealer advertising practices that constitute unfair or deceptive acts or practices, including a dealer not selling a vehicle or vehicles at an advertised price, and using advertising terms such as "at cost", "below invoice" or similar words unless the price represents the dealer's actual cost net of any holdbacks, rebates, promotional fees or other manufacturer incentives on the vehicle. New York's law mandates that the advertising be viewed from the perspective of what is omitted as well as what is explicitly stated to determine whether considered in totality the ad is deceptive. These are just examples of current state laws and regulations that govern auto dealer advertising.

The advertising requirements for dealers are different in each state. The Attorney General and state Motor Vehicle Department websites are two good resources to find rules and regulations concerning what advertising activities are permissible and impermissible for auto dealer advertising. Attorney General websites usually publicize enforcement actions brought against auto dealers for deceptive trade practices, including deceptive advertising. Many state Attorney General offices publish specific guidelines for auto dealer advertising in that state as well.

For example, many states prohibit a dealer from selling a vehicle at a price higher than an advertised price even if the consumer has not seen the advertisement. In some states, this rule will not apply if the advertisement provides clearly and conspicuously that the consumer must bring in or at least mention the advertisement to get the advertised price. You should check all your advertising against your state guidelines as well as the FTC's rules and guidelines. In the present environment of aggressive enforcement, it is a best practice to have your local attorney review all advertising.

A number of states have laws governing advertising of rebates. One example is California. In California, a disclaimer that dealer participation may affect consumer cost is required when a dealer must contribute to the cost of an incentive in order to participate in a manufacturer or distributor incentive. Nevada requires that if a dealer contributes to a manufacturer's rebate, it must advertise that dealer participation may affect final price. Terms like "rebate" and "cash back" must be expressed in specific dollar amounts.

# Case Study

As part of its "Operation Ruse Control," the FTC brought an enforcement action against a dealer in the south. Among the charged deceptive advertisements of this dealer were ads that failed to disclose "triggered" terms required by TILA or the CLA. Advertising a monthly payment amount is a triggering term and requires clear and conspicuous disclosure (remember the four P's—prominence, presentation, placement, and proximity) of the "triggered" terms—for credit sales, the APR, number of payments, amount of each payment, and the down payment; for leases, the total amount due at lease signing, the number of lease payments, the amount of each, whether a security deposit is required, and whether the customer has any back-end liability under the lease such as a disposition fee or the difference between the appraised value and actual value under an open-end lease. In several instances, the dealer failed to prominently disclose that an additional $3,000 was required as a down payment. This made the actual vehicle price $3,000 more than the advertised price.

The FTC also cited the dealer for "rebate stacking," advertising vehicle prices that included the application of rebates for which not all customers were qualified to receive. The FTC claimed "In fact, in numerous instances, the advertised discount and price are not generally available to consumers. In numerous instances, the advertised discount and price are subject to various qualifications or restrictions. Such qualifications or restrictions have included, for example, being a recent college graduate."

The FTC found the following disclosure to be inadequate and deceptive in reference to the availability of rebates: "The selling price shown appears after calculating dealer offers, it is for informational purposes only. Price can include all available rebates, not all customers may qualify for the offers, incentives, discounts or financing."

Since the rebates and advertised prices were not generally available to consumers, the FTC brought an enforcement action against the dealer which was resolved by the dealer signing a 20-year consent decree with the FTC concerning its advertising practices. Any dealer ad which the FTC determines to be unfair or deceptive—even one that does not involve failure to disclose triggered terms or rebate stacking—will cause the dealer to be sued for $16,000 per violation. As described above, two dealers who had signed advertising consent decrees with the FTC and then were charged with violating the consent decrees by running deceptive ads of a different type paid substantial penalties—in one case $360,000 and in the other case, $80,000—to the FTC.

# Recommended Practices

1. If you conduct direct marketing, scrub your target lists for persons who have excluded themselves from the means of communication you intend to use (telemarketing, faxes, and email). You should keep a separate list of consumers who opt out of telemarketing, faxes and email and be sure to not use auto dialers (and remember, any device that has the capacity or could be upgraded to automatically dial is an auto dialer) for cell phones or artificial voice or pre-recorded telemarketing messages for any phones unless you first obtain the customer's written consent to receive pre-recorded calls at the designated number. All cell phone telemarketing calls (which include text messages) require the consumer's prior written signed consent to include that the consent is not being given for the purchase of any goods or services. Adequately scrub telemarketing lists of phone numbers against the FTC's National Do Not Call Registry, your state's Do-Not-Call list and your dealership's list of persons who have asked not to be called. The Direct Marketing Association (www.the-dma.org) also maintains "do not contact" lists that you should scrub your lists against. If you are telemarketing, get assurances from vendors on having obtained customer consents and exclusions of persons listed on federal and state Do-Not-Call lists, then double-check against state Do-Not-Call lists, as well as your own dealership's list of customers who have asked not to be called. The uncapped class action liability potential under the TCPA ($500 - $1500 for each message or call sent without the required consent) makes this a critical area for you to be compliant.

2. Understand what you can and cannot do under advertising laws and regulations particularly given the FTC's aggressive enforcement of deceptive advertising. The FTC's website, www.ftc.gov, and state Attorney General websites provide a great deal of information on auto industry advertising guidelines. Your state Attorney General's website may show or describe ads that have been determined to be unfair or deceptive, and check the Attorney General's website for recent enforcement proceedings involving auto dealer advertising as well. In addition to the 32 FTC settlements for deceptive Internet advertising in the past four years, there were several dozen Attorney General enforcement actions against auto dealer advertising in 2014, many involving settlements in excess of $100,000. Make sure your ads are not similar to those. If the advertising includes financing references, remember that certain "triggering terms" in advertising—most notably the amount of any payment—require additional disclosures under TILA Regulations M and Z. State Motor Vehicle Departments also have rules and regulations for dealer advertising, and you should check their websites as well. Be sure to know state as well as FTC limitations on using words like "free," "$100 above invoice" and other advertising terms, as the rules vary state-to-state. Make sure your advertising is clear and conspicuous using the four "P"s (prominence, presentation, placement and proximity) as a starting point. It is a best practice to have your attorney review all your advertising before publication.

3. Avoid even the appearance of false or misleading advertising. Be able to prove the truth of literally every statement in your advertising and avoid putting required disclosures in "mouse type" or in a color that blends into the background or by pop-ups on websites. Use plain English writing and don't use abbreviations not commonly understood by the public. If you are advertising sales of repossessed or off-lease vehicles, be prepared to show that substantially all of the vehicles meet those criteria. If your ad says "factory authorized," be prepared to produce the written "factory authorization" that supports that statement. Be wary of advertisements promising credit to subprime borrowers (e.g., "bankruptcy not a problem"). If you use an advertising agency, try to get the agency to indemnify you if the ads it produces lead to litigation or an FTC or Attorney General action. Be very careful with footnotes to headlines or inviting copy text in your ads.

Fast-talking TV or radio disclaimers are also problematical. The CFPB specifically cited fast-talking telemarketers as part of the deceptive selling process. The FTC has also warned about running ads where every statement is literally true on a stand-alone basis but the "sting" or impression of the entire advertisement collectively is deceptive or misleading. The FTC looks at an ad in totality of its impression and not just the literal accuracy of all statements.

4. Don't stack rebates to advertise the price of a vehicle. Rebates that are available to the general public can be itemized as deductions from the MSRP. You can show additional conditional rebates separately from the vehicle pricing and those should be itemized along with the qualifications for each as well. Note that state laws also govern the advertising of rebates such as the California and Nevada laws referenced above.

5. Be specific in listing in the Used Car Buyer's Guide the vehicle systems covered by any warranty. "Powertrain" is not adequate for this purpose. If you give a warranty in connection with the sale of a used car, always offer a "limited warranty" and not a "full warranty." The obligations that accompany the description of a full warranty are detailed and onerous.

6. Understand your state's law on a dealer's ability to disclaim warranties and make sure it is clear in service contracts you sell. If you have "entered into" a service contract, you cannot disclaim implied warranties under the MMWA. Service contracts and insurance contracts to cover the obligations can be structured in a number of different ways, each of which has different tax and liability issues. Two examples are "retro" policies and "reinsurance" policies. In "retro" policies, a portion of the customer premiums is sent by the dealer to an insurer who deposits it into an account to pay claims. When contracts expire or at predetermined times, the dealer receives a portion of the earned premiums. In reinsurance policy programs, the dealer sends a fixed amount to an insurance company who in turn cedes the amount to a reinsurance company that may be affiliated with the dealer. The insurer offsets claims payments against sums paid to the reinsurance company. When National Warranty went bankrupt, reinsurance companies were deemed to own the reserves, which remained available for customer claims. Retro accounts were considered part of National Warranty's bankruptcy estate and not available to satisfy consumer claims. State insurance laws also contain requirements for insurance and reinsurance for service contracts. State laws also determine whether the sale of GAP is an insurance product (requiring a license from the state Insurance Department) or not. Review how your service contracts are structured and insured with your lawyer and accountant.

   Adopt a social media policy in accordance with the guidelines described above and in consultation with your attorney or compliance professional. Make sure that your social media policy does not inhibit employee communications to the point where your policy could be held by the National Labor Relations Board to violate rights of employees to engage in "concerted activities" under federal labor law. Be careful of Facebook ads - buy them through Facebook rather than simply posting them on your Facebook page.

7. Remember that advertising online must be considered from the perspective of all devices that will be used to review it, including cell phones and tablets. So your ads have to be responsive and adaptive to different types of devices and be clear and conspicuous in all of them. If you cannot be clear and conspicuous in a medium like Twitter, do not advertise on Twitter; instead simply invite your Twitter followers to visit your website.

# Additional Resources



**Section 5 of the FTC Act – A consumer compliance handbook published by the Federal Reserve Board to promote compliance with Section 5 of the FTC Act which prohibits unfair and deceptive acts and practices:**
www.federalreserve.gov/boarddocs/supmanual/cch/200806/ftca.pdf

**FTC Guidelines for Advertising:**
http://www.business.ftc.gov/documents/bus35-advertising-faqs-guide-small-business

**FTC Guidelines for Advertising and Marketing on the Internet:**
http://business.ftc.gov/documents/bus28-advertising-and-marketing-internet-rules-road

**A Dealer's Guide to the Used Car Rule:**
http://business.ftc.gov/documents/bus13-dealers-guide-used-car-rule

**Information about the Self-Regulatory Program for Online Behavioral Advertising and the Advertising Icon:**
http://www.aboutads.info/principles/

**Complying with the FTC's Telemarketing Sales Rule:**
http://business.ftc.gov/documents/bus27-complying-telemarketing-sales-rule

**Press Release and Details concerning two 2013 FTC consent decrees with dealers on deceptive advertising practices:**
http://www.ftc.gov/opa/2013/09/autoads.shtm

**State UDAP laws:**
http://www.nclc.org/images/pdf/udap/analysis-state-summaries.pdf

**A Business Person's Guide to Federal Warranty Laws, including the MMWA:**
https://www.ftc.gov/tips-advice/business-center/guidance/businesspersons-guide-federal-warranty-law

(continued)

**FTC Businessperson's Guide to federal warranty laws:**
https://www.ftc.gov/tips-advice/business-center/guidance/businesspersons-guide-federal-warranty-law

**FTC Guide on Complying with the CAN-SPAM Act:**
http://business.ftc.gov/documents/bus61-can-spam-act-compliance-guide-business

**Summary of June 2015 FCC Rulings on the TCPA:**
https://apps.fcc.gov/edocs_public/attachmatch/FCC-15-72A1.pdf

**.com disclosures – The FTC's Guide to Advertising on the Internet:**
http://www.business.ftc.gov/documents/bus41-dot-com-disclosures-information-about-online-advertising
http://www.ftc.gov/sites/default/files/attachments/press-releases/ftc-staff-revises-online-advertising-disclosure-guidelines/130312dotcomdisclosures.pdf

**A Good Summary of Guidelines for Advertising:**
http://www.ahbbo.com/adsftc.html

**Industry Self-regulatory Principles for Online Behavioral Advertising:**
http://www.iab.net/media/file/ven-principles-07-01-09.pdf

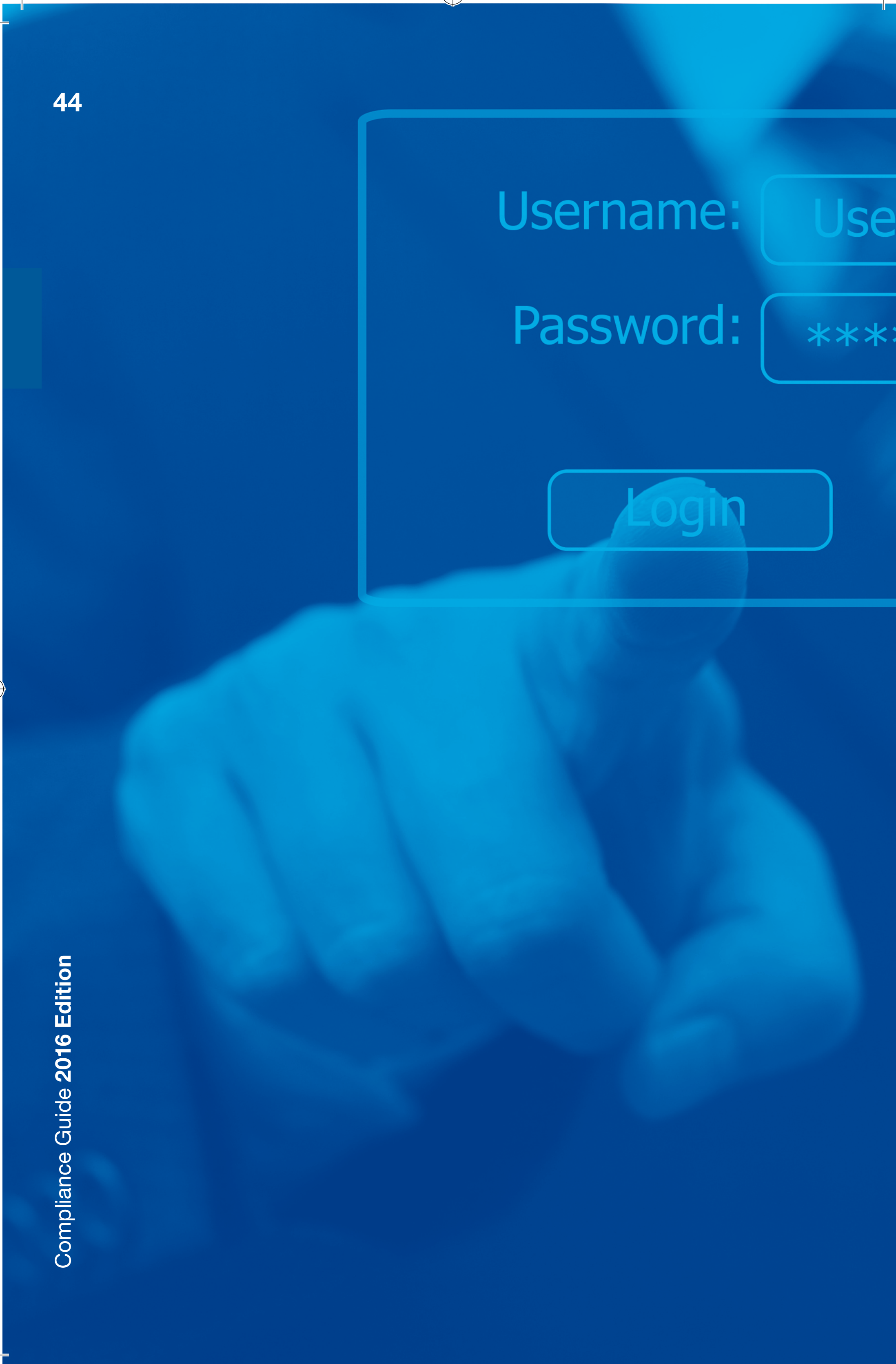
**The FTC's Seven Deadly Sins of Dealer Advertising:**
http://www.fi-magazine.com/news/story/2015/09/ftc-official-releases-7-deadly-sins-of-dealer-advertising.aspx?ref=enews-tuesday-new-20150915&utm_campaign=enews-tuesday-new-20150915&utm_source=Email&utm_medium=Enewsletter

**MMWA:**
http://business.ftc.gov/documents/bus01-businesspersons-guide-federal-warranty-law

**How to Write a Social Media Policy:**
http://www.inc.com/guides/2010/05/writing-a-social-media-policy.html

**“In fact, in numerous instances, the advertised discount and price are not generally available to consumers. In numerous instances, the advertised discount and price are subject to various qualifications or restrictions. Such qualifications or restrictions have included, for example, being a recent college graduate.”**

**- FTC Claim**


Username:
Password:
Login

—
Chapter Three
—



# Data Safeguards and Identity Theft Protection

## Background

A 2011 ID Analytics study found that approximately 45 million people in the U.S. are deliberately manipulating their identities to get credit, and eight million people are using multiple Social Security numbers. A single person in Philadelphia had 165 Social Security numbers, 44 birthdates and three different first names.

Identity theft continues to be one of America's most profitable white-collar crimes. The U.S. Department of Justice reports identity theft fraud has now surpassed the illegal drug trade as the most lucrative crime in the nation and it continues to grow. A leading identity theft think tank (Javelin Strategy & Research) reported that there were 12.7 million cases of identity theft in 2014. Tens of thousands of Social Security numbers are sold online each month. Consistent with the 2011 ID Analytics study, the Internal Revenue Service ("IRS") reports 8 – 11 million people each year to the Social Security Administration who are using someone else's Social Security number. Credit bureaus routinely establish multiple consumer files – sometimes as many as 30 to 40 or more – under a single Social Security number. The Identity Theft Resources Center found that in 2009, auto credit identity fraud was close to 29% of new account fraud. New account fraud in total was up 20% in 2010 and 13% in 2011. In 2012, fraudulent online retail payments reached 7.4% ($318 billion) of all retail transactions. In 2013, the total amount of identity fraud was $18 billion. In 2014, identity fraudsters stole $16 billion with a new identity stolen every two seconds (Source: Javelin Strategy & Research).

The U.S. Secret Service investigates ID theft cases. Bruce Townsend, Deputy Director of the U.S. Secret Service, said, "There is no question" identity thieves are targeting dealerships. "The information (dealerships) have has value," he said. "It is just as valuable as currency." Mr. Townsend headed the West Tennessee office of the Secret Service for three years. At least a third of the ID theft cases that crossed his desk involved auto dealerships, he said. In 2014, for the 15th year in a row, the leading consumer complaint to the FTC was identity theft, representing 13% of all complaints. Tax identity fraud constituted almost one-third of the identity theft complaints and IRS imposter complaints rose 2300% from 2013. Florida, California, Georgia, and Michigan were the states with the most identity theft complaints.

Large numbers of customer information data breaches continue to occur. Even the Pentagon's and White House's secured networks were hacked. There were approximately 3,014 reported data breaches in 2014, with over 1.1 billion personal records breached, a 22.3% increase in the number of records lost and a 28.5% increase in the number of data breaches disclosed in 2013. (source: Risk Based Security). One study indicated that almost 30% of cyberclaims were directed at companies with under $50 million in revenue. It is not just the Fortune 500 getting breached. Sony suffered the largest breach but 72.5% of 2014's incidents exposed between one and ten-thousand records. Hacking and fraudulent activity accounted for 97.6% of the records lost. A number of "new" breach types emerged in 2014, including: "Improper Security Procedure," "Unauthorized Publication," and "Stolen Files." One study indicated 23.6% of all incidents were the result of insider activity – 192 malicious and 285 accidental. (source: Risk Based Security). Other studies showed a much higher number of insider activity particularly at small and medium-sized businesses like most auto dealerships. IS Decisions reported that insiders are the greatest risk of data breaches. That unhappy employee, or rogue insider who will go to any length to gain access to the organization's crown jewels, share the sensitive data they get their hands on and even put it to some other unscrupulous use such as selling it to organized crime. 62.6% of incidents involved the theft of passwords and 50.5% of incidents involved the theft of user names as well.

In a 2012 study by Verizon, 76% of intrusions exploited weak or stolen passwords or other credentials. 75% were driven by financial motives and considered to be opportunistic attacks. Employees leaving customer information out in the open, posting it online or sending it through insecure media such as Web-based email, not securely destroying customer records and losing laptops with unencrypted customer information were the main ways that customer data was compromised.

The FTC has referred to its Safeguards and Red Flags Rules as the 360° of preventing identity theft. The Safeguards Rule is designed to protect customer data by safeguarding and securely disposing of customer information in both paper and electronic format. This is the front end of identity theft prevention. The Red Flags Rule is designed to detect, prevent and mitigate identity theft at account origination including accounts originated by auto dealers. This is the back end of identity theft prevention. Dealer violations of either the Safeguards Rule or the Red Flags Rule risk civil penalties in FTC regulatory enforcement actions as well as damages and attorney's fees in private litigation under state laws.

The FTC has brought over 53 enforcement actions for violations of the Safeguards Rule. In June 2012, the FTC brought its first data Safeguards Rule enforcement proceeding against an auto dealer in Georgia after information on 95,000 consumers was compromised. The FTC also has authority to seek $3,500 per knowing violation of the Safeguards or Red Flags Rule under the Fair Credit Reporting Act.

A data security breach may be your dealership's biggest prospective liability. A 2015 study of the "all-in" cost of a data security breach estimated the cost at $217 per record compromised with the average company spending $6.5 million in the aftermath of the breach. (Source: Ponemon Institute). This included costs for things such as remediation, legal, PR, forensics, communications, regulatory, diversion of management and employee time, loss of customers and expenses to preserve the company's name and reputation in the community. Imagine the potential cost to your dealership if a terminated employee downloaded your CRM database onto a USB drive from his or her office PC before leaving your dealership. Data breaches by external hackers are also becoming increasingly more sophisticated and numerous and demand ongoing diligence in response.

This Chapter discusses federal and state laws and regulations relating to a dealer's obligations to safeguard and securely dispose of customer information and to verify customer identities. Dealers can pay a heavy price for data security breaches and sales to identity thieves. Additionally, the risks to dealers from certain forms of identity theft are changing dramatically as lenders look to dealers to repurchase contracts – even contracts that have paid for a period of time – representing financing to illegal immigrants and other identity thieves. Courts have also been more liberal in allowing consumers to bring class actions against firms that suffer security breaches of customer information.

## Important Laws and Regulations

**The FTC Safeguards Rule** – The FTC Safeguards Rule requires auto dealers to ensure the security and confidentiality of their customers' personal information by using appropriate administrative, technical and physical safeguards. The Rule also requires auto dealers to take reasonable steps to ensure that affiliates and service providers safeguard the customer information provided to them.

Under the Safeguards Rule, an auto dealer must develop and implement a written information security program that is appropriate to the dealership's size and complexity, the nature and scope of its activities, and the sensitivity of the customer information at issue ("Information Security Program"). The dealer's Board of Directors (or its highest governing authority) must approve the initial Information Security Program, and take responsibility for it. A senior officer must be appointed to be the Information Security Program manager responsible for developing, overseeing, implementing, training, updating, and administering the Information Security Program, but the final responsibility will rest with the Board of Directors or the senior management team.

An Information Security Program must include certain basic elements to ensure it addresses relevant aspects of a dealer's operations. The Information Security Program must:

- Describe how the program will protect customer information – both in paper and electronic format – and protect against anticipated threats to information security;
- Designate one or more employees to coordinate the information security program;
- Identify and assess the risks to customer information in each relevant area of the company's operation, and evaluate the effectiveness of the current safeguards for controlling these risks;
- Design and implement a safeguards program, and regularly monitor, test, and update it;
- Select service providers that can maintain appropriate safeguards, make sure your contract requires them to maintain safeguards, and oversee their handling of customer information;
- Include a security incident and data breach response plan in your information security program for use in the event of any irregularity or in the event any consumer information is lost, stolen or compromised;
- Test, evaluate, and adjust the program in light of relevant circumstances, including changes in the firm's business or operations, or the results of security testing and monitoring.

Dealers must regularly monitor and test their Information Security Program, evaluate its effectiveness, and adjust it accordingly. Three critical areas to address are: 1) employee training and management; 2) information systems; and 3) monitoring, detecting, preventing and responding to attacks, intrusions and systems failures. The FTC has also ruled that failing to have a defensible password security policy or permitting "weak" administrative passwords such as common words with no capitalization (e.g., "password"), numbers or symbols (e.g., "12345") can constitute inadequate data security. The FTC also faulted a leading social networking provider for storing and sending passwords in plain text emails.

Recently, the FTC's consent decrees have become much more specific on minimum security tools required as a baseline for safeguarding information. Among specific security requirements cited by the FTC were the following:

- Checking references or doing background checks before hiring employees who will have access to customer information.
- Asking every new employee to sign an agreement to follow your company's confidentiality and security standards for handling customer information.
- Limiting access to customer information to employees who have a business reason to see it. For example, give employees who respond to customer inquiries access to customer files, but only to the extent they need it to do their jobs. Very few people in your dealership need access to all customer information and you should limit permissions accordingly.
- Controlling access to sensitive information by requiring employees to use "strong" passwords that must be changed on a regular basis. (Tough-to-crack passwords require the use of at least six characters, upper- and lower-case letters, and a combination of letters, numbers, and symbols.)
- Using password-activated screen savers to lock employee computers after a short period of inactivity.
- Developing policies for appropriate use and protection of laptops, PDAs, cell phones, or other mobile devices. For example, make sure employees store these devices in a secure place when not in use. Also, consider that customer information in encrypted files will be better protected in case of theft of such a device. Encrypt customer information wherever it is located.
- Training all employees is a critical FTC priority. Train employees to take basic steps to maintain the security, confidentiality, and integrity of customer information, including:
    - Locking rooms and file cabinets where records are kept;
    - Using complex passwords and not sharing or openly posting employee passwords in work areas;
    - Encrypting sensitive customer information when it is transmitted electronically via public networks;
    - Not clicking on email links or attachments from unknown sources (phishing);
    - Referring calls or other requests for customer information to designated individuals who have been trained in how your company safeguards personal data; and
    - Reporting suspicious attempts to obtain customer information to designated personnel.

- Regularly reminding all employees of your company's policy — and the legal requirement — to keep customer information secure and confidential. Again, train all employees and consider posting reminders about their responsibility for security in areas where customer information is stored, like file rooms.

- Develop policies for mobile devices and employees who use personal devices to make certain that those devices are secured. One way to do this is by using Mobile Device Management Software (MDM) which creates a secure channel for communications to and from your network and can be used to monitor and track usage as well.

- Developing policies for employees who telecommute. For example, consider whether or how employees should be allowed to keep or access customer data at home. Also, require employees who use personal computers to store or access customer data to use protections against viruses, spyware, and other unauthorized intrusions.

- Imposing disciplinary measures for security policy violations including termination of employment.

- Preventing terminated employees from accessing customer information by immediately deactivating their passwords and user names and taking other appropriate measures.

**Information Systems** – Information systems include network and software design, and information processing, storage, transmission, retrieval, and disposal. Replace systems such as Windows versions XP or earlier that are no longer supported and make sure your anti-virus, anti-malware, firewall and other security software is up to date at all times. Microsoft estimates that Windows 8 is 21 times more secure than Windows XP.

Here are some suggestions on maintaining security throughout the life cycle of customer information, from data entry to data disposal:

- Know where sensitive customer information is stored and store it securely. Know its lifecycle throughout your organization. Make sure only authorized employees have access. For example:

    - Ensure that storage areas are protected against destruction or damage from physical hazards, like fire or floods.

    - Store physical records in a room or cabinet that is locked when unattended.

    - When customer information is stored on a server or other computer, ensure that the computer is accessible only with a "strong" password and is kept in a physically-secure area.

    - Place customer information on a separate secure server or in a secure cloud-based server. Limit permissions and require additional access requirements (two-factor authentication) such as a randomly-generated token number and additional password to be able to access the server.

    - Where possible, avoid storing sensitive customer data on a computer with an Internet connection. It is a good practice to provide "read only" access to customer information and disable the ability to download customer information onto third-party devices (USBs, external hard drives, etc.).

    - Maintain secure backup records and keep archived data secure by storing it off-line and in a physically-secure area.

    - Maintain a careful inventory of your company's computers, servers, and any other equipment on which customer information may be stored.

    - Monitor employees accessing customer information in both paper and electronic format. You should review the monitoring regularly to detect any unusual spikes in activity and quickly find out the reason.

    - Get a static IP address from your Internet Service Provider. This will keep your IP address from changing and enable sites like Dealertrack to only accept requests for customer information from your trusted IP address. This can be a major protection in the event employees' user names and passwords are compromised.

    - Use a cloud-based proxy server or a software-based proxy server to prevent users from going to sites that are associated with viruses, malware or that are otherwise insecure.

- Take steps to ensure the secure transmission of customer information. For example:

    - When you transmit credit card information or other sensitive financial data, use a Secure Sockets Layer (SSL) or other secure connection, so that the information is protected in transit.

    - If you collect information online directly from customers, make secure transmission automatic. Caution customers against transmitting sensitive data, like account numbers, via email or in response to an unsolicited email or pop-up message.

    - If you must transmit sensitive data by email over the Internet, be sure to encrypt the data.

    - Do due diligence and obtain appropriate assurances from third-party service providers who have access to your customer information and make sure their standards for protection are at least as comprehensive as yours. Reserve the right to do security audits of third-party vendors for compliance with required security standards.

- Dispose of customer information in a secure way and, where applicable, consistent with the FTC's Disposal Rule. For example:

    - Keep only the sensitive customer information you need and only for as long as you need it. Then securely destroy it in both paper and electronic form. Information like Social Security numbers, drivers licenses, and card account numbers are literally toxic if compromised. Keep them securely for as short a period of time as is necessary only.

    - Consider designating or hiring a records retention manager to supervise the disposal of records containing customer information. If you hire an outside disposal company, conduct due diligence beforehand by checking references or requiring that the company be certified by a recognized industry group.

    - Burn, pulverize, or shred papers containing customer information so that the information cannot be read or reconstructed.

    - Wipe hard drives to destroy or erase data when disposing of computers, disks, CDs, magnetic tapes, hard drives, laptops, PDAs, cell phones, or any other electronic media or hardware containing customer information.

- As stated above, keep customer information only as long as you need it and then consistently and securely destroy it.

**Detecting and Managing System Failures** – Effective security management requires your company to deter, detect, and defend against security breaches. That means taking reasonable steps to prevent attacks, quickly diagnosing a security incident, and having a plan in place for responding effectively. Consider implementing the following procedures:

- Monitoring the websites of your software vendors and reading relevant industry publications for news about emerging threats and available defenses. Update your systems and Safeguards Information Security Program regularly in response.
- Maintaining up-to-date and appropriate programs and controls to prevent unauthorized access to customer information. Be sure to:
  - Check with software vendors regularly to get and install patches that resolve software vulnerabilities;
  - Use anti-virus, anti-malware, and anti-spyware software that updates automatically;
  - Maintain up-to-date firewalls, particularly if you use a broadband Internet connection or allow employees to connect to your network from home or other off-site locations;
  - Regularly ensure that ports not used for your business are closed; and
  - Promptly pass along information and instructions to employees regarding any new security risks or possible breaches.
- Using appropriate oversight or audit procedures to detect the improper disclosure or theft of customer information. It's wise to:
  - Know the lifecycle and path of information that comes into your network. Monitor for any irregularities which may indicate an intruder has gained access to your system;
  - Keep logs of activity on your network and monitor them for signs of irregular activity or unauthorized access to customer information;
  - Use an up-to-date intrusion detection system to alert you of attacks;
  - Monitor both in- and out-bound transfers of information for indications of a compromise, such as unexpectedly large amounts of data being transmitted from your system to an unknown user; and
  - Insert dummy accounts into each of your customer lists and monitor the dummy accounts to detect any unauthorized contacts or changes.
- Assess the vulnerability of your website and computer network to commonly known and reasonably foreseeable attacks, such as SQL injection attacks. Stress testing your system regularly by a security firm is a good practice to meet this requirement.
- Implement simple, free or low-cost, and readily available security defenses to SQL and similar attacks.
- Use readily available security measures to monitor and control connections from your network to the Internet.

- Prevent users from downloading “P2P” file-sharing network software that can allow any network user to access other users’ data servers.

- Employ reasonable measures to detect unauthorized access to consumer information such as by keeping log events, paper file access records, and other records of persons accessing consumer information. Watch for changes in users’ access behavior. If a user’s access to customer records increases unexpectedly, quickly find out why.

- Implement system procedures to preclude downloading of customer information to portable media such as USB drives or external hard drives. Ideally, customer information should remain on a server with read-only access on user devices.

- Conduct regular audits of your security system and operations to determine the effectiveness of your Safeguards program and to correct any deficiencies.

- Make customer information “read only” and not downloadable to any remote devices such as cell phones or tablets. These devices are typically harder to secure and should not have customer information retained in their hard drives.

- Take steps to preserve the security, confidentiality, and integrity of customer information in the event of a security incident or data breach in accordance with your Incident Response Plan which must be part of your Safeguards Information Security Program. If a breach occurs:

  - Take immediate action to secure any information that has or may have been compromised. For example, if a computer connected to the Internet is compromised, disconnect the computer from the Internet but do not unplug it so you can make a forensic copy. Do the same for infected servers.

  - Preserve and review files or programs that may reveal how the breach occurred.

  - If feasible and appropriate, bring in security and forensics professionals to help assess the breach as soon as possible.

  - Pre-assign responsibilities under the incident response program to specific individuals at the dealership so a response team can be quickly assembled and begin to take action immediately.

- Consider notifying consumers, law enforcement, and/or businesses in the event of a security breach. For example:

  - Notify consumers if required by law. Forty-eight states plus Puerto Rico and the District of Columbia have laws that require consumer notification. Your response program should include template letters for customers in all states and territories.

  - Notify law enforcement if the breach may involve criminal activity or there is evidence that the breach has resulted in identity theft or related harm. Certain state laws require the Attorney General or other state regulator to be notified or receive copies of notices that are sent to consumers.

  - Notify the credit bureaus and other businesses that may be affected by the breach.

  - Check to see if breach notification is required under applicable state law although Texas law requires breach notices to be given to residents of all states including those in states that don’t specifically require breach notices. California includes an Internet user’s log-in name and password to the menu of personal information that is covered by its breach notification law. Check your state law on the standard, if any, of threshold of possible harm that requires giving these notices.

- Consider as a best practice offering consumers one to two years of credit monitoring or other identity protection service at no charge. A number of states now require providing these services.
- Don't delay in sending the notices once you determine the nature and size of the breach and have taken steps to correct it. Some state laws have tight timeframes for when notices to consumers and government authorities must go out.
- Test your response program periodically and make appropriate changes.
- Consider obtaining cybersecurity insurance to cover costs of responding to a breach. Cybersecurity insurance is available in forms to cover specific costs (e.g., costs to notify customers and provide credit monitoring, costs of forensics and other consultants to identify and contain the breach) and is affordable based on the extent of coverage and policy deductibles.

Consumer information must be kept secure and confidential at all times and it is important to protect information from the moment it is received until the moment it is securely destroyed. A study by Michigan State University estimated that 51% of all security breaches occur in the workplace, so tracking and monitoring the activity of dealership employees with respect to their access to customer information – in both printed and electronic form – is very important. The FTC has cited a failure to monitor system logs as another deficient security practice.

A critical issue is employees using their personal smart phones, tablets and other personal devices to access non-public personal information of consumers through their employer networks. "BYOD" or "bring your own device" has become the shorthand expression for use of personal devices for business purposes. The benefits of BYOD often include reduced hardware costs for the company as well as greater employee satisfaction from using a single portable device for workplace and personal use.

However, BYOD use adds another element of security risk that should be addressed in your Safeguards Program. A comprehensive risk assessment should be conducted to assess whether employees are already using their own devices for dealership business and accessing non-public personal information of consumers in doing so. The risk assessment should identify the types of devices and security features available to select the best technical means for program implementation, and develop the specific policies and procedures governing BYOD administration and management. A good example is Multiple Device Management Software (MDM) that controls all third-party devices accessing your system and sends and receives information from the device securely. Lack of physical control over the device should be high on the list for every dealership – the baseline assumption always is that the device will be lost or stolen, or at the very least, accessible to unauthorized third parties. Placing tracking devices on these devices if lost or stolen is a prudent security practice but may raise privacy concerns among employees. Another good practice is to make it clear that intertwining business and personal communications on one device creates a risk of personal information being exposed when parties are in litigation. A best practice is to provide that the employer has the right and capability to wipe or erase all data remotely from any device used for business purposes—and that means the device may be wiped entirely, including personal photos and contacts. Dealerships also must consider various technical issues, which include the use of untrusted devices, wireless networks or applications; support for multiple mobile operating systems; installation of security patches and software updates; and interaction with other systems for data synchronization and storage. In the FTC's 2012 consent decree with a Georgia dealer that encountered a breach of 95,000 consumers, the genesis of the breach was a P2P system installed on an employee's home PC that the employee used to access dealership customer non-public personal information and which thereby became available to other users of the P2P network who were able to access the customer information as well. In 2014, hackers broke into JPMorgan Chase's system through the personal computer of an employee who was working from home. From there, the intruders reportedly were able to move further throughout the network through the employee's virtual-private-network connection. Vendors with access to your customer information should be limited and monitored. Home Depot's huge data security breach occurred when a vendor using a compromised PC accessed Home Depot's system which allowed a hacker to get into Home Depot's system as well and create accounts and stealth utilities to steal data.

Employees may resist the implementation of security software and measures on their personal devices as well as forced encryption of customer information in transit to and from the device and at rest on the device which is a best practice. Dealerships also must detect and prevent "jail breaking" of the device where the employee circumvents the organization's security policies and measures, a practice that MDM software can make more difficult. Consider having the dealership provide remote devices to employees that you can centrally manage and secure.

