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Center for Financial Institutions Policy

# Auto Race to the Bottom

## Free Markets and Consumer Protection in Auto Finance

Research Note

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# AUTO RACE TO THE BOTTOM: Free Markets and Consumer Protection in Auto Finance

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## 1.0 Introduction

The Cambridge Winter Center for Financial Institutions Policy is pleased to present this research note in conjunction with its ongoing research program on the post-crisis evolution of U.S. consumer finance.[2]

Over the past several months, the Federal Reserve, Congress, and the Administration have been considering ways to strengthen and rationalize consumer protection in financial services. Central to that debate is the proposed creation of a new agency focused exclusively on this issue, the Consumer Financial Protection Agency (the "CFPA").

Despite pronounced industry opposition, a consensus appears to be developing among policy-makers that the proliferation of dubiously structured and marketed consumer financial products helped fuel an unsustainable bubble in credit and asset values prior to the financial crisis, and visited widespread distress among households thereafter. Proponents of the CFPA argue that it would help prevent similar problems in the future.

Even among proponents, however, there are varying conceptions of the scope and function of the CFPA.[3] One of the most significant variations is in the treatment of auto finance. Specifically, the CFPA as envisioned by the House Financial Services Committee would exclude auto dealers

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[2] Cambridge Winter is a non-profit, non-partisan think tank focused on fostering a rational, fact-based dialogue on U.S. financial institutions policy. Cambridge Winter does not engage in lobbying activities, nor does it accept fees or other compensation for its services, including the publication of this report. The firm is pursuing three research programs over the course of 2009-10: (1) Sleeping Watchdogs -- Bank Governance and Regulation Before the Fall; (2) Out of the Shadows -- Industry Structure as a Determinant of Financial Services Stability; and (3) Consumer Finance 3.0 -- Crisis, Reform, and the Next Decade of Consumer Lending, under which this note is published.

[3] *Compare* U.S. Department of the Treasury, Financial Regulatory Reform: A New Foundation ("Treasury White Paper"), available at *http://www.financialstability.gov/docs/regs/FinalReport_web.pdf,* accessed November 13, 2009, pages 55-70 (original Administration proposal for the CFPA), *with* Discussion Draft of September 25, 2009, to be reported as H.R. 3126, 111th Congress: Consumer Financial Protection Agency Act of 2009 ("Frank Discussion Draft"), available at *http://www.house.gov/apps/list/speech/financialsvcs_dem/cfpa_discussion_draft_for_markup.pdf*, accessed November 13, 2009.

from the CFPA's coverage.[4] The Administration's original proposal would have included them.

This research note does not address the issue of whether the CFPA itself is advisable. Instead, it is meant to inform debate on, assuming there is a CFPA, whether auto dealers should be included in its mandate. In particular, it (a) summarizes the structure of the auto finance industry, and the role of dealers within it; (b) identifies the analytical premises for excluding financial services activities from the CFPA's scope; (c) evaluates, in light of that analytical framework, whether dealers should be exempted; and (d) highlights the likely competitive implications in the industry if the exemption becomes law.

## 2.0 Executive Summary

The exemption of auto dealers from the CFPA is conceptually flawed. It is logically discordant with the basic premises underpinning the CFPA; it further fuels long-term instability in U.S. financial services by discriminating against community banks and credit unions; it intervenes with the free market in a way that is both distorting and inequitable.

Notably, analysis of the dealer exemption need not even first evaluate whether the CFPA itself is advisable. One need only acknowledge that, if Congress ultimately chooses to create the CFPA, it will be because it believes (1) that consumer protection is a materially important objective in financial services; (2) that comprehensive rule-making will prevent problematic opportunities for regulatory arbitrage; and (3) that centralized supervision of consumer protection is more effective than a decentralized approach that is tied to prudential regulation.

Those logical premises are clearly relevant to auto dealers' financing activities. Dealers are not a niche part of an immaterial market; they are the single largest channel (with 79% market share) in the origination of auto loans and leases, a business that (at more than $850 billion in outstandings) is larger than the entire credit card industry.

Moreover, auto finance is demonstrably susceptible to unfair and deceptive practices, and those practices are demonstrably not held in check by private market forces alone. Intentionally creating a fragmented approach to regulation in auto finance -- one set of rules for auto dealers, another set for banks and credit unions -- would invite the kind of "race to the bottom" in consumer practices that was manifest during the credit bubble. At the same time, the exemption discourages a "race to the top": by granting the dominant players in the business a specially permissive regulatory regime, policy-makers would tilt the field against more customer-friendly business models, principally at community banks and credit unions.