**FTC Consumer Report Information and Records Disposal Rule** – The Disposal Rule requires persons who maintain or otherwise possess consumer information for a business purpose to properly dispose of such information by taking reasonable measures to protect against unauthorized access to or use of the information in connection with its disposal. For example, paper records should be cross-shredded, burned or pulverized so the consumer information cannot be read. Consumer information must also be destroyed or erased from all electronic media so that the information cannot be read or reconstructed. For PCs, copiers, smart phones, tablets, and fax machines, this means not only deleting the information but wiping the hard drive clean, as deleted information can remain on the hard drives of these digital devices even if the data is "deleted" by the user. The FTC has ruled that consumer information should be retained only for the period during which it is actually needed, and then securely destroyed. Adopt and follow a strict consumer records retention and destruction policy at your dealership. Also, the Disposal Rule requires due diligence and supervision of your records disposal company as well. Records destruction procedures should be included as a part of a dealership's Information Security Program and followed systematically.

Also, the Fair Credit Reporting Act ("FCRA") prohibits printing more than the last five digits of a credit or debit card number or the card's expiration date on any electronically printed card transaction receipt. Damages for doing so are $100 - $1,000 per receipt for willful violations (generally a knowing or reckless violation) with no cap on damages in a class action. MasterCard and Visa can also assess fines starting at $5,000 for the first violation and going up from there. Make sure your card processing machines are set up to not print any more than the last five numbers and do not print the card's expiration date as this has been a source of many class actions.

**State Data Security Laws** – States are also enacting strict data security laws that apply to all organizations that maintain information about their residents. Massachusetts mandates that any entity that possesses personal information on any Massachusetts residents must develop a comprehensive written information security program and adhere to a series of specific data security requirements, including strict user ID protocols, limiting information collected, and encrypting all personal information stored on laptops and portable devices or transmitted wirelessly or across public networks. Employee access must be limited and paper records must be locked up. Nevada also requires encryption when electronically transmitting any personal consumer or account information of Nevada residents and has effectively codified the Payment Card Institute

Data Security Standard ("PCI-DSS") for credit and debit card information and transactions. Minnesota and Washington make merchants who retain certain credit or debit card information (CVC numbers, debit PINs or magnetic stripe data) liable to card issuers for the cost of issuing replacement cards if there is a breach of security of the retained information. Texas, Massachusetts and California are considering similar laws and regulations. Card issuers have sued merchants who are breached to recover their cost of paying losses on stolen cards as well as the cost of notice and reissuance of new cards. These costs have become effective as of October 1, 2015; cards with computer chips will replace magnetic stripe cards and the cost of producing a chip card well exceeds the cost of producing a mag stripe card. The use of chip cards also requires more sophisticated card readers that can read a random code generated by the device. If you do not have and use such a chip card reader after October 1, 2015, you the dealer face the risk of being liable for a fraudulent transaction committed using a chip card.

Plaintiffs in data breach cases have also been more successful recently in avoiding having class actions dismissed at the outset. In one case in the federal Seventh Circuit, a merchant compromise of 350,000 cards was followed by 9,200 customers having incurred fraudulent charges to their accounts. The court indicated "there are identifiable costs associated with the process of sorting things out"—the aggravation and loss of value of the time needed to set things straight (get replacement cards, etc.), to reset payment associations after card numbers are changed, and to pursue relief for unauthorized charges. With respect to the plaintiffs who have not yet seen fraudulent charges on their accounts, the Seventh Circuit said those plaintiffs had standing because there was a "substantial risk" of future harm. This alleged actual injury was enough to let the class action against the merchant go forward. The remaining victims were also required to spend time and money replacing cards, fighting off fraudulent charges, and monitoring their credit scores. This too was considered sufficient for the class action to proceed.

**Social Security Number Protection Laws** – At least 34 states have passed laws restricting the use, communication, posting or mailing of Social Security numbers (SSNs). Many of these state laws prohibit denying goods or services to a person who declines to give their SSN. Twenty-six states, including California, New York, Texas and Pennsylvania, prohibit printing of SSNs on ID cards. Twenty-eight states prohibit communicating SSNs to the public or posting or displaying them, and 24 states prohibit mailing SSNs within an envelope. At least six states—Connecticut, Massachusetts, Michigan, New Mexico, New York and Texas—require companies that collect SSNs to have policies in place to protect the SSNs. The Texas law applies to businesses that require a person disclose their SSN to obtain goods or services or enter into a business transaction with the company. Connecticut, Michigan and Texas also require businesses to disclose their SSN protection policy on their websites or in paper copy. In Texas, this means that any business which requires individuals to disclose their SSN, must have a SSN protection policy and must make the policy available to the individuals concerned. The protection policy must be geared towards protecting all personal information, not only the SSN.

California's law provides a good example of prohibited activity. The law prohibits:

- Printing SSNs on ID cards or badges
- Printing SSNs on documents mailed to customers, unless the law requires it or the document is a form or application
- Printing SSNs on postcards or any other mailer where it is visible without opening an envelope
- Avoiding legal requirements by encoding or embedding SSNs in cards or documents, such as using a bar code, chip, or magnetic strip

- Requiring people to send SSNs over the Internet, unless the connection is secure or the number is encrypted
- Requiring people to use an SSN to log onto a web site, unless a password is also used
- The law applies to businesses, government, and other entities.

SSNs should be truncated in any visual or printed form and be safeguarded in electronic and paper files. Encryption of Social Security numbers is a best practice for electronic records and mandatory in transmitting Social Security numbers over electronic networks such as the Internet.

**Security Breach Notice Laws** – As noted above, 48 states, Puerto Rico, the District of Columbia and the City of New York have enacted laws requiring businesses, including dealerships, to give notices to their residents in the event their personal information is compromised. Texas has extended its law to cover all persons in all states. However, these laws are not consistent in terms of what types of information breaches trigger the notice requirement (for most, it is name plus Social Security number, drivers license number, or account number plus any required PIN but California and Florida include email address and log-in credentials or a security question answer); the timing, content and manner of giving notice; notices to give to government agencies, law enforcement, and credit bureaus (e.g., in Massachusetts the Attorney General must be notified, in New Jersey, the state police); and penalties for failure to give notices in a timely manner. If your consumer information records (physical or electronic) are wrongfully accessed or used, you may be subject to different and conflicting notice requirements depending on where the affected customers reside. Your Information Security Program must contain a response program with procedures to identify and stop the breach, notify law enforcement and list requirements for data breach notices that comply with the state laws of where your customers are located, including having template notices for each state already drafted. Federal legislation to provide for a uniform national form of breach notice and requiring two years of free quarterly credit card reports to victims has been introduced in the U.S. Congress but no legislation has passed as of the date of this Compliance Guide.

**FTC Safeguards Enforcement Activity** – As previously noted, the FTC has taken a very aggressive approach toward companies with inadequate data security practices, by bringing over 53 enforcement actions using its sweeping "unfair or deceptive acts or practices" authority under Section 5 of the FTC Act as the hook. The federal Third Circuit affirmed the FTC's power to oversee cybersecurity. The court stated in a unanimous ruling that "deficient cybersecurity" practices, which "fail to protect consumer data against hackers," may be found to be "unfair" practices under the Act, subject to FTC enforcement. In addition to the inadequate data security practices (listed in FTC Safeguards Rule above), the FTC has cited, among other things, keeping sensitive information longer than it is needed; using commonly known default passwords; using P2P networks to transmit sensitive information; allowing wireless access to sensitive information; and excessive file-sharing as examples of security shortfalls. During the past year, the FTC brought and settled numerous enforcement actions against companies that did not have adequate data security programs in place. The FTC considers inadequate data security practices to be an "unfair trade practice" for which it can seek enforcement and oversight penalties along with monetary fines. Consent decrees entered into by the FTC have included 10-20 years of FTC oversight, biennial audit certifications by specialized security firms, monetary penalties that can total up to $16,000 per violation, and costly mandatory systems and operational upgrades. A senior FTC official stated that auto dealers "should treat consumer information as if it were cash."

**Identity Theft**

**OFAC** – The U.S. Treasury Department's Office of Foreign Assets Control ("OFAC") mandates that no U.S. person (including auto dealers) can do any business—cash or credit—with persons or entities included on OFAC's list of Specially Designated Nationals and Blocked Persons ("SDN List"). These are lists of persons or entities suspected of being associated with or funding terrorist organizations and other criminal enterprises. The list is frequently updated, making it difficult to check on your own although a searchable version of the list is published on OFAC's website, http://www.treasury.gov/ofac/downloads/sdnlist.txt. A credit bureau or electronic identity verification service can systematically check a customer against the current SDN List. You must run all of your customers – both cash and credit – against the SDN List. You should also run service and parts customers who make unusual orders (e.g., high quantities of materials that could be used in making an explosive device) or who otherwise seem suspicious. If you get a preliminary match, OFAC lists a series of steps to determine if you have a true match or a false positive. If you believe you have a true match after following those steps, you must call OFAC at 800-540-6322 or 1-202-622-2490, and you cannot do business with that person unless instructed otherwise. Penalties can include civil penalties of $1 million per violation, fines up to $10 million, plus imprisonment for up to 30 years. In 2015, OFAC imposed a civil penalty of $7.7 million against PayPal for inadequate SDN List checking procedures and a penalty of $1.7 million against UBS for facilitating securities transactions with a person on the SDN List. Given the presence of terrorist groups such as ISIS targeting terrorist attacks in the U.S., it is important to run OFAC checks on persons who rent vehicles from your dealership or engage in other acts that could be an element of a terrorist act. You don't want to be the dealer that sold parts, vehicles or other devices that helped facilitate a terrorist attack on our homeland.

**FTC Red Flags Rule** – The Red Flags Rule requires a dealership to perform a risk analysis to develop and implement a written Identity Theft Prevention Program ("ITPP") to detect, prevent, and mitigate identity theft. It is not a "one size fits all" rule. A dealer's ITPP must be appropriate to the size and complexity of the dealership and the nature of its operations. The Red Flags Rule does not apply to cash sales, although if a customer pays more than $10,000 in cash or cash equivalents, you must file an IRS/FINCEN Form 8300 within 15 days of the cash sale and send a written notice to the customer that you have filed the Form 8300 by January 31 of the following calendar year. See "Cash Sales" in Chapter 5.

A robust ITPP that you consistently apply with all customers is important, as the FTC indicated Red Flags would be a priority area for 2016. The Red Flags Rule is designed to prevent your dealership from becoming a victim of identity fraud. Auto dealers lose when they finance a vehicle to an identity thief and, typically, the vehicle is long gone by the time the identity theft is discovered. Most lender agreements require the dealer to repurchase the contract with an identity thief, even if the customer has made several payments. The Red Flags Rule goes a step further. The Rule requires lenders to do periodic reviews of accounts in their portfolio (along with written-off accounts) to attempt to detect and mitigate further identity theft. So more lenders are examining delinquencies and written-off accounts for identity theft, even accounts that may have paid for substantial periods of time. Instead of just writing these accounts off as credit losses as they did in the past, lenders are now forcing dealers to repurchase accounts they identify as identity theft accounts, such as sales to illegal immigrants, even if the identity thief has made payments for a period of time. A dealer in Utah received three "repurchase" demands in one day from a national lender on accounts that had been originated and assigned by the dealer to the lender up to a year earlier. This "back end" repurchase risk presents perhaps your biggest financial risk from identity theft. A good ITPP program will protect you, the dealer, more than anyone else.

The dealer's Board of Directors (or its highest governing authority) must approve the initial ITPP, and take responsibility for it. A senior officer must be appointed to be the ITPP program manager ("Program Manager"), responsible for developing, overseeing, implementing, training, updating, and administering the ITPP, but the final responsibility will rest with the Board of Directors or the senior management team.

The Red Flags Rule requires a four-step compliance process: The first step is to identify appropriate "red flags" for your ITPP. Red flags are patterns, practices or specific activities that indicate the possible existence of identity theft. The Red Flags Rule lists 26 potential red flags that you must consider for your ITPP, but many will not apply to auto dealers. Others may. The types of covered accounts a dealer originates (and for Buy-Here-Pay-Here dealers, the covered accounts it maintains), a dealership's individual experiences with identity theft and those of similarly situated dealerships, and appropriate regulatory and law enforcement guidance may be the best sources for determining your dealership's red flags. For example, red flags for accounts that are opened over the Internet (like eBay Motors) may differ from those accounts originated face-to-face at your dealership.

The second step of the Red Flags Rule is to employ procedures to detect the presence of any of your identified red flags in individual consumer credit transactions as well as business credit transactions you identify as posing identity theft risks. An electronic identity verification service such as Dealertrack Red Flags can help you compare the customer's reported information to fraudulent databases and stolen Social Security numbers, among other red flags. Also it is important to examine customer's IDs (front and back) for tampering or counterfeiting, and to carefully review credit reports for unusual patterns of recent activity or other irregularities. These are three excellent ways to identify red flags in customer transactions for persons who come to your dealership. Internet customers who you may never meet require even more diligence. Out-of-wallet or knowledge-based authentication questions that ask information which only the real person would know (an example is listing five people and asking which one the customer knows, one being the real person's brother-in-law) can help determine the legitimacy of the customer's identity. Out-of-wallet questions are available from electronic identity verification services and are critical for Internet customers whom you will never meet personally at your dealership store although it is always a good idea to try to get the customer to come to the dealership to pick up the vehicle.

The third step requires your ITPP to have steps to take when you identify red flags in customer transactions but cannot adequately clear them with the customer, such as by the customer providing additional documents or information such as a passport, Social Security earnings statement, or original utility bills. Out-of-wallet questions also provide a way to gain comfort with the customer's identity if red flags are uncovered. Escalate any unresolved red flags to the Program Manager and continue to question the customer until you are satisfied, one way or another. In August 2009, a dealer in Colorado was suspicious of a customer and questioned him during a test drive. The dealer declined to do business with the customer, who was later arrested in New York City for possessing bomb-making materials and charged with planning a terrorist attack in New York. Identity thieves like fast, easy transactions and will often come to a dealership late at night before closing on a weekend. If they encounter a diligent ITPP and are detained with questioning and requests to document their identity, many will just leave and go to another dealer who is not as diligent.

For the fourth and final step, you must update your ITPP periodically (but not less often than once per year) based upon your dealership's own experiences and new information concerning identity theft from regulators, law enforcement and industry experts. An ITPP is a dynamic program and should be re-evaluated continually. For example, one new wrinkle on identity theft and Safeguards involves the thieves contacting overnight delivery couriers to request a change of delivery address for a package containing a customer's personal deal documents and misrouting them to the criminal. It is a good practice to instruct any overnight courier service you deal with not to permit any re-routing of deliveries for packages you send out to customers.

Employees who perform program functions should prepare annual reports to the Program Manager concerning the ITPP's effectiveness and making suggestions for improvement. The Program Manager should then use these reports and other identity theft resources to make an annual report to your Board or senior management detailing the effectiveness of the ITPP and proposing material changes. Training of employees and strict oversight of ITPP service providers who have access to your customers' data are also critical tasks that the Red Flags Rule requires. Document everything you do and keep copies of all identity-related documents (e.g., the report of the electronic identity verification service and anything the consumer gives you to prove their identity) in the deal jacket in case you are audited. Apply your ITPP to every customer unless you know them personally.

As noted above, identity theft fraud to finance autos is on the rise. In 2007, only 4% of reported finance-related identity theft fraud involved auto financing. In 2008, the figure rose to 22% of reported identity theft finance fraud, and in 2009 auto credit identity fraud was 29% of reported incidents. (Source: Identity Theft Resources Center). New identity fraud credit accounts increased by over 20% in each of 2010 and 2011. A government report issued in 2009 found that only 50% of attempted identity fraud in auto finance was detected prior to funding. In 2014, the National Insurance Crime Bureau uncovered an identity theft ring in Detroit that fraudulently leased five cars worth more than $300,000, which the thieves altered the VINs and planned to sell to unsuspecting consumers.

Many garage policies no longer cover identity theft losses, or charge a substantial incremental premium to do so.

**The FTC Address Discrepancy Rule** – The FTC Identity Theft Address Discrepancy Rule ("Address Discrepancy Rule") is a companion rule to the Red Flags Rule. It requires users of consumer reports who receive a notice of address discrepancy from a consumer reporting agency to have reasonable policies and procedures in place to form a reasonable belief that the consumer report relates to the consumer about whom the report was requested. There are multiple John Smiths and this Rule is intended for you to take appropriate steps to verify that you have the right one. Dealers who establish a continuing relationship with consumers for whom they have received a notice of address discrepancy and who routinely furnish information to consumer reporting agencies, must also reasonably confirm the accuracy of the address provided by such consumers and furnish the verified address to the consumer reporting agency that provided the consumer report and notice of address discrepancy.

# Case Studies

On June 14, 2012, the FTC entered its first consent decree with an auto dealer for violating the Gramm-Leach-Bliley Act, the FTC Privacy and Safeguards Rules, and Section 5 of the FTC Act.

The 20-year consent decree which requires biannual certifications from a professional security firm was based on the dealer's lackluster compliance with the FTC Safeguards Rule, particularly by allowing a salesman who had downloaded a P2P file-sharing network on his home computer to access the dealership server remotely, compromising the non-public personal information of 95,000 customers. Any violation of the consent decree will cost the dealer $16,000 each and this figure will no doubt be amended upwards over the course of the 20 years. The security audits alone will cost the dealer a substantial sum every two years.

A P2P (peer-to-peer) file-sharing network (think of Napster as an early version) refers to a computer network in which each computer in the network can act as a client or server for the other computers in the network, allowing shared access to files and peripherals such as music or videos, without the need for a central server. P2P networks are commonly used to share and play videos, music, games, and other interactive content. In effect however, every person on the P2P network can access data from every other person on the network and, in this case, that data included the customer information contained on the dealer's central servers. Files shared on a P2P network are available for viewing or downloading by anyone using a PC with access to the P2P network, and data frequently can't be deleted from the network. You really need to do an IT review of your system to see if a P2P network has been installed by any user. Your people may use them to share games, videos, and music, but P2P networks can share customer data as well.

The FTC also determined that the dealer had failed to assess risks in consumer information it collected and stored online and didn't adopt any policies, such as an incident response plan, to limit the extent of disclosure. The dealer also failed to use methods to detect and investigate unauthorized access to information or adequately train employees. Implied but not stated was that the dealer did not have in place a formal Safeguards Information Security Program, as the FTC cited the dealer for not designating an officer to head the Program.

The dealer also had problems with privacy notices. The FTC determined that the dealer was not sending privacy notices to its customers and failing to provide a mechanism for consumers to opt out of third-party data sharing. Their privacy notice is attached to the FTC's complaint, and it is woefully inadequate under GLB. Among other things, it says, "We do not provide for an opt-out due to agreement made where the disclosure is necessary to process or service a transaction for you the consumer therefore not required."

In 2015, the federal Seventh Circuit Court of Appeals ruled that the risk of future harm to affected customers is enough to enable the customers to sue, including on a class action basis, the company that allowed their personal information to be compromised. In reversing a lower court that had dismissed the case, the Seventh Circuit Court held the likelihood of personal data exposure following a system breach "is immediate and very real." This was the first federal appellate court to rule on the issue of standing (ability to sue) to assert data breach claims. The case will mean that dealers and other companies that incur a security breach will have to contend with more lawsuits after security breaches. In the case, it was uncontested that the data breach exposed 350,000 consumers' personal data. In discovery, the defendant company acknowledged that 9,200 individuals' credit card data had since been used fraudulently. The Seventh Circuit determined that the breach victims "should not have to wait until hackers commit identity theft or credit-card fraud in order to give the class standing, because there is an 'objective reasonable likelihood' that such an injury will occur.' In so finding, the Court asked "Why else would hackers break into a store's database and steal consumers' private information." If a victim has standing as the Seventh Circuit ruled, claims for negligence, breach of contract, and UDAP violations could be asserted. Statutory as well as actual damages could be available along with recovery of the victim plaintiffs' attorney's fees.

# Recommended Practices

1. The FTC has identified 10 critical steps for data security of non-public personal information (NPI):

   a. Start with security – Don't collect or keep NPI you don't need and design data security in all aspects of your business.

   b. Control access to data sensibly – Actively manage your data and develop policies to manage it during its lifecycle. Limit permissions to those who need it and give permissions to only what they need. Don't keep NPI longer than you need to do so.

   c. Require secure passwords and authentication – consider two-factor authentication to access NPI. Something you know (a complex password) and something you have (a randomly-generated number from an ID token).

   d. Store sensitive personal information securely and protect it during transmission – Encrypt NPI and other sensitive data in accordance with best industry practices during its lifecycle.

   e. Segment your network and monitor who's trying to get in and out – Monitor using firewalls, intrusion detection software, and don't allow computers to connect to computers as attacks can bleed from one to others.

   f. Secure remote access to your network – Ensure endpoint security and put limits on access in place.

   g. Apply sound security practices when developing new products – Train developers and engineers in secure coding, test and verify proxies and vulnerabilities. Conduct a privacy impact assessment for new products.

   h. Make sure your service providers implement reasonable security measures – Do due diligence, contractually require protections and have an audit capability. Try to assess liability for data security breaches.

   i. Put procedures in place to keep your security current and address vulnerabilities that may arise – Have a detailed security incident response program included in your Safeguards policy. Update your security software and procedures on a regular basis.

   j. Secure paper, physical media, and devices – Prevent NPI from being downloaded or copied onto remote devices like USBs or external hard drives. View-only access to NPI on a segregated server is a best practice.

2. Create a culture of security in your dealership and get senior management buy-in. Limit permissions to access customer information to only those persons who need access to perform their jobs; require passwords to contain letters, symbols and numbers and be changed frequently. Know the flow of information that enters your system and monitor for any unusual data flows in or out. These may be signs that a hacker has entered your system and is compromising security. Keep logs of who accesses customer information and when they do so for both electronic and paper files. Train your employees on the importance of safeguarding customer infor mation. Do not leave credit apps or credit reports out in the open or in unsecured file drawers. Consider using processes that can determine if your employees are actually following the policies and procedures in your Information Security Program. Regularly review access logs of the consumer information records

and follow up promptly if you see any unusual spikes in any employee or other user accessing customer files. Lock down files at night and on weekends and implement a “clean desk” policy that requires all paper documents containing customer information to be locked up when not in use. The FTC fined a dealer in Georgia $30,000 for having documents containing customer information located in plain sight on a salesperson’s desk.

3. Create an Information Security Program that details how you safeguard and securely dispose of all your consumer information. Include a detailed data security incident and security breach response plan in the Information Security Program. Follow FTC guidelines for Information Security Programs and know your state’s law on use, communication and display of Social Security numbers and consumer notification requirements in the event of a data breach. Avoid storing consumer information longer than is necessary or allowing access using widely-known simple passwords. Make sure your dealership’s Information Security Program includes detailed provisions for the secure disposal of consumer information, both paper and electronic. Train and re-train employees, perform stress tests to evaluate your systems regularly and update provisions as required. Destroy hard drives and flash drives on computers, copiers, fax machines and wireless devices using industry standard procedures before discarding them or trading them in for replacements. Disable USB flash memory drives. Try to store customer information only in secure central servers and preclude the ability to download it. Some states (for example, Massachusetts) require that customer information contained on laptops, tablets, cell phones and other remote devices must be encrypted. Massachusetts and Nevada also require personal information about residents be encrypted in transmissions, which is a best practice in any event and required for credit card data transmission.

4. Manage user permissions to give customer information access only to those employees and service providers having a legitimate business need and give them only the permissions they need. More than half of all identity theft originates in the workplace according to a recent study. In addition to negligently making customer information available for theft by outsiders, employees can and do steal customer information and sell it to identity thieves. So it is critical that you keep event access logs of those persons who access your customer information in both paper and electronic files. Review the access logs regularly to monitor patterns of irregular activity by users. Set your system to prevent downloading or file transfers of customer information to computers, USB memory sticks, PDAs, cell phones, tablets, or other remote devices, and disable PC PSTs. If you have a credit application on your website, make sure it is encrypted and begin safeguarding and tracking access to it from the time it is completed by the consumer and securely transmitted to your dealership. Keep your anti-virus, anti-malware, and firewall software up to date. If you permit employees to use their own devices to access dealership information, do a risk assessment of BYOD issues and see if it is feasible for your dealership to implement a policy to enable employees to use personal devices. If so, employ MDM software to manage the devices. If not feasible, cease their ability to do so and require that only company-issued devices be used to access dealer databases and information.

5. BYOD policies present challenges for dealers. Dealers can go a long way towards controlling risk by: 1) ensuring that employees are adhering to strong passwords and are using the same security software and rules that are dealership policy for other applications; 2) having an "acceptable use" policy that ensures that employees are not sharing their device with other persons; prevents viewing inappropriate material; and controls what applications are installed; and 3) encrypting any corporate-owned data that might reside on the device. Text messaging should also be discouraged as it is discoverable from the device in litigation and the use of acronyms or shorthands often leads to misunderstandings that can be potentially

damaging. Have a pre-established plan in place to deal with data security breaches. The FTC has said that your Information Security Program must include a detailed incident and breach response and notice plan to execute in the event of any security breach or database hack in which customer information is or may have been wrong fully accessed, whether by internal or external persons. Pre-identify a team of people to manage the breach and responses. The team should represent each department that might be affected by a breach or that has to be mobilized to interact with the public, including legal, human resources, privacy, security, IT, communications, and, if you are publicly traded, investor relations. Part of the team's role is to analyze risks to data, data flow, and worst-case scenarios. Test your plan periodically by doing mock drills. Consult your attorney to know your state law and the laws of your customers' states of residence about when you have to give notices to customers about data breaches. Consumers have recently been more successful in claims against retailers for not timely giving notice under state data security breach notice laws. For example, in a case against Target based on its breach of credit card information, consumers filed cases under all 48 state laws, some of which did not allow for private lawsuits. But other state laws were ambiguous—as was the case in Colorado, Delaware, Iowa, Kansas, Michigan and Wyoming—and the court permitted the plaintiffs' cases to go forward. Where state laws were silent as to a private right under the security breach laws, the court inferred a private right of action in all states except Rhode Island where if a law doesn't give a private right of action, it cannot be inferred. But as to all other states, the court agreed with the plaintiffs that there is an implied right to sue under the data breach notification laws. In 2015, a California court ruled similarly with respect to the Sony data security breach involving claims of negligence, breach of implied contract, and statutory claims. Sony argued that the plaintiffs endured no current or threatened injury that is impending, but the court rejected those arguments. The judge stated "The[se factual allegations] alone are sufficient to establish a credible threat of real and immediate harm, or certainly impending injury."

6. Prepare template customer communications in advance and consider retaining a forensics expert who can quickly capture and analyze your IT system to identify the source of an electronic breach and mitigate further losses. Consider channeling all third-party communications through only one person for consistency. The steps you take in the first 48 hours after a data security breach may be the most critical to mitigating the breach and minimizing losses. Those steps should be laid out in advance in your security breach response plan. That is why your plan should assign roles to breach team response members in advance so each knows their precise responsibilities and the response team can be immediately assembled.

7. Do not transmit customer information over insecure channels such as unencrypted email, P2P systems, or wireless access points. These are not secure media. The FTC has cited the absence of data loss prevention software and an intrusion detection system in these media as inadequate practices for an Information Security Program.

8. Run an OFAC SDN List check on every customer, cash or credit. If you get a preliminary hit, follow the steps listed by OFAC to determine whether the hit is a "false positive." Do not do business with the customer until you are certain that they are not the person listed on the SDN List. Keep a record of OFAC checks for 5 years.

9. Develop a risk-based Red Flags Identity Theft Prevention Program ("ITPP") and implement it consistently for all consumer credit customers and business credit customers that present identity theft risks. Use your ITPP with every customer and document that you're doing so. Choose red flags that are appropriate to the size, location and activities of your dealership. If you sell vehicles over the Internet or to customers who never physically come to your dealership, take enhanced steps to verify those customers' identity. Examine photo IDs, look at recent credit bureau

activity, and use an electronic identity verification service to compare customer information against databases of fraudulent activity and to assess the customer's given Social Security number. Identify any red flags in your ITPP that these actions reveal. If you cannot readily resolve the red flags with the customer, use knowledge-based authentication "challenge" or "out-of-wallet" questions as well. One best practice to address a questionable Social Security number is to ask the customer to access their Social Security earnings statement on their smartphone or a dealership PC. This can be done at http://www.ssa.gov/myaccount/. Escalate problematic customers to your Program Manager and continue to seek additional information or ask more out-of-wallet questions. Make sure your ITPP program has a process for documenting your ITPP activities for each credit customer. Do ongoing training and periodic testing of your ITPP. Refine and update your Program as new information about identity theft comes to your attention. Don't forget about holding an annual Program review for participating employees and making an annual report to your Board of Directors and senior managers.

10. Educate your employees about the risks of identity theft and the three social networking attacks of phishing (websites that are established to look like legitimate sites and emails claiming to be from people you know or recognize); vishing (phone calls from identity thieves claiming to be from financial institutions or other credible sources seeking personal information); and smishing (text messages on mobile devices). As email spam filters have become more sophisticated, fraudsters have turned to other socially engineering methods that prey on consumers' trust. The common use of mobile devices makes smishing an easy scheme. Tell employees not to click on any Internet link unless they are certain of the legitimacy of the source. Emails purporting to be genuine from friends, law enforcement, or trusted institutions contain links that unload malware onto the employee's PC and network if clicked on. Remember that Dealertrack will never ask for your password or call you to initiate a password resetting session. If you receive any such calls, report them immediately to security@dealertrack.com.

# Additional Resources

## FTC Safeguards Rule:

**Department of the Treasury, information and links to the OFAC SDN List:**
http://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/default.aspx

**OFAC – The Seven Steps to Take if You Get a Preliminary OFAC SDN List Match for a Customer:**
http://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_compliance.aspx#match

**Searchable OFAC List:**
http://www.instantofac.com – A site that lets you enter a business name to see if it matches an entry on the OFAC list.

**FTC Safeguards Rule:**
https://www.ftc.gov/enforcement/rules/rulemaking-regulatory-reform-proceedings/standards-safeguarding-customer

**Consumer Information Disposal Rule:**
https://www.ftc.gov/tips-advice/business-center/guidance/disposing-consumer-report-information-rule-tells-how

**Start with Security: A Guide for Businesses**
https://www.ftc.gov/tips-advice/business-center/guidance/start-security-guide-business

**State Data Security Breach Notification Laws:**
http://www.ncsl.org/default.aspx?tabid=13489

or

https://www.perkinscoie.com/en/news-insights/security-breach-notification-chart.html

**Information Compromise and the Risk of Identity Theft: Guidance for Your Business:**
https://www.ftc.gov/tips-advice/business-center/guidance/information-compromise-risk-identity-theft-guidance-your

**List of Social Security number 3-digit originating "area numbers" assigned to each state:**
http://www.socialsecurity.gov/employer/stateweb.htm – Note that beginning June 25, 2011, the Social Security Administration began to issue Social Security numbers at random and ceased using the assigned state 3-digit origination numbers for new SSNs.

**Good article on phishing, pharming, vishing and smishing:**
http://security.intuit.com/phishing.html

**“On June 14, 2012, the FTC entered its first consent decree with an auto dealer for violating the Gramm-Leach-Bliley Act, the FTC Privacy and Safeguards Rules, and Section 5 of the FTC Act.”**

**- FTC Ruling**

—

# Chapter Four



—

# Privacy and Consumer Information Sharing

## Background

Federal law and regulations limit how dealers can collect, use, and share non-public personal information as well as credit information about a person. A number of laws and regulations require that dealers give disclosures concerning information collection and sharing practices to potential customers before they become customers (which occurs when they receive a financial product or service from the dealer), and to consumers (persons who provide information to seek but don't obtain a credit product) prior to the time the dealer intends to collect, use, or share their information. Customers and consumers both have the right to opt out of some, but not all, information use and sharing.

By its own count, the FTC has brought more than 300 privacy-related enforcement proceedings over the past 15 years. This Chapter discusses federal laws and regulations relating to customer information collection, use, and sharing, and the privacy of consumer data. As used here, the word "customer" will mean both consumers and customers unless otherwise stated.

## Important Laws and Regulations

**The Fair Credit Reporting Act ("FCRA")** – The FCRA requires a dealer to have a "permissible purpose" to access a customer's credit report or credit score. The FCRA also contains restrictions on sharing and using customer credit and consumer report information with both affiliated and non-affiliated companies. It requires notices to be given to customers about certain information sharing ("FCRA Privacy Notices"). FCRA Privacy Notices are typically combined with privacy notices required by the Gramm-Leach-Bliley Act ("GLB") into one comprehensive privacy notice for the dealership ("FCRA-GLB Privacy Notice"). In fact, GLB requires that you include in your privacy notice any disclosure required under the FCRA regarding certain types of sharing. The FTC has published model "safe harbor" privacy notice forms and has a privacy notice form-builder feature on its website, www.ftc.gov. See the list of resources at the back of this Chapter for the exact web page sites. The FCRA categorizes consumer credit information into two types:

1. "Transaction and experience" information, this being the dealer's own experience with the customer such as a customer's payment history on any credit account (for example, a service department "house" account or a customer's payment history for a buy-here-pay-here dealer account), name, address, and phone number would be a species of transaction and experience information; and

2. "Other" information, which is essentially any information obtained from a credit report, a credit score, or credit information about the consumer obtained from a third party ("credit information").

Under the FCRA, dealers can share transaction and experience information with affiliates, such as sister dealerships, insurance affiliates or a parent company, although the affiliates' use of the shared information is subject to the requirements of the Affiliate Marketing Rule discussed below. The Affiliate Marketing Rule applies to all affiliate sharing of any customer information, both transaction and experience information and credit information. So while a consumer cannot prevent sharing of transaction and experience information with a dealer's affiliates, he or she can opt out of the affiliates using that information to market to them under the requirements of the Affiliate Marketing Rule.

Dealers may share transaction and experience information with non-affiliates (unrelated companies such as sellers of non-automobile products, realtors, charities, or local merchant associations) if the customer is given an FCRA-GLB Privacy Notice describing the right to opt out of non-affiliate sharing of transaction and experience information and the customer fails to opt out.

Under the FCRA, dealers can only share credit information with their affiliates, and then only if the customer is given notice of the sharing and the right to opt out, but fails to do so.

Whenever the FCRA or GLB gives the customer the right to opt out of data sharing, the FTC has said the dealer must wait 30 days from giving the customer a privacy notice before beginning to share information. This is so the customer has time to decide whether or not to opt out up front although the customer can opt out of sharing later at any time and the dealer must promptly then cease to share the customer's information. The 30-day rule does not apply if the customer has no right of opt out, such as when an affiliate or third-party is acting only as a service provider to the dealer for the customer's transaction or a joint marketer as discussed below. However, such sharing is limited to the service provider performing the service or the joint marketing of a financial product or service with another financial institution and the customer information cannot be used for any other purpose. A dealer's disclosures to service providers and joint marketers must be stated in the FCRA-GLB Privacy Notice.

**The Gramm-Leach-Bliley Act ("GLB") and the FTC Privacy Rule ("Privacy Rule")** – GLB and the Privacy Rule provide consumers with protections on how creditors are permitted to collect, use and share their non-public personal information ("NPI"). NPI is essentially any identifying information a dealer obtains from or about a customer in connection with a possible credit transaction. GLB and the Privacy Rule also require giving customers privacy notices ("GLB Privacy Notices") describing how a creditor collects, uses, and shares NPI, and giving customers rights to opt out of certain types of sharing. The Privacy Rule implements the privacy provisions of GLB. An exception to the right to opt out of third-party sharing applies and permits sharing with service providers and for joint marketing agreements with other financial companies under which the dealer and another financial institution jointly market a different credit product such as a credit card. In Vermont, consumers must affirmatively opt in to both affiliate and non-affiliate sharing, and in California, consumers must opt in to joint marketing agreements before their information can be shared.

**FTC Affiliate Marketing Rule** – The Affiliate Marketing Rule is an FTC regulation published pursuant to the 2003 Fair and Accurate Credit Transactions Act ("FACT Act"). The Affiliate Marketing Rule does not prohibit affiliate sharing of NPI, transaction and experience or credit information under the terms described above. But it does require giving the customer an additional notice (or putting additional terms in a FCRA-GLB privacy notice) that informs the customer of their right to opt out of the affiliate using the shared information to market to him or her. So if your dealership has affiliated dealerships, insurance companies, other companies or even a parent dealership group, the dealer must give its customers the right to opt out of the affiliates' use of any shared "eligibility" information (NPI combined with transaction and experience or credit information) to market to them. The Affiliate Marketing Rule notice can either be included in the dealer's FCRA-GLB Privacy Notice or be given separately. If you use a separate Affiliate Marketing notice (such as the model "safe harbor" notice published by the FTC with the Affiliate Marketing Rule), you only need to give the Affiliate Marketing notice once every five years, not every year, as you must do for FCRA-GLB Privacy Notices for as long as the consumer remains a customer. However, for consistency, it is a best practice to include the Affiliate Marketing notice in your FCRA-GLB Privacy Notice.

The Affiliate Marketing Rule contains greater potential liability than does the Gramm-Leach-Bliley Act ("GLB") with respect to customer privacy rights. While the FTC and state regulators can bring enforcement actions for failing to provide GLB Privacy Notices, customers cannot sue directly under GLB. However, the Affiliate Marketing Rule notice gives a customer the right to bring a lawsuit under the FCRA for any violation of the Affiliate Marketing Rule, including the right to bring a class action. Remedies include the possible recovery of up to $1,000 per violation plus attorney's fees and unlimited punitive damages for each willful violation, with presumably every individual solicitation by an affiliate being a separate violation. You, the dealer, are at risk if you fail to give the Affiliate Marketing Rule Privacy Notice or if your affiliate markets to a consumer who has opted out of affiliate marketing under this Rule.

The Privacy Rule enables a dealer to give one privacy notice to cover the GLB and FCRA requirements and opt-out provisions, as well as the Affiliate Marketing Rule notice requirements. It is a recommended practice to give this FCRA-GLB privacy notice to customers when first taking their personal information for credit (such as when they fill out a credit application or respond to an online solicitation). If a dealer maintains a credit relationship with a customer (e.g., a buy-here-pay-here dealer), the dealer must give another privacy notice to the customer annually during the term of the credit relationship. It is also a recommended practice to post the privacy notice on the dealership's website as well as to deliver a copy to consumers who come into your stores.

The FCRA-GLB Privacy Notice should describe how the dealer collects, uses, and shares customer NPI, including information about former customers. The FCRA requires that the privacy notice must also give the customer the right to opt out of sharing credit information ("other information") with affiliates and GLB requires the right of opt out for transaction and experience information with non-affiliates. A dealer can share customer information with service providers or financial institutions that are joint marketers (entities with which you share information solely to jointly market the financial product like a credit card, and for no other purpose); this is permitted by the FCRA and GLB provided the dealer discloses this sharing to the customer in its FCRA-GLB Privacy Notice.

The FTC and banking regulators have published model "safe harbor" FCRA-GLB Privacy Notices written in plain English using column formats. There are six alternative forms a dealer can use, depending on whether it shares information, whether it includes the Affiliate Marketing Rule notice, and how it allows customers to opt out. Four of the six forms can be printed on the front and back side of a single sheet of 8.5 x 11 inch paper; the remaining two forms require 8.5 x 14 inch paper or two sheets of 8.5 x 11 inch paper. Using one of these six forms will provide a "safe harbor" from liability for an inadequate privacy notice. The FTC has established a page on its website to construct such a privacy notice (see references at the end of this Chapter). A sample of Form 1 of the "safe harbor" notice is contained at the end of this Chapter.

Certain state laws also require additional disclosures to be in privacy notices. California, Nevada, and Vermont are three such states and dealers with consumers in those states should add additional disclosure language at the foot of their privacy notices.

Of course, the dealer's information collection, sharing, and use practices must always be consistent with what is disclosed in its privacy notices. The FTC has brought enforcement proceedings for deceptive trade practices against numerous companies including an auto dealer that did not follow the practices described in their privacy notices. For example, in August 2012, the FTC fined Google $22.5 million for misrepresenting promises in its privacy notice for users of its Apple Safari Web browser.

As noted above, for all privacy notices, whenever a customer has a right to opt out, you can't begin sharing their information until at least 30 days after the date you give them the privacy notice. The FTC has ruled the customer must have at least 30 days to consider whether or not they want to opt out and this 30-day waiting period applies to all opt-outs. The FCRA-GLB Privacy Notice should give the customer a toll-free phone number, website address, or mailing address to exercise their opt-out rights. Only if the customer fails to opt out during those 30 days may information sharing for the disclosed purposes subject to the opt out thereafter begin. If a customer opts out after the initial 30-day period, promptly remove them at that time from common databases or information that is stored and recall their information from persons you have shared it with, if possible. Reserve the right to do so in your information-sharing agreements.

Additionally, courts and the FTC have ruled that privacy notices are literally contracts between a company and its customers, so a dealership's business practices must follow what is stated in its privacy notice. The FTC has brought deceptive trade practice enforcement proceedings against companies that violated statements contained in their own privacy notices such as "we will never share any of your personal information." These proceedings show the importance of writing privacy notices using language in the present tense and not the future tense. Reserve the right to amend your privacy notice by giving the customer a revision or informing the customer that a revised privacy notice has been posted to your website. Always date your privacy notices as well.

The FCRA, as amended by the FACT Act and implementing regulations, contains other privacy provisions as well. For example, if a dealer accepts credit or debit cards, any electronically printed card receipt that is given to the customer must truncate all but the last five digits of the card number and cannot show the card expiration date. If not, class action liability can result. Damages for doing so are $100 - $1,000 per receipt for willful violations (generally a knowing or reckless violation) with no cap on damages in a class action. MasterCard and Visa can also assess fines starting at $5,000 for the first violation and going up from there. Make sure your card processing machines are set up to not print any more than the last five numbers and do not print the card's expiration date as this has been a source of many class actions.

A dealer is also required to give identity theft victims copies of transaction documents used in connection with any identity theft incident involving the use of their identity at the dealership if the customer provides sufficient proof of their legitimate identity. Social Security numbers should also be truncated to only the last four digits on printed documents to comply with many state laws.

Other than providing consumers the opportunity to “opt out” of certain kinds of data sharing, privacy notices are not negotiable and should not be negotiated with any customer, even if the customer refuses to sign the privacy notice (a customer’s signature on a privacy notice is not required). The privacy notice is a statement of the dealer’s privacy practices applicable to all its customers and changing it for any customer will create an impossible situation to monitor and comply. You should use one of the federal “safe harbor” FCRA-GLB Privacy Notice forms, and the customer’s signature, while a good practice to get, is not legally required.

**Driver’s Privacy Protection Act (“DPPA”)** – The DPPA is a federal law restricting the release and use of personal information from state motor vehicle records. “Personal information” means information identifying an individual such as a photograph, Social Security number or driver’s license number. In general, dealers can use personal information from motor vehicle records only for limited purposes such as to verify the accuracy of information the customer provides to the dealership. The DPPA makes it illegal to obtain drivers’ information for unlawful purposes or to make false representations to obtain such information. The DPPA establishes criminal fines for non-compliance, and establishes a civil cause of action for drivers against those who unlawfully obtain their information. Drivers can recover $2,500 in statutory liquidated damages plus punitive damages, attorney’s fees and equitable relief.

**Tracking Customers on the Internet**

No federal law or regulation directly prohibits the use of “cookies” to track consumer behavior on a dealer’s website or to track the customer’s linking or proceeding to other websites after leaving the dealer’s site.

However, the FTC has issued its final Privacy Report in March 2012, Protecting Consumer Privacy in an Era of Rapid Change: Recommendations for Businesses and Policymakers, indicating that Web tracking should be subject to a “Do Not Track” mechanism. The FTC has stated its support of an initiative of the Better Business Bureau in association with media and marketing companies to get companies that track consumer Web behavior to adopt a self-regulatory program that will give consumers enhanced control over the collection and use of data regarding their Web viewing for online behavioral advertising purposes. The FTC’s Self-Regulatory Principles for Online Behavioral Advertising, initially published in 2009, have been adopted by many companies that track online behavior and represent a “best practice for disclosing the nature of their Web tracking and giving the consumer an opportunity to opt out. More recently, an Advertising Option Icon and accompanying language have been adopted to be displayed within or near online advertisements or on Web pages where data is collected and used for behavioral advertising. The icon links to a clear disclosure statement regarding the company's online behavioral advertising data collection and use practices as well as an easy-to-use opt-out mechanism. The FTC has stated that privacy should be promoted at every stage of a product design and made transparent to consumers. It also has said that data should only be collected consistent with the context of a particular transaction or consumers' relationship with the company, or as required or authorized by law. Beyond that, the FTC has indicated that companies should make appropriate disclosures to consumers at “a relevant time and in a prominent manner – outside of a privacy policy or other legal document.” The Chairman of the FTC summarized their position as follows: “We have proposed a "Do Not Track" mechanism that will allow you [the consumer] to easily specify what information you want to share about your browsing behavior and have those preferences travel with you to every website you visit. Technologies to create such a system exist already.”

The FTC brought a series of enforcement actions in 2014 against companies that either indicated they did not track or offered consumers a "do not track" option, but tracked their online behavior and generated reports gleaned from the tracking nevertheless.

California and Delaware also have enacted “Do-Not-Track” disclosure laws. These laws require privacy notices to include disclosures relating to “do-not-track” and online behavioral tracking. It requires disclosing how you respond to “do-not-track” or other mechanisms that allow consumers to signal their preferences on collecting their personal information across third-party websites or online services if you collect such information. The California law also requires you to disclose whether “other parties” can collect personally-identifiable information about a consumer who uses your website over time and across different websites or services. These disclosures can be made by a clear and conspicuous hyperlink in your privacy notice to an online location describing the effect of any program you follow to allow the consumer to express its “do-not-track” preferences. The statutes generally apply to mobile apps as well.

**FTC and FCC Rules on Telemarketing and Using Cell Phone Numbers** – Regulators are cracking down on telemarketing and the making of unsolicited phone calls, especially to cell phone numbers. Almost 30% of U.S. households no longer have land lines and use their cell phone as their home number, so these new rules require caution when calling customers because the cost of calling or texting to cell phones can be $500 - $1,500 under the Telephone Consumer Protection Act.

Laws and regulations concerning telemarketing, email and fax restrictions are discussed in Chapter 2 (Marketing and Advertising Vehicles and Credit Terms) under Important Laws and Regulations.

## Case Studies

The FTC's June 2012 consent decree with the Georgia dealer dealt with the dealer's failure to deliver and adhere to promises in its privacy notice. According to the FTC, the dealer "did not provide its customers with annual privacy notices and did not provide a clear and conspicuous opt-out notice that accurately explains to its customers their rights to opt out of any sharing of non-public information with unaffiliated third parties." Additionally, the FTC cited the dealer for misstatements in the privacy policy such as "We restrict access to non-public personal information about you to only those employees who need to know that information to provide products and services to you. We maintain physical, electronic, and procedural safe guards that comply with federal regulations to guard non-public personal information." The FTC indicated in its Complaint that in truth and in fact, the dealer did not implement reasonable and appropriate means to protect consumers' personal information from unauthorized access. As such the FTC determined that this quoted statement "was and is false or misleading, in violation of Section 5(a) of the FTC Act."

Thus the FTC ruled the security statement violated the FTC Privacy Rule and imposed in the consent order a condition that the dealer "is prohibited from misrepresenting in any manner, expressly or by implication, the extent to which respondent maintains and protects the privacy, confidentiality, or security of any personal information collected from or about consumers." Any further privacy issues with this dealer that violate the consent order will incur financial penalties of up to $16,000 per day.

Courts have also ruled that privacy notices are contracts with customers and a company that violates its privacy policy can be sued, including in a class action, for breach of contract. This has been found true in cases where a creditor shared information with affiliates or with third parties and the customer alleged that he or she relied on the firm's privacy notice stating it would not share in doing business with the firm. Although there is no private cause of action under Gramm-Leach-Bliley, many state Unfair and Deceptive Acts and Practices ("UDAP") laws provide to the effect that a violation of any federal consumer protection statute (such as Gramm-Leach-Bliley) automatically constitutes a violation of the state UDAP law. Many of these state laws permit recovery of treble damages and attorney's fees and permit class actions or private attorneys general actions.

# Recommended Practices

1. Create your FCRA-GLB Privacy Notice using the FTC's Model Consumer Privacy Online Form Builder that explains what personal information your dealership collects, how it collects and uses the personal information, and with whom it shares the information. (See example at the end of this Chapter.) Write your FCRA-GLB privacy notice in the present tense ("We do the following") and avoid hyperbole such as "we will never share your information" or "we maintain the highest security practices." Date your privacy notice. If you share customer information with affiliates, be sure to comply with the Affiliate Marketing Rule. A best practice is to include the Affiliate Marketing Rule disclosure and notice in your model FCRA-GLB Privacy Notice form. Alternatively, use the "safe harbor" notice under the Affiliate Marketing Rule to disclose the customer's right to opt out of the affiliates' use of customers' eligibility information to market or solicit. You can then give this notice once every five years, unlike the FCRA-GLB Privacy Notice which you have to give annually for as long as the person remains your customer. (Note that if you sell a vehicle to a customer and assign the contract to a financing source, that person is no longer considered your customer for privacy notice purposes unless they have another credit relationship with your dealership.) It is prudent to have your privacy notices reviewed by your counsel to ensure the notices contain all of the required disclosures. You should also make sure that your privacy notices accurately reflect your actual information collection and sharing practices. Be careful about pooling information with affiliates or your parent company into a central database, as doing so can be considered sharing information with affiliates.

2. It is a best practice to indicate in your FCRA-GLB Privacy Notice that you do share information with third parties. Many DMS providers "pull" information out of your DMS system and use it for their own purposes and not merely to service your account. Doing so is considered third-party sharing under GLB. If your privacy notice says "we don't share" and your DMS provider is taking and giving access to customer information to third parties (even without your knowledge), you may be in breach of your privacy notice and face a prospective class action. Better to indicate you do share and give customers the right to opt out. Designate someone at your dealership to manage opt outs and, to keep it simple. If a customer opts out of any type of sharing, opt them out of every kind of sharing so you are not managing multiple opt out databases. Very few customers (less than 1%) opt out so managing opt outs should be a manageable process. But indicating you do share will provide you the best protection.

3. Give your FCRA-GLB Privacy Notice to each consumer who provides you their personal information and every customer with whom you do business and give it when the person first provides you their personal information, or soon thereafter. Clearly and conspicuously post your FCRA-GLB Privacy Notice on your dealership website, link to it from your online credit application form (a good practice is to compel a consumer to link to the privacy notice and be forced to scroll through it before they can submit the online credit application) and give a copy to every consumer who comes into your store and inquires about financing. The FTC has an internal group that reviews company privacy notices and "mystery shops" to uncover violations. Periodically review your privacy notices and make sure they accurately reflect what information you collect and what you do with it. If you hold your own contracts (e.g., buy-here, pay-here dealers) or maintain any consumer credit accounts (such as house accounts in your service department), you must mail these customers a new FCRA-GLB Privacy Notice each year and a new Affiliate Marketing Notice every five years.

4. Date your privacy notices so that you will always know that the version you are using is current. If you use one of the model notice forms, this dating reserves the right to change your privacy notice at any time. Put updated privacy notices on your website when you do make a change. The model "safe harbor" FCRA-GLB Privacy Notice forms require dating your privacy notices.

5. Set up a process in your dealership to collect and manage all customer opt outs from your customers relating to information sharing, affiliate use, telemarketing, emails, revocations of consent to make calls or texts to cell phones, and fax transmissions. Customers have many opt-out rights. One way to manage them is to establish separate opt-out lists for each of these and use them before sharing information or conducting marketing activity as necessary. However, to simplify the process and reduce the chance for errors, keep one master list of customers who send opt-out notices to your dealership concerning any information sharing and remove all these customers from all databases that you share or use for contact purposes, including common databases within a dealership group. Only about one half of 1% of consumers respond to opt-out notices according to the American Bankers Association, so you are not likely to need to remove many customers from your information sharing by doing this. Having a single omnibus opt-out system is a much simpler process and will make you less likely to commit an error that could constitute a compliance violation.

6. Know where your data is located, its flow throughout your system during its lifecycle, who is accessing and who is capable of accessing your customer data whether through your DMS or otherwise. Contractually prohibit your DMS providers from pulling customer data from your DMS system for any reason other than to service your account. Any such accessing must be disclosed and appropriate opt-out rights given in your privacy notice. Make sure to contractually require your affiliates and other entities with which you share customer information to comply with your privacy notices as well. If customers whose information you share later opt out, recall their names from your database and require your affiliates and other entities with which you have shared their information to delete their information as well, unless the affiliate or other entity has established an independent business relationship with the customer.

7. If your dealership is engaged in online tracking for advertising purposes, you should consider use of the Advertising Option icon and giving consumers a Do-Not-Track opt out mechanism. At minimum, disclose in your Terms of Use on your website what you are doing in the way of placing cookies on users' devices and the nature of the tracking you do. Transparency in data collection and use was a priority in the FTC's Final Privacy Report released in March 2012. The FTC applied similar principles to mobile apps and devices in February 2013. If you may have customers in California or Delaware, note the requirements of the California and Delaware "Do-Not-Track" laws described above.

8. Data security, discussed in Chapter 3, is also an important element of customer privacy. If your customer's information is not properly secured, in both paper and electronic format, you will likely be in violation of your own privacy notice and risk regulatory action and possible civil liability for breach of contract or an unfair trade practice. The recent success of plaintiffs in preventing civil cases from being dismissed for lack of causation or damages appears to be a national trend that will cost you attorney's fees to defend and possible trial or settlement exposure.

# Additional Resources

**A Summary of the Financial Privacy Requirements of the Gramm-Leach-Bliley Act:**
http://business.ftc.gov/documents/bus53-brief-financial-privacy-requirements-gramm-leach-bliley-act

**The FTC's Privacy Rule and Auto Dealers:**
https://www.ftc.gov/tips-advice/business-center/guidance/ftcs-privacy-rule-auto-dealers-faqs

**FTC Model Online Privacy Notice Builder:**
http://www.federalreserve.gov/bankinforeg/privacy_notice_instructions.pdf

**Line-by-line instructions to complete model privacy notice:**
http://www.gpo.gov/fdsys/pkg/FR-2009-12-01/html/E9-27882.htm

**Background on the FCRA:**
http://epic.org/privacy/fcra/

**Good articles on the privacy requirements of GLB and the FTC Privacy Rule:**
http://www.business.ftc.gov/documents/bus67-how-comply-privacy-consumer-financial-information-rule-gramm-leach-bliley-act

https://help.equifax.com/app/answers/detail/a_id/36/~/fcra-summary-of-rights

**Information about the DPPA:**
http://www.accessreports.com/statutes/DPPA1.htm

# Example of a Model Privacy Notice Form

| | |
|---|---|
| **FACTS** | **WHAT DOES [NAME OF DEALER] DO WITH YOUR PERSONAL INFORMATION?** Rev **[insert date]** |
| **Why?** | Financial companies choose how they share your personal information. Federal law gives consumers the right to limit some but not all sharing. Federal law also requires us to tell you how we collect, share, and protect your personal information. Please read this notice carefully to understand what we do. |
| **What?** | The types of personal information we collect and share depend on the product or service you have with us. This information can include:<br>■ Social Security Number and **[income]**<br>■ **[account balances]** and **[payment history]**<br>■ **[credit history]** and **[credit scores]** |
| **How?** | All financial companies need to share **customers'** personal information to run their everyday business. In the section below, we list the reasons financial companies can share their **customers'** personal information; the reasons **[name of dealer]** chooses to share; and whether you can limit this sharing. |

| Reasons we can share your personal information. | Does **[name of dealer]** share? | Can you limit this sharing? |
|---|---|---|
| **For our everyday business purposes –** such as to process your transactions, maintain your account(s), respond to court orders and legal investigations, or report to credit bureaus. | Yes | No |
| **For our marketing purposes –** to offer our products and services to you | Yes | No |
| **For joint marketing with other financial institutions** | Yes | No |
| **For our affiliates' everyday business purposes –** information about your transactions and experiences | Yes | No |
| **For our affiliates' everyday business purposes –** information about your creditworthiness | Yes | Yes |
| **For our affiliates to market to you** | Yes | Yes |
| **For our nonaffiliates to market to you** | Yes | Yes |

| | |
|---|---|
| **To limit our sharing** | ■ Call **[phone number]** – our menu will prompt you through your choice(s)<br>■ Visit us online: **[website]** or<br>■ Mail the form below<br>**Please note:**<br>If you are a *new* customer, we can begin sharing your information 30 days from the date we sent this notice. When you are *no longer* our customer, we continue to share information as described in this notice.<br>However, you can contact us any time to limit our sharing. |
| **Questions?** | Call **[phone number]** or go to **[website]** |

| | | | |
|---|---|---|---|
| Leave Blank<br>OR<br>**[If you have a joint account, your choice(s) will apply to everyone on your account unless you mark below.**<br>❑ **Apply my choices only to me]** | Mark any/all you want to limit:<br>❑ Do not share information about my creditworthiness with your affiliates for their everyday business purposes.<br>❑ Do not allow your affiliates to use my personal information to market to me.<br>❑ Do not share my personal information with nonaffiliates to market their products and services to me. | | |
| | **Name** | | Mail to:<br>**[Name of Dealer]**<br>**[Address 1]**<br>**[Address 2]**<br>**[City], [ST] [ZIP]** |
| | **Address** | | |
| | **City, State, Zip** | | |
| | **[Account #]** | | |

# Example of a Model Privacy Notice Form

*Continued*

**Page 2**

| Who we are | |
|---|---|
| **Who is providing this notice?** | **[insert]** |
| **What we do** | |
| **How does [name of dealer] protect my personal information?** | To protect your personal information from unauthorized access and use, we can use security measures that comply with federal law. These measure include computer safeguards and secured files and buildings. |
| **How does [name of dealer] collect my personal information?** | We collect your personal information, for example, when you:<br>■ **[open and account]** or **[deposit money]**<br>■ **[pay your bills]** or **[apply for a loan]**<br>■ **[use your credit or debit card]**<br>**[We also collect your personal information from other companies.]**<br>**or**<br>**[We also collect your personal information from others, such as credit bureaus, affiliates, or other companies.]** |
| **Why can't I limit all sharing?** | Federal law gives you the right to limit only<br>■ sharing for affiliates' everyday business purposes – information about your creditworthiness<br>■ affiliate from using your information to market to you<br>■ sharing for nonaffiliates to market to you<br>State laws and individual companies may give you additional rights to limit sharing. **[See below for more on your rights under state law.]** |
| **What happens when I limit sharing for an account I hold jointly with someone else?** | **[Your choices will apply to everyone on your account.]**<br>OR<br>**[Your choices will apply to everyone on your account – unless you tell us otherwise.]** |
| **Definitions** | |
| **Affiliates** | Companies related by common ownership or control. They can be financial and nonfinancial companies.<br>■ **[affiliate information]** |
| **Nonaffiliates** | Companies not related by common ownership or control. They can be financial and nonfinancial companies.<br>■ **[nonaffiliate information]** |
| **Joint marketing** | A formal agreement between nonaffiliated financial companies that together market financial products or services to you.<br>■ **[joint marketing information]** |

**Other important information**

**[insert other important information]**

Add California, Nevada, or Vermont notice language if you have consumers in those states who may deal with your dealership. If you track customers, provide a link to disclosures required under California's and Delaware's "Do-Not-Track" laws.

**Vermont residents:** We will not share information we collect about you with nonaffiliated third parties, except as permitted by Vermont law, such as to process your transactions or to maintain your account. In addition, we will not share information about your creditworthiness with our affiliates except with your authorization.

**California residents:** We will not share information we collect about you with nonaffiliated third parties, except as permitted by California law, such as to process your transactions or to maintain your account.

**Nevada residents:** We are providing you this notice under state law. You may be placed on our internal Do Not Call List by going to the following Webpage: ag.state.nv.us/about/contactform.htm. Nevada law requires we provide the following contact information: Bureau of Consumer Protection, Office of the Nevada Attorney General, 555 E. Washington St., Suite 3900, Las Vegas, NV 89101; Phone number-702.486.3132; email: BCPINFO@ ag.state.nv.us.

**Additional Notice for California and Delaware Residents:** Some browsers incorporate a “Do-Not-Track” (DNT) feature that, when turned on, signals to websites and online services that you do not want to be tracked. Because there is not yet an accepted standard for how to respond to a DNT signal, we do not currently respond to DNT signals on this website or on websites where we provide advertisements, content, or other services.

Chapter Five



# Credit Applications, Credit Reports and Contracts

## Background

Since the late 1960s, federal law has restricted the use of credit reports and required creditors to notify consumers of credit decisions and describe credit terms in finance contracts. The federal Consumer Credit Protection Act, passed in 1968, includes the Truth in Lending Act ("TILA"), the Fair Credit Reporting Act ("FCRA") and the Equal Credit Opportunity Act ("ECOA"), as well as other laws relating to wage garnishments and debt collection practices. The 2003 FACT Act added additional consumer rights, disclosures and protections concerning credit reports, affiliate information sharing, identity theft protection and risk-based pricing notices to the FCRA. Title X of the 2010 Dodd Frank Act, known as the Consumer Financial Protection Act of 2010, requires additional consumer disclosures in adverse action notices. State laws also govern disclosures, limit charges, and require certain additional consumer disclosure forms for motor vehicle retail installment sales and lease contracts.

This Chapter discusses federal laws relating to credit reports, credit applications, retail installment sales contracts ("RISCs"), lease agreements, adverse action notices when a dealer is unable to get a customer financed, and risk-based pricing notices to consumers upon receipt of a credit application.

## Important Laws and Regulations

**The Fair Credit Reporting Act ("FCRA")** – In addition to the information sharing restrictions described in Chapter 4 (Privacy and Customer Information Sharing), the FCRA is a federal law that regulates, among other things, the access, use, and distribution of information that meets the definition of a "consumer report," including a credit score. A consumer report, more commonly known as a credit report, is not only information found in a credit report you acquire from a consumer reporting agency; it can include information you obtain from third parties as well, such as a customer's employer or landlord.

The FCRA defines "consumer report" as follows:

> **(1) In general.**— The term "consumer report" means any written, oral, or other communication of any information by a consumer reporting agency bearing on a consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living which is used or expected to be used or collected in whole or in part for the purpose of serving as a factor in establishing the consumer's eligibility for—
>
> > **(A)** credit or insurance to be used primarily for personal, family, or household purposes;
> >
> > **(B)** employment purposes;

The FCRA requires a dealer to have a "permissible purpose" to obtain a consumer's credit report. A consumer's written consent is the best proof of a permissible purpose and is required to access a consumer's credit report in Vermont. Most credit application forms contain language giving the consumer's consent to obtain their credit report. However, a dealer also has a permissible purpose if it is clear to both the dealer and the customer that the customer is initiating a financed vehicle purchase or lease transaction and the dealer has a legitimate business need for the information, such as to arrange financing requested by the customer. The FTC has stated that pulling a credit report for negotiation purposes or for cash customers is not permitted under the FCRA without the customer's prior written consent to do so.

The FCRA also requires giving the consumer an "adverse action notice" if the creditor used a credit report, in whole or in part, as a factor in denying credit to the consumer or offering the consumer credit on terms less favorable than those the consumer requested (unless the consumer accepts the less favorable terms). Adverse action notices are discussed below. Under the Risk-based Pricing Rule, if the customer obtains credit "on material terms that are materially less favorable than the most favorable terms available to a substantial proportion of your credit customers," you must send the customer a "risk-based pricing notice" or you can just give a "credit score disclosure exception notice," to all customers who submit a credit application. These notices are also discussed in more detail below.

**The Equal Credit Opportunity Act ("ECOA") and the Federal Reserve Board's Regulation B** – This law and the Federal Reserve Board's and Consumer Financial Protection Bureau's Regulation B prohibit auto dealer discrimination in granting or denying credit. Both the FCRA and ECOA also mandate time frames (30 days after receipt of a completed credit application) for notifying the applicant of the credit decision (e.g., offering credit, informing the consumer that additional information is necessary to make a credit decision, making a counteroffer, or sending an adverse action notice). An ECOA adverse action notice must be in writing and either provide specific reasons why the credit application was denied or counter-offered (additional explanatory disclosures are required if one of the reasons is low credit score) or tell the consumer whom they can call at the dealership within 60 days to get the reasons.

The ECOA also requires that credit application forms contain certain disclosures, such as the consumer's right to not reveal income from alimony, child support, or separate maintenance if the consumer does not want such income to be considered as a basis for repaying the credit obligation. Certain state laws impose additional notice requirements in credit applications. For example, in New York the credit application must indicate that a consumer report may be requested in connection with the application and that upon request the consumer will be told whether a consumer report was ordered and the name of the credit bureau that furnished the report. Regulation B also requires that multiple consumer applicants affirmatively state on the credit application whether or not they want to apply for joint credit.

**Adverse Action Notice Obligations** – As noted previously, both the FCRA and ECOA require creditors to give consumers notices if they take adverse action in response to credit applications. Adverse action means a refusal to grant credit or a refusal to grant credit in substantially the amount or on substantially the terms requested by the consumer, unless the consumer accepts a counteroffer of credit. Adverse action also means terminating an account or changing its terms in a manner unfavorable to the consumer. An example is unwinding or re-contracting a "spot delivery" contract.

"Creditors" are required to send adverse action notices. Auto dealers are creditors in vehicle financing transactions because they are involved in negotiating the credit terms such as by rehashing with financing sources, negotiating with the customer, and marking up "buy rates." They are also typically named as the creditor on the RISC, which they later sell to a financial institution. As creditors, dealers must give adverse action notices to consumers in three situations:

1. When a dealer takes a credit application but does not send it to any financing source, typically because the consumer is credit-challenged;

2. When a dealer unwinds or re-contracts a spot delivery deal; and

3. When the dealer is unable to get the customer financed on terms acceptable to the dealer.

So if a dealer cannot get the customer financed either because no financing source offers credit terms acceptable to the dealership or because the customer declines the dealer's final offer of credit after concluding negotiations, the dealer must send the customer an adverse action notice. A lender's adverse action notice will not protect the dealer from being non-compliant as it does not contain the necessary disclosures that must be given by the dealer including but not limited to naming the credit bureaus used by the dealer and the federal agency that administers compliance which, for the dealer, is the Federal Trade Commission (FTC). It is a common misunderstanding that a dealer can rely on a lender's adverse action notice; it can't.

Generally, a single form can be used for all adverse action notices. Additional language is required if the dealer's decision was based in whole or in part on information received directly from a third-party that is not a consumer reporting agency. An adverse action notice must inform the consumer of the adverse action; either give two to four reasons for the adverse action or tell the consumer whom they can call at the dealership within 60 days to get the reasons; identify any consumer reporting agency that provided a credit report or credit score used by the dealer; provide the consumer's credit score, information about the credit score, and up to four to five "key factors" that adversely affected the credit score (up to four key factors unless one of the factors is the number of recent credit inquiries in which case up to five key factors). The notice must contain other mandatory language as well. A sample adverse action notice is attached at the end of this Chapter.

Since most banks and financial institutions give specific reasons for adverse action in their adverse action notices, dealers will want to use the option that permits telling consumers they can call for the reasons. If a consumer does call, the dealership should disclose two to four reasons for the adverse action as recorded in the deal jacket. Avoid using low credit score as one of the reasons. If low credit score is given as one of the reasons, additional disclosures are required to indicate the factors where the consumer fell the farthest below the average score for each of those factors achieved by persons whose total score was slightly above the minimum passing score or the factors for which the applicant's score fell farthest below the average score for each of those factors achieved by all applicants. You won't know these factors as these are not the same as the "key factors" used in adverse action notices to describe the factors that most adversely affected the credit score. For this reason, it is best not to give "low credit score" as a reason but rather to give the reasons in the customer's credit file that most contributed to the adverse action.

If the dealer uses credit information obtained from someone other than a consumer reporting agency, the adverse action notice must so inform the consumer and give them the right to learn the nature of that information if they make a request in writing within 60 days. An example would be information received directly from the consumer's employer, landlord, or directly from a private creditor.

**Risk-based Pricing Notices** – The Risk-based Pricing Rule took effect January 1, 2011, and was amended effective August 15, 2011. Its purpose is to inform consumers that they received worse credit terms than other consumers because of information in their credit reports. It is the consumer's giving of a credit application that triggers the Risk-based Pricing Rule notice requirement. A creditor who uses a consumer report and provides credit to the consumer on "material terms that are materially less favorable than the most favorable terms available to a substantial proportion of consumers from or through that person" either has to give these customers a "risk-based pricing notice" or give a "credit score disclosure exception notice" to all credit applicants. "Material terms" means the APR.

For auto dealers, giving the credit score disclosure exception notice is the easiest way to comply. You must give this notice to each consumer who applies for credit (including both joint applicants individually). The credit score disclosure notice contains the consumer's credit score; the date and identity of the person providing the credit score; the national distribution of credit scores among consumers under the credit scoring model used, disclosed in either a bar chart form or in language indicating where the customer falls in the national range of credit scores; and certain language disclosures about credit scores in general. You should give this notice as soon as possible after obtaining the customer's credit score but at or before the earlier of consummation of the transaction or three business days from receipt of the credit application. You can hand the notice to the consumer personally at the dealership or mail it. In the Commentary to the Risk-based Pricing Rule, the FTC said three business days is acceptable unless the deal closes earlier. If you use multiple credit scores, you must disclose the one you most relied on, or if you didn't primarily rely on one, you can disclose any one of the multiple scores (except in California where you have to disclose all the credit scores you accessed). You don't need to give a credit score disclosure notice to consumers who apply for specific credit terms and receive exactly those terms. Also, if a consumer does not have a credit score, you must give that consumer a special form alternative notice as well. Note that the credit score disclosure exception notice does not require disclosing the four to five "key factors" that adversely affected the credit score. The "key factors" disclosure is only required for adverse action notices.

Under the Risk-based Pricing Rule, if you give the consumer an adverse action notice, technically you don't need to give the credit score disclosure notice as well. However, there are practical problems that make it a best practice to give every credit applicant a credit score disclosure notice. The credit score disclosure notice must be given up front, as soon as reasonably practicable after obtaining a credit score, whereas a dealer has 30 days to try to make a deal before having to give an adverse action notice. If you think you won't get the customer financed and don't give the credit score disclosure notice but wind up getting the customer financed later in the 30-day period, you will be out of compliance on the timeliness in giving the required credit score disclosure notice. There are no compliance risks under the Risk-based Pricing Rule if you wind up giving a consumer a credit score disclosure notice, so it is a best practice to give every credit applicant a credit score disclosure notice as early as possible even if you later have to give them an adverse action notice as well. This will also simplify your process by not having to make decisions early on as to who will and who will not ultimately get financed.

What if your dealership doesn't pull credit reports or credit scores? According to the FTC, you must still give a credit score disclosure notice. This may require you to buy a credit score if you cannot get the correct form and score from the lender. If you pull a customer's credit report through Dealertrack, you will receive both a credit score disclosure notice and an adverse action notice customized for the consumer and correlated to the credit scoring model used as the Rule requires.

An open issue exists as to whether co-signers and/or guarantors are "applicants" under federal consumer protection laws as the federal Circuit Courts have split on the issue. The CFPB has actively argued that they are applicants and entitled to the same notices and protections as credit applicants under Truth in Lending, ECOA, and the FCRA. The U.S. Supreme Court is expected to rule on this issue some time in 2016.

**Security Freeze Laws** – All consumers can now freeze their credit files by contacting individually any or each of the three national credit bureaus, Equifax, Experian, and TransUnion. If a customer does freeze their credit file, you will be unable to pull their credit report or credit score unless he or she first "thaws" their credit file by calling each credit bureau. The "thawing" process should take less than five minutes, but it requires customers to use a PIN provided to them by the credit bureau when they first froze their credit file. Consumers must also pay a small fee to thaw their frozen credit file, the amount of which varies by state.

**Truth in Lending Act ("TILA") Requirements** – TILA, the federal Consumer Leasing Act (a subsection of TILA), and the Federal Reserve Board's and Consumer Financial Protection Bureau's Regulations M (leasing) and Z (loans and credit sales) govern disclosures of credit terms to consumers. TILA and state laws also contain disclosure and other requirements for credit applications and consumer credit contracts. Many state laws cap Annual Percentage Rates ("APRs") and other charges as do the federal Servicemembers Civil Relief Act and Military Lending Act discussed below. TILA, Regulation Z, and the Consumer Leasing Act and Regulation M do not apply to credit transactions and consumer leases in excess of $54,600. However, it is a best practice to comply with TILA and the Consumer Leasing Act regardless of the amount of the obligation on all credit transactions and consumer leases. A number of states require compliance with TILA on all credit transactions, regardless of the credit amount.

TILA requires dealers to break down the cost of credit into two mutually exclusive categories: the amount financed and the finance charge. Examples of required disclosures in retail installment sales contracts ("RISCs") for the amount financed include an itemization of the amount financed representing components of the financed obligation which are advanced by the dealer to the borrower or paid to others on the borrower's behalf such as vehicle cost, taxes, registration fees, and sums paid to pay off credit obligations on a consumer's trade-in vehicle. Insurance (credit or property) can be a component of the amount financed if it is disclosed that credit insurance is not required to obtain credit and the consumer can obtain credit or property insurance from any carrier of their choice. Finance charge includes many types of charges that TILA defines as part of the finance charge and represents the cost of credit. The finance charge must be disclosed as the total amount of finance charges and the cost of credit expressed as an APR in the RISC. These disclosures must be more conspicuous than any other required disclosures. The federal Consumer Leasing Act and Regulation M require disclosure in lease agreements of the vehicle's gross and adjusted capitalized cost, residual value, depreciation and amortization, and rent charges. State laws also may require other disclosures (e.g., excess mileage charges for leases) and mandate that certain contract terms be conspicuously disclosed as well. Both RISCs and lease agreements must state the monthly payments and term of the payment obligations.

A dealer must be careful not to charge a credit customer more for a vehicle or aftermarket product than it charges a cash customer unless the difference is included in the finance charge and APR calculation in a retail installment sales contract or rent disclosure in a lease agreement. Amounts paid to third parties where the dealer will retain or earn a part of the charge must be identified with a legend stating that the dealer may keep part of the amounts paid to others.

TILA and Regulation Z also prohibit rolling negative equity on a trade-in into the cash price of the purchased vehicle. Negative equity should either be used to reduce the customer's down payment (but not below $0) or itemized under "Amounts Paid to Others" and not hidden as part of the sales price of the vehicle. Courts have ruled that if a dealer rolls negative equity into the sales price of a vehicle, it may be subject to class action liability.

TILA also requires listing items that a consumer is not required to purchase but affirmatively elects to do so. Burying the cost of aftermarket items such as vehicle etching, service contracts, rustproofing, and other items into the cash price of the vehicle constitutes "payment packing." If these items are not disclosed in the itemization of amount financed, they are considered to be part of the finance charge and both the total finance charge and APR must be adjusted accordingly. A California dealer was sued in a class action for including vehicle etching in the cash price of new motor vehicles without disclosing that it was doing so or that the vehicle etching was optional. Like negative equity, theft protection services must be itemized in the amount financed to avoid being a part of the finance charge.

TILA also addresses the subject of deferred down payments (also called "pick up payments"), a practice in which the consumer agrees to make a portion of the contractual down payment at a time later than contract signing and vehicle delivery. A deferred portion of a down payment may be treated as part of the down payment if it is payable not later than the due date of the second otherwise regularly scheduled payment and is not subject to any finance charge. However, most lender agreements require the dealer to represent and warrant that it has received the down payment in full prior to assigning any contract to the lender. Thus, while TILA permits deferred down payments, there is a strong risk that a lender will require a dealer to repurchase a RISC for breaching the rep and warranty that the down payment has been received in full.

TILA also provides several ways to disclose pick up payments. If the pickup payment is treated as part of the down payment, it must be subtracted from the amount financed. Further, it may, but need not, be reflected in the payment schedule. But if the pick up payment goes in the payment schedule, it must be included in the total of payments. State laws also have provisions relating to deferred down payments. Some states require a separate disclosure of the deferred portion of the down payment on the RISC. Non-disclosure of the deferred portion on the face of the RISC may violate state law.