[4] *See* Amendment No. 24 to H.R. 3126 by Mr. Campbell and Mr. Posey, available at *http://www.house.gov/apps/list/speech/financialsvcs_dem/campbell_-_posey_086_xml.pdf* (the "Campbell Amendment").

The exemption would also encourage long-term instability in the market's structure. The auto finance market consists of two basic distribution channels: the dealer (or "indirect") channel, which is generally funded by a handful of large national banks and Wall Street capital markets platforms; and the retail (or "direct") channel, which generally consists of credit unions and community and regional banks. By artificially distorting the auto finance market in favor of the dealers' distribution channel, the exemption encourages the primacy of Wall Street funding sources over traditional bank deposit funding. As evidenced by the crisis, intentionally chasing businesses from traditional banks and credit unions into Wall Street funding models creates the real potential for disruptive volatility over time.

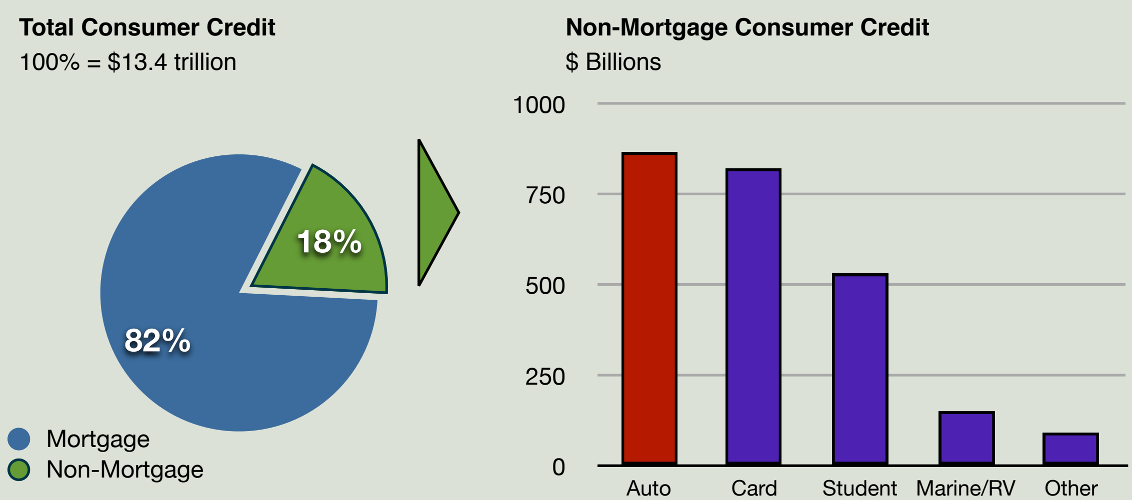
## 3.0 Auto Finance Primer

Auto finance is big business in the United States. Although American households' credit obligations are dominated by mortgage and home equity debt, auto finance -- which includes both loans and leases -- constitutes the next largest category, edging out even revolving credit card balances. *(See Figure 1).*

Despite its size, the industry is not especially complex. That said, evaluating policy alternatives for the business does require a basic understanding of the industry's (1) distribution channels, (2) funding models, and (3) key changes during the credit bubble and crisis.

*Figure 1*

**Consumer Loan & Leases, 3Q09**




Source: Federal Reserve; Sallie Mae; JP Morgan; Cambridge Winter

## 3.1 Distribution channels

As in the mortgage business, auto loans[5] are originated through both direct and indirect channels. *(See Figure 2).*

"Direct channels" -- which include branch-based, telephone-based, and online models -- involve lenders interacting with borrowers themselves. Although direct channels have become more efficient over time, their share of overall originations remains stubbornly low, at only a fifth of the market.