**FTC Credit Practices Rule** – The FTC Credit Practices Rule prohibits certain unfair contract provisions, such as making consumers assign their wages to get credit, prohibiting consumers from asserting claims against the seller, or a creditor taking a lien on household goods to secure payment.

The Credit Practices Rule also requires giving co-signers an FTC-mandated notice describing their potential liability if the consumer fails to pay. The notice must be given and signed by the co-signer before the co-signer becomes obligated on the agreement. A "co-signer" is different from a co-buyer, co-borrower, or co-applicant because a co-signer receives no tangible benefit from the agreement, but undertakes liability as a favor to the main debtor who would not otherwise qualify for credit. On the other hand, a co-buyer (one who shares in the purchased goods), a co-borrower (one who shares in the loan proceeds), or a co-applicant do receive benefits. Therefore, they are not considered co-signers under the Rule, and you are not required to provide the co-signer notice to them. A classic example of a co-signer is a parent cosigning for their child's credit obligation. Many states have additional requirements for co-signer notices so check with your local attorney on the co-signer notice required in your state. Recall that when two applicants for credit apply for financing, they are required to indicate on the credit application whether or not they intend to apply for joint credit.

**Electronic Signatures and Records** – Under the Uniform Commercial Code, a "signature" is "any symbol executed or adopted by a party with present intent to authenticate a writing." The federal Electronic Signatures in Global and National Commerce Act (the "ESIGN Act") and the Uniform Electronic Transactions Act ("UETA"), adopted in almost all states and the District of Columbia, provide that electronic signatures and records have the same legal status as ink signatures and paper records. They do not change the disclosure or content requirements of documents except that in consumer transactions for laws that require records or disclosures to be provided to the consumer "in writing," (such as a review copy of a RISC under TILA), a specific electronic documents disclosure must be given to the consumer concerning the consumer's right to obtain the documents in paper form. The dealer must obtain the consumer's electronic consent to receive electronic documents, describe how consent can be withdrawn and confirm the hardware and software required to receive the electronic documents. The dealer must also obtain the consumer's consent electronically, or confirm his or her consent electronically, in a manner that reasonably demonstrates the consumer can access information in the electronic form that will be used to provide the documents and information that are the subject of the consent.

These laws were passed to facilitate e-commerce and resolve any uncertainty about whether electronic documents and signatures are as valid as paper ones. They are. As a result, a consumer's digital signature on an electronic signature pad linked to an electronic document or their digital signature on a tablet used to provide the documents is the equivalent of their ink signature on a paper document. A click-through to a website can also be an electronic signature. The electronic document can be stored in an electronic filing cabinet or vault and should be retained for a period of time equal to the retention period for a paper version of the same document. Under TILA, the consumer must receive a copy of the disclosures that the consumer can keep.

As described in Chapter 9 on Recordkeeping and Destruction of Records, all states permit dealers generally to convert most paper records to electronic format so they can be stored as electronic files instead of paper files. Electronic storage provides greater document security and, if done properly, can more easily be searched for individual documents or groups of documents in the event of an inquiry or eDiscovery in a litigation or claim. Electronic storage can also enable an orderly systematic document retention and destruction process and reduce human error in destroying paper documents or implementing document storage policies inconsistently.

**Servicemembers Civil Relief Act (SCRA)** – Formerly called the Soldiers and Sailors Civil Relief Act, this law imposes a 6-percent rate cap on pre-existing secured credit, including auto finance credit, during the period of military service. These provisions apply to both the person in military service and their dependents with respect to obligations entered into by such persons before the service member was called to active duty status. The SCRA allows service members to terminate pre-service automobile leases if they are called for military service of 180 days or longer. Service members who sign automobile leases while on active duty may be able to terminate an automobile lease if they are given orders for a permanent change of station outside the continental United States or to deploy with a military unit for a period of 180 days or longer. This law also permits a court to stay (delay) the repossession of a vehicle for a period up to nine months after the military service is completed. It requires a court to review and approve any repossession if the service member took out the loan and made a payment before entering military service. The court may delay the repossession or require the lender to refund prior payments before repossessing. It can also appoint an attorney to represent the service member, require the lender to post a bond with the court and issue any other orders it deems necessary to protect the service member. A large subprime auto finance lender agreed to pay $9.35 million to settle a SCRA claim with the Department of Justice (DOJ). The DOJ charged the lender with failing to obtain court orders before repossessing motor vehicles owned by protected service members, preventing them from obtaining a court's review on whether their repossessions should be delayed or adjusted in light of their military service.

Another federal law, the Military Lending Act, limits the APR on new credit extended to active service members and their dependents to 36% APR on vehicle title loans and refinancings. The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") created an office in the Consumer Financial Protection Bureau ("CFPB") called the Office of Servicemember Affairs. The mandate for this Office is to ensure that "service members and their families are educated and empowered to make better informed decisions regarding consumer financial products and services offered by motor vehicle dealers, with a focus on motor vehicle dealers in the proximity of military installations." The Office of Servicemember Affairs has entered into an information-sharing alliance with the military's Judge Advocate Generals to share information on consumer complaints from service members and their families. Independent and buy-here-pay-here dealers that do business with service members may be subject to new CFPB rules and scrutiny regarding how they deal with service members. Franchised dealers may receive FTC scrutiny as well. In 2013, the CFPB entered into a consent decree with U.S. Bank and a service provider in which they collectively agreed to pay $6.5 million in reimbursements and penalties for Truth in Lending violations involving disclosure violations and deceptive sales practices for misrepresenting the true cost and coverage of aftermarket service contracts and GAP insurance under an auto financing program created for active service members. In today's environment, service members are a favored constituency of regulators.

**Car Buyer's Bill of Rights** – California and Minnesota have passed laws known as the Car Buyer's Bill of Rights. These laws give consumers additional rights and require dealers in these states to make additional written disclosures to consumers with respect to certain charges and aftermarket products and provide standards for selling "certified" used vehicles. California requires an itemization of all aftermarket products which can be done by using a menu. California's law also gives the car buyer the right to purchase a two-day option to cancel a used car purchase of under $40,000; requires the dealer to disclose the consumer's credit scores (along with the range of possible scores from the credit bureaus) which can be satisfied by giving a federal Risk-based Pricing credit score disclosure notice that discloses all credit scores for the consumer accessed by the dealer; and caps a dealer's ability to mark up the "buy rate" offered by finance sources to dealers. Minnesota's law requires dealers at the customer's request to give a notice and disclosure of the credit bureaus used by the dealer or financing source. Other states' laws cap a dealer's ability to mark up a "buy rate" as well, certain states have two-day return policies on used car sales, and State Attorney General auto dealer guidelines address what is required to advertise a used vehicle as "certified."

**Spot Deliveries** – Spot deliveries refer to the practice of a dealer placing a consumer in a vehicle "on the spot" to make a sale prior to obtaining a lender's approval to finance the contract. However, the sale is made contingent on the dealer obtaining financing for the purchase, typically by a financing source agreeing to buy the RISC the customer has signed with the dealer.

Spot deliveries are regulated by state not federal law, and are not permitted in approximately 16 states, including Maryland, Massachusetts, Pennsylvania, and Wisconsin. The FTC is also actively investigating spot deliveries in the aftermath of its ongoing series of roundtable hearings to identify issues in auto finance for which it may use its new streamlined rulemaking authority to publish unfair and deceptive auto dealer acts and practices regulations. Numerous dealers received FTC subpoenas in 2014 and 2015 for information about spot deliveries.

Many states have very specific requirements for spot deals and forms that dealers must use for “spot agreements” or “conditional sales contracts” that require the consumer to return the car or re-contract if the dealer cannot find a financing source willing to buy the contract on terms acceptable to the dealership within a designated number of days. For example, Arkansas, Louisiana, Maine, New Hampshire, North Carolina, Texas, Oklahoma and Tennessee are very specific about spot deliveries and what can and cannot be included in a spot agreement. Ohio and Louisiana require dealers to use a spot agreement if the dealer delivers a vehicle to a consumer conditioned on financing.

Whatever your state requires, don’t forget to use spot agreements for leasing transactions as well as sales transactions. Any language changes from your state’s approved or court-tested form documents may put the dealer out of compliance and risk facing a possible lawsuit or regulatory claim. States also regulate spot delivery practices such as limiting fees for miles driven by the customer, prohibiting selling the customer’s trade-in vehicle until the deal is finalized, and limiting the number of days to obtain financing approval. There is very little state law uniformity on spot deliveries, so consult an attorney and know your state’s laws and regulations on spot deliveries.

Unless prohibited from doing so in a state (such as those named above that do not allow spot deals), make sure to get the customer to sign a spot agreement. This is important because without a signed spot agreement, the dealer will have signed an unconditional RISC with a buyer for the purchase and financing of a vehicle. If the dealer can’t sell the RISC, and there is nothing in the sales contract that lets the dealer cancel or unwind the deal, the dealer is obligated to honor the deal. Spot agreements are also helpful in defending against a consumer’s claim that he or she thought the original contract was final. Courts generally have viewed dealers who use spot agreements more favorably than dealers that do not.

It is important to put language in spot agreements that permits either the dealer or the consumer to unwind the deal if the dealer cannot find a financing source willing to purchase the contract “on terms acceptable to the dealership.” This language is intended to allow the dealer to reject a financing source’s terms for purchasing the agreement. So if the financing source won’t permit the dealer to keep part of the finance charge or will buy the deal only at a deep discount, the dealer needs to have the right to reject such a deal.

In addition to a spot agreement, it is a good practice to have the customer sign a document called “An Acknowledgement of Rewritten Contract” or similar document when they return to the dealership to sign a new contract. This document provides that the customer can cancel the transaction and does not have to sign the new contract; details the changes in the new contract terms such as credit terms, payment, APR and amount financed; states that no duress was used to get the consumer to sign the new contract; and can contain other provisions as well. Such a document can be very helpful to show that the consumer made an informed and voluntary decision to sign the new contract. It is also a good practice to conduct another menu transaction when you re-contract an unwound spot deal.

Don’t ever backdate the new contract to the original date of vehicle delivery. This practice is effectively prohibited by TILA’s disclosure requirements which mandate that finance charges can only accrue from the date of consummation, which is the date the consumer signs the new contract. If the contract is backdated, the APR and finance charge disclosures will be incorrect as they are calculated from the wrong date, i.e., the backdated date. This will cause an understatement of the APR which must be calculated from the date of the new signature. Class actions have been brought against dealers who backdate new contracts on unwound spot deals.

Courts and the FTC have come down hard on dealers who sell the customer's trade-in and then attempt to unwind a spot deal. In a 2005 case in Kentucky, a dealer who sold the customer's trade-in was held liable for conversion (the civil equivalent of theft) when the spot deal unwound. The court ruled that the dealer took away the consumer's vehicle and left him or her with no means of transportation unless he or she accepted new substituted onerous contract terms. Even if the dealer gave the consumer its proceeds for the trade-in (which the dealer had to do), the consumer was not made whole. The moral of this and similar cases: put the trade-in aside or make it clear to anyone looking at it that any sale will have to wait a few days.

Remember that unwound and re-contracted spot deliveries are also "adverse action" for purposes of the federal ECOA and FCRA. Dealers must give the consumer an adverse action notice for canceling the first contract.

When a dealer unwinds a spot deal, all of the information concerning both the original and re-contracted transaction (including the spot agreement) needs to be kept for the legally required period of time, a minimum of 25 months under the ECOA. Most lawyers advise their dealer clients to keep the documents for five years, which is the statute of limitations period for a claim under ECOA and the FCRA. Certain state laws, such as those in California, Washington and Wisconsin, may require dealers to keep documentation for up to seven years or longer. Also, you must cease document destruction if you are subject to or believe you may be subject to a lawsuit or regulatory inquiry to which the documents may be relevant. In unwound spot deals that get re-contracted, it may be a good practice to keep all the documentation from both transactions together in one master deal jacket in case an issue comes up later. The dealer should be prepared to show that the dealership made a good faith effort to get the original deal financed with its financing sources, but was unable to do so on terms acceptable to the dealership. A pattern of numerous unwinds of spot deals may give plaintiffs' lawyers grounds to claim the dealer is engaging in "yo-yo financing," which can be a deceptive trade practice under Section 5 of the FTC Act or state law. One dealer in Oklahoma testified in a deposition that it unwound over 50% of its spot deals which suggested an unfair or deceptive trade practice in the way it operated its business. Be careful to monitor what percentage of your spot deals are unwound. If you see the percentage rising, investigate and train your sales and F&I officers on what types of deals you believe your lenders will buy. A pattern of yo-yo financing before a jury can be a six-figure verdict waiting to happen. And remember, in most states, if a consumer prevails under a consumer protection statute, it can also recover its attorney's fees which typically exceed $100,000 as well.

**The Federal Odometer Law** – This law requires sellers of motor vehicles to disclose to buyers in writing the odometer reading of the vehicle being sold and prohibits tampering with odometer devices. The buyer must review and sign the disclosure. For used car sales, the odometer reading must be disclosed on the title. Specific additional disclosures are also required by this law and applicable regulations. State laws govern registration and titling requirements as well.

**Internet Sales** – This is an emerging area of the law as dealers continue to increase the number of sales to out-of-state buyers through their websites or using Internet sites like eBay Motors. When a dispute arises, the buyer will attempt to sue the dealer in the buyer's home state and claim that the dealer should have been licensed in their home state or that the law of their home state applies to the transaction. To date, courts have generally held that an isolated sale to a buyer in a far-off state does not in-and-of-itself make the dealer subject to that state's jurisdiction or laws. However, if a dealer engages in numerous transactions with that state's residents or targets residents of that state in its advertising, then the result may be different and the dealer may be subject to a lawsuit and have to comply with laws of the remote state. Many states have some type of law applying their licensing provisions to out-of-state dealers. Consult a knowledgeable attorney on ways to "localize" Internet sales to the dealer's home state and resist the long-arm jurisdiction of remote states. This is especially important if the customer signs the documents in that remote state and the dealer then ships the vehicle there without the customer ever physically coming into the dealership's store.

**State Law Restrictions on Fees** – State laws also limit or restrict fees, especially "doc fees," to a specific dollar amount or a reasonable amount in relation to the actual costs of preparing and filing documentation. A great deal of litigation has occurred relating to the propriety of doc fees charged by dealers in states where no specific amount is provided by law. In Arkansas, for example, plaintiff attorneys have successfully claimed that dealers who charge doc fees for preparing retail installment sales contracts are practicing law without a license. Know your state law on permissible doc fees and consult your local attorney if no specific amount is permitted or the doc fees are limited to being "reasonable."

**Cash Sales** – If a customer purchases a vehicle with cash or cash equivalents that total in excess of $10,000, you must file IRS/FINCEN Form 8300 within 15 days after receiving the cash payment. This form can now be filed electronically. For this purpose, "cash" is not only currency but currency equivalents such as traveler's checks, cashier's checks, money orders and other documents that are not a product of an existing and ongoing relationship between the customer and a financial institution. So, for example, a personal check and a bank check representing the proceeds of an auto loan made to the customer by the bank are not considered cash or cash equivalents because they are part of an ongoing relationship between the customer and the bank. If the customer conducts a "related transaction" (another transaction within 24 hours such as buying another vehicle for cash), then you must total all the cash and cash equivalent payments from both transactions for purposes of calculating whether you collectively meet the greater than $10,000 threshold for filing IRS/FINCEN Form 8300. By January 31 of the following calendar year, you must send a notice to the customer informing him or her that you filed an IRS/FINCEN Form 8300 on them during the prior calendar year.

The penalties for failure to comply with IRS cash reporting laws can be devastating if the IRS deems a failure to be intentional or in reckless disregard of the dealer's obligations. Intentional disregard is the knowing or willful failure to file. Merely failing to file on time subjects a dealer to a penalty of $100 per return, up to a maximum of $1.5 million over a calendar year. Intentional disregard raises the minimum penalty to $250 per return and the maximum penalty, which the IRS usually imposes if it deems the dealer in intentional disregard is the greater of $25,0000 per return or the cash received in the transaction up to $100,000 per transaction. A dealer should adopt a written policy to educate employees on cash reporting including the definition of cash and cash equivalents; the dealer's obligations and how to avoid structuring transactions with the person providing the cash to avoid the reporting requirement. You should also file a SARS form with the U.S. Treasury Department if you suspect the customer is laundering money from an illegal activity. The criminal penalties for money laundering, the signals of money laundering and a strong statement of the policy of the dealership that it will not do a suspicious transaction and will report suspicious transactions to the authorities should also be a part of your compliance plans. Train, monitor and use the DMS system in the background to flag transactions based on types of funds received.

**Disclosure of Starter-Interruption Devices or GPS Systems**
Dealers who charge customers for these devices when the dealer or finance company requires that they be used violate TILA unless such charge is included in the disclosure of the finance charge and APR. Because these items are charged to credit and not cash customers, they should be included in the finance charge. They are analogous to a consumer paying lenders' acquisition fees. They are part of the finance charge but should be itemized in the amounts paid to others in the itemization of amount financed, but then subtracted from the total of the amount financed. Dealers who don't disclose these devices being installed on the vehicles face class action risks under TILA.

**Failing to Obtain the Customer's Signature** – If you fail to obtain a customer's signature on a RISC, Buyer's Order or other document, it is never appropriate for the dealer to sign the customer's name unless the dealer has a written power of attorney from the customer permitting it to do so. Otherwise, doing so can constitute the crime of forgery for which jail time can be imposed in many states. It will also void a retail installment sales contract or lease, which means the lender can require the dealer to repurchase the contract.

A dealer in Michigan sold a vehicle to a consumer and committed a litany of violations in doing so. Plaintiff consumer was not given a review copy of the RISC disclosing the finance charge prior to the time of sale. She didn't take delivery because the dealer was going to install a GPS device. When she returned to pick up the vehicle and a copy of the RISC, she was told the price she was being charged for the vehicle included a $570 bank fee based on her credit rating. It also included an extended warranty the Plaintiff did not want. When she called the warranty company to cancel, the warranty company indicated it had not received any paperwork from the dealer. She never received a refund. She made her first payment to the creditor-assignee, CAC, but when she went to make her second payment a CAC representative informed her that the dealer had canceled the contract. The dealer claimed she had not provided all the required documentation and told her to return the car or it would be repossessed. Plaintiff didn't return the car, and the dealer repossessed it and then sold it to a third-party without informing the plaintiff.

The Court ruled that the dealer had violated Truth in Lending by failing to disclose a hidden finance charge – the bank fee based on the consumer's credit risk. It awarded plaintiff $1,000 in statutory damages.

The Court next awarded the consumer her requested $2,000 in punitive damages against the dealer for the dealer's failure to send an adverse action notice under ECOA when it canceled the contract. ECOA allows for the recovery in individual actions of up to $10,000 in punitive damages for a violation of ECOA with a limit on class action punitive damage liability of the lesser of $500,000 or 1% of the creditor's net worth.

The Court also treated the dealer's repossession of the vehicle as a conversion (theft) of property because the consumer had never signed a spot agreement entitling the dealer to cancel the contract and the consumer was not in default of the RISC when the vehicle was repossessed. Under Michigan law, a plaintiff is entitled to treble damages for conversion. Valuing the vehicle at $8,000, the Court awarded treble damages in the sum of $24,000.

Finally the Court awarded the plaintiff damages under the Uniform Commercial Code (UCC) because the dealer sold the car without giving the plaintiff notice of its intended disposition or a description of her potential deficiency liability. The Court calculated these damages in the sum of $2,778.20, this being the amount of the time price differential plus 10% of the cash price of $8,000.

The Court also awarded the plaintiff $3,600 in attorney's fees and $377 in court costs. The total amount of the judgment entered against the dealer totaled $34,555.20, this for an $8,000 vehicle sale.

**Recent Litigation Involving Payoffs of Trade-In Vehicles** – A number of class actions have been filed against dealers relating to practices concerning payoff amounts listed in RISCs being incorrectly stated to the detriment of the customer. Typically, a dealer will obtain from the trade-in lender an automated 10-day or 15-day payoff amount. That amount may be included in the amount financed portion of the RISC and the RISC will typically provide it is only an estimate and the dealer is agreeing to pay the amount shown to the lender. The dealer does not make any statement that the figure is accurate.

If the dealer pays off the trade-in on the day it accepts the vehicle, the trade-in lender will refund the customer unearned finance charge from the 10-day quote. The problem arises when a dealer waits a number of days—maybe as many as 10 or 15—to pay off the lien. The class actions charge that in such event, the consumer is charged an additional sum being the daily finance charge under the old contract from the day the consumer surrendered the trade-in to the day the dealer gets around to sending in the payoff.

No courts have ruled on this issue yet but the risk of an adverse ruling is out there. If possible, a good practice would be to obtain a "same-day" payoff quote (Dealertrack offers same-day payoff quotes from many lenders) and charge the consumer that amount with the dealer paying any additional daily finance charges from delaying to make the payoff. This approach will cost you some money but until the class actions are decided, it may be a prudent way to proceed.

You may also have difficulty getting same-day payoff quotes from certain lenders. Dealertrack is integrating same-day payoff quotes for many lenders but other lenders at this writing don't have the functionality yet. In that case, you may have to calculate the payoff by subtracting the daily finance charge from the 10- or 15-day notice. Some lenders provide a daily rate to make this easier to do. Dealertrack provides a means to calculate a same-day payoff by providing the daily interest accrual.

A dealer in Detroit sold a 2006 Chevy Cobalt to a plaintiff who put down $1,248 on a spot delivery deal. When the dealer unwound the spot deal demanding an additional $1,500 down payment, the customer could not do so and the dealer revoked the RISC and kept the car. The buyer sued the dealer for, among other things, not giving her an adverse action notice when it attempted to change the terms of the RISC and revoked the signed RISC in unwinding the spot deal. The dealer admitted that it never issues adverse action notices and the court awarded the plaintiff $1,248 in actual damages and $10,000 in punitive damages for failing to issue the adverse action notice. The lesson of this case is clear. You as a dealer are a "creditor" for adverse action notice purposes and if you unwind a spot deal, you must give the customer an adverse action notice as noted above.

# Recommended Practices



1. Always have a "permissible purpose" to pull a consumer's credit report. A signed authorization from the consumer (generally on a credit application) is strongly preferred but not required when both the dealer and customer understand they are close to completing a credit transaction, except in Vermont where obtaining the customer's written consent is required. Most credit applications, which are usually signed by the consumer, contain language where the consumer agrees that you can access their credit report. Financing sources usually obligate dealers to either post or provide to credit applicants a list of the names and addresses of the financing sources with which the dealer does business and to which the dealer may send their credit application. This is required by the Fair Credit Reporting Act (FCRA).

2. Give or send a Risk-based Pricing credit score disclosure exception notice to every applicant for credit. Obtain the consumer's credit score and the distribution of credit scores for the scoring model used from a credit bureau or a third-party source such as Dealertrack. The only exception is for customers who do not have a credit score, and they should receive the FTC Risk-based Pricing Rule notice for consumers without a credit score. If you don't typically pull credit on applicants, you may have to buy a credit score to give the credit score disclosure notice to all credit applicants. Give the notice to the consumer as soon as possible after getting the credit score information necessary to complete the credit score disclosure notice form. Give the notice by the earlier of closing the deal or within three business days. Keep a copy in the deal jacket. While not required, it is a good practice to get the customer to sign the file copy of the credit score disclosure notice acknowledging receipt. Remember that Dealertrack provides a personalized credit score disclosure notice if you access the credit score or credit report using Dealertrack.

3. Send adverse action notices when required. Remember the three situations in which you must send an adverse action notice: a) You take a consumer's credit application but do not send it to any financing source; b) You unwind or re-contract a spot delivery deal; and c) You can't get the customer financed either because no financing source approves the customer's credit application on terms acceptable to your dealership or the customer does not accept or use your final credit offer after negotiations are completed. When unwinding or re-contracting a spot deal, a good practice is to hand the customer the adverse action notice along with the new contract when they return to the dealership or when they return the vehicle in an unwound spot transaction. Note that adverse action notices require inclusion of a consumer's credit score and credit score disclosures including up to four to five key factors that adversely affected the credit score if the credit score was a factor in the adverse action. See the model adverse action notice included at the end of this Chapter. Remember that Dealertrack provides a personalized adverse action notice if you access the credit score or credit report using Dealertrack.

4. Accurately fill in all spaces on the RISC and give the customer time to read the contract before they sign it. Contract terms must be stated accurately. If the customer wants to have someone help them understand the contract, let that person read the contract as well. Do not pressure a consumer to sign a contract without reading it first. Do not misrepresent the terms of a contract. Do not roll negative equity into the sales price of the vehicle. Do not engage in payment packing by including additional optional items in the vehicle price. Do not backdate contracts, especially on re-contracted spot deliveries that you unwind.

5. Do not charge credit customers higher prices than cash customers on vehicles or aftermarket products. Be prepared to show that vehicle prices are individually negotiated in all cases, there is no set price in advance and there is no negative purchase price differential for credit as opposed to cash customers. Use a menu-

selling process for aftermarket items to show you consistently offer the same products to all consumers at the same prices. For menu selling, employ the 300% rule – offer 100% of your products to 100% of your customers, 100% of the time. Comply with the California and Minnesota Car Buyer's Bill of Rights and/or other applicable state law requirements for disclosures of aftermarket products.

6. Know your state laws on permissible fees you can charge, especially doc fees. Don't charge excessive doc fees or any fees in excess of your state's specific limits. Plaintiffs' lawyers have brought UDAP cases under state law claiming that doc fees are excessive charges and hidden profits that dealers charge which are unrelated to their actual costs.

7. If spot deliveries are permitted in your state, always use a spot agreement containing terms permitted or required by your state's law or approved in a case decided by a state appellate court. Include language that gives both you and the buyer the right to unwind or re-contract if you cannot obtain financing approval for the original contract "on terms acceptable to the dealer." Your attorney should review and approve your form spot agreement for compliance with your state's laws. Track your percentage of unwound spot deals. A significant percentage can lead to claims of deliberate "yo-yo" financing by the dealership which courts have held to be an unfair trade practice. A reasonable sales or F&I officer should have a good sense of what kinds of paper their lenders will buy so your unwind rate should be below 10% of the spot deals you sign.

8. Do not sell the customer's trade-in vehicle when doing a spot delivery until you have finalized financing and delivery of the customer's new vehicle purchase or lease. Selling a trade-in vehicle before you have a final deal completed can subject you to a conversion (theft) claim or similar liability. Reported cases in which the dealer sells the consumer's trade-in and then unwinds the spot deal almost always are critical factors in a UDAP or similar finding against the dealer. The FTC has cautioned against doing so as well.

9. Document the customer's consent to re-contract an unwound spot deal. When you re-contract a spot deal, get the customer to sign a form acknowledging their right to unwind the deal but indicating that re-contracting is their voluntary choice. Show on the form the different terms from the initial contract that you could not get financed. Do not backdate the new contract the customer is signing. Date the new contract on the day when both parties sign. And don't forget to give the customer an adverse action notice for unwinding the original contract.

10. Be able to show customers how they can quickly thaw their frozen credit files. For customers who have placed security freezes on their credit files, have a sheet of paper available containing the phone numbers of all three national credit bureaus (Equifax, Experian and TransUnion) for the customer to call to temporarily "thaw" their credit files so that you can pull a credit report on the customer. This will require the customer to have available the PIN issued to them by the credit bureau when they first froze their credit file. The credit bureau is not obligated to thaw the credit file without the PIN. If the customer does not have the PIN, perhaps they can call someone at their home to get it. If the customer has their PIN, they can "thaw" their credit file and make their credit report and credit score available to you in a matter of minutes by simply calling the phone number for each credit bureau. It is not advisable for you to take the customer's PINs or offer to make the calls for the customer, although you can give the customer access to a private phone in the dealership if necessary. If you spot deliver or sell a vehicle to a customer with a frozen credit file, proceed with extreme caution. Consider obtaining additional information, such as a pay stub, bank statement or other evidence of the customer's creditworthiness, and be especially diligent when verifying the customer's identity. Few lenders will purchase a contract for a customer on whom they cannot pull credit.

# Additional Resources

FCRA:
http://www.consumer.ftc.gov/articles/pdf-0111-fair-credit-reporting-act.pdf

ECOA and Regulation B:
http://www.fdic.gov/regulations/laws/rules/6500-2900.html

The OCC's Handbook containing information on TILA:
www.occ.treas.gov/handbook/til.pdf

**Car Buyer's Bill of Rights:**
California:
http://www.consumer.ca.gov/publications/car_buyer_rights.shtml

Minnesota:
http://www.mada.org/Portals/70/Documents/Legal/Consumer/BillRightsBulletin.pdf

Servicemembers Civil Relief Act:
http://www.military.com/benefits/content/military-legal-matters/scra/servicemembers-civil-relief-act-overview.html

The Risk-based Pricing Rule:
https://www.ftc.gov/news-events/press-releases/2011/07/ftc-federal-reserve-board-issue-final-changes-risk-based-pricing

Information about Filing IRS Form 8300 on cash deals with cash payments over $10,000:
http://www.irs.gov/pub/irs-pdf/p1544.pdf

# 100 Example of an Adverse Action Notice Form

Dealer Name:

Street Address:

City, State, Zip+4:

Phone number:

Applicant Name:

Address:

City, State Zip+4:

Date:

Dear :

Thank you for applying to us for vehicle financing. After carefully reviewing your application, we are sorry to advise you that we cannot provide credit to you at this time or that we cannot provide credit on the terms you requested.

You should understand that as a dealer, we generally sell or lease vehicles on credit only if a third-party like a bank or finance company will agree to buy the contract from us on terms that are financially acceptable to us. Regrettably, we could not do that in this instance.

If you would like a statement of specific reasons why your application was denied, please contact our Finance Manager at the number or address shown above within 60 days of the date of this letter. We will provide you with the statement of the reasons within 30 days after receiving your request. If we provide the reasons to you orally, you have the right to request us to confirm them in writing within 30 days of our receiving your written request to do so. You should also receive letters from the financing sources to which we submitted your credit application giving their reasons for not providing credit to you or not providing credit on the terms you requested.

If we obtained information from a consumer reporting agency as part of our consideration of your application, it is checked and its name, address, and toll-free telephone number is shown below. The reporting agency played no part in our decision and is unable to supply specific reasons why we have denied credit to you. You have a right under the Fair Credit Reporting Act to know the information contained in your credit file at the consumer reporting agency. You have a right to a free copy of your report from the reporting agency, if you request it no later than 60 days after you receive this notice. In addition, if you find that any information contained in the report you receive is inaccurate or incomplete, you have the right to dispute the matter with the reporting agency.

You can find out about the information contained in your file (if one was used) by contacting each consumer reporting agency that is checked below:

| | | |
|---|---|---|
| ☐ Experian<br>P.O. Box 4500<br>Allen, TX 75013<br>(888) 397-3742<br>www.experian.com | ☐ Equifax<br>P.O. Box 740241<br>Atlanta, GA 30374<br>(800) 685-1111<br>www.equifax.com | ☐ TransUnion<br>P.O. Box 2000<br>Allen, TX 75013<br>(800) 888-4213<br>www.transunion.com |

☐ If this box is checked, we also obtained your credit score from the ____________ consumer reporting agency and used it in making our credit decision. Your credit score is a number that reflects the information in your credit report. Your credit score can change, depending on how the information in your credit report changes.

Your credit score: ________________ Date: ________________

Scores range from a low of ____________ to a high of ____________

Key factors that adversely affected your credit score:

______________________________________________________________

______________________________________________________________

*[Number of recent inquiries on credit score]*

If you have any questions regarding this notice,

you should contact:

Dealer name:

Dealer address:

Dealer's telephone number:

Sincerely,

NAME OF DEALER

Notice: The federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The federal agency that administers compliance with this law concerning this creditor is the Federal Trade Commission, Equal Credit Opportunity, Washington, DC 20580.

“The lesson of this case is clear. You as a dealer are a “creditor” for adverse action notice purposes and if you unwind a spot deal, you must give the customer an adverse action notice.”

- Court Ruling


CONTRACT
day of

Chapter Six



# The FTC Act, the Dodd-Frank Act and State Unfair and Deceptive Acts and Practices (“UDAP”) Laws

## Background

UDAP laws are designed to protect consumers from unfair and deceptive trade practices in the marketplace, including false or misleading advertising. They cover merchants of goods and services generally, not just auto dealers. These laws were originally passed to ease the legal burden for proving common law fraud.

The original UDAP law is Section 5 of the Federal Trade Commission (FTC) Act, which prohibits unfair and deceptive acts and practices. However, the FTC Act does not afford consumers any private right of action and many practices require the FTC to first obtain an enforcement consent order prior to seeking the $16,000 per violation penalty that the Act permits if the consent order is violated.

Under Section 5 of the FTC Act, an act or practice is unfair when:

(1) It causes or is likely to cause substantial injury to consumers as determined by the FTC;

(2) The injury is not reasonably avoidable by consumers; and

(3) The injury is not outweighed by countervailing benefits to consumers.

A “substantial injury” typically takes the form of monetary harm, such as fees or costs paid by consumers because of the unfair act or practice. However, the injury does not have to be monetary. An injury is not reasonably avoidable by consumers when an act or practice interferes with or hinders a consumer’s ability to make informed decisions or take action to avoid that injury. Injuries caused by transactions that occur without a consumer’s knowledge or consent are also not reasonably avoidable. Injuries that can only be avoided by spending large amounts of money or other significant resources also may not be reasonably avoidable. Actual injury is not required to support an unfairness claim; it need only be likely.

An act or practice is deceptive when:

(1) The act or practice misleads or is likely to mislead the consumer as determined by the FTC;

(2) The consumer's interpretation is reasonable under the circumstances; and

(3) The misleading act or practice is material.

To determine whether an act or practice has actually misled or is likely to mislead a consumer, the totality of the circumstances is considered. Deceptive acts or practices can take the form of a representation or omission. The FTC also looks at implied representations, including any implications that statements about the consumer's debt can be supported.

Section 1036 of the Dodd-Frank Act gives the Consumer Financial Protection Bureau (CFPB) authority to publish rules and bring enforcement actions against creditors that engage in unfair, deceptive or abusive acts or practices ("UDAAPs"). The new wrinkle is the "abusive" practices which focus on a consumer's inability to understand the terms of a product or their reasonable reliance on the creditor to act in the consumer's interests. CFPB Director Richard Cordray has indicated that no regulations will be issued to further define "abusive" trade practices beyond what is contained in the Dodd-Frank Act. Regulation of abusive trade practices will be by means of the CFPB bringing enforcement actions against creditors that the agency believes are engaging in abusive practices. While neither the CFPB nor the FTC have authority under Dodd-Frank to enforce "abusive" trade practice restrictions against franchised auto dealers, the FTC has effectively expanded its unfair trade practice enforcement authority to address auto dealer conduct that may meet the "abusive" trade practice prohibitions. The CFPB can enforce abusive trade practices directly against independent and buy-here-pay-here dealers, as well as against most auto lenders who may then have contractual recourse against the dealer that originated the paper.

All 50 states and the District of Columbia have also enacted their own UDAP laws (also called "Little FTC Acts"). In addition to these laws authorizing Attorney General actions, many state UDAP laws give consumers a private right of action to obtain injunctions and recover actual damages, court costs, and attorneys' fees. Many of the laws also permit recovery of statutory, punitive, or treble damages as a deterrent to deceptive or unfair business conduct. Some UDAP laws permit a consumer to bring a lawsuit as a private Attorney General. Most UDAP laws allow class actions as well. In California for example, at least 85 dealers were reported as being sued between mid-July and September 2014.

This Chapter discusses auto dealer liability risks for unfair, deceptive and abusive practices under the FTC Act, the Dodd-Frank Act and state UDAP laws. As these laws are a "catch all" for bad conduct, they present a substantial risk for a variety of misdeeds in selling vehicles to, or financing vehicles for, consumers.

## Important Laws and Regulations

**Section 5 of the FTC Act** – Section 5 of the FTC Act prohibits "unfair methods of competition and unfair or deceptive acts and practices in or affecting commerce" against consumers. Enforcement authority is vested in the FTC and the FTC has not hesitated to use its authority, most recently for lax data security practices that it considers to be an unfair act or practice and for deceptive dealer advertising as discussed in Chapter 2. The FTC can bring an administrative enforcement action and, depending on the nature of the violation, bring a court action to seek injunctive relief or damages in the sum of $16,000 per violation. Where it obtains injunctive relief (typically through a consent agreement with the complained-of party in an administrative proceeding), it can also seek $16,000 per violation if the injunction or consent order is violated. One dealer that violated a consent decree by engaging in what the FTC considered to be deceptive advertising paid a $360,000 penalty to settle a second enforcement action. Another such dealer paid an $80,000 fine. States look to FTC lawsuits or consent decrees as precedent for their own UDAP laws.

**Unfair Trade Practices**

The FTC has noted that “[u]njustified consumer injury is the primary focus of the FTC Act.” As noted above, the FTC’s standard for “unfairness” is: (1) whether the practice creates a substantial consumer injury; (2) whether the injury exceeds any offsetting consumer benefits or benefits to competition; and (3) whether the injury was one that consumers could not reasonably have avoided. For these purposes, conduct can be “unfair” even if it is not “deceptive.” The FTC considers “deceptive” practices to consist of a material representation, omission or practice that is likely to mislead a consumer to the consumer’s detriment examined from the perspective of a reasonable consumer or a targeted group. “Unfair” is broader than “deceptive.” It is not necessary for any consumer to have complained of an act or practice if the FTC believes it “is likely to cause substantial injury to consumers. Unfair practices are broader than deceptive practices and can mean essentially anything the FTC believes is wrongful to consumers.

Most recently, the FTC has focused its unfair trade practice authority on inadequate Safeguards programs and failure to protect customer information from wrongful access or use. The FTC’s standard for unfairness is quite broad. Now, substantial injury to consumers is the most heavily weighed element, and it alone may constitute an unfair practice. Such an unfair practice is illegal pursuant to the FTC Act unless the consumer injury is outweighed by benefits to consumers or competition, or consumers could reasonably have avoided such injury. The FTC may also consider public policy, but only in determining whether substantial injury exists. The FTC has also been given a streamlined process to issue new rules and regulations for auto dealer unfair and deceptive trade practices by the Dodd-Frank Act. Previously, the FTC had to conduct detailed studies and hold hearings under procedures contained in the Magnuson-Moss Act and demonstrate that the prohibited act was “prevalent” in the industry. Now, the FTC merely needs to publish proposed regulations for a comment period and then can adopt final rules or regulations after reviewing the comments without having to make the prior showing that the regulated practices are “prevalent.” One authority indicated the lead time for the FTC to enact unfair or deceptive practice regulations against auto dealers has been reduced from approximately seven years to approximately one year. In 2011, the FTC conducted a series of roundtable hearings on dealer auto finance practices and continues to investigate practices like spot deliveries, with the expectation that the FTC will use its new streamlined authority to restrict or limit dealer practices or require more transparent disclosures to consumers. However, the FTC appears to be employing the CFPB’s general practice of not writing rules or regulations but “regulating by enforcement,” which means bringing actions for previously-allowed practices that the FTC first deems to be unfair or deceptive when it brings an enforcement proceeding against a dealer, thereby putting other dealers on notice that the practice is unfair or deceptive.

**Deceptive Conduct**

Most dealer deceptive conduct involves failure to make required disclosures (e.g., triggered terms under TILA or the CLA when a dealer advertises a payment amount), written or oral misrepresentations or omissions of material information both in advertisements and in personal dealings with a consumer. The issue is whether the act or practice is likely to mislead, rather than whether it causes actual deception. The FTC considers the facts and circumstances of the transaction in order to reach its conclusion. As discussed in Chapter 2, the FTC has made a strict interpretation of deceptive dealer advertising a priority with its 2014 Operation Steer Clear and its 2015 Operation Ruse Control.

The FTC has pursued numerous deceptive practice claims against auto dealers. For example, FTC regulations set forth restrictions on advertising practices it considers to be deceptive, such as “bait and switch” advertising and advertising discounts from MSRP if few, or any, sales below MSRP take place in the dealer’s geographic area. "Rebate stacking," where multiple rebates available only to select groups (military, recent college grads, first-time car buyers, etc.) are advertised together to calculate a vehicle price, even though few, if any, consumers will qualify for all of them, is another deceptive practice. The FTC has brought complaints against dealers for misrepresenting the down payment in lease and financing transactions; failing to disclose fees, security deposits, etc.; selling vehicles with known defects that consumers were not able to determine (e.g., selling new vehicles with paint defects likely to cause rust, odometer rollbacks, and other concealment of conditions on used vehicles); and payment packing. The FTC has indicated that advertising the fuel economy of vehicles can also trigger liability. The FTC has also taken the position that no item can be advertised as “free” when the primary item being sold (such as an automobile) is subject to a negotiated price. In fact, the FTC has issued an entire regulation on when the word “free” can be used in advertising without being deceptive. From 2012 through 2015, the FTC brought 32 deceptive practice enforcement actions against dealers. Five involved dealers who advertised that they would pay off a customer’s trade-in balance even if the customer was “under water.” At least four involved dealers advertising prices and discounts that were either not available to all consumers or deceptive in terms of being available only on higher-priced, “loaded” vehicles, terms that were not disclosed. Others are discussed in Chapter 2 including deceptive pricing, concealment of terms, and making the advertised terms available on only a small number of vehicles. The FTC is being very aggressive on scrutinizing dealer advertising especially on the Internet and in social media. Disclaimers or qualifications must be disclosed “clearly and conspicuously” and in close proximity to the advertised language they qualify. Each of the 32 actions brought by the FTC involved 20-year consent decrees with the dealer (two of them involved dealers who violated prior consent decrees) and no doubt will be followed by class action UDAP claims in states where consumers have that right.
See Chapter 2 for more details.

**“Abusive” Practices**

Under Section 1036 of the Dodd-Frank Act, abusive practices include practices that materially interfere with the consumer’s ability to understand a term or condition of the product or service or take unreasonable advantage of a consumer’s lack of understanding, inability to protect their interests, or their reasonable reliance on the credit provider (dealer) to act in the consumer’s interests. CFPB Director Richard Cordray indicated the agency would not publish regulations further clarifying what are abusive practices but would do so by bringing enforcement actions against perceived violators. Said Cordray, “For an institution, if they are in a situation, they should be thinking carefully about whether they are taking unreasonable advantage of their customer… It’s a customer by customer thing.” Again, the CFPB does not have authority to enforce “abusive” trade practice violations against franchised auto dealers but abusive trade practice conduct may support a private UDAP or other action under state law. Honesty and transparency in the sales and F&I processes are perhaps the best defense to a claim of an unfair or abusive practice.

Section 1042 of Dodd-Frank extends this UDAP enforcement authority to State Attorneys General and other regulators. Already, four State AGs and the New York

Superintendant of the Department of Financial Services have brought civil actions involving creditors other than auto dealers. The civil penalties are provided in Dodd-Frank Section 1055 and are draconian:

- First tier for any violation of law, rule or final order or condition imposed in writing by the CFPB—up to $5,000 per day during which the violation or failure to pay continues.
- Second tier for recklessly engaging in violation of a federal consumer financial law, up to $25,000 per day during which the violation continues.
- Third tier for knowingly violating a federal consumer financial law, up to $1 million per day during which the violation continues.

The FTC and CFPB signed a memorandum of understanding in December 2012 to share information and will coordinate their supervisory and enforcement efforts among their respective regulated entities. The FTC has partnered with 32 law enforcement agencies in the U.S. and Canada to implement Operation Ruse Control. Collectively, they brought over 185 actions against auto dealers. Both the FTC and the CFPB have signed similar memoranda of understanding with State Attorneys General.

**State UDAP Laws** – State UDAP laws are not uniform and a number of states apply different tests for "unfairness" than does the FTC. Many use a standard of: (1) whether the practice, even if not previously considered unlawful, offends public policy under any state authority; (2) whether it is unethical, immoral, oppressive or unscrupulous; and (3) whether it causes substantial injury to consumers. This is a lower threshold than the FTC's "unfairness" standard. Many state UDAP laws cover Internet or out-of-state transactions if a resident of the state is adversely affected.

State Attorneys General are very liberal in using UDAP statutes to bring claims against auto dealers. For example, the New York Attorney General used its authority under New York's UDAP law to send "cease and desist" letters to 45 dealers and fine 15 dealers for allegedly deceptive advertising in connection with the 2009 "Cash for Clunkers" program.

The New York Attorney General also has claimed that placing vehicle etching charges, fees and the like on a Buyer's Order can be an unfair trade practice. Payment packing has been a particularly frequent source of Attorney General claims under UDAP laws. Payment packing happens when a dealer adds items such as alarms, fabric protection, etching or window tinting to the price of the car so that the buyer does not really know how much he or she is paying for these add-ons. The law requires dealers to itemize the add-ons to let the buyer decide whether he or she wants to buy them. This law applies to all car sales, new and used. The New York Attorney General sued a Long Island dealer for payment packing and surreptitiously altering contract prices after agreeing with customers to a different price and terms. The same dealer had settled similar charges with the Attorney General for $41,000 in 2004. The Washington Attorney General entered into a consent decree with a credit insurance marketing group that it alleged to be a leader in training car dealerships how to engage in payment packing of credit insurance. The consent decree also required restitution for customers from the prior 3-year period and payment of $250,000 in fines and attorney's fees to the State. The Washington AG also entered into a deceptive advertising consent decree with a Washington dealer group imposing in excess of $100,000 in penalties with another $75,000 in penalties suspended and additional violations to incur an enhanced penalty of $25,000 each. An Arizona dealer settled a UDAP charge with the Attorney General by paying $225,000 because of allegedly "deceptive advertising and sales practices." The Vermont Attorney General settled UDAP cases with eight auto dealers for failing to honor advertised sales prices. The consent decree required the dealers to reimburse consumers for overcharges and make all advertising and vehicle sales contracts available to the Attorney General's office. One dealer paid $16,000 in penalties to the State. The Massachusetts Attorney General collected $225,000 from a family of three auto dealerships for advertising misleading prices, payment packing and getting customers to sign blank contracts in which the dealers increased the agreed-upon prices, among other violations. Private lawsuits, especially class actions, are perhaps a dealer's biggest risk under state UDAP laws. Among class actions that have been brought successfully against auto dealers under state UDAP laws are class actions for:

- misrepresentations about the vehicle's fuel efficiency, safety features and warranty;
- challenges to the amount of "doc fees" charged to consumers (in one case, a dealer settled with the New York AG to repay a total $86,826 to 174 consumers who were charged a bogus $499 administrative fee, and also to pay a $50,000 penalty to the State);
- payment packing;
- retaining amounts of itemized sums listed as "amounts paid to others" on retail installment sales contracts without disclosing that the dealer may retain part of the funds;
- concealing negative equity in the cash price of a vehicle;
- violating the FTC's Used Car Buyer's Rule which requires a Used Car Buyer's Guide to be affixed to the window of each used vehicle offered for sale or lease (remember that a federal law violation is automatically a UDAP violation under many state UDAP laws);
- hiding the cost of an "etch" product in the vehicle's sale price;
- imposing extra charges when customers who leased cars attempted to exercise their right to purchase at a previously determined price; and
- other patterns and practices consistently charged to all or substantially all of the dealership's credit consumers.

UDAP plaintiffs are not bound by contractual limitations of liability or merger clauses, contributory negligence and often do not have to prove reliance on the unfair or deceptive act. Arbitration clauses may not apply as well depending on state law and how the clauses are drafted. Also, courts have ruled that it is not a good defense that the seller acted in good faith under the advice of counsel. Unlike the FTC, most state courts adopt the least sophisticated consumer standard for assessing whether a practice could be unfair or deceptive and do not use a "reasonable consumer" standard.

UDAP statutes are written very broadly and courts hold they are to be liberally construed in favor of the consumer. This puts conceivably any selling or financing practice at risk from a disgruntled consumer. As a "catch-all" for dealer misconduct, UDAPs offer consumers a powerful weapon in many states.

**Criminal Liability for Deceptive or Unfair Dealer Practices** – Criminal violations have been brought against auto dealers in extreme situations when their conduct meets the requirement of criminal fraud and related statutes under federal or state law.

A federal statute makes it a felony to make a knowing and willful misrepresentation to a federally insured financial institution. Under this statute, indictments have been brought and dealers have paid criminal fines or been imprisoned for defrauding banks in order to obtain financing. In one North Carolina case, the dealership principal and 10 employees were indicted by the federal government for criminal acts including falsifying down payments by using fictitious "house rebates," grossly inflating trade-in values, overstating customers' income and using fictitious employment on credit apps. In one case, the dealer principal pled guilty to a series of felony charges to avoid jail time and agreed to two years' probation, a $50,000 fine, up to $1.19 million in restitution and was forced to get out of the automobile business for a minimum of two years. A South Dakota dealer principal was sentenced to 30 months in prison, plus a term of three years of supervised release and ordered to pay restitution of $7 million for causing fraudulent financial reports and record entries to a series of Midwestern banks. In Alabama, nine dealership employees were sentenced in 2015 to jail time for bank fraud and interstate wire fraud in an action brought by the Department of Justice in conjunction with the FTC as part of the FTC's Operation Ruse Control.

The federal odometer tampering statute has been a basis for indictments against dealers as well. Altering vehicle titles and documentation to reflect the inaccurate mileage only compounds the crime, and the Justice Department has indicted dealers for doing so. Criminal fraud charges have also been brought against dealers who lure in low-income buyers with deals that are too good to be true. In Connecticut, a dealer sales manager pled guilty and seven dealership employees were sentenced to five years in jail for mail fraud and other charges arising out of failing to disclose charges for products they told consumers were free; billing customers for items never installed in the vehicles; providing low monthly payments but failing to disclose large balloon payments at the end of the financing term; inflating customer income on credit apps; and charging customers higher prices than they agreed to pay for the cars.

Mail order fraud, wire fraud, and bank fraud are only examples of criminal conduct prosecuted at the federal and state level. Employees of dealerships have been indicted for forging documents (credit apps, contract changes) and on identity theft charges for using the personal information of customers to obtain credit, goods and services in the customers' name. One dealer used the identity of two customers to commit wire fraud and mail fraud against lenders who also were not timely paid off on trade-ins or floor plans. This subjected the dealer to a maximum of 32 years in prison and $1 million in criminal penalties. A 25-year-old man was sentenced to 15 years in jail for using people's personal information he received at his car dealership to create more than $1 million in fake car loans and pocket nearly half of it from the scam in the largest case of identity theft Missouri has ever prosecuted, according to the Missouri Attorney General. A New York dealer was indicted on criminal grand larceny charges when he failed to pay off the balance of financing on a customer's trade-in vehicle.

**Liability for In-Store Fraudulent Charges on New Chip Cards**

Dealers may be liable for fraudulent use of credit cards at their facilities effective October 1, 2015 if they do not upgrade their credit card terminals. The major credit card issuers have been busy issuing to all cardholders new chip-enabled credit cards ("EMV Cards") to address the growing concern with data breaches and stolen credit card information. The EMV Card generates a unique, one-time code for each transaction. As of October 1, 2015, there is a new EMV Card standard for liability for face-to-face or in-store fraudulent payments. After October 1, liability for fraudulent use of a credit card falls on merchants who have not upgraded their systems (meaning replacing their old magnetic stripe-only point-of-sale (POS) devices with EMV-enabled terminals that are capable of authenticating the payment card with its integrated chip) if chip card technology could have prevented the fraud. To avoid liability for fraudulent charges, you should audit payment processing systems, inventory the POS systems, and initiate deployment of chip-enabled terminals if you have not already done so. Work with your merchant acquirer to accomplish this upgrade as soon as possible.

# Case Study

The New Jersey Division of Consumer Affairs reached a settlement of $1.8 million, plus consumer restitution, from eight related auto dealerships and their owners, all for deceptive sales tactics at the dealerships.

The two principals of the dealers were accused of failing to disclose existing mechanical defects or past damage to used cars; charging for supplemental warranties and other costly aftermarket items without customers' consent; and failing to honor the negotiated or advertised prices for the vehicles. The two principals had settled similar allegations in 1999.

In addition to bait-and-switch tactics and add-on sales without consent, consumers alleged that the dealerships failed to refund deposits in a timely manner after consumers either canceled sales or were denied financing; advertised cars without including required information such as a VIN, thus preventing consumers from being able to check the vehicle's history of damage and use; and failure to provide consumers with titles and registrations in a timely manner.

In 1999, the two principals agreed to pay $450,000, including $250,000 as a compensatory fund for consumers, to settle similar complaints by consumers. The new settlement requires a payment of $1.8 million, which includes $1,733,059 and $66,941 to reimburse the state's investigative costs and attorney's fees. In addition to that payment, the defendants must work to resolve the complaints of 45 consumers who documented their allegations with the Division of Consumer Affairs. Finally, under the settlement, the defendants must at their own cost, hire a state-approved compliance monitor for two years to oversee the defendants' compliance with all applicable federal and state laws, rules, and regulations, as well as reviewing the defendants' internal policies and procedures to make any changes, facilitate the resolution of additional consumer complaints, and provide quarterly written reports to the New Jersey Division of Consumer Affairs.

New Jersey was also active against dealers for unfair and deceptive conduct in 2015.

A New Jersey State Superior Court Judge ordered a dealership to pay $693,645.91 after finding that it violated the state's consumer protection laws and regulations a total of 640 times, following legal action brought by the Attorney General's Office and the State Division of Consumer Affairs.

The state's 10-count complaint alleged that the dealer and its manager violated the New Jersey Consumer Fraud Act, the Motor Vehicle Advertising Regulations, the Automotive Sales Regulations, the Used Car Lemon Law (UCLL) and UCLL regulations by, among other things, advertising used vehicles for sale without disclosing:

- To consumers the vehicle's prior damage or prior use.
- Selling vehicles "as is" when they qualified for a warranty.
- Permitting third parties to advertise, offer for sale and/or sell used vehicles on Craigslist that were titled to the dealer.

The state in its filed complaint also alleged that the dealer:

- Failed to provide consumers with title and registration to used vehicles prior to the expiration of temporary title and/or registration.
- Required that consumers sign blank sales documents.

- Offered used vehicles for sale at the dealership location that did not have prominently displayed the Federal Trade Commission Used Car Buyers Guide, and failed to otherwise indicate whether vehicles came with warranties.
- Offered for sale used vehicles that did not have the total selling price conspicuously posted.
- Advertised and/or offered for sale used motor vehicles through its website, without the required statement that "price(s) include(s) all costs to be paid by a consumer, except for licensing costs, registration fees and taxes."
- Failed to itemize documentary service fees.
- Since at least 2007, failed to pay the 50 cent administrative fee for each used vehicle sold, as required by the UCLL and UCLL regulations.

Officials indicated the defendants failed to file a response to the complaint, resulting in the Judge entering a final judgment by default.

The judgment requires the defendants to pay $640,000 in civil penalties, $31,200.91 in reimbursement to the state for its legal and investigative costs and $22,445 in restitution to seven consumers.

By the terms of the default judgment, the dealer must comply with all applicable state laws and regulations in its business practices.

"The penalty ordered in this matter is appropriate and should send a clear message to all motor vehicle dealerships that violating our consumer protection laws and regulations comes at a steep price," New Jersey acting attorney general John Hoffman said.

"We are continuing to review the practices of new and used motor vehicle dealers to ensure consumers are not taken advantage of," Hoffman continued.

"The evidence presented to the court by the Division of Consumer Affairs resulted in a favorable decision for consumers," New Jersey acting state director of consumer affairs Steve Lee said. "Dealerships must not withhold information from consumers that the dealerships are required by law to provide."

As noted above, UDAP activity can also result in criminal prosecution. The U.S. Attorney's Office in Birmingham, working with the FBI and the Internal Revenue Service, Criminal Investigation Division, as well as the FTC, obtained guilty pleas over the past year from three sales managers, two finance managers and four salesmen at a dealership in Birmingham to a conspiracy to boost auto loans and vehicle sales through fraudulent means.

Authorities say the dealership employees' violations included inflating buyer's income, naming straw purchasers who could qualify for loans, and listing non-existent vehicle accessories in order to boost a loan amount (so-called power booking).

(continued)

"The defendants from [the dealership] defrauded auto loan lenders by falsifying customer information on loan applications, which also harmed customers by inflating the value of the vehicles they bought or saddling them with loans the dealership officials knew they could not afford," the U.S. Attorney said.

"These predatory practices in providing auto loans, often to people with credit problems or insufficient income, threaten consumer safety and the stability of the auto loan industry."

The eight employees were sentenced to prison terms up to 30 months in jail in one case and five years' probation following one year of home detention in another. Restitution was also required from several of the employees.

## Recommended Practices

1. Adopt a dealership code of conduct emphasizing honesty and transparency with customers and train all your employees on it. While you can't specifically prohibit every possible practice your employees should not do, you can establish a set of principles and guidelines to govern employee conduct. Your employees have to know how you want your business to be conducted, and each employee should sign their affirmation that they understand and will comply with the code of conduct to reflect well on your dealership. Your code of conduct and training should contain specific standards of behavior that exemplify the principles embodied in the code of conduct. Enforce your code of conduct by reviewing deal files, listening to customers and stressing the importance of proper behavior. Make employees understand shortcomings and why it is necessary to immediately correct them. Make compliance with the code of conduct a part of compensation decision-making.

2. Be honest, direct, transparent, and fair in all dealings with consumers. Make sure customers have the chance to read and understand all documents they are signing. When selling a vehicle, understand the difference between puffery (stating a salesperson's fanciful opinion about a vehicle) versus making representations about a vehicle which can be legally actionable under UDAP laws if relied upon by consumers. Consumers have won or favorably settled numerous cases against auto dealers when the dealer made representations about a vehicle's performance qualities, condition, prior usage and financing terms. Active concealment of damage repair or defects in a used car sale or odometer tampering run the risk of both a UDAP claim and a lawsuit for common law fraud. Putting inaccurate information on credit applications to induce financing approvals runs the possibility of criminal prosecution for bank fraud and mail fraud.

3. Know your state's law on the amount of "doc fees" a dealer can collect, and if the law does not prescribe a specific amount, be sure you can reasonably defend your "doc fees" in relation to your cost of preparing documents and titling work for vehicles you sell. Many states permit "reasonable" doc fees but do not give any guidance on what constitutes "reasonable" for this purpose. A series of cases claimed dealers who charged doc fees were practicing law without a license since charging a person for preparing a legal document (the retail installment sales contract) is considered practicing law. States split on these cases but courts in Missouri and Arkansas upheld the argument and ruled that the dealers were in fact practicing law without a license. Contact your lawyer about what is a permissible "doc fee" in your state.

4. Establish a consumer complaint resolution process and include timelines for a quick and efficient resolution. Try to establish an informal mediation process with your consumers either with a neutral officer at the dealership or through a local association such as your regional auto dealer association or a mediation company. Many problems can be resolved by an effective mediator prior to litigation or arbitration if the dealer and customer are at an impasse. A consumer complaint process is an integral element of a Compliance Management System, Consult your local attorney on the possible use of arbitration clauses and class action waivers if mediation or informal efforts to resolve disputes are unavailing. Arbitration and class action waivers are discussed in Chapter 8.

5. The Consumer Financial Protection Bureau has established a complaint hotline and website for consumer finance complaints, including auto financing complaints, and the CFPB affirmatively engages in swiftly resolving the complaints (typically in favor of the consumer) and using the database to provide information to the FTC or State Attorneys General for further action. For these reasons, you don't want to have a customer file a complaint against you with the CFPB. Thus it is critical that

you do everything possible to resolve consumer complaints in-house, even if it means being liberal in meeting the consumer's concerns. A customer filing a complaint on the CFPB's complaint hotline can put you "on the radar screen" for the CFPB, FTC, or Attorney General, not a good place to be. To make things worse, the CFPB now publishes all of the consumer complaints online so all your disgruntled consumers will have their allegations on the CFPB complaint website where plaintiffs' lawyers will be actively watching.

6. Have an attorney or compliance professional do periodic compliance audits and "mystery shopping" at your dealership to identify areas that might support UDAP violations. Remember that in many states a violation of any federal consumer protection law or regulation (e.g., failing to publish a Spanish-language Used Car Guide on a used vehicle that was negotiated for sale in Spanish, failure to provide an adverse action notice) is an automatic violation of a state's UDAP law. Promptly correct any deficiencies identified using appropriate staff training to avoid repetition or other conduct that may lend itself to being an unfair or deceptive trade practice. Remember to live by your dealership's code of conduct and train your employees frequently.

# Additional Resources



A summary of the evolution of the FTC's rules on unfair acts and practices including its current standards:
http://www.federalreserve.gov/boarddocs/supmanual/cch/ftca.pdf

A summary of the FTC's views on the standard for deceptive acts or practices under Section 5 of the FTC Act. The FTC has since elaborated on this statement to indicate it is the likelihood of misleading a consumer, not whether the consumer was in fact misled, that is an element of the action:
https://www.fdic.gov/regulations/compliance/manual/7/VII-1.1.pdf

The FTC's position on using the word "free" in advertising:
http://www.law.cornell.edu/cfr/text/16/251.1

The FTC's summary of the Used Car Buyer's Rule:
http://www.business.ftc.gov/documents/bus13-dealers-guide-used-car-rule

A list of free FTC compliance publications:
http://www.consumerfraudreporting.org/pubs_business.htm

A 2009 study comparing the UDAP laws of the 50 states:
http://www.nclc.org/images/pdf/udap/report_50_states.pdf

Summary of State UDAP Laws (2009):
https://www.nclc.org/images/pdf/udap/analysis-state-summaries.pdf

A New Hampshire state document that in Part II describes in detail the workings of New Hampshire's UDAP statute. This article provides a good summary of UDAP laws generally:
http://doj.nh.gov/consumer/sourcebook/1st-word.htm

Details about the CFPB's consumer complaint hotline:
http://www.consumerfinance.gov/complaint/

—
Chapter Seven
—


# Aftermarket Product Selling

## Background

This Chapter discusses laws, regulations, and case decisions concerning marketing and advertising of aftermarket products. Federal and state laws govern the methods and content of advertising and marketing as well as the disclosure of aftermarket items. The CFPB and the FTC have taken particular interest in aftermarket product sales and brought enforcement actions for deceptive sales practices.

Most dealers attempt to sell aftermarket products to consumers at the time of a vehicle purchase. Typically, the products that are offered include vehicle service contracts; GAP (guaranteed auto protection); credit life and disability insurance; debt cancellation protection; etching or theft protection devices; and other products that are generally marketed as enhanced protection of the vehicle or the customer's credit obligations. Aftermarket transactions also include products and services to accessorize a vehicle. Aftermarket sale transactions usually take place in the F&I office after the customer and the salesperson have agreed on a vehicle and price. Be aware that damaging headlines, consumer litigation and administrative enforcement proceedings have resulted from non-compliant F&I sales practices used by dealers in selling aftermarket products.

Since the 1960s, the FTC has exercised enforcement authority over false or misleading advertising and other wrongful activity under the authority of Section 5 of the FTC Act. This law and its state counterparts are discussed in Chapter 6 (UDAPs). The Dodd-Frank Act's addition of prohibitions against "abusive" trade practices adds another liability risk potential and the CFPB has been very active in bringing enforcement actions and compelling up to $200-$800 million settlements against credit card companies and an auto finance lender that the CFPB determined had deceptively advertised add-on products like credit insurance, disability payment insurance, debt cancellation and identity theft protection. The settlements in these cases were punitive in amount with several consisting of giving full refunds to all customers who bought the aftermarket products. The CFPB has expressed publicly its concerns over deceptive and abusive sales of aftermarket products especially to subprime consumers.

CFPB Director Richard Cordray specifically mentioned add-on products in his opening remarks at an auto finance field hearing on September 18, 2014 in Indianapolis stating that consumers:

"… may encounter certain add-on products such as a warranty, rustproofing, roadside protection, service plans, and more. By the time they have made all those choices, they may be invested in the car and impatient to finish up and drive it home… Consumers should not be lured into a deal by misleading statements about the benefits of the product they are being sold. And consumers should get clear and intelligible contracts centered on terms they can understand."

In fining a bank for add-on product misconduct, Cordray stated, "We have consistently warned companies about practices related to add-on products and we will do what is necessary to prevent further harm to consumers."

In recent years, NADA research has determined that more than 50% of the profits for the average dealership come from the sale of aftermarket products and the majority of these sales are for vehicle service contracts. Aftermarket items must be disclosed separately and a dealer must clearly disclose that their purchase is voluntary and not required to obtain financing. States such as California and Minnesota have detailed regulations in their Car Buyer's Bill of Rights about how various aftermarket items must be separately disclosed to the consumer.

The sale of aftermarket products in auto finance will continue to be closely scrutinized by the FTC and CFPB for unfair, deceptive and abusive trade practices. The punitive nature of the CFPB's settlements (in one case, it required a credit card issuer to reimburse in full every customer that had signed up for an add-on product via telemarketing from August 2010 until January 2012 and to reimburse customers who had been talked out of terminating as well) makes this a priority risk area for auto dealers. With respect to aftermarket sales in auto financing, the CFPB entered into a consent decree with Dealers Financial Services (DFS) (a service provider for U.S. Bank) for misrepresenting the costs and benefits of GAP insurance and service contracts covering certain repairs. The CFPB found that a military auto financing program included deceptive statements about the cost and coverage of the service contracts made by the service provider. The CFPB held that DFS made deceptive statements by stating the service contract "will add just a few dollars to your monthly payment" when in fact the average cost was $40 per month and stating that GAP would cost "only a few pennies a day" when in fact the average cost was over 40 cents per day. DFS was also found to have misrepresented the extent of the service contract's coverage and failed to disclose exclusions. The CFPB required DFS to pay restitution in the sum of $3.3 million.

## Important Laws and Regulations

**Disclosure Rules for Aftermarket Sales** – State laws require that specific notices be given to consumers with regard to certain aftermarket products. For example, most state insurance laws require the dealer to inform customers that purchasing insurance from the dealer is not required to obtain credit and that the consumer can obtain insurance from any insurance agent of their own choice. (Federal Truth in Lending also requires this disclosure to keep the insurance cost from being included as a part of the finance charge.) Many state laws require prominent disclosures concerning GAP liability and insurance in leasing transactions as well. If a dealer fails to prominently disclose that the purchase of an aftermarket item is voluntary and not required for credit, the cost of the item is considered a part of the "finance charge" for TILA purposes and the APR must be calculated to reflect that fact. A dealer must also disclose if it will retain a portion of the premium or charge.

In addition, most state laws (and, effectively, federal Truth in Lending and Regulation Z as well) expressly prohibit “payment packing,” a practice whereby the dealer adds charges for additional optional aftermarket goods or services to a negotiated vehicle sale or lease price without first disclosing to the consumer that the goods or services are optional and then obtaining their consent to buy at an itemized price. The California and Minnesota Car Buyer’s Bill of Rights also require a separate disclosure to be given to the buyer describing the price and the effect on the consumer’s monthly payment of each service contract, insurance product, debt cancellation agreement such as GAP insurance, theft deterrent device, exterior or interior surface protection product and contract cancellation option. The disclosure form must itemize these charges, disclose each item’s price and show the cost of the consumer’s monthly payments with and without the selected items. The dealer must obtain the consumer’s signature on this written disclosure prior to signing the sales contract. This is a best practice for dealers in other states as well and using an electronic menu is one of the best ways to comply.

Discrimination claims (both common law and under anti-discrimination laws like the ECOA) have been brought against dealers whose pricing and sales practices for aftermarket products are not consistent among protected classes of persons, such as women or minorities. While laws and regulations may not specifically require consistency in sales approaches, variations in sales practices may still trigger the possibility of being sued under various legal theories, notably UDAP laws described in Chapter 6 or “disparate impact” credit discrimination as described in Chapter 1.

**Insurance Products** – In selling aftermarket products, it is critical to know how the dealership’s home state characterizes certain protection products such as GAP, debt cancellation products, and service contracts. In some states, these are considered “insurance,” which may require the dealer to be licensed by the State Insurance Department and to give the customer disclosures in the RISC that are different from disclosures for non-insurance products. In other states, where these products are not considered insurance, they still need to be itemized in the “Amounts Paid to Third Parties” box on a retail installment sales contract (RISC) or lease agreement if provided by third parties with a notation that the dealer may retain a portion of the charges. Federal law requires that credit insurance and GAP coverage be initialed or accepted by the consumer in writing. This is typically done by having the consumer initial an insurance box on the retail installment sales contract or lease agreement.

State laws on how products are characterized can change. For example, prior to 1997, New York considered a service contract that covers wheel and tire damage caused by road hazards such as a blowout to be an insurance product. As such, only a licensed insurer could sell this product. However, the New York legislature amended the State’s Insurance Law to provide that a manufacturer or seller of a tire or its agent (such as an auto dealer) may offer coverage for damage to a wheel or tire from road hazards without needing an insurance license.

Both the FTC and CFPB have emphasized transparency, understanding, and fairness in the treatment of consumers. Aftermarket products are a ripe area for consumer misunderstandings, and it is important that your F&I people take the time to carefully explain what each product costs and the benefits it provides. Scripts and Q&As for aftermarket selling will be examined by regulators as will any recordings of aftermarket selling sessions. Make sure yours tell a good story.

# Case Study

The FTC fined a New Jersey dealer $184,290.00 for alleged deceptive aftermarket product selling of a payment plan to its customers. The plan claimed to allow customers to save on finance charges over the life of their credit obligation by making one half a payment every two weeks instead of the full payment at the end of the month. What the dealer failed to tell customers, however, was that the fees and charges to participate in the plan cost more than the average customer would save in finance charges. The dealer sold the bi-weekly payment product to approximately 1,084 customers over a period of two-and-a-half years.

In its consent decree with the dealer, the FTC set a tone for what it expects in connection with the sale of any aftermarket product:

> "IT IS FURTHER ORDERED that respondents and their officers, agents, representatives, and employees, directly or indirectly, in connection with the advertising, marketing, promotion, offering for sale, or sale of any add-on product or service shall not misrepresent or assist others in misrepresenting, in any manner, expressly or by implication: A. That any person will provide any add-on product or service to any consumer; B. The total costs to purchase, receive, or use, or the quantity of, the add-on product or service; C. Any restriction, limitation, or condition on purchas ing, receiving, or using the add-on product or service; D. Any aspect of the performance, efficacy, nature, or characteristics of the add-on product or service; E. Any aspect of the nature or terms of any refund, cancellation, exchange, or repurchase policy, including, but not limited to, the likelihood of a consumer obtaining a full or partial refund, or the circumstances in which a full or partial refund will be granted to the consumer; F. That any add-on product or service has the ability to improve, repair or otherwise affect a consumer's credit record, credit history, credit rating, or ability to obtain credit; and G. Any other material fact.
>
> IT IS FURTHER ORDERED that respondents and their officers, agents, representatives, and employees, directly or indirectly, in connection with the advertising, marketing, promotion, offering for sale, or sale of any payment program or add-on product or service shall not make any representation or assist others in making any representation, in any manner, expressly or by implication, about the benefits, performance, or efficacy of any payment program or add-on product or service, unless at the time such representation is made, respondents possess and rely upon competent and reliable evidence that substantiates that the representation is true."

The FTC as well as the CFPB are actively investigating the sale of aftermarket products of all types for unfair and deceptive practices of all types. The CFPB has questioned the value of aftermarket products in relation to their cost and have asserted that they have authority over the sale of all aftermarket products if they are financed by a consumer. While the CFPB does not have authority to bring an action directly against a franchised auto dealer, it can bring actions against independent and buy-here-pay-here dealers and refer franchised dealer violations to the FTC or a State Attorney General. Many commentators believe that regulatory oversight of aftermarket product selling will be the next frontier for attacks against auto dealers in 2016.

## Recommended Practices

1. **If you conduct direct marketing of aftermarket products, scrub your target lists for persons who have excluded themselves from the means of communication you intend to use (telemarketing, faxes and email).** You should keep a separate list of consumers who opt out of telemarketing, faxes and email and be sure to not use auto dialers or pre-recorded telemarketing messages unless you first obtain the customer's written signed consent to receive autodialed or pre-recorded calls at a designated number with such consent containing language that "I understand that this consent is not a condition of purchase or credit." Adequately scrub telemarketing lists of phone numbers against the FTC's National Do Not Call Registry, your state's Do-Not-Call list, and your dealership's list of persons who have asked not to be called. The Direct Marketing Association (www.the-dma.org) also maintains "do not contact" lists that you can scrub your lists against. If you are telemarketing, get assurances from vendors on exclusions of persons listed on federal and state Do-Not-Call lists and double-check against state Do-Not-Call lists, as well as your own dealership's list of customers who have asked not to be called. If you are calling cell phone numbers, getting a prior written signed consent with the above language is required or a penalty of $500 - $1,500 per call can be assessed in a class action. Recent case law has indicated if a vendor you use calls cell phones without the necessary consents, you are liable for the violation.

2. **Understand your state's law on a dealer's ability to disclaim warranties and make sure it is clear in service contracts you sell whether you have "entered into" the service contract, in which event you cannot disclaim implied warranties under the Magnuson-Moss Warranty Act (MMWA) discussed in Chapter 2 (Marketing Vehicle Products and Credit Terms).** Service contracts and insurance contracts to cover the obligations can be structured in a number of different ways, each of which has different tax and liability issues. Two examples are "retro" policies and "reinsurance" policies. In "retro" policies, a portion of the customer premiums is sent by the dealer to an insurer who deposits it into an account to pay claims. When contracts expire or at predetermined times, the dealer receives a portion of the earned premiums. In reinsurance policy programs, the dealer sends a fixed amount to an insurance company who in turn cedes the amount to a reinsurance company that may be affiliated with the dealer. The insurer offsets claims payments against sums paid to the reinsurance company. When National Warranty went bankrupt, reinsurance companies were deemed to own the reserves, which remained available for customer claims. Retro accounts were considered part of National Warranty's bankruptcy estate and not available to satisfy consumer claims. State insurance laws also contain requirements for insurance and reinsurance for service contracts. Review how your service contracts are structured and insured with your lawyer and accountant.

3. **Charge substantially the same price for each product and each grouping of products.** Do not surcharge credit customers, as the surcharge is considered part of the "finance charge" under TILA and must be calculated into the APR and disclosed in the RISC. A pattern of surcharging groups of credit customers also risks a legal claim of disparate impact credit discrimination if you surcharge protected classes of persons such as women and minorities. The CFPB has made reference to such types of claims in its public statements about add-on products.

4. **Obtain and always use a good electronic menu product for consistency in selling aftermarket products in the F&I office.** Understand what is legally required by your state's law and prepare scripts, FAQs, and presentations that fairly and honestly state what the product is and how much it will cost. Go through the menu-selling process with every customer the same way. Consider adopting the "300% Rule": presenting 100% of your aftermarket products to 100% of your customers

100% of the time and at the same price. Consistent menu selling can provide an excellent defense to charges of payment packing, deceptive sales practices, and discrimination. An electronic menu enables you to easily change products and packages and show the customer how different products will affect their monthly payments. The CFPB has emphasized the importance of being transparent and giving disclosures that consumers can readily understand. Using an electronic menu can meet this requirement much more than does the traditional “four square” or other confusing paper negotiation worksheets. Make sure to keep a copy of the signed menu in each deal jacket.

5. **Have every customer sign a final menu that clearly shows which products were offered, which were accepted and which were declined.** Offer every product to every customer and have the customer sign or initial their acceptance or rejection of each product. Do this both for individual products and packages of products such as “gold,” “silver,” or “platinum.” Remember that in California and Minnesota, you need a separate disclosure document for aftermarket products under their Car Buyer’s Bill of Rights. Similar bills are pending in the legislatures of other states such as Massachusetts and Maryland.