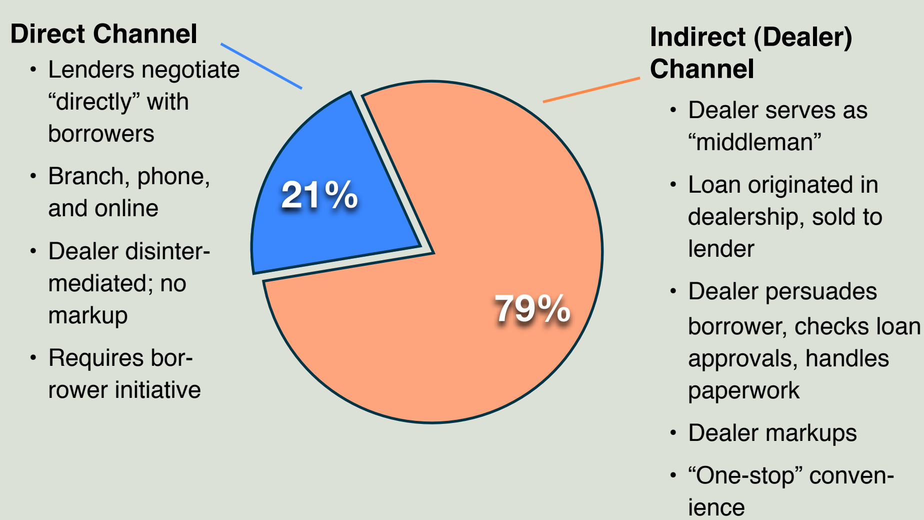
"Indirect" channels involve some manner of intermediation -- a middleman -- between the lender (like a bank or finance company) and the borrower. In auto finance, the finance and insurance staff at auto dealers (typically called the "F&I office") serve that middleman function. Like other credit intermediaries, F&I staff obtain borrower information sufficient to obtain loan approvals from lenders, persuade the borrower to agree to a loan, and document the loan as necessary. As with mortgage brokers, auto dealers are compensated through multiple revenue streams: (1) they typically charge a "mark up" on loans, so the rate the borrower agrees to pay is higher than the rate that the ultimate lender quotes the dealer; (2) they may charge front-end origination fees; and (3) they attempt to use the loan sales process as a platform from which to sell high-margin, non-lending products.

Although individual lenders can, and frequently do, participate in both direct and indirect channels, most lenders skew towards either working directly with customers themselves, or working through auto dealers. *(See Figure 3).*

The "captive" finance companies (that is, those finance companies, like GMAC, historically owned by manufacturers) favor the indirect channel. Because auto manufacturing is an enormously scale-intensive

*Figure 2*

**Auto Finance Channel Mix, 2007**

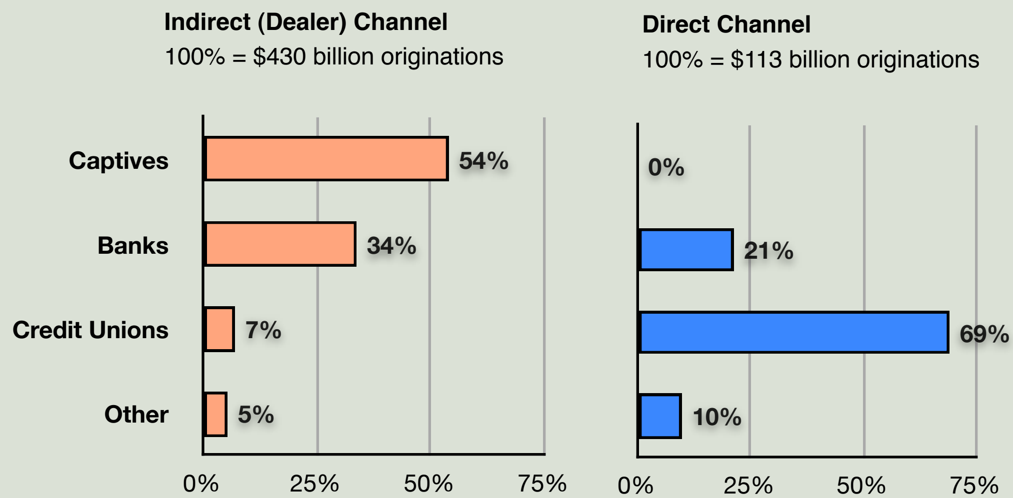



Source: J.D. Power; Cambridge Winter

[5] For simplicity, this note will hereafter refer to both loans and leases as "loans".

*Figure 3*

**Market Share of Major Channels, 2007**




Source: J.D. Power; Cambridge Winter

business, manufacturers tend to feel pressure to artificially stimulate consumer demand for their products when sales volumes slow.[6] In some measure because of manufacturers' willingness to subsidize consumer credit in order to drive car sales, captives have come to control more than half of the indirect auto finance channel.