6. **Monitor and adjust your menus, presentation scripts, and practices to address consumer feedback and your CSI scores.** Adapt your menu and aftermarket product selling to take into account changes in the law or unintended consumer negative reaction. Train and test your employees prior to their beginning to menu sell and regularly audit their performances. Some dealers videotape F&I office sales transactions. This is a subject you should discuss with your attorney. Know, however, that if you are ever audited by a regulator, you will have to produce copies of all the videotaped menus for the regulator to review as part of its investigation.

# Additional Resources

A Guide to the FTC Telemarketing Sales Rule:
http://business.ftc.gov/documents/bus27-complying-telemarketing-sales-rule

Summary of June 2015 FCC Rulings on the TCPA:
https://apps.fcc.gov/edocs_public/attachmatch/FCC-15-72A1.pdf

A Businessperson's Guide to Federal Warranty Laws, including the MMWA:
http://business.ftc.gov/documents/bus01-businesspersons-guide-federal-warranty-law

A Good Summary of Guidelines for Internet Advertising:
http://www.ahbbo.com/adsftc.html

https://www.ftc.gov/sites/default/files/attachments/press-releases/ftc-staff-revises-online-advertising-disclosure-guidelines/130312dotcomdisclosures.pdf

MMWA:
http://business.ftc.gov/documents/bus01-businesspersons-guide-federal-warranty-law

Chapter Eight



# Arbitration and Mediation

## Background

2015 saw important developments in the areas of arbitration and class action waivers in consumer contracts.

Section 1028 of the 2010 Dodd-Frank Act directed the Consumer Financial Protection Bureau (CFPB) to conduct a study on consumer arbitration and report to the U.S. Congress concerning the use of pre-dispute arbitration clauses in contracts for consumer financial products, including retail installment credit agreements. Section 1028 also states the CFPB, "by regulation, may prohibit or impose conditions or limitations on the use of an agreement between a covered person and a consumer for a consumer financial product or service providing for arbitration of any future dispute between the parties, if the Bureau finds that such a prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers." The regulation would have to be consistent with the study.

In March 2015, the CFPB issued its arbitration study. The study particularly focused on consumer arbitration clauses that waived the right to bring class actions, either in court or by arbitration. The CFPB concluded that arbitration agreements restrict consumers' relief for disputes with financial service providers by limiting class actions. The report found that, in the consumer finance markets studied, very few consumers individually seek relief through arbitration or the federal courts, while millions of consumers are eligible for relief each year through class action settlements. It also found that arbitration clauses did not result in the reduction of pricing to consumers. The CFPB concluded in effect that class actions provide consumers with a better chance for relief than an arbitration, although their statistics did not support that conclusion. The CFPB, after another hearing on arbitration in October 2015, indicated it was inclined to issue a rule that would prohibit arbitration clauses that include class action waivers. Additionally, the potential rules would require companies to report individual arbitration to the CFPB, including the nature of the claim(s) and resolution. The CFPB would both analyze the data and publish the reported claims and resolutions on its website. The statutory authority given to the CFPB may operate to override court decisions that have upheld the use of mandatory arbitration clauses and class action waivers in consumer financial services contracts.

For example, in 2011, the U.S. Supreme Court ruled in a 5-4 decision in the case of AT&T Mobility, LLC v. Concepcion, that arbitration agreements in standard form consumer financial services contracts that waive the right to pursue a class action are enforceable and the Federal Arbitration Act ("FAA") preempted a California court ruling to the contrary. The case involved a large number of consumers, each of whom had been overcharged by a small amount of money (approximately $30) so that it was unattractive for any consumer to bring an individual action. Each consumer's contract provided for mandatory arbitration and a waiver of any right to bring or participate in a class action.

Based on these circumstances, the federal Ninth Circuit Court of Appeals in California had ruled the class action waiver as unconscionable under the law of California and thereby unenforceable. Under these facts, the class action waiver had been ruled to undermine California consumer protection statutes which rely on private causes of action for enforcement. Even the FAA provides that arbitration agreements are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."

The Supreme Court reversed the ruling, citing the authority of the FAA. The Supreme Court ruled that the Ninth Circuit's decision and California's law stood as an obstacle to the intent of Congress, as expressed in the FAA, of favoring arbitration where the parties have agreed to it as part of a contract. It also held that class action waivers are not inconsistent with the intent of Congress or the FAA, noting that "[a]rbitration is a matter of contract, and the FAA requires courts to honor parties' expectations." The Supreme Court further ruled that "States cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons."

In the aftermath of the Concepcion decision, plaintiff's lawyers have continued to attempt to invalidate arbitration clauses for unconscionability under state law with limited success in doing so. For example, in October 2012, two federal Circuit Courts of Appeal (the 3rd and 11th Circuits) affirmed district court orders granting defendant creditors' motions to compel arbitration on an individual, rather than on a class-wide, basis over plaintiffs' objections that class-arbitration waiver clauses in their credit card and wireless telephone service agreements were unconscionable and unenforceable. The circuit courts followed Supreme Court precedent from Concepcion. On the other hand, courts from Massachusetts to California have struggled to invalidate consumer arbitration clauses as unconscionable under state law. In Missouri, the Missouri Supreme Court addressed the issue of whether the arbitration agreement as a whole was unenforceable as unconscionable under Missouri contract law. The majority concluded that it was indeed unenforceable as unconscionable under Missouri law because it was:

- Non-negotiable and hard for consumers to understand;
- The record showed it would be unlikely for the plaintiff to be able to retain counsel to proceed individually in arbitration;
- There was considerable disparity in bargaining power; and
- The substantive terms much were less fair to consumers than those of the agreement upheld in Concepcion

However, Concepcion was decided on the law prior to the Dodd-Frank Act which gives the CFPB authority to issue a regulation prohibiting arbitration clauses as noted above.

Any CFPB final regulations on mandatory arbitration clauses would not apply to any consumer contract for 180 days after the effective date of the regulations. While auto dealers are exempt from the CFPB's general jurisdiction, lenders and finance companies that purchase dealer sale and lease agreements are not exempt. Many observers believe that the CFPB could take steps to indirectly restrict or eliminate the use of arbitration clauses and class action waiver clauses in auto finance contracts by applying its findings and limitations to lenders as yet another way to indirectly regulate auto dealers' use of arbitration clauses and class action waivers in retail installment sales contracts or leases.

A consumer's attorney will always try to get their case heard in a state court before a jury, preferably as a class action.

The federal Class Action Fairness Act of 2005 actually made it easier to file a class action if there are at least 100 class members and the total amount sued for exceeds $5 million. Jury members may have unfavorable opinions of auto dealers and may be sympathetic to the plaintiff class of consumers if the case gets to them for a decision. But the Concepcion case is making such cases more difficult to bring if the underlying contracts contain a mandatory arbitration clause. If properly drafted by allowing the consumer reasonable access to a fair and inexpensive dispute resolution process and forum like the consumer-friendly clause in Concepcion, at least for now, most courts will enforce these clauses.

Understanding that possible regulations from the CFPB limiting or even prohibiting mandatory arbitration clauses containing class action waivers in consumer contracts may be coming, this Chapter discusses federal laws relating to arbitration and the types of arbitration clauses that may be stricken by state courts as unconscionable and unenforceable in the aftermath of the Concepcion decision, notwithstanding federal law that favors arbitration generally. Note also new requirements by the American Arbitration Association for filing and obtaining approval of arbitration clauses before the AAA will agree to arbitrate a dispute.

## Important Laws and Regulations

**The Federal Arbitration Act ("FAA")** – This law, originally passed in 1925, states a broad national policy in favor of enforcing agreements to arbitrate and applies whenever a transaction involves "interstate commerce." Interstate commerce means some aspect of the transaction touches more than one state and is an easy standard to meet. It should cover most automobile sales and financing transactions if any person or item purchased comes from out of state (such as the financing source or provider of an aftermarket product). Generally, the FAA preempts inconsistent state laws such as a state law that prohibits arbitration of consumer claims. The U.S. Supreme Court has also held as a general proposition that the FAA does not allow class arbitrations absent an agreement between the parties in their arbitration clauses. The validity and preemptive effect of the FAA was affirmed in the Supreme Court's Concepcion decision. However, it is arguable that the Dodd-Frank Act, which gives the CFPB authority to issue regulations limiting arbitration clauses and class action waivers in consumer finance contracts, effectively amended the FAA by giving this authority to the CFPB.

While more difficult after Concepcion, courts still have the power to refuse to enforce an arbitration clause if they find the clause to be "unconscionable" or void under the state's public policy. The so-called "Savings Clause" of the FAA (arbitration agreements are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract") permits a challenge on grounds of fraud, duress or unconscionability. One court described unconscionability as "the absence of meaningful choice on the part of one of the parties, together with contract terms that are unreasonably favorable to the other party." A California court held that while Concepcion and the FAA require that class action waivers be enforced, the case does not preempt generally applicable state contract law defenses, such as fraud, duress, or unconscionability, from applying to other provisions of the arbitration agreement.

To defeat a claim of unconscionability, the arbitration clause or arbitration agreement must be carefully drafted and should cite the Federal Arbitration Act by name. Some state courts have refused to enforce arbitration clauses that do not treat both parties equally, are buried in small boilerplate type in non-negotiable contracts or contain hardships from a consumer's perspective. An arbitration clause should be conspicuous in a contract and be in larger type and bolder printing than the rest of the document. It should give either party the right to arbitrate, but prohibit class action arbitrations. The arbitration and class action waiver clause should appear near the customer's signature or require separate initialing by the consumer. State law may require other provisions to be specifically spelled out in an arbitration agreement. If exceptions for small claims actions or repossessions are stated, they must be clear and conspicuous.

Courts that have upheld arbitration clauses against challenges of unconscionability have looked favorably on language stating that the dealer will pay the consumer's costs of filing for arbitration if the consumer is unable to afford them. Provisions that give the consumer a choice of arbitrators, such as the American Arbitration Association, JAMS, the National Arbitration Forum, or the Better Business Bureau, are also helpful against such challenges.

The U.S. Supreme Court also recently held that under the FAA, if an arbitration clause gives to the arbitrator the right to determine the enforceability of the clause, then a court does not have authority to do so. Nevertheless, courts generally decide the enforceability of a mandatory arbitration clause in a contract.

It is important to avoid putting one-sided provisions in arbitration agreements since there is a chance that courts may not enforce them. One court defined such clauses as "ones in which there is an absence of meaningful choice coupled with draconian contract terms unreasonably favorable to the other party." Examples of such clauses to avoid include a provision that gives the dealer, but not the consumer, the right to go to court, such as a clause that lets a dealer obtain a court order to collect payments or judicially repossess a vehicle without going through arbitration; confidentiality requirements concerning disputes; clauses designating inconvenient or expensive forums for arbitration; or a clause that fails to explain how the arbitration process works. Any provisions viewed as unreasonably one-sided that are contained in a "take it or leave it" form contract run the risk of making the arbitration clause unconscionable. A recent Ninth Circuit ruling refused to enforce a mandatory arbitration clause and held its ruling was not preempted by the Federal Arbitration Act because it required a plaintiff to pay administrative and filing fees that are "so high as to make access to the forum impracticable."

As noted above, the CFPB has released its Dodd-Frank Act-required study and has indicated it will likely issue regulations prohibiting arbitration clauses with class action waivers due to their conclusion that consumers fare better in class actions. While a deeper read of the study does not appear to support such a finding, the CFPB is likely to publish proposed regulations that will limit or restrict arbitration clauses with class action waivers. The proposed regulations will be subject to comment and it will be important for dealers and dealer trade associations to weigh in on the regulations and oppose any part of them that restricts or limits arbitration clauses with class action waivers. Comments should also emphasize that the CFPB's regulations should not apply to auto dealer retail installment sales contracts because Section 1029 of the Dodd-Frank Act excludes from the CFPB's supervisory, enforcement and rulemaking authority, auto dealers that sell, lease and service motor vehicles and routinely assign their contracts and lease agreements to unaffiliated third parties, which covers most franchised auto dealers.

In addition, notwithstanding the Concepcion decision, the legal interpretation of arbitration clauses is constantly evolving, and dealers should try to keep abreast of changes as they occur, especially in case decisions in the dealer's home state. A dealer's arbitration clauses should be carefully and fairly drafted and made prominent and conspicuous to the consumer. In a recent Florida case, the consumer was able to get the arbitration clause thrown out because the deal was negotiated in Spanish and while the dealer employee explained the contract to the consumer in Spanish, the consumer testified that the arbitration clause was never mentioned nor explained to him by the dealer.

**The Revised Uniform Arbitration Act** – This Act has been adopted by 14 states and the District of Columbia, and is being considered by others. The Revised UAA is drafted to avoid preemption by the FAA and generally expands the authority of an arbitrator. An example is giving arbitrators the authority to award interim relief in a proceeding as well as punitive damages and attorney's fees if warranted under applicable law. States also have other arbitration laws, some of which are very unfavorable to consumer arbitration.

**American Arbitration Mandatory Arbitration Clause Filing Policy** - Effective September 1, 2014, the American Arbitration Association ("AAA") requires you to annually register your arbitration language for approval by the AAA for compliance with its "Consumer Due Process Protocol" and pay a fee. The fee was $500 in 2015, and annually thereafter. Filing an approval by a general forms provider will not satisfy this requirement. Each dealer must make its own filing and pay its own fees. If you don't register in advance, you may register at the time you are seeking to arbitrate a matter but must pay an additional fee of $250.

The AAA will evaluate your arbitration language to see if it complies with the Due Process Protocol. If it complies, your arbitration clause will be posted on the AAA's Consumer Clause Registry for public access along with your dealership's name, address, and other related documents and information. You can register your arbitration clause at consumerreview@adr.org or at this website:

www.adr.org/consumerclauseregistry.

If AAA determines that your arbitration clause does not comply, an amended version can be resubmitted after payment of an additional $500 fee. Also, dealers should note that the mere fact that an arbitration clause has been reviewed and approved by the AAA does not guarantee that a court will agree to enforce the arbitration clause.

In view of this annual filing burden, you may want to consider other arbitration entities in your clauses such as JAMS or you can reference selection of an attorney or former judge listed on your state's accredited ADR list as an acceptable arbitrator.

# Case Study

A number of courts have invalidated arbitration and class action waiver clauses in the aftermath of the Concepcion case, citing the FAA's "savings clause" that arbitration agreements are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract," and then applying state laws of unconscionability. Other state laws such as UDAP laws can also apply to invalidate arbitration clauses. For example, a 25-store group in Ohio had its arbitration clause stricken and a class action of persons who signed agreements with the arbitration clause between 1999 and 2007 certified when a dealer customer brought a "bait and switch" suit arising out of a spot delivery deal. The class certification was upheld on appeal. The class consisted of "thousands" of individuals.

The plaintiffs stated that the dealership had told them they were approved for 0% financing by GMAC and could take the vehicle home for the weekend. When they returned on Monday, the dealer said GMAC would approve only 1.9%. The plaintiffs accepted that rate and signed the documentation. About a month later, the dealer told the plaintiffs that GMAC had rejected them but a local bank would provide 9.4% financing. The plaintiffs refused to sign a new contract at that rate and sued under the Ohio UDAP law.

The dealership's arbitration clause provided that "any dispute between you and dealer (seller) will be resolved by binding arbitration." It did not name the forum or venue but only said arbitration procedures were simpler and subject to limited court review. The clause ended by saying "See General Manager for information regarding arbitration process."

The trial and appellate courts both ruled that this arbitration clause was incomplete and misleading and violated the state's UDAP law (the Ohio Consumer Sales Practices Act) and constituted an unfair and deceptive practice. Ohio law requires that all material terms must be included in a written contract for the sale of an automobile. By statute, failure to do so is a deceptive and unfair act and practice. Since the arbitration clause failed to include all material statements for its use by failing to advise consumers of the rules of the American Arbitration Association and the fees associated with arbitration, it violated the statute. Since thousands of customers had signed the same clause over an eight year period, the class was certified and the court awarded each class member $200 as well as issuing an injunction and declaratory judgment against the dealer. The class certification was affirmed initially by the Ohio Supreme Court but after years of litigation, later vacated because the Ohio Consumer Sales Practices Act requires a showing of actual damages for recovery and plaintiffs could not meet that burden on a class basis. It took the dealer 15 years of litigation and a huge amount of attorney's fees to finally reach that result on the statutory technicality. In other states, consumers can recover statutory damages under state UDAP laws which would have produced a million-dollar judgment against the dealer as such laws allow consumers recovery of their attorney's fees as well.

# Recommended Practices

1. **Use arbitration and class action waiver clauses to gain rights to avoid frivolous lawsuits and class actions.** These clauses may make a consumer's case less attractive to a plaintiff's lawyer if the lawyer cannot obtain class action status or a jury trial. The Supreme Court's Concepcion ruling makes these clauses more likely to be upheld and the CFPB has not yet issued any proposed or final regulations limiting or precluding the use of such clauses.

2. **Make sure the arbitration clause specifies the Federal Arbitration Act as authority and states specifically that the customer is waiving any right to litigate or arbitrate on a class action basis.** Any ambiguity in the language may be construed against the dealer. Review your arbitration clauses or arbitration agreements with your attorney for what activity is necessary to ensure that "interstate commerce" is involved so the FAA will apply. It is a best practice to include the arbitration clause in both the Buyer's Order and the retail installment sales contract (RISC) or Leasing Agreement. A good practice is to provide that the arbitration clause is to be interpreted by a court, not the arbitrator. A 2013 case that was silent on this point allowed the arbitrator to interpret the clause to allow classwide arbitration.

3. **Your attorney will also be able to help you navigate state arbitration laws and provide language to make certain that your state's laws on unconscionability will not apply to potentially negate the arbitration clause or arbitration agreement that you are using.** Avoiding the types of "fee and cost shifting" provisions that the New Jersey and Florida courts refused to apply is a good example. Have a periodic "check-up" with your attorney to make sure that new cases have not changed what is necessary to make your arbitration language bulletproof. If your dealership is in a state that is unfavorable to arbitration clauses even after the Concepcion ruling, consider designating the arbitrator as the person with authority to rule on the enforceability of the arbitration clause against challenges such as unconscionability. Discuss doing this with your attorney first.

4. **Give the customer time to read and understand the entire RISC or Leasing Agreement, but especially the arbitration clause.** The arbitration clause in a Buyer's Order, RISC, or lease agreement, or a stand-alone arbitration agreement should be clear and conspicuous, preferably in bold type and in a larger type size than other provisions. If the deal was negotiated in Spanish or another foreign language, make sure to explain the arbitration clause to the consumer in that language when explaining the contract terms of the deal. It is a best practice to give the consumer a translation of the arbitration clause as well. Getting a consumer's signature or initialing on an arbitration clause is another best practice.

5. **Consider mediation as an alternative or precursor to arbitration or litigation.** Mediation is an informal process in which a trained third-party works to help both parties identify common ground and resolve their differences in a casual setting. The American Arbitration Association has rules for mediation, but even a process in which an uninvolved senior officer of the dealership sits down with the customer can be far more effective in resolving a dispute that seems to be at an impasse. Many dealer associations have established informal mediation processes for their members. Consider looking into them. The Consumer Financial Protection Bureau (CFPB) has established a complaint hotline for motor vehicle financing disputes as well as other consumer credit complaints. The CFPB has said that it will use the complaint database to identify problematic creditors and consider enforcement actions against creditors such as independent and buy-here-pay-here dealers and make referrals to the FTC and State Attorneys General for action against entities like franchised auto dealers against which numerous complaints are filed.

So resolving disputes informally within your dealership has taken on an added importance to avoid your dealership getting on the CFPB's radar screen. Consider revising your procedures for customer disputes and make every effort to resolve disputes informally within the dealership or using a third-party mediator so you don't wind up on the CFPB complaint list or in a lawsuit challenging the validity and enforceability of your arbitration clause.

6. **Avoid one-sided terms that favor the dealership.** Cases in which arbitration clauses have been thrown out as unconscionable almost invariably gave the dealer greater rights than the consumer. Consider using clauses that give the consumer a choice of arbitrators and venue for the arbitration (although remember that if you use AAA, you will need to register your arbitration clause as described above), provide for the dealer to pay a portion of the filing fee if the consumer is unable to do so and other indications of a general sense of fairness in the arbitration process. The arbitration clause in the Concepcion case was very favorable to the consumer and included, among other things, that AT&T pay all costs for non-frivolous claims, the consumer had a choice to arbitrate in their home county, in person, by telephone or on written submissions, and denied AT&T having any right to seek attorney's fees from the consumer. If you want to preserve the right to repo a vehicle, make sure you give the consumer a similar right to bring a case in small claims court.

7. **Consider having the consumer separately sign or initial the arbitration clause in the buyer's order and contract.** To defeat a claim of procedural unconscionability, some attorneys recommend that you give the consumer a short period of time after signing the contract to opt out of the arbitration requirement. Few customers will do so and giving the opt-out right provides a strong counterargument to the claim that the consumer had no meaningful choice.

8. **If your arbitration clause is contained online, a court has indicated a mere click-through to accept the terms and conditions may not be enough to validate the arbitration clause.** The court held that in light of the obscure presentation of the Web page, there was no evidence that the consumer was agreeing to terms embedded in other hyperlinks on the Web page. The court concluded that "even an exceptionally careful consumer would not have understood" that clicking the button would be agreeing to an arbitration clause.

9. **In "single document" rule states (e.g., California, Michigan), make sure the arbitration clause is contained in the Retail Installment Sales Act and not in a stand-alone document.** A court in Michigan refused to enforce a stand-alone arbitration agreement. The court also held "that where there is no valid arbitration agreement, there can be no federal preference to compel its enforcement." After much litigation, a court in Maryland ruled that having the arbitration clause in the Buyer's Order but not the RISC was not fatal under Maryland's "single document rule," but to avoid this risk, make sure the arbitration clause is contained in both the Buyer's Order and the RISC.

# Additional Resources

**JAMS provides good information on consumer arbitration and gives model arbitration clauses:**
http://www.jamsadr.com/consumer-arbitration/

**AFSA Publication Summarizing Mandatory Arbitration Issues (2005):**
http://www.americanfinsvcs.com/CMS/fileREPOSITORY/Mandatory%20Arbitration%20Report%20AFSA%20KSE%20June-July%202005.pdf

**The U.S. Supreme Court's decision in the Concepcion case:**
http://www.supremecourt.gov/opinions/10pdf/09-893.pdf

**Website of the American Arbitration Association which contains additional information on the registration requirement:**
http://www.adr.org/

**Website of the National Arbitration Forum:**
http://www.adrforum.com/

**An article concerning the Consumer Financial Protection Bureau's new complaint system and how it works:**
http://www.mondaq.com/unitedstates/x/197780/Consumer+Law/The+CFPB+Company+Portal+Its+Your+Companys+Radar

Chapter Nine



# Recordkeeping and Destruction of Records

## Background

The records of an auto dealer are critical assets of its business. Company records include all records that are produced and received in connection with the operation of the dealership's business, whether such records are in a physical format (e.g., paper files) or electronic format (e.g., Email, Word, PowerPoint or Excel files). A company record may be as obvious as a memorandum, an email or a contract, or something less obvious, such as a computerized desk calendar, an appointment book, an IM (Instant Message), a text message from a cell phone, an expense record, a social media website entry, or a blog posting.

Information contained in flash drives, memory sticks, PSTs, USB drives, backup tapes, on wireless devices such as iPhones, Android phones, PDAs, tablets and other portable media can also be company records. It is important that your dealership have a policy on records maintenance and retention and that your records be kept centrally rather than contained on local PCs or portable devices to the greatest extent possible. You have to know where your records are located before you can effectively manage them.

This is especially true for electronic records. The Federal Rules of Civil Procedure and many state laws which govern the litigation process make discovery of electronic documents in a lawsuit an expensive, time-consuming and cumbersome process that may require you to search numerous locations for records and produce them in their original and all revised formats within a very short period of time. Different formats can include "metadata" and other information hidden behind a document, revealing its origin, changes and distribution, among other things. By failing to produce electronic documents when required to do so, even inadvertently, courts may impose fines, sanctions or issue adverse instructions to a jury.

For example, the Consumer Financial Protection Bureau (CFPB) expects electronic records to be produced in native and all other formats beginning often within 20 days of their service of a Civil Investigative Demand (CID). If a company's records are contained on numerous remote devices, the burden of identifying and producing records in a timely manner may be difficult or impossible to meet.

Both the federal government and the states have many specific record retention periods for dealer records. For example, the IRS requires keeping tax and payroll records for a minimum of three years and longer if relevant to the administration or enforcement of an IRS law.

State record retention laws range from employment records to service and waste disposal records, and record retention requirements are not uniform among the states. Every state has its own retention requirements for dealer sales records, auto repair and servicing records, tax records, payroll and employment records and environmental and facility-related records, among others. Consult your local counsel or compliance professional when establishing retention periods for specific categories of your dealership's records.

The FTC has also weighed in on retaining records containing non-public personal information of consumers (NPI). The FTC has repeatedly warned that companies should retain NPI data only as long as necessary to fulfill the business purposes for which it was collected and then securely dispose of it.

This Chapter focuses principally on federal laws and regulations regarding records concerning vehicle sales, leases, and F&I records.

## Important Laws and Regulations

Federal and state record retention requirements generally apply no matter what the record's format or characteristic (i.e., both physical and electronic). Failure to retain records for the required time periods can subject a dealership to penalties or fines, cause the loss of rights and benefits, obstruct justice, or place the dealership in contempt of court or subject to negative jury instructions in litigation.

For example, ECOA requires that all written or recorded information concerning a credit applicant (including any credit report on the consumer or any notation of action taken, such as adverse action notices, Risk-based pricing notices, and decisions sent back by finance sources as well as any documents submitted by the consumer such as paystubs) must be retained for a minimum period of 25 months after the consumer is notified of the action taken on their credit application (e.g., approval, counteroffer, adverse action notice, or notice of incomplete application). This includes information on completed deals, "dead deals," or withdrawn credit applications, where the dealer never completes a credit transaction with the consumer. However, many attorneys advise dealers to retain these records for five years from notification of the credit decision, which is the statute of limitations period during which a consumer can bring a claim under ECOA or the FCRA. OFAC records must be retained for five years as well. California, Washington, and Wisconsin law require certain deal records to be kept for seven years. Other states may impose additional retention period requirements. Consult your local counsel on the appropriate retention period for your dealership in your state.

As you know, federal privacy laws and regulations require that documents containing personal customer information must be handled, maintained and disposed of in a secure manner. See the discussion under "FTC Consumer Report Information and Records Disposal Rule" in Chapter 3 Data Safeguards and Identity Theft Protection. If these documents and records are not securely maintained or not securely destroyed when no longer required or of use or value, they may be vulnerable to unauthorized acquisition or use – for example, to perpetuate identify theft, or to commit a fraud. Further, a dealership may be subject to an enforcement action by the FTC for violating the Safeguards Rule and Disposal Rule or in private litigation or administrative proceedings under state law.

The FTC has cited companies for keeping consumer information longer than is necessary as a shortcoming in data security that, along with other security deficiencies, can constitute "unfair acts or practices" in violation of Section 5 of the FTC Act. Again, the FTC has repeatedly stated its position that you should keep records containing customer information only for as long as necessary, and then destroy them in a secure manner, uniformly for both paper and electronic records.

The Telemarketing Sales Rule requires telemarketing scripts and materials, customer information and other information relating to telemarketing campaigns be kept for a minimum of 24 months from the date the record is produced. If a dealer uses a telemarketing firm, the dealer should consider requiring the telemarketing firm by contract to retain the necessary records on its behalf. However, record retention remains the dealer's responsibility. An agency's failure to do so for the dealer will not provide a viable defense in court.

Email and text messages present a particular challenge for records retention programs, particularly as email and text messages have become preferred means of business communications. It is important to develop and consistently implement a specific policy on email and text message retention and deletion. There is no magic time period during which you must retain emails or text messages, but long email or text message retention periods will cause a greater expense in searching and identifying relevant emails and texts in the event of a lawsuit. The same is true for other forms of instant messages and chats, which are also electronic records. Employees should also be discouraged from hitting "reply to all" on emails as it causes emails to proliferate and possibly to be reforwarded to the wrong people.

In the event of actual or threatened litigation or regulatory enforcement proceedings, a dealer must immediately implement a "litigation hold" process suspending all electronic and physical document destruction and requiring employees to identify and preserve relevant documents, including emails and text messages. Even inadvertent or negligent destruction or loss of email, texts, or other documents relevant to a threatened or pending lawsuit or investigation can be grounds for a court to impose sanctions for "spoliation" (destruction) of evidence. Recently, a number of states have recognized private tort claims for the negligent spoliation of evidence.

Electronic technology has made the issue of recordkeeping and destruction far more complex and critical than was the case when all records were kept only in paper format. Electronic records include more than Word documents, emails, and text messages. They include any electronically stored information generated or contained in the hard drive of any media or in any storage item including PCs, servers, copiers, fax machines, smartphones, tablets, PDAs, USB flash drives, laptops and other portable devices. Electronic records include drafts, IMs, charts, PowerPoints, spreadsheets and other documents composed, sent or received by the device. They constitute probably the largest percentage of documents your dealership creates and uses today. If you are sued, discovery of electronic documents becomes a costly process as you need to search all devices and cannot simply rely on what is on your central servers.

**Electronic Storage of Business Records** – Both the federal government and most states have adopted a form of the Uniform Photographic Copies of Business and Public Records as Evidence Act. Except for certain limited categories of documents, states generally permit the conversion of paper documents to electronic form for recordkeeping purposes. Federal and state evidence laws also permit the use of electronically converted documents in lawsuits or regulatory proceedings. The overriding requirements are that the electronic records be authentic reproductions of the original and be deemed to be reliable, trustworthy and accurate. A paper record should be electronically captured at or near the time of the event or transaction and must be complete and available for retrieval as requested for regulatory or business purposes. The context and the structure of the electronic record must also be preserved for the full retention life of the record, including any migration of the record from one system or medium to another. If a record is electronically converted in a trustworthy manner, the original paper record generally can be securely destroyed.

## Case Study

A North Carolina dealer was sued in a class action alleging the dealer had sold cars without requiring down payments but fraudulently issued retail installment sales contracts indicating down payments had been made in order to obtain financing approval for higher amounts. In pretrial discovery, the court ordered the dealerships to produce internal cover sheets documenting the down payments. (In North Carolina, the dealer must document in writing the amount of cash down payments and retain these records for four years). The named plaintiff purchased a vehicle without making a down payment in 2003 but the sales contract indicated a $2,000 down payment. An ex-dealer employee testified in a deposition that the dealership documented these false down payments as “Customer Funding Assistance” on internal accounting documents known as “cover sheets.” The cover sheets were kept secret and not shown to the customers or the financing sources. He further testified that the cover sheets would record internally whether or not a down payment was real or falsified. From this testimony, the Court concluded that the cover sheets were “critical evidence of false down payments” in the dealers’ possession.

In early 2004, the dealer was required to repurchase three contracts due to illusory down payments. This class action was filed in February 2006 alleging a scheme to use fake down payments documented internally by cover sheets not shown to the customer or the financing source. Plaintiffs served discovery requests seeking the cover sheets in March 2007 and the Court ordered the dealer to produce them.

At his deposition in July 2007, the dealer’s President testified that the dealer’s normal policy was “to destroy the Cover Sheets and they were still doing it despite the lawsuit.” When Plaintiff’s attorney requested the dealer to stop destroying the cover sheets, the dealer’s attorney replied saying “our client is going to continue with its normal business practice that has been in place for many years” despite the Court’s order compelling discovery of documents that included the cover sheets. The dealer’s counsel later told the Court that cover sheets were destroyed at month end in the ordinary course of business and that the cover sheets no longer existed.

However, it later came to light that in an earlier case involving a financing source, the dealer had produced numerous cover sheets even though the dealer’s counsel indicated to the Judge that no cover sheets existed in that case either. To make matters worse, the North Carolina DMV seized records from the dealership and found many cover sheets. The plaintiff later gained access to cover sheets from the prior litigation and the DMV. At that point, the dealer President changed his story.

The Court acknowledged the self-contradicting testimony and wrongful actions of the dealership. It ruled that the dealer had destroyed probative evidence to identify class members, and the Court entered an order that the evidence destroyed would have assisted the plaintiffs in their case. The Court imposed “sanctions” on the dealership for spoliation of evidence as well. These sanctions included giving a negative jury instruction that the cover sheets would have supported plaintiffs’ case, discounting any of the dealer’s arguments on class certification based on the absence of the cover sheets, and ordering the dealer to pay the plaintiff’s attorneys fees incurred during the discovery process relating to the cover sheets.

# Recommended Practices

1. **Have a comprehensive record retention policy for both paper and electronic records and consistently apply it.** Know what records you keep and keep only records you need for business. Know where they are located, and why you keep them there. Categorize your records and know the federal and state laws on mandatory time periods for retaining different categories of records. Avoid maintaining records in the hard drives of personal computers, laptops, tablets, memory sticks, PSTs, flash drives or remote storage devices such as smartphones. It is a best practice to maintain records only on central servers and limit users to "read only" access on their remote devices. Your records policy should define how, for how long and where your records are maintained, as well as when and how records are to be destroyed. Your practices should be consistent with your policy. The policy should also describe your dealership's and each employee's responsibilities relating to company records. Train your employees on your policy and obtain their written acknowledgement to comply with it. Limit and log all access to all records (paper and electronic) containing personal customer information. Consider having a policy to automatically delete all email and text messages after a short period of time unless a "litigation hold" is necessary because you have learned of the fact or possibility of litigation or a governmental investigation being commenced. In that event, all records destruction must cease immediately until you have fully searched and preserved all materials (both paper and electronic) that may be relevant to the litigation or investigation.

2. **Consider using electronic documents and obtaining electronic signatures instead of paper ones.** Electronic documents – credit applications, contracts, notices, consents – can be more securely stored centrally in limited-access electronic databases or in a secure cloud server where they won't get lost in file warehouses, and are capable of being recalled by a simple series of keystrokes on a personal computer. Scan paper documents to upload into your electronic document storage system. Most states generally permit electronic storage of records, including conversion of paper original documents to electronic format for storage. Certain electronic records systems permit key word or phrase searching to locate documents as well. This makes locating documents much less tedious particularly if the records are maintained in a central server or repository and not on PCs and remote devices. Your records storage policy should also address employees using their own devices for dealership business. No NPI should be permitted to be downloaded to any personal device or storage means such as a USB port or external hard drive.

3. **Retain company records only until they are of no further use or value to you and after any legally imposed retention time periods have expired.** After a record's current use or need has passed, either securely destroy the record or store it in a safe and secure location that is less accessible. After the legally mandated time period for retaining the record has expired, promptly and securely dispose of the record. Securely destroy all records containing any personal information of customers, especially records that contain Social Security numbers, drivers licenses, and credit or debit card account numbers. Be careful in discarding old computers, cell phones, flash drives, iPhones and smart phones. Even "deleted" information may remain on a hard drive or flash memory. Copiers and fax machines also contain hard drives that retain copies of records, especially if they contain scanning functions or Internet connections. Destroy the hard drive or use a software program that will irrevocably erase and expunge all of the information before trading the items in or discarding them. In 2013, a medical services provider was assessed a multi-million-dollar penalty for not wiping the hard drives of leased copiers before returning them to the vendor.

4. **Implement and enforce a policy concerning retention periods for email and text messages.** Most casual email and text messages should be purged from your system within a very short period of time. Junk email can be purged immediately. Identify a general time frame from creation in which all email (both sent and received items) will be purged unless a user takes affirmative action to archive or otherwise preserve the email as a business record. (A practical tip is to not allow users to preserve emails in mass; make preservation an email-by-email task.) Attempt to centralize all emails and avoid the ability of email to be moved to PC hard drives, memory sticks, PSTs, USB drives, remote devices or forwarded to a Web-based email address or other non-central storage. Do the same with text messages. Many companies don't store them at all although a litigation hold would require you to keep them. Encourage employees to use other more effective means of communication such as phone calls and in-person meetings. Educate employees on good email practices such as limiting the number of recipients and ccs and sending shorter emails only for the purpose of creating action by the recipient. Avoid excessive ccs. Consider disabling the "Reply to All" feature of your email system as doing so creates multiple copies of the record that can in turn be redistributed to many places. Have a procedure to suspend email and text message purging in the event of a litigation hold until all email and text messages relevant to the litigation hold have been identified, segregated and preserved. Failure to do so may give rise to a "spoliation" claim. As noted above, negligent spoliation is actionable in some states. If you are a party to a lawsuit, spoliation can lead to an adverse jury instruction concerning the purged information in the federal courts and all states.

5. **Identify and retain any records that may be relevant to a lawsuit or possible regulatory inquiry.** Establish a process for a "litigation hold" that halts the document destruction process for paper and electronic documents (including emails and text messages) so as not to destroy documents that may be relevant to ongoing or potential litigation or to a government inquiry, examination, or audit. A consistent document destruction policy and centralization of electronic records onto company or cloud-based servers, and not individual PCs or remote devices like flash drives, laptops, tablets, smart phones or external hard drives, can facilitate electronic discovery in litigation.

6. **Secure records that contain consumer information in accordance with your FTC Safeguards Rule Information Security Program and destroy these documents securely when they are no longer required under your FTC Information Disposal Program.** Be consistent in recordkeeping and destruction times.

7. **Exercise due diligence in hiring a vendor to store, dispose of and destroy your records.** Have a trusted employee of your dealership supervise any vendor destroying your records that contain customer information. Ask the vendor about its background checking processes and their bonding of employees who will collect and destroy customer information documents. Do your diligence on a vendor who will store your records in a cloud server, particularly as to their security certifications and experience in handling attempted or actual breaches of their server. Your contract with such a vendor should give you the right to audit and obtain a copy of their security audits and impose indemnification and liability on the vendor for any costs or losses incurred in any data security breach of their cloud or system that results in your customer information being wrongfully accessed or compromised, including the costs of sending notices and giving affected customers at least a year of credit monitoring services.

# Additional Resources

**A website that provides directions for erasing data from many models of cell phones and wireless devices:**
http://www.wikihow.com/Delete-Cell-Phone-Memory

or

http://www.packerthomas.com/services/links/AutoRecordRetention.pdf

**When to shred: Purging data saves money, cuts legal risk:**
http://www.computerworld.com/s/article/9114882/When_to_shred_Purging_data_saves _money_cuts_legal_risk

**An excellent website collection of practices concerning records management and destruction:**
www.arma.org

or

http://www.packerthomas.com/services/links/AutoRecordRetention.pdf

**Auto Dealer General Record Retention Guidelines (not state specific):**
http://cbmcpa.com/int/wp-content/uploads/2014/01/Record-Retention-Guidelines.pdf

or

http://www.mada.org/userfiles/fck/file/RecordRetentionNADA.pdf

or

http://www.packerthomas.com/services/links/AutoRecordRetention.pdf

or

http://www.hhcpa.com/files/Record-Retention-Guidelines.pdf

**“It is a best practice to maintain records only on central servers and limit users to “read only” access on their remote devices.”**

**- Randy Henrick**
Dealertrack

—

## Chapter Ten



—

# Implementing a Compliance Management System at Your Dealership

The preceding Chapters show that compliance is a critical priority for any auto dealer and, if done properly, will save costs, expenses, fines, damages, and penalties from regulator or Attorney General investigations, consumer claims and lawsuits, and attorney's fees necessary to defend your dealership. A best practice is to adopt a Compliance Management System (CMS). A robust and effective CMS is a critical element of a well-run dealership. A CMS is designed to ensure that the dealership's policies and practices are in full compliance with the requirements of federal and state consumer protection laws. It is also designed to bring a culture of compliance into your dealership and needs to start with strong Board of Directors and senior management support.

Each dealership is subject to oversight by the FTC, CFPB, or State Attorneys General. These agencies have expressed the need for CMS systems as an initial step in an audit process. A CMS should develop and maintain a sound policy and compliance program for its entire set of products and services relating to consumers. An effective CMS program will include components addressing: oversight — name a senior dealership officer to be in charge of the CMS; training internal employee and system monitoring; a consumer complaint response process; audits; third-party service provider oversight; recordkeeping; and advertising/marketing practices. The CMS should be approved by your Board of Directors or, if you don't have a Board, your executive officers and dealer principal(s). The senior officer in charge of the CMS should report to your Board or senior management group on dealership compliance at least semi-annually and preferably quarterly, so that omissions or potential violations are quickly identified and corrected.

Much of your CMS will include a compilation of policies that we have discussed in this Compliance Guide. These include your Privacy, Safeguards, Data Destruction, Red Flags, Fair Credit, Record Retention, and other policies referenced in the preceding chapters. Three critical components of a CMS are training programs on unfair, deceptive, and abusive acts and practices that are designed to ensure honesty and transparency in all customer dealings; a formal customer complaint process that includes mediation and escalation of customer complaints to a non-involved senior officer of the dealership or a neutral third-party such as a retired judge or dealer association representative; and a policy on advertising and marketing. Procedures for investigating, managing, and dealing with third-party vendors to which you have outsourced any of your compliance activities should also be included.

Training and monitoring employees is critical to keeping the dealership compliant. Recall, for example, that the number-one cause of data security breaches is employee negligence. The training must include basic security requirements that you include in your Safeguards program. These include, among others, not clicking on email links or opening attachments unless you know and trust the source of the email; using complex passwords (upper and lower case letters, numbers, and symbols) and changing them frequently; not sharing passwords; not downloading any programs or applications that are not approved by your IT staff; and complying with dealership policies on use of personal or mobile devices. Monitoring data flow in your system and user activity to identify possible patterns of irregularities is also critical. Employees should also be trained on unfair, deceptive, and abusive acts and practices and conduct that could be deemed to be such. Emphasizing honesty and transparency in all customer interactions is a stated priority of the FTC and CFPB. Training under other dealership policies and programs is also a critical element of a CMS.

Regulators expect that you will have in place a formal program for tracking and responding to consumer complaints. As described in Chapter 6 (Unfair and Deceptive Acts and Practices), the CFPB has established an online consumer complaint database and the FTC encourages consumers and businesses to file complaints about auto dealerships as well. These complaints go a long way towards establishing which dealerships the FTC and State Attorneys General will investigate for violations. You want to stay off the regulatory radar screens and seek to resolve consumer complaints informally through the dealership. This is not just about increasing CSI scores. It's about avoiding the costs, expenses, and divergence of management time from a regulatory investigation. Your CMS should describe the process for customer complaints, timelines for responding, escalation and mediation processes, and the resolution by a senior dealership officer or neutral third-party, if necessary. As noted previously, it is penny wise and pound foolish to not give consumers the benefit of doubts and to not go the extra mile to resolve consumer complaints even if it means the consumer may receive more than you believe they are entitled. Treat every customer individually but use a consistent process of initiating complaint responses within a short period of time and having appropriate escalation procedures. Do whatever you can to resolve the complaint in your dealership.

Advertising is currently the FTC's number-one enforcement priority against auto dealers. Thirty-two enforcement actions have been brought over the last four years with almost all of them resulting in 20-year consent decrees. Operation Ruse Control has brought hundreds more in partnership with other law enforcement entities. Any advertisement deemed unfair or deceptive will lead to substantial penalties such as the two dealers which the FTC deemed to have violated an earlier consent decree being assessed fines of $360,000 and $80,000 for repeat but totally unrelated deceptive advertisements. Make sure your advertising agencies understand the FTC's advertising requirements described in Chapter 2 of this Compliance Guide and try to get the agency to indemnify you for creating non-compliant ads. Have a process for legal review of your advertisements. Make sure your ads don't stack rebates or advertise terms that are not generally available to all consumers. And make sure disclosures meet the requirements for being clear and conspicuous—prominence, proximity, placement, and presentation in relation to the claim. The first thing the FTC will look for in evaluating advertisements is whether Truth in Lending (TILA) or Consumer Leasing Act (CLA) "triggered terms" are prominently disclosed. Take special note of advertising payment amounts as a payment amount is a triggering term under both TILA and the CLA. Be careful to not omit material terms that can make an advertisement unfair or deceptive.

The FTC and CFPB have been particularly concerned with vendor management oversight policies and functions as much of your compliance work, as well as your business processes, may be outsourced to third parties. You are ultimately responsible for the performance and any failures to perform or comply by your vendors. Your CMS should contain a policy for selecting, managing, auditing, and resolving service, security, and performance issues with third-party service providers, and include the right to audit. It is not enough to delegate even elements of your compliance obligations to third parties. You need to stay on top of them and make sure they are following your policies, particularly if they will have the ability to access non-public personal information of your customers. In the CFPB's 2012 Bulletin on service providers, the agency indicated that it is critical to: (1) conduct thorough due diligence of service providers; (2) review service providers' compliance policies, procedures, internal controls, and training materials; (3) include clear compliance expectations in service provider contracts as well as appropriate and enforceable consequences for non-compliance; (4) regularly monitor service providers for compliance; and (5) take prompt and appropriate action for non-compliance, including termination of contracts.

The CFPB has issued guidance about the components of a CMS. These represent best practices for dealers not subject to CFPB jurisdiction as well. A CMS must have control procedures to ensure your dealership stays compliant. Compliance audits, policy reviews, corrective action, and policy and procedure modifications on an ongoing basis are required. The CMS and component policies should also provide that dealership employees will be held personally responsible for compliance failures which should include adverse compensation consequences and termination of employment for repeat offenders.

The FTC and CFPB expect a proactive approach to compliance. This means not only having a detailed CMS, but also a system for proactively preventing and detecting potential non-compliance with the law before a consumer harm occurs. The FTC examines Board of Director and management oversight; compliance policies and programs; consumer complaint procedures and responses; and compliance audits as a minimum. From the CFPB's perspective, a dealership that is able to adopt a CMS under the active leadership of its Board or senior officers, particularly in the area of adopting and implementing the NADA Fair Credit Compliance Policy and Program and establishing a systematic procedure for quickly resolving consumer complaints, will be best positioned.

A CMS does not have to be a hugely complex document. Many of the policies and procedures you will already have in effect if you have addressed the issues described in this Compliance Guide. The CMS brings it all together and will be an important document to present to regulators if you are ever investigated.

# Additional Resources:

**What Exactly is a Compliance Management System?**
http://www.dealermarketing.com/exactly-compliance-management-system/

**The FTC Wants to Know: Do You Have a Compliance Management System?**
https://digitaldealer.com/columns/the-ftc-wants-to-know-do-you-have-a-compliance-management-system

**CFPB Requirements for a Compliance Management System:**
http://files.consumerfinance.gov/f/201308_cfpb_supervisory-highlights_august.pdf

**"A robust and effective CMS is a critical element of a well-run dealership."**

**- Randy Henrick**
Dealertrack

# Looking Ahead: The Presence of the CFPB is Changing the Consumer Protection Environment for Auto Dealers

The hard-charging entry of the CFPB into indirect auto financing is likely to continue in 2016. Additional confidential regulatory resolution settlements with large lenders and non-bank auto finance companies are very possible. Whether these lenders reduce permissible markups to 1%-1.25% as did Honda Finance and Fifth Third this year or begin flat fee pricing remains to be seen. So far, that has not occurred on any widespread basis.

There seems little doubt that the CFPB will attempt to move into additional areas relevant to dealers such as aftermarket products, privacy, and data security. Encouraged by and in cooperation with the CFPB, the FTC will continue its aggressive push against dealer advertising, Safeguards shortfalls, and unfair and deceptive acts and practices. Both agencies appear to disdain writing regulations and have adopted a style of regulating by enforcement. This means that you learn what is and is not acceptable by the terms of consent decrees resulting from enforcement actions with other dealerships. The FTC, for example, has brought over 53 enforcement actions in the Safeguards and data security area and over 32 involving advertising. The terms of these enforcement actions become the de facto regulations by which dealers must abide.

The CFPB expects institutions will produce written policies and procedures, design and offer consumer financial products in accordance with federal consumer financial laws, and maintain effective systems and controls to manage compliance responsibilities. This means the CFPB will focus both on policies and procedures and actual acts and practices, including consumer-level transactions. The CFPB has released a comprehensive Supervision and Examination Manual, and several additional guidance documents and bulletins that shed light on all of the different ways their examiners oversee companies. While the CFPB does not have authority over franchised auto dealers, lenders are likely to continue the pattern of taking steps to assess dealer compliance as a precondition to doing business. Implementing your own CMS, policies, processes, and procedures across your business is the best way to position yourself for the coming lender efforts to do for the CFPB indirectly what it cannot do directly. Safeguards and a prospective data breach may be your biggest financial risk.

If your dealership is a Dealertrack customer, it is a good idea to use Dealertrack's free functionality to restrict bureau pulls and credit app access and compliance documents to and from only trusted IP addresses associated with your dealer stores. Hackers are getting more sophisticated when it comes to stealing user names and passwords and a number of dealers were hit with keylogging malware on user PCs that enabled fraudsters to steal user names and passwords to access dealer customer information and pull credit reports from remote IP addresses. If done on a wide-scale basis, a data breach or wrongful use of stolen dealer credentials to pull credit reports could become an expensive liability and compliance nightmare. Limiting use to trusted dealership IP addresses is a good way to stop a criminal who has gained access to a user's system log-in credentials. In fact, doing so should be an element of your Safeguards Program. One survey found that almost half of small businesses that experienced a data security breach went out of business within six months of the breach.

Establishing a culture of compliance, data security, transparency and honesty with customers has never been more important than it is today. So is establishing processes to be able to document your compliance deal by deal. An electronic system that identifies which processes were completed for each deal can be invaluable if an audit or regulatory inquiry occurs. And don't forget the importance of a systematic customer complaint system. Seek to resolve complaints using a consistent process with timelines and escalation procedures. Remember that winding up on the CFPB's online complaint database is a far worse scenario than resolving a dispute in favor of a customer.

We hope this Compliance Guide will put you on the path to establishing and maintaining best practices for your sales and F&I activities. We appreciate your business and welcome any feedback. Send your comments to randy.henrick@dealertrack.com.

Dealertrack Technologies, Inc.
Randy Henrick
January 1, 2016

**"Establishing a culture of compliance, data security, transparency and honesty with customers has never been more important than it is today."**

**- Randy Henrick**
Dealertrack

# Glossary

**Adverse Acti n** A refusal to grant credit in substantially the amount or on substantially the terms requested in a credit application unless the creditor makes a counteroffer and the consumer uses or accepts the credit offered in the counteroffer. Also the termination of, or unfavorable change to, an existing credit account or an action taken in connection with a credit application or an account that is adverse to the interests of the consumer. Unwinding or re-contracting a spot delivery deal is an example of this "unfavorable change" type of adverse action.

**Adverse Action Notice** Under ECOA, any creditor "who in the ordinary course of business regularly participates in a credit decision, including setting the terms of credit," needs to notify a consumer of taking adverse action on a credit application if it cannot get the consumer financed within 30 days after receiving the completed application. This includes an auto dealer that participates in the credit process such as by negotiating financing, rehashing or marking up "buy rates." Under the FCRA, an adverse action notice must be provided if the adverse action was based in whole or in part on information contained in a consumer report and must identify the credit bureau whose report was used. An FCRA adverse action notice must also include the customer's credit score used by the creditor and additional information, including up to four - five "key factors" that adversely affected the credit score. These two notices (ECOA and FCRA) can be combined into one adverse action notice form that must include mandatory language from the ECOA, Regulation B and the FCRA. A sample of such an adverse action notice is set forth at the end of Chapter 5 of this Compliance Guide.

**Affiliate** Any company that is related by common ownership or common corporate control with another company. A Non-Affiliate is any company that has no such common ownership or control.

**Affiliate Marketing Rule**

An FTC Rule published under the 2003 FACT Act that requires you to give a notice and opt-out rights to your customers if you share any customer information with your Affiliates such as sister dealerships, in-house insurance agencies, or a parent group. You must give the customer the right to opt out of your Affiliates using any shared information for marketing or solicitation purposes. The notice need only be given once every five years, unlike a FCRA-GLB privacy notice that must be given once every year that the consumer remains a customer. It is a best practice to include the Affiliate Marketing Rule notice together with your dealership's privacy notice and to use a "safe harbor" FTC form of privacy notice to do so. You can create such a privacy notice by going to the following webpage: http://www.federalreserve.gov/bankinforeg/privacy_notice_instructions.pdf and using Forms 1, 3 or 5 to create your privacy notice to include the Affiliate Marketing Rule notice. A sample of such a privacy notice is set forth at the end of Chapter 4 of this Compliance Guide.

**Arbitration**

A process by which a dispute is decided by a private individual or panel of individuals under a set of agreed-upon rules instead of through a lawsuit. Arbitrators are not always required to strictly follow legal precedent in making their decisions. Grounds to appeal arbitration awards are very limited.

**Balloon Payment**

A final lump-sum payment due at the end of a finance contract or lease that is more than two times the amount of the regularly-scheduled payment. The lump sum payment must be disclosed at the time of sale and financing.

**Bank Secrecy Act**

A federal anti-money laundering law that requires reporting to the Treasury Department certain suspicious activity transactions and currency transactions in excess of $10,000 on IRS/FINCEN Form 8300. This form can now be filed electronically. Dealers should also report to the Financial Crimes Enforcement Network (FINCEN) in the Treasury Department transactions that may involve money laundering of funds from illegal activity even if the total of such funds does not meet the $10,000 threshold.

**BYOD**

"Bring Your Own Device," a shorthand for employees using personal smart phones, tablets, and other remote devices for business purposes. If your dealership permits employees to combine business and personal use on non-dealership-issued equipment of any type, you need to implement hardware and software protocols on the devices, restrict certain uses and permissions to safeguard customer information, and protect against unauthorized access to or use of the dealership's and its customers' information. BYOD policies should be addressed in your Safeguards and Data Destruction programs.

**CAN-SPAM Act**

A federal law that regulates sending of commercial email messages. It requires that recipients be given an opt-out method which must be honored within 10 business days. The law also bans false or misleading header information, prohibits deceptive subject lines, requires commercial email to be identified as an advertisement and requires the sender to include a valid physical postal address. If a customer opts out of receiving email from you, you thereafter cannot sell, lease, exchange or otherwise transfer or release that email address to any third-party including through any transaction or transfer that contains the email address.

**Car Buyer's Bill of Rights**

Consumer protection laws in California and Minnesota. The California law requires dealers to give consumers a minimum two-day option to cancel a used car purchase if the cash price is less than $40,000. Both California and Minnesota require the dealer to make disclosures of certain aftermarket items accepted by the customer indicating in a separate document the monthly payment with and without the items. In Minnesota, the dealer must give a written disclosure telling the customer of their right to obtain the names and contact information of all credit bureaus that provided consumer reports to the dealer and financing sources that were used in evaluating the credit application. California's law also requires disclosure to the consumer of all credit scores used by the dealer. Minnesota's law requires a special notice form informing the consumer of their credit scores while the Risk-based pricing credit score disclosure notice satisfies this requirement under the California law. Both laws also require the dealer to give the customer a full inspection report and meet other requirements to advertise or sell a used vehicle as "certified." The California law also caps a dealer's ability to mark up financing source "buy rates" to consumers and both laws require other disclosures as well. For example, California requires a disclaimer that dealer participation may affect consumer cost when a dealer must contribute to the cost of an incentive to participate in a manufacturer or distributor incentive.

**CIP**

A Customer Identification Program prescribed by the USA PATRIOT Act by which a creditor establishes formal policies and procedures for verifying the identity of its customers and preventing money laundering. Auto dealers that act as agents for a bank (such as in originating two-party paper) are required to implement the bank's CIP. Auto dealers are presently exempt from needing to establish CIP programs. But see "Red Flags Rule" below.

**Class Action** A legal process by which one person sues a defendant on behalf of a class of similarly situated persons for damages or other relief for all persons included within the class. A class action requires the class members to have received similar treatment from the defendant and be too numerous to include in an individual lawsuit. Class arbitration is a similar process before an arbitrator or panel of arbitrators instead of a judge. The federal Class Action Fairness Act makes certain in-state disputes more likely to be heard in state courts and requires greater judicial scrutiny of settlements and attorneys' fees awards to the plaintiffs' lawyers. The Federal Arbitration Act strongly favors arbitration and should be cited as legal authority for any arbitration clause, including an arbitration clause in which a customer gives up their right to bring a class action. In 2015, the CFPB released a study which it claimed showed that consumers fare better with class actions than arbitration and indicated that it may, pursuant to authority in the 2010 Dodd-Frank Act, issue proposed regulations prohibiting the use of arbitration clauses containing class action waivers in consumer financial services contracts.

**Closed-End Lease** In a closed-end lease, the lessee is not obligated to buy the vehicle at end of term. However, some closed-end leases offer lessees a purchase option at the end of the lease term, either for a pre-specified amount or fair market value. Compare Open-End Leases.

**Cloud Computing** The use of computing resources (hardware and software) that are delivered as a service over a network (typically the Internet). An IT outsourcing system in which a service provider's computing virtual resources and servers are pooled to serve multiple users in a multi-tenant model, with different physical and virtual resources dynamically assigned and reassigned according to user demand. Think of it as infrastructure as a service (e.g., hosting services, storage services, network bandwidth). Generally priced on a pay-as-you-go basis.

**Consent Decree**

A formal settlement between a company and a regulator such as the FTC or CFPB in response to an actual or threatened regulatory administrative or enforcement proceeding. Most FTC consent decrees subject the company to 20 years of regulatory oversight by the agency, require external reviews and certifications of its policies and conduct, and can impose fines or restitution penalties for conduct that the FTC deems to have violated applicable laws or regulations. Consent decrees are often followed by civil lawsuits raising the same allegations that led to the consent decree. Any violation of an FTC consent decree is typically subject to a fine of up to $16,000 per violation under Section 5 of the FTC Act. CFPB consent decrees have generally required restitution to affected consumers along with penalties. Most CFPB consent decrees have required total payments, penalties, and customer remuneration well in excess of $100,000.

**Consumer**

An individual who initiates the process of seeking a financial product or service from your dealership to be used primarily for personal, family or household purposes. For example, if someone applies for credit to finance a vehicle purchase for personal use at your dealership, he or she is a “consumer,” even if credit is not extended to that individual.

**Consumer Financial Protection Bureau (“CFPB”)**

An independent federal agency established by the 2010 Dodd-Frank Act to supervise certain institutions, enforce consumer protection regulations, and issue new regulations under approximately 18 federal consumer protection laws (including TILA, ECOA, FCRA and FDCPA). Auto dealers that sell, lease, and also service vehicles and do not obtain customer financing from Affiliates, such as most franchised dealers, are not subject to the CFPB’s direct supervisory, enforcement, or regulatory authority. Buy-here-pay-here and many independent dealers are subject to direct CFPB supervision and enforcement. The FTC has supervisory and enforcement jurisdiction over franchised auto dealers. The Federal Reserve Board retains authority to issue statutory regulations under the consumer protection laws within the CFPB’s jurisdiction to the extent they affect auto dealers and the Fed is expected to follow the CFPB’s lead on the substance of the regulations so there is a “level playing field” for all creditors. Dodd-Frank also authorizes the CFPB to publish rules and enforce violations constituting “abusive trade practices” which involve taking advantage of a consumer’s lack of knowledge about a consumer financial product or their reliance on a dealer to act in their interests. The FTC may enforce conduct similar to abusive trade practices under its unfair practices authority under Section 5 of the FTC Act.

**Consumer Leasing Act ("CLA")**

A part of the federal Truth in Lending Act that governs disclosures in consumer lease transactions. The authority for the Consumer Financial Protection Bureau's and the Federal Reserve Board's Regulation M. This is one of the laws for which rulemaking authority (except with respect to franchised auto dealers) was transferred to the CFPB.

**Consumer Reporting Agency ("CRA")**

Also called a "credit bureau." Any person or entity which, for monetary fees, dues or on a cooperative nonprofit basis, regularly engages in whole or in part in the practice of assembling or evaluating consumer credit information or other information on consumers for the purpose of furnishing consumer reports to third parties.

**Co-signer**

Also called a "guarantor." A person who agrees to be liable on a loan, lease, or credit sale if the borrower or co-borrower does not pay. Typically, the co-signer does not have an interest in the vehicle but is liable on the credit agreement. Dealers must give co-signers special notices under the FTC's Credit Practices Rule both at the time of cosigning and when the primary obligor defaults. Certain states (e.g., Wisconsin) have additional disclosure requirements for co-signers. An example of a co-signer is a parent who signs to be liable on credit granted to their adult child who has not established a credit history sufficient to warrant credit being granted to the child alone. There is a split among the federal Circuit Courts as to whether co-signers are "applicants" for purposes of Truth in Lending and ECOA. Until the Supreme Court decides the issue, it is a best practice to give the same notices to a co-signer as you give to the credit applicant(s) for which the person is co-signing.

**Credit Card Bust Out**

A means of identity theft in which the criminal makes repeated use of a stolen credit card to make down payments on vehicles while delivering frequent checks written on non-existent checking accounts to the credit card company to keep the credit card line open to make more down payments. The criminal uses the "float time" of the check clearance process to commit additional identity theft using the stolen credit card.

**Credit Discrimination**

A practice by which members of one or more “protected classes” under ECOA (race, color, religion, national origin, sex, marital status, age, receipt of public assistance or exercise of consumer credit rights) are denied credit or provided worse credit terms than similarly-qualified other persons who are not in a protected class (e.g., Caucasian men under age 40). Credit discrimination is generally proven by either a “disparate treatment” (knowing or intentionally discriminating) or a “disparate impact” or “effects test” in which a facially-neutral practice (e.g., marking up buy rates) is statistically demonstrated to result in higher pricing to the members of the protected class, sometimes by as little as five basis points according to recent enforcement/supervision actions by the CFPB. Knowledge or intent to discriminate is not required in a disparate impact case. The Obama Administration’s Department of Justice (DOJ) and the CFPB have made credit discrimination enforcement actions a priority and the DOJ has brought disparate impact actions against auto dealers based on rate markups resulting in worse credit terms for persons in protected classes. The CFPB’s 2013 Guidance on Indirect Auto Credit is also premised upon “disparate impact” credit discrimination from dealers marking up buy rates differently to similarly-situated customers. Credit discrimination can also be proven by a disparate treatment case in which the creditor is shown to have intentionally discriminated against persons in a protected class or, more recently, the creditor is shown to have known or should have known that a disparate impact existed but did nothing about it to create a “pattern or practice” of discrimination. Credit discrimination is discussed in greater detail in Chapter 1 of this 2016 Compliance Guide. See also “Disparate Impact Credit Discrimination” described below.

**Credit Header**

A credit header is identifying information of a person from a credit report. It includes name, mother's maiden name, date of birth, sex, address, prior addresses, telephone number, and the Social Security number. Credit headers are used for location of individuals, identity verification, and for target marketing.

Credit headers came into use after the FTC changed its definition of a credit report in the course of settling a case against TRW (now Experian). The FTC allowed the CRAs to treat credit headers as "above the line" information and to sell it with no legal protections for the subject consumer. The reasoning was that this information did not relate to credit, and thus should not be considered part of the credit report.

**Credit Sale**
A transaction in which a seller agrees to sell an item to a consumer for a set or variable price in a fixed number of installment payments over time, instead of requiring a cash payment in full up front. Most auto financing is done by a dealer making credit sales to consumers and then assigning its rights to collect the installment payments to a bank or financial institution. Also called closed-end credit. Sometimes referred to as a three-party credit transaction (dealer, financial institution, and consumer). Compare Loan.

**Credit Score**
A numerical system intended to determine the non-payment risk that a consumer might pose to a potential creditor. The scoring algorithm takes into account many factors, including credit history, recent credit inquiries, open credit lines, recent credit activity, and debt-to-income ratio. It also factors in whether a consumer pays bills on time or has outstanding or delinquent balances on existing credit accounts. Credit scores are consumer reports within the meaning of the FCRA and need to be disclosed in adverse action notices if used in any way in making a credit decision. A Risk-based pricing credit score disclosure agreement indicating a credit applicant's current credit score along with information about the date and provider of the score is one way to comply with the FTC's Risk-based Pricing Rule.

**Customer**
A consumer who signs a credit or lease agreement, purchases an insurance product, or otherwise obtains a financial product or service from your dealership. A consumer who receives credit becomes a customer.

**Deferred Down Payment**
Also called a "pick up" payment. A creditor may defer payment of all or a portion of the down payment in a transaction provided the deferred down payment is paid in full by the second scheduled installment payment and is not subject to any finance charges. However, check your lender agreement as it may contain a representation and warranty that you received the entire down payment for each assigned contract. If you assign the contract with the down payment still owing, you will be in breach of that representation and warranty and may be required by the lender to repurchase the contract.

**Department of Justice (DOJ)**
The federal executive department of the U.S. government, responsible for the enforcement of the law and administration of justice in the United States. The federal Cabinet-level agency responsible for enforcing U.S. laws generally. Headed by the Attorney General. The DOJ has authority to bring lawsuits against auto dealers for violations of most federal consumer credit laws and regulations.

**Depreciation**
Reduction in a vehicle's value due to age, mileage, and wear and tear. The "Residual Value" is the predicted value of the vehicle at the end of a lease term established at the beginning of the lease assuming normal wear and tear.

**Disparate Impact Credit Discrimination**

A claim for credit discrimination under ECOA that does not require any knowledge or intent to discriminate on the part of the dealer. Also referred to as the "effects test." There are three parts to the analysis:

1. Under a disparate impact analysis, a neutral business practice (such as marking up a lender's buy rate) is examined to determine if application of the practice has a disproportionately negative effect on a protected class of persons under ECOA, these being: (1) race, color, religion, national origin, sex, marital status, or age (provided the applicant has the capacity to contract); (2) because all or part of the applicant's income derives from any public assistance program; or (3) because the applicant has in good faith exercised any right under the federal Consumer Credit Protection Act.
2. If so, the burden then shifts to creditor to show the practice meets in a significant way, the legitimate goals of the business. No requirement that the challenged practice be essential or indispensable, only significant and non-discriminatory.
3. If so, burden then shifts to regulator to show that the business goals can be met by means that are less disparate in their impact. If the regulator cannot show this, then there is no disparate impact credit discrimination because a significant, non-discriminatory business reason is the cause of the rate differential.

It is also questionable whether disparate impact is a legitimate cause of action at all under ECOA. ECOA prohibits only "disparate treatment" which is intentional or knowing credit discrimination against persons in protected classes. An example is redlining in real estate lending where a lender will not lend to minority communities. ECOA does not have "effects" test language and Congress in 1976 rejected inclusion of such language in ECOA. Disparate impact was created by regulators in 1994 as a concept borrowed from employment laws to further the purpose of the ECOA. But when a law is clear and unambiguous on its face, regulators should not receive deference to interpretations that change the meaning and intent of the statute as "disparate impact" does with ECOA.

In 2015, in a Fair Housing Act case, the U.S. Supreme Court ruled that to prevail in a disparate impact case, the plaintiff or government must show more than a mere statistical correlation. It must show a "robust causation" between a business policy that is an "artificial, arbitrary, and unnecessary barrier" and the disparate impact. The Supreme Court also reaffirmed that a significant legitimate business interest is a defense to a disparate impact claim and that making a profit is such a legitimate business interest.

**DMS**

A dealer management system that consists of software to enable the dealer to efficiently manage all aspects of the dealership's operations.

**The Dodd-Frank Act**

The Dodd-Frank Wall Street Reform and Consumer Protection Act. The comprehensive banking reform and consumer protection law passed by the Congress and signed by President Obama on July 21, 2010. The Act reforms many aspects of bank regulation and authority and in Chapter 10, establishes the CFPB as a new agency in the Federal Reserve Board to protect consumers, re-write regulations under many consumer protection acts, and enforce violations concurrently with the DOJ, FTC, and State Attorneys General. The Dodd-Frank Act also streamlines the process for the FTC to promulgate rules relating to unfair and deceptive practices by auto dealers.

**Drivers Privacy Protection Act ("DPPA")**

A law prohibiting disclosure by state Departments of Motor Vehicles (DMVs) or other authorized persons of personal information consisting of that which identifies an individual, including an individual's photograph, Social Security number, driver identification number, name, address (but not the five-digit zip code), telephone number, and medical or disability information from DMV records or otherwise without the individual's prior written consent. Exceptions exist to verify or correct information about the individual and for certain motor vehicle safety or theft situations. Resale or redisclosure of the information by a recipient are highly limited. Penalties include potential criminal liability and a private cause of action for $2,500 in liquidated damages plus punitive damages, attorney's fees and equitable relief.

**ECOA**

The Equal Credit Opportunity Act. As implemented by the Consumer Financial Protection Bureau's and the Federal Reserve Bureau's Regulation B, ECOA prohibits discrimination in all aspects of a credit transaction on the basis of race, color, religion, national origin, sex, marital status, age, the fact that all or part of an applicant's income is derived from any public assistance program, or the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act ("protected classes"). ECOA also requires creditors to send credit decisions, adverse action notices, and other communications to consumers within 30 days after receiving a completed credit application. Rulemaking authority for ECOA was transferred from the Federal Reserve Board to the CFPB as of July 21, 2011 for all creditors except franchised auto dealers. The Federal Reserve Board retains ECOA rulemaking authority for ECOA regarding franchised auto dealers.

**eDiscovery** Pretrial discovery of electronic documents such as electronic records and email in lawsuits. In federal litigation, the parties are required to agree on schedules for the timing and scope of eDiscovery subject to court approval. If litigation is threatened or commenced, a "litigation hold" must be implemented immediately to preserve and identify relevant electronic documents and their locations. The litigation hold must cause a cessation of any scheduled destruction of electronic documents. Courts have imposed severe sanctions on companies that do not take action to locate and produce electronic records and prevent even inadvertent destruction of email, text messages, and other electronic documents wherever they are located, including on individual PCs, mobile devices and flash drives. Text messages contained on cell phones and tablets are examples of data that may need to be turned over in eDiscovery.

**EMV Cards** Europay, Visa, and MasterCard chip-embedded credit and debit cards. Effective October 1, 2015, card association rules impose chip card risk of loss liability for in-person fraudulent transactions on a dealer that does not have a card processing device capable of reading chip cards as opposed to traditional magnetic stripe cards. Chip cards are more secure than magnetic stripe cards because they are hard to counterfeit and generate a unique random transaction number to authenticate each transaction unlike a magnetic stripe card that can be easily counterfeited and used by simply reading the information on the magnetic stripe. EMV card risk-of-loss liability does not apply to card-not-present transactions such as telephone or Internet card transactions.

**E-SIGN Act** A federal law that permits electronic signatures to substitute for paper signatures in most consumer and commercial transactions. Enables electronic contracting of motor vehicle retail installment sales. Requires consent disclosures to the consumer and communications indicating a "reasonable demonstration" of a consumer's ability to receive electronic communications along with their electronically-communicated consent to conduct business electronically in consumer transactions such as auto finance.

**FACT Act**

The Fair and Accurate Credit Transactions Act. A 2003 federal law that amended the FCRA and provided consumers with credit report disclosure rights and identity theft protections. Through the FACT Act amendments, the FCRA now restricts affiliate use of shared information for marketing or solicitation purposes; requires notices of credit score information under the Risk-based Pricing Rule; provides new identity theft protections by requiring dealers to implement a written Identity Theft Prevention Program under the Red Flags Rule; gives consumers the right to access their credit reports once per year from each national consumer reporting agency (Equifax, Experian, and TransUnion) for free; expands consumer rights to dispute items in credit files; and requires detailed consumer notices on credit applications and credit reports, among other things. Also requires credit and debit card electronic receipts to truncate all but the last five card numbers and not print the card expiration date.

**FCRA**

The Fair Credit Reporting Act. Governs the permissible uses of credit reports and requires disclosures to consumers when a credit report is used in making an adverse credit decision. Also requires giving consumers opt-out rights with respect to sharing of consumer report information with affiliates or the use of shared information by affiliates for marketing or solicitation purposes. Contains requirements for credit bureaus and reporting creditors to make credit reports more accurate, to correct inaccurate reporting and not report or re-report erroneous items. Enables prescreening unless the consumer has opted out of all credit bureau prescreening. Also the law pursuant to which the Red Flags Rule and Risk-based Pricing Rule are authorized.

**Federal Odometer Act**

A federal law that prohibits the manipulation of odometer devices and mileage readings on them. It requires a person transferring ownership of a vehicle to give to the person obtaining ownership a written disclosure of the odometer's mileage reading. If the transferor knows the odometer reading is incorrect or inaccurate, he must state in the disclosure that the actual mileage is unknown. For used cars, the odometer disclosure typically is made on the vehicle's title. The Act also prohibits persons from tampering with an odometer. Dealers are required to retain written odometer disclosures for five years. The federal Department of Transportation issues regulations implementing the requirements of the Act.

**FTC**

The Federal Trade Commission, a federal agency that regulates and enforces consumer credit and privacy laws, among other duties. The FTC is the regulator for franchised auto dealers on consumer protection, privacy and data safeguards, and identity theft prevention as well as other consumer protection laws and regulations. The FTC is authorized to supervise franchised auto dealers and bring enforcement actions for violation of federal consumer protection laws and regulations including under its general authority in Section 5 of the FTC Act which prohibits unfair and deceptive acts and practices. The Dodd-Frank Act streamlined the process for the FTC to issue new regulations concerning unfair and deceptive practices by auto dealers.

**FTC Safeguards Rule**

The FTC's rule pursuant to GLB that requires dealers to develop and implement a comprehensive written Information Security Program to secure, safeguard and protect customer information in all forms of media. The Safeguards Rule requires a dealer to designate a named individual as the Program Manager responsible for implementing and managing the program including ongoing training and monitoring of employees on the need to protect customer information. A Safeguards Program must include a security incident and breach incident response plan and address all prospective threats to the security of non-public personal information maintained by the dealership. The Information Security Program must be periodically updated to address new security threats and regulatory guidelines.

**FTC Telemarketing Sales Rule and FCC Telemarketing Regulations**

The Telemarketing Sales Rule is an FTC regulation requiring disclosures in telemarketing campaigns and prohibiting deceptive or abusive telemarketing acts or practices. The Rule also sets out a series of disclosures for product telemarketing and must be read in connection with the FCC's regulation of telemarketers under the Telephone Consumer Protection Act. The FTC Rule prohibits telemarketing to persons whose phone numbers are on the FTC National Do Not Call Registry. The FCC requires obtaining a consumer's prior express written consent to receive pre-recorded telemarketing calls to landlines and cell phones as well as requiring prior written consent to the use of an auto dialer to make calls or send text messages to cell phone numbers (text messages are considered a form of calling). The FCC requires the prior written consent identify the specific phone number to which it applies and indicate that the consent is not given as a condition for the purchase of a product or service. The FTC Rule governs telemarketing conduct. It enables a consumer to opt out of a company's telemarketing and prohibits certain patterns of conduct in conducting telemarketing. States also have Do-Not-Call lists that must be used to scrub telemarketing lists, and your dealership must keep its own list of customers who have requested not to be called and delete those persons from telemarketing campaigns as well. Statutory penalties for failure to obtain the necessary consents range from $500 - $1,500 per call and are unlimited in class actions without regard to actual damages suffered.

**GAP**

Guaranteed Auto Protection. GAP is optional consumer protection that covers the difference between what the car is worth and what the customer owes on the car. It comes into play if the car is stolen or totaled (damaged to the point that repair would cost more than the car is worth) while the owner is still making payments. Whether or not GAP is insurance and requires an insurance license to be sold is determined by state law. In New York, for example, a dealer can sell the consumer a "GAP waiver" that is not insurance and covers a total loss due to theft or casualty. But to do so, the dealer must disclaim the right to claim against the consumer for the GAP amount and is limited to selling the GAP waiver for the insurance cost to the dealer of obtaining the GAP insurance for itself.

**GLB** The Gramm-Leach-Bliley Act. A federal law requiring auto dealers, creditors and other "financial institutions" to protect and safeguard the privacy of customers' non-public personal information and not share such information with third parties unless the customer is given notice and the opportunity to opt out of the sharing. GLB also requires giving a consumer a privacy notice describing the dealer's information collection, use, and sharing practices when a customer first provides personal information and annually thereafter if the person is still a credit customer. Consumers who do not become customers must be given a privacy notice before you begin sharing their information. The FTC regulates auto dealers' compliance with GLB and has published its Privacy Rule, Safeguards Rule, and Disposal Rule to implement the GLB requirements. The Safeguards Rule and Disposal Rule mandate using administrative, technical and physical safeguards to protect the security, confidentiality and integrity of customer information in its gathering, retention, and disposal, in both electronic and paper form. The FTC has published model privacy notices for compliance with GLB. A sample of such a privacy notice is set forth at the end of Chapter 4 of this Compliance Guide.

**Gross Capitalized Cost** The total selling price of the leased vehicle including negotiated selling price plus optional equipment such as GAP coverage and anti-theft devices. Also referred to as "cap cost."

**Identity Theft or Identity Fraud** Under federal criminal law, identity theft takes place when someone knowingly transfers, possesses or uses, without lawful authority, a means of identification of another person with the intent to commit, or in connection with, any unlawful activity such as fraud. Under this definition, a name or Social Security number is considered a "means of identification." So is a credit card number, cellular telephone electronic serial number, or any other piece of information that may be used alone or in conjunction with other information to identify a specific individual. See Synthetic Identity Theft and Traditional Identity Theft.

**Information Security Program** Also called a Safeguards Program. The administrative, technical and physical safeguards you use to access, collect, distribute, process, protect, secure, store, use, transmit or otherwise handle Non-Public Personal Information of consumers and customers. This program must also contain provisions dealing with how you will respond in the event of a security breach of information. The term also refers to written documents and procedures evidencing these safeguards.

**Inquiry**

A request to a consumer reporting agency for a credit report. Only persons having a "permissible purpose" under the FCRA or consumers requesting their own credit report may obtain a credit report in response to an inquiry. Inquiries other than consumer inquiries of their own credit report appear on the consumer file, are reported in subsequent credit reports, and are used as factors in credit scoring algorithms.

**IRS/FINCEN Form 8300**

A form required to be filed with the IRS within 15 days of completing a cash sale or multiple cash sales in related transactions (generally multiple transactions within 24 hours or which you know or should know are connected) for which the customer paid cash or cash equivalents (cashier's checks, travelers checks or other instruments not evidencing a continuing relationship with the bank such as a personal check or the proceeds of a bank auto finance loan) totaling in excess of $10,000. The Form 8300 can now be filed electronically. Regulations require informing a customer on who you filed a Form 8300 that you did so by January 31 of the following calendar year. Keep a copy of all filed Forms 8300 for five years. Penalties for failing to file Form 8300 can range from $100 per return not filed, up to a maximum of $1.5 million per calendar year to the greater of $25,000 per return or the cash received in the transaction up to $100,000 per transaction if the IRS deems the dealer to be in intentional disregard of its obligations, which the IRS frequently does.

**ITPP**

Identity Theft Prevention Program. See "Red Flags Rule" below.

**Joint User**

An FTC comment to the FCRA that allows dealers to share credit reports with other companies jointly involved in the credit decision (such as prospective lenders) without becoming a consumer reporting agency. Since a credit application is considered to be a consumer report, this doctrine is important when submitting credit applications to financial institutions to avoid compliance obligations and liability risks that come along with being a consumer reporting agency. A dealer should provide a customer with a list of its lenders and the lenders to which it is sending the credit application to mitigate the risk of the dealer or lenders being deemed a consumer reporting agency.

**Junk Fax Prevention Act of 2005**

A federal law that prohibits sending unsolicited facsimile advertisements to persons unless the person consents in writing to receive fax advertisements or the sender has a "prior business relationship" with the recipient and the recipient has not opted out of receiving faxes from the sender. Senders of unsolicited faxes must include a clear and conspicuous notice on the first page on how the recipient can opt out of future faxes from the sender at no cost. Persons who opt out must be removed from all fax lists within 30 days.

**Loan**

In contrast to a credit sale, a transaction in which a bank or financial institution directly lends a consumer money and the consumer agrees to pay the loan back with interest over time. Sometimes referred to as a two-party credit transaction (bank and consumer). Dealers may act as agents for banks in originating two-party loans for consumers. Compare Credit Sale.

**Magnuson-Moss Warranty Act (MMWA)**

A federal law that governs warranties in connection with the sale of consumer products including automobiles. The Act requires disclosures concerning express and implied warranties and restricts disclaimers of implied warranties if a dealer sells a service contract within 90 days of the vehicle sale. The law contains mandatory disclosure language for warranties, including what vehicle systems are covered, which ones are not, the duration of the warranty, how a customer gets warranty service, and what obligations the customer has as a condition to warranty service. This law also prohibits certain acts and provides consumers with remedies for breaches of warranties including the ability to bring class actions and recover damages and attorneys' fees. The e-Warranty Act, which became law in 2015, now permits, but does not compel, manufacturers to avoid the requirement by directing consumers to their websites to find the terms and conditions of their consumer warranties. However, the law is awaiting regulations to be issued by the FTC prior to taking full effect.

**Menu Selling**

A process by which each customer who has agreed to purchase or lease a vehicle is presented with a document indicating each optional aftermarket item available from the dealership along with its price and its effect on the customer's monthly payment. A menu should disclose groupings of aftermarket offerings (e.g., Platinum Package, Gold Package, Silver Package) the same way. The customer initials an acceptance or decline for each product. The purpose of menu selling is to offer 100% of a dealer's customers 100% of its aftermarket products 100% of the time and to mitigate risks of claimed discrimination in pricing or offering of products selectively or at different prices. In California and Minnesota, the Car Buyer's Bill of Rights requires separate itemized disclosures of consumer-accepted aftermarket products that must be given to and signed by the consumer prior to signature of the retail installment sales contract.

**Metadata** Literally, data behind data in electronic documents such as emails and Microsoft Office documents. Properties of electronic documents can reveal who created the document, when it was created, accessed, and who it was distributed to, plus changes made along the way. Additional metadata can be gleaned from computer systems forensics analyses. Metadata can be valuable in litigation and is the reason why most electronic discovery requests seek electronic documents to be produced in their native (original) form, as opposed to a printed or electronic image format (e.g., .pdf or .tif format).

**Military Lending Act** An act supplemented by Department of Defense regulations that prohibits making payday loans, vehicle title loans and tax refund anticipation loans to a military member or their family at an APR greater than 36% and provides the loan cannot be refinanced by the same lender. The Military Lending Act does not apply to a credit transaction to finance the purchase or lease of an automobile. However, the Consumer Financial Protection Bureau has established an Office of Servicemember Affairs to educate service members about credit and to coordinate complaints by and responses to service members and their families about consumer credit, including auto finance credit.

**National Do Not Call Registry** An FTC list of telephone numbers populated by consumers who have indicated their desire not to receive telemarketing calls. States also maintain do-not-call registries and your dealership should also keep a record of persons who have asked not to be called. Exclude all such persons from telemarketing lists. See also FTC Telemarketing Sales Rule and FCC Telemarketing Requirements.

**Negative Equity** A term used to describe a consumer whose trade-in vehicle is worth less than their credit pay-off balance for the car. Also called “upside down” or “under water.” Negative equity can be paid off and financed in a vehicle purchase or lease transaction. However, TILA requires negative equity to be disclosed either by reducing the consumer’s down payment (but not below $0) or itemizing the amount of negative equity separately in the Amount Financed list of Amounts Paid to Third Parties. Negative equity should never be added to increase the cash price of the vehicle, and dealers who do so may be subject to class action liability. The FTC brought five enforcement proceedings resulting in consent decrees in 2012 for deceptive advertising against auto dealers that advertised they would pay off a customer’s negative equity when in fact the dealers were financing the negative equity for the customer or forcing the customers to pay it off in cash.

**Non-public Personal Information (NPI)**

Personally identifiable financial information provided by a consumer to a dealer or otherwise obtained by the dealer and any list or grouping of consumers derived from any personally identifiable financial information that is not publicly available. This includes any information a consumer provides on a credit application or any information derived from a consumer report or credit transaction. It also includes lists of credit customers or even the fact of a customer being a credit customer. Information you collect through a "cookie" in connection with an inquiry about a financial product or service can also be non-public personal information. The term does not include anonymized and aggregated information that does not contain personal identifiers such as names, addresses, Social Security numbers, driver's license numbers or account numbers.

**OFAC**

The Office of Foreign Asset Controls. An agency of the United States Department of the Treasury under the auspices of the Under Secretary of the Treasury for Terrorism and Financial Intelligence. OFAC administers and enforces economic and trade sanctions based on U.S. foreign policy and national security goals against targeted foreign states, organizations, and individuals. Among other things, OFAC publishes the SDN List which is a frequently-updated list of persons with ties to blocked countries or persons with whom you cannot do any business. See SDN List below.

**Open-End Lease**

In contrast to a closed-end lease, a lease that obligates the lessee customer to purchase or arrange for the sale of the vehicle at the end of the lease term.

**Opt-out**

The right of a consumer under GLB and the FCRA to remove themselves from information sharing with third parties and certain information sharing and all information usage by Affiliates of a dealer. Whenever a consumer has a right of opt-out (e.g., Affiliate Marketing Rule, sharing credit information with Affiliates, sharing any information with a third-party), a dealer must wait 30 days from the day it delivered its privacy notice informing the consumer of their opt-out rights before sharing the consumer's information and only then provided the consumer does not opt out within the 30 days. This is true even if the consumer does not choose to opt out during the 30 days. The only exceptions to the requirement to wait 30 days before using or sharing the customer's information is for service providers involved in the customer transaction or joint marketing agreements with other financial institutions to market a financial product or service, provided these are disclosed to the customer in the privacy notice. Whenever a consumer opts out of any information sharing or Affiliate marketing, it is a best practice to opt them out of all databases that are shared with Affiliates or third parties. A "safe harbor" model privacy notice has been published by the FTC. See example of Form 1 of the model privacy notices at the end of Chapter 4 of this Compliance Guide.

**PCI-DSS**

The Payment Card Industry Data Security Standard applicable to merchants such as auto dealers who accept credit or debit cards for payment. PCI-DSS includes requirements for security management, policies, procedures, network architecture, software design, and other critical protective measures to protect customer credit and debit card account data. Among other things, merchants are prohibited from storing information contained on the magnetic strip of cards or the three-digit CVC/CVV code imprinted on the signature panel of cards or debit card PINs or access codes. Card information must be captured and transmitted over encrypted media, and terminals must print only the last five digits of a card number and cannot print the card expiration date. Merchants who violate PCI-DSS are subject to penalties from the card associations and networks and may incur civil liability as well. Nevada has also made compliance with PCI-DSS a requirement of Nevada law. Nevada has essentially adopted the PCI-DSS as its legal standard for card security. See EMV Cards above for liability issues for fraudulent transactions using chip cards.

**Permissible Purpose**

According to the FCRA, a dealer must have a “permissible purpose” to pull a customer’s credit report. A customer’s written consent is always the best permissible purpose. However, the FCRA lists several other conditions for permissible purpose without the customer’s written consent, except that Vermont requires a written consent in all cases. Otherwise, a dealer can pull the credit report without the customer’s written consent only if it is clear to both the customer and the dealer that the customer is initiating the financing or lease of a vehicle and the dealer has a legitimate business need for the credit report, such as to arrange financing requested by the consumer. However, a customer merely walking into a showroom does not give the dealer a permissible purpose to pull the customer’s credit report. Absent the customer’s written consent, you never have a permissible purpose to pull a consumer report for negotiation purposes or for a customer paying cash.

**Phishing**

Social engineering techniques used by identity thieves to "fish" for personal information on the Internet. Generally done by creating fake emails and websites that appear legitimate but are designed to attempt to get users to disclose their personal information or click on a weblink which puts a keylogger virus or other malware on your PC that tracks your keystrokes on a banking or personal information website. "Vishing" involves sending an email to get the consumer to call a fraudulent number to reveal personal information. "Smishing" involves the use of text messages to induce the consumer to reveal personal information or go to websites that will download a virus onto their mobile device. "Spear-phishing" is a phishing message directed to targeted company executives and directors that may indicate the desire to purchase or partner with the company and include an attachment such as a claimed Non-Disclosure Agreement to initiate discussions.

**Power Booking**

A practice by which a dealer inflates the value of a vehicle to a financing source in order to get the customer financed. For example, a dealer might indicate a vehicle possesses additional "soft" items such as running boards, roof racks, or alloy wheels that a customer could change or remove after possession. Hard power booking is listing higher ticket items such as sunroof, leather seats, a larger engine, or the like. Power booking is fraud perpetrated on the lender and will cause the lender to make the dealer repurchase the account, especially if it has gone delinquent (which frequently occurs since the customer would not qualify for credit without the power booking). Power booking may also constitute the crime of criminal fraud in some states. In 2015, nine employees of a dealership in Alabama were sentenced to jail time for power booking and inflating customer incomes on credit applications. These activities constituted bank fraud and interstate wire fraud and were prosecuted by the DOJ in conjunction with the FTC as part of the FTC's Operation Ruse Control.

**Predatory Lending Laws**

Predatory lending laws prohibit discrimination and abusive credit terms and practices in lending. These laws are principally used to protect minority groups and women. These laws also prohibit onerous terms and penalties in finance agreements and generally enable private consumer lawsuits seeking actual and punitive damages, and attorneys' fees. State and federal regulators generally can bring enforcement actions seeking fines and penalties as well.

**Preemption**

A doctrine by which certain federal laws such as the Federal Arbitration Act, TILA, ECOA, and FCRA preempt and override conflicting state laws on the same subject. Also a doctrine created by courts construing the National Bank Act for federally regulated financial institutions to do business uniformly in all states by using their home state law to preempt certain other states' laws. The 2010 Dodd-Frank Act limited preemption of state consumer protection laws to banks and not their subsidiary or affiliated corporations and only when application of the state law would discriminate against the national bank, or prevent or significantly interfere with the national bank's exercise of its powers, such determination to be made on a case-by-case basis by the Office of Comptroller of the Currency. Certain other federal laws also expressly preempt state laws.

**Privacy Notice (FCRA-GLB Privacy Notice)**

An initial or annual notice concerning your collection and sharing of personal information that is required to be given to your consumers and customers under GLB and the FTC Privacy Rule. The FCRA also requires notices that give the consumer the right to opt out of Affiliate sharing of credit information and its Affiliate Marketing Rule requires a notice that gives consumers the right to opt out of Affiliates using any shared information for marketing or solicitation purposes. The required privacy notices are typically combined into one FCRA-GLB Privacy Notice although the Affiliate Marketing privacy notice can be given separately. Model privacy notice forms have been issued by the FTC and use of one of these forms is intended to provide a "safe harbor" from liability. See a sample of Form 1 of the model privacy notice at the end of Chapter 4. Of course, a dealer's practices of collecting and sharing consumer information must comply with what is disclosed in its privacy notice.

**Puffery**

A seller's exaggerated expression of its subjective opinion about the merits of a product, as opposed to a factual description of a characteristic of a product. One court described puffery as "exaggerated advertising, blustering, and boasting upon which no reasonable buyer would rely." A factual statement about a vehicle is not likely to be considered puffery. Puffery is a subjective, fanciful boast or some vague generality about how wonderful a vehicle is as opposed to a factual representation about the vehicle. Puffery is generally not legally actionable whereas factual representations, if material and relied upon by the customer, can be legally actionable as misrepresentations or deceptive trade practices. Puffery does not include misrepresentations or claiming benefits vehicles do not possess or any statement made for the purpose of deceiving prospective purchasers.

**Rebate Stacking** A deceptive advertising practice in which a dealer prices a vehicle after applying a series of rebates that few, if any, customers will qualify for. An example is pricing a vehicle and indicating a reduction for "rebates" where the rebates include recent college grad, military, returning lessee, loyalty, and perhaps other rebates for which few, if any, consumers can meet all of the qualifications. Itemize rebates and don't reduce the purchase price in advertising except for rebates that are available to substantially all of your customers.

**Red Flags** Any pattern, practice, or specific activity that indicates the possible existence of identity theft at your dealership.

**Red Flags Rule** An FTC Rule that requires auto dealers to develop and implement a written Identity Theft Prevention Program (ITPP) designed to detect, prevent, and mitigate identity theft in connection with establishing or maintaining consumer credit accounts and business accounts that present identity theft risks. The Red Flags Rule is not a "one size fits all" rule. Your ITPP must be appropriate to the size and complexity of the dealership and the nature and scope of its activities. The plan must identify relevant red flags; develop procedures to detect the presence of any red flags in credit transactions; prescribe ways to respond appropriately to any red flags that are detected; and be periodically updated to address new risks and experiences with identity theft. The dealership's Board of Directors must approve the dealership's initial ITPP and designate a senior dealership officer to develop, oversee, implement and administer the ITPP. The Rule also requires oversight of service providers, annual reporting to the Board or senior management, and training of all employees who participate in the ITPP. In 2013, the FTC revised its Guide to the Red Flags Rule to emphasize the need for annual review and oversight by the Board or senior management and to make appropriate changes based on experiences with attempted identity theft or new insights gleaned from studies and other materials. The FTC has identified Red Flags as a priority area for 2016.

**Rent charge** In a lease, the cost of credit, being analogous to the finance charge or interest on a credit sale or loan agreement.

**Reseller** A consumer reporting agency that assembles and merges information contained in the database of another consumer reporting agency or multiple consumer reporting agencies and does not itself maintain a database of the assembled or merged information from which new consumer reports are produced.

**RISC** A Retail Installment Sales Contract. This is the document that a dealer signs with a consumer to sell and finance the sale of a vehicle under the time-price doctrine. See Credit Sale and compare Loan. The dealer will then sell the RISC and the consumer's obligations to make payments under the RISC to a bank or finance company except for buy-here-pay-here dealers who hold RISCs and collect payments from buyers directly. Requirements for RISCs are set forth in state motor vehicle retail installment sales acts as well as in federal Truth in Lending.

**SDN List** Specially Designated Nationals and Blocked Persons List. OFAC's list containing persons, countries and organizations, such as known terrorists, with which U.S. entities are prohibited from doing any business. Every customer – cash and credit – must be checked against the SDN List at the time the customer relationship is established. If there is a definitive match, you must call OFAC and cannot do business with the individual or entity until the hit is cleared. OFAC updates the SDN List several times a month and publishes it on its website. Penalties for noncompliance are substantial and can range as high as $1 million in civil penalties per violation or criminal penalties of up to $10 million and 30 years imprisonment.

**Security Freeze** A consumer's right to lock down their credit file, including their credit report and credit score, from being accessed by new creditors. This right is available to all consumers. A consumer can initiate a security freeze online, by phoning, or sending a certified letter to each national credit bureau where the consumer wants his or her file frozen. A freeze can be temporarily "thawed" in less than five minutes by the consumer going online or calling the credit bureau and using a special PIN provided by the credit bureau to the consumer when the file was first frozen. Security freezes do not prevent the consumer's credit file from being used by the credit bureau in generating prescreening lists for making credit offers.

**Service-members Civil Relief Act**

A federal law that imposes a 6% rate cap on pre-service credit obligations during the member's period of military service. This includes secured credit such as motor vehicle financing for members of the military and their dependents. A service member or their dependent may also terminate an auto lease if the service member, after the lease is executed, enters military service for a period of 180 days or more. A service member or his dependent may also terminate an auto lease entered into while the service member was on active duty if the service member receives military orders for a permanent change of station outside the continental U.S. or a deployment of 180 days or more. For any lease termination, the vehicle must be returned to the lessor within 15 days of delivering the notice of termination. During the period of military service, a vehicle cannot be repossessed without a court order.

**Single Document Rule**

Provisions of state laws such as Minnesota and California that require all of the agreements of the dealer and buyer to be contained in a single document, typically the RISC. The purpose of this rule is to prohibit dealers from relying on separate agreements containing financing terms which contradict those disclosed in the RISC or required by law. Courts in some states have held that the single document rule may not require everything to be in one piece of paper and permit multiple, contemporaneous pieces of paper such as, for example, a deferred down payment agreement or a buyer's order. Consult your local attorney on whether your state has a single document rule and what it permits, if anything, in the way of multiple pieces of paper containing the consumer's obligations.

**Social Media**

Websites such as Facebook, LinkedIn, YouTube, and Twitter where consumers share information with other people in a virtual community. Companies can establish social media pages to promote their products and services interactively as well as purchase advertising on social media sites to target specific types of users. Social media sites are widely used by consumers who reveal preferences and interests and can raise challenges for auto dealers when a disgruntled consumer posts negative information about the dealership to a social networking site. Employees also use social media. A best practice is to adopt a social media policy that focuses on engaging consumers, participating, influencing, and monitoring social media sites. Employee posts on social media sites should be addressed in the social media policy as they may qualify as protected free speech particularly if related to unions or other concerted activity. All advertising rules and requirements that apply to media advertising generally also apply to social media advertising including ensuring that any disclaimers are clear and conspicuous in relation to the devices that will likely be used to view the ad (cell phone, tablet, laptop, etc.).

**Spoliation** The destruction or significant alteration of evidence. Spoliation is actionable as a cause of action in some states but typically justifies an adverse inference to a jury at trial and the imposition of sanctions against the party that committed the spoliation. The inadvertent destruction of electronic records where a "litigation hold" should be in place may give rise to a spoliation claim or jury instruction even if the destruction was not purposeful to the claim.

**Straw Purchaser** A third-party who buys an automobile and finances it in his name for someone else (who will be the actual driver) because of that other person's age, bad credit, or lack of credit, etc. Straw purchases can be the basis for a violation of the FTC Credit Practices Rule because the straw purchaser may actually be serving as a co-signer and straw purchasers may also violate the terms of lender agreements prohibiting deception in the identity of the car buyer. Straw purchasers often act for persons unable to purchase a car in their own right such as persons on the SDN List. A dealer has a responsibility to know its ultimate customer, not just the straw buyer.

**Steering** When a dealer finances a customer at a higher rate with one lender than the customer could qualify for with another lender. Also refers to the practice of sending customer credit applications to lenders that finance lower-qualified customers generally instead of lenders that may finance the customer at more favorable terms based on their credit quality. Steering can be one basis for a claim of credit discrimination if protected classes of persons are steered to higher rate lenders than those for which they otherwise qualify.

**Sweepstakes** A "game of chance" in which consumers enter to win prizes picked at random. A sweepstakes must have a "no purchase necessary" means of entry (typically by mailing in a postcard) and sweepstakes rules must state the date the sweepstakes ends, the odds of winning or that the odds depend on the number of entries received. States like New York, Florida and Rhode Island require bonding of certain consumer sweepstakes and other states have specific disclosure requirements. In contrast, a "game of skill" involves winning a prize by objectively outperforming other contestants in a universally assigned task (e.g., employee who sells the most vehicles in a month). Federal law requires the sweepstakes disclosure to provide that no purchase is necessary and making a purchase does not increase one's chances of winning as well as giving the consumer a way to remove themselves from future mailings from the sweepstakes sponsor.

**Synthetic Identity Theft**

Identity theft in which the criminal creates a fake identity using real personal data elements of different people to do so. For example, a synthetic identity thief may use a valid Social Security number with a different name, date of birth, or address to establish credit. A 2010 study found that at least 20 million people unknowingly share their Social Security number with a synthetic identity thief. Credit bureaus establish multiple files for people using the same Social Security number. 88% of new identity theft is believed to be synthetic identity theft and it is frequently how illegal immigrants establish an identity in the U.S. Compare Traditional Identity Theft.

**TILA**

The federal Truth in Lending Act (TILA) includes the federal Consumer Leasing Act, together with Federal Reserve Board (for auto dealers) and Consumer Financial Protection Bureau (for other creditors) Regulations Z and M. TILA provides for mandatory consumer disclosures in credit and leasing transactions and the advertising of credit. Regulation M covers consumer leasing transactions. Regulation Z covers credit sales, open-end credit (e.g., credit cards or lines of credit) and loans. TILA is among the laws for which rule-writing authority was transferred to the Consumer Financial Protection Bureau except for auto dealers for which rule-writing authority remains with the Federal Reserve Board.

**Traditional Identity Theft**

Identity theft in which the criminal actually takes over the identity and credit accounts of a real person and uses the person's actual identity to commit fraud. Frequently, the real person does not learn of the identity takeover until well after the fact when the real person is denied credit or collectors or creditors start calling in reference to accounts opened or used by the traditional identity thief.

**Trigger Leads**

A questionable mortgage product sold by credit bureaus to dealers and lenders and used in the auto finance context. When a creditworthy consumer's credit report is accessed by an auto dealer, doing so triggers a notice to the trigger leads buyer (another dealer or lender) who also receives the consumer's cell phone number to call the consumer and counteroffer him or her on the spot. Trigger leads are of dubious legality under the FCRA prescreening rules and also raise privacy issues and possible tort claims under state laws as well. Five states (Connecticut, Kansas, Kentucky, Vermont and Wisconsin) restrict the use of trigger leads in the mortgage context and Wisconsin limits the use of trigger leads in all consumer credit transactions. Trigger leads have been upheld by courts in the mortgage financing context but no case has upheld trigger leads in auto finance.

**UCC** The Uniform Commercial Code adopted in all 50 states. It contains rules on sales practices, express and implied warranties, financial instruments, and the use of goods to secure loans or credit transactions, among other things. Article 9 of the UCC outlines procedures to repossess a vehicle securing auto credit in default and to dispose of the vehicle in either a commercially reasonable public sale or a lawful private sale.

**UCCC** The Uniform Consumer Credit Code, a body of state law containing consumer protections and remedies. Versions of the UCCC have been adopted in Colorado, Idaho, Indiana, Iowa, Kansas, Maine, Oklahoma, Utah and Wyoming. South Carolina and Washington have adopted laws that are similar to the UCCC.

**UDAPs and UDAAPs** Unfair and Deceptive Acts and Practices (UDAP) laws and Unfair, Deceptive and Abusive Acts and Practices (UDAAPs). UDAP laws include Section 5 of the FTC Act and similar "Little FTC Act" state laws used frequently by the FTC and state Attorneys General to correct and obtain damages for consumer abuses by automobile dealers and other entities. Penalties under FTC Act Section 5 can total $16,000 per violation, per day. The FTC takes the position that inadequate data security practices and unfair or deceptive advertising are a violation of Section 5. Many state UDAPs include private consumer remedies and several make any violation of a federal law or regulation involving consumer protection a state UDAP violation as well. The Dodd-Frank Act additionally prohibits "abusive" trade practices and gives authority to the CFPB to issue prohibition regulations and bring enforcement actions to stop unfair, deceptive and abusive acts and practices and extends that authority to State Attorneys General and regulators as well. Abusive acts are those that take advantage of a consumer's inability to understand product terms or the consumer's reasonable reliance on the creditor (dealer) to act in the consumer's interests. Penalties that the CFPB can assess for UDAAP violations can be as high as $1 million per day for knowing and intentional violations. Franchised auto dealers are not subject to the CFPB's enforcement authority for abusive trade practices but abusive conduct may subject franchised auto dealers to actions for unfair practices under other laws such as Section 5 of the FTC Act or a state UDAP law.

**UETA**

Uniform Electronic Transactions Act. Adopted in 48 states and the District of Columbia, this law provides a framework for conducting transactions electronically instead of by paper. UETA is the state counterpart to the federal E-SIGN Act.

**Unconscionability**

A doctrine used to void contracts or provisions of contracts as being unfair and void against public policy and used particularly by plaintiffs' lawyers in challenging the enforceability of arbitration and class action waiver clauses in consumer finance contracts. Unconscionability consists of both an absence of meaningful choice for the party opposing enforceability of the agreement such as a non-negotiable contract (so-called procedural unconscionability) combined with contract terms that are unreasonably favorable to the other party (substantive unconscionability).

**The USA PATRIOT Act**

A post-9/11 law requiring, among other things, that creditors verify the identity of every customer, and establish formal anti-money laundering programs. The Treasury Department has not implemented a final rule for auto dealers as of December 2015, but FINCEN, the Federal Crimes Enforcement Network, has the authority to submit requests to dealers to search their records for transactions with specified individuals. The law also restates pre-existing dealer requirements to report on IRS/FINCEN Form 8300 all cash or cash-equivalent transactions of more than $10,000 as a vital anti-money laundering tool. Dealers also should report suspicious activity that suggests possible money laundering or transactions for the benefit of suspect individuals, such as a vehicle sale that the dealer learns the customer intends to export abroad and suspects the export may be to a prohibited country. This should be done without regard to whether the $10,000.01 threshold for filing a Form 8300 has been met.

**Used Car Rule** An FTC rule requiring dealers to prominently and conspicuously post a Buyer's Guide on all used cars prior to the car being offered for sale or lease. The Buyer's Guide must disclose detailed warranty information and contain other consumer disclosures. If the sale negotiations are conducted in Spanish, a Spanish version of the Buyer's Guide must be posted on the car. A final Buyer's Guide must be given at the sale reflecting any changes, and it operates as an amendment to the sales contract. The Used Car Rule does not apply in Maine or Wisconsin, where similar state regulations require posted disclosures on used vehicles. Other states may have additional requirements for posting disclosures on used vehicles.

**Warranty** A promise by the manufacturer or seller of a vehicle to make repairs or correct defects during a defined period of time. Warranties can be express or implied, full or limited, and are a part of the cost of the vehicle. The warranty terms must be clearly and conspicuously summarized, with the full warranty terms made available to the customer under the MMWA. Separate vehicle protection coverage that a customer pays for in addition to the vehicle price is a "service contract," and different legal rules apply to warranties and service contracts. Implied warranties are governed by state law but cannot be disclaimed by a dealer who sells the customer a service contract within 90 days of the vehicle sale.

**"If done on a wide-scale basis, a data breach or wrongful use of stolen dealer credentials to pull credit reports could become an expensive liability and compliance nightmare."**

**- Randy Henrick**
Dealertrack

2016



# Penalties for Violation of Federal Consumer Credit Laws and Regulations

# Penalties for Violation of Federal Consumer Credit Laws and Regulations

| Compliance Obligation | Civil and Regulatory Penalties for Each Violation |
|---|---|
| **Privacy Notices** | Up to $16,000 |
| **Signed Credit Application** | Up to $3,500 in civil penalties + up to $10,000 in punitive damages |
| **Risk-Based Pricing Rule Notice** | Up to $3,500 in civil penalties |
| **Red Flags Rule** | Up to $3,500 in civil penalties + contract repurchase |
| **OFAC SDN List Clearance** | Up to $1 million per violation |
| **Adverse Action Notices** | Actual damages + up to $10,000 in punitive damages |
| **Credit Disclosures in RISC** | Up to $2,000 per violation + class actions |
| **Disclosures in Lease Agreement** | Up to $2,000 per violation + class actions |
| **Cash Deals - IRS Form 8300 filing** | $100 + up to greater of $500,000 - $1.5MM based on business revenues Intentional Disregard - greater of cash amount or $25,000 up to $100,000 |
| **Used Car Rule Buyers Notice** | Up to $16,000 + state law remedies |
| **Odometer Tampering** | Up to $2,000, maximum of $100,000 for violations |
| **Telemarketing Restrictions** | $16,000 per call + $5,000 to $1 million per day in civil penalties + state law remedies |
| **Safeguarding Customer Information and Secure Disposal** | Up to $16,000 per day + state law remedies |
| **Warranty Disclosures** | Recover purchase price, cost of replacement vehicle, loss in value and other penalties plus state law remedies |
| **Data Security Breach** | Estimated "all in" loss of $201 per record compromised |
| **Unfair or Deceptive Practices (UDAPs)** | $16,000 federal + private state lawsuits |

| Potential Criminal Penalties | Federal Laws That Apply |
|---|---|
| Up to 10 years in jail + $500,000 fine if activity > $100,000 in a year. | GLB and FCRA |
| | ECOA and FCRA |
| | FCRA and 2003 FACT Act |
| | FCRA + lender agreements |
| Up to $10 million + 30 years in jail | OFAC Rules, USA PATRIOT Act |
| | ECOA, Regulation B, FCRA |
| $5,000, 1 year in jail or both | TILA, Regulation Z |
| $5,000, 1 year in jail or both | TILA, Regulation M |
| | IRS Code |
| | FTC Credit Practices Rule |
| Fines, 3 years in jail or both | Federal Odometer Act |
| | FTC Telemarketing Rule<br>Telephone Consumer Protection Act |
| | FTC Safeguards and Disposal Rules |
| | Magnuson-Moss Act + state laws |
| | 47 state laws, FTC Safeguards Rule |
| Varies by state | FTC Act § 5 and state UDAP laws |

# 190 Penalties for Violation of Federal Consumer Credit Laws and Regulations

| Summary of Law | Administrative Penalties |
|---|---|
| **Truth in Lending Consumer Leasing Act** (Fed Regs M and Z) | Actual damages and twice the finance charge. Minimum of $100, Maximum of $1,000. |
| **Drivers Privacy Protection Act** | $2,500 liquidated damages per violation + punitive damages + under federal law attorney's fees. |
| **Equal Credit Opportunity Act** (Fed Reg B) | FTC may refer a violation to the U.S. Dept of Justice to bring a civil action for actual and punitive damages and injunctive relief. |
| **Fair Credit Reporting Act** (includes Red Flags Rule, privacy disclosures and Risk-based Pricing Rule liability) | $3,500 per violation. Any violation also violates FTC Act § 5 with potential for damages of up to $16,000 per violation. |
| **Adverse Action Notices** (see ECOA and FCRA) | FCRA - $3,500 per violation. $16,000 per violation if FTC enters into an enforcement decree. |
| **OFAC** | Up to $1 million per violation. |
| **UDAP Laws** (FTC Act § 5 and State laws) | FTC Act – up to $16,000 per violation. State laws vary. Recent state consent decrees on dealer advertising have been in excess of $100,000. The CFPB can recover damages of up to $1 million per day against independent and buy-here-pay-here dealers. |
| **IRS Form 8300 reporting of cash payments in excess of $10,000** | $100 for failing to file and correct Form 8300 within 30 days with an aggregate annual limit of $1.5 million. For businesses with gross receipts not greater than $5 million, the aggregate is $500,000. Additional intentional disregard penalty for failing to file and correct is the greater of $25,000 or the amount of cash received. Same penalties for failure to furnish notice to persons on whom Form 8300s were filed except that the intentional disregard penalty is $250,000 or $200,000 for a business with gross receipts not greater than $5 million. |

| Civil Lawsuits | Criminal Penalties |
|---|---|
| Class action damages of up to the lower of $500,000 or 1% of creditor's net worth. | Willful and knowing violations - fine of $5,000, 1 year in prison or both. |
| | Criminal penalties under federal law. |
| Actual damages and punitive damages not to exceed $10,000 per violation. Class action damages of up to the lesser of $500,000 or 1% of dealer's net worth. | |
| Private right of action for certain provisions (e.g., Affiliate Marketing Rule). Damages up to $1,000 per violation and unlimited punitive damage liability. | |
| ECOA – Actual damages + punitive damages up to $10,000 per violation, not to exceed the lesser of $500,000 or 1% of dealer's net worth. Unlimited punitive damages under FCRA. | |
| | Up to $10 million + 30 years imprisonment. |
| Private causes of action for actual, statutory and punitive damages are permitted under most state UDAP laws. Some states allow recovery of treble damages. | Varies by state. |
| | |

# Penalties for Violation of Federal Consumer Credit Laws and Regulations

| Summary of Law | Administrative Penalties |
|---|---|
| **Used Car Rule** | Up to $16,000 per violation in a proceeding brought by the FTC. In addition, possible State AG claims under UDAP laws and Motor Vehicle sales laws. |
| **Federal Odometer Act** | The Department of Transportation can impose penalties of up to $2,000 per violation up to a maximum amount for a series of violations of $100,000. |
| **FTC Safeguards and Disposal Rules** | Potential FTC fine of $16,000 per day. FTC has entered into 20-year consent decrees requiring biannual security firm audits and requirements for updating dealer security systems. |
| **FTC Telemarketing Rule and FCC Rulings** | Up to $16,000 for each violation plus redress to injured consumers. For dealers, subject to CFPB regulation $5,000 to $1 million for each day a violation continues. |
| **Magnuson-Moss Warranty Act** | May constitute an FTC § 5 Act UDAP. |
| **Telemarketing Consumer Protection Act of 1991 (TCPA) and FCC Regulations prohibiting use of auto dialers or text messages to cell phones or use of pre-recorded messages to cell phones or land lines without the prior written consent of the consumer** | |

* The above laws and regulations have provisions for assessing the wrongdoer plaintiffs' attorneys' fees and costs or costs of regulatory investigation along with civil or criminal penalties. In an individual or class action, the plaintiffs' attorney's fees can easily be six figures or more depending on the length and complexity of the case.

| Civil Lawsuits | Criminal Penalties |
|---|---|
| Possible UDAP claims or fraud claims under state laws. | Varies by state. |
| Civil actions can collect the greater of three times the actual damages or $10,000. | Criminal fines or three years in prison, or both. |
| Possible UDAP, breach of contract, and negligence claims under state laws. Courts have permitted lawsuits against retailers who incurred security breaches compromising customer information. | |
| Individual call recipients and State AGs can obtain up to $500 per violation, the amount trebled for willful or knowing violations. | |
| Consumers can recover damages from the breach. This includes remedies already available under state law, such as recovery of the purchase price, market price of a replacement, loss in value due to the problem, recovery of other costs, and statutory penalties, if any. "Other legal and equitable relief," court costs and attorneys' fees are also recoverable. Breach of written warranty, breach of implied warranty, breach of service contract and failure to comply with obligations are the four causes of action directly referenced in the Act. | |
| $500 - $1,500 per call or text message sent to any wireless number you can't prove you have prior written consent in proper form to call or text. Class action liability is unlimited. | |
| | |

# Notes

For the latest Compliance news
and information, visit us at:

**blog.dealertrack.com/compliance**

Dealertrack

**Dealertrack.com**

888.705.7926
1111 Marcus Avenue, Suite M04,
Lake Success, NY 11042

A COX AUTOMOTIVE BRAND