In notable contrast to the captive finance companies, credit unions tend to have relatively strong consumer franchises, and no meaningful commercial business with dealers, so they disproportionately favor the direct channel. Put another way, credit unions have a competitive advantage working directly with customers, and very little to lose in their relationships with auto dealers.

Commercial banks' channel preferences tend to vary according to their size. Most community banks are too small too compete meaningfully in the indirect channel, and instead participate directly with their retail customers. Many of the largest commercial banks, by contrast, are large players in the dealer channel.

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[6] Auto manufacturing is scale-intensive principally because of its extraordinarily high fixed costs. In a high-fixed cost business, losing sales volume can be especially challenging: sales revenue declines, but costs stay stubbornly high. By contrast, stimulating sales through incentives (e.g. 0% down, $1000 cash back, the "cash for clunkers" program) can be, in the short term and on the margin, a logical decision even if incremental sales bring in diminished marginal revenue, because marginal costs stay low. Of course, sales incentives typically cannot reverse a long-term secular decline. *See generally* Niladri Ganguli, T. V. Kumaresh, and Aurobind Satpathy, Detroit's New Quality Gap*, McKinsey Quarterly* (February 2003).

## 3.2 Funding models

The split between direct and indirect distribution channels also has major implications on the funding model for auto finance.

Auto dealers, of course, have no privileged access to funding with which to make consumer loans. As a result, in the vast majority of cases, dealers originate loans knowing that they will be assigned to lenders with whom they work.

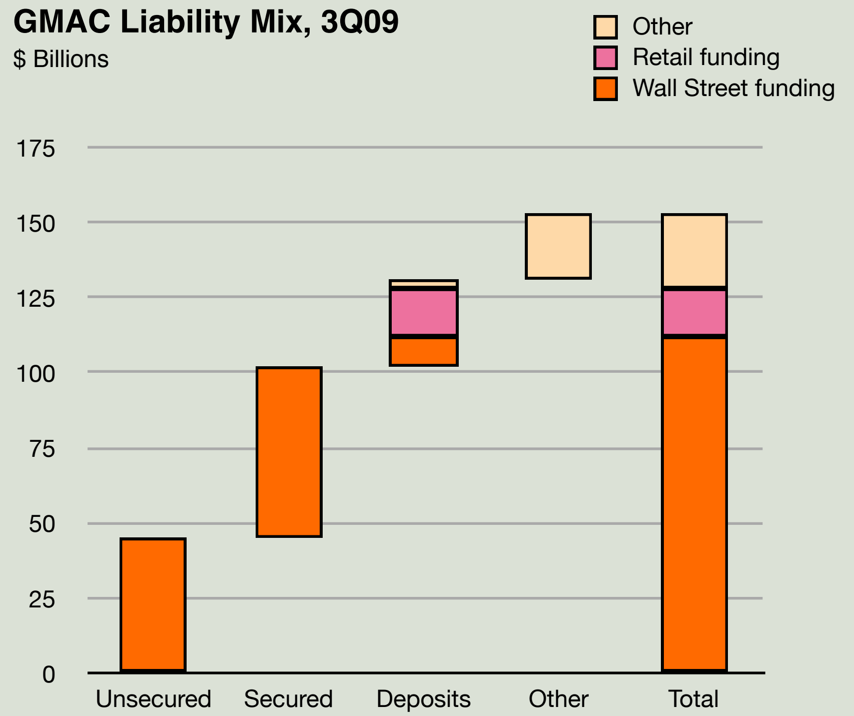
The lenders that work with dealers, in turn, are more often than not the captive finance companies. Captive finance companies are not banks.[7] Among other things, this means that they lack the branch networks or commercial customer bases to reliably attract low-cost, stable deposit funding. Instead, they rely heavily on capital markets funding, which is typically raised by Wall Street firms' unsecured or asset-backed securities origination businesses. Indeed, even GMAC, which has been the beneficiary of serial taxpayer capital infusions, as well as the conversion into a bank holding company charter in 2008, remains reliant on Wall Street funding today. *(See Figure 4).*

By contrast, because the most significant lenders in the direct channel tend to be credit unions and smaller banks, the funding model for direct auto loans tends to rely more heavily on traditional deposits than on the capital markets. Most small banks and credit unions lack the scale to reliably access the asset-backed markets, and simply selling whole loans to Wall Street (so that they might be packaged with other

*Figure 4*

**GMAC Liability Mix, 3Q09**

$ Billions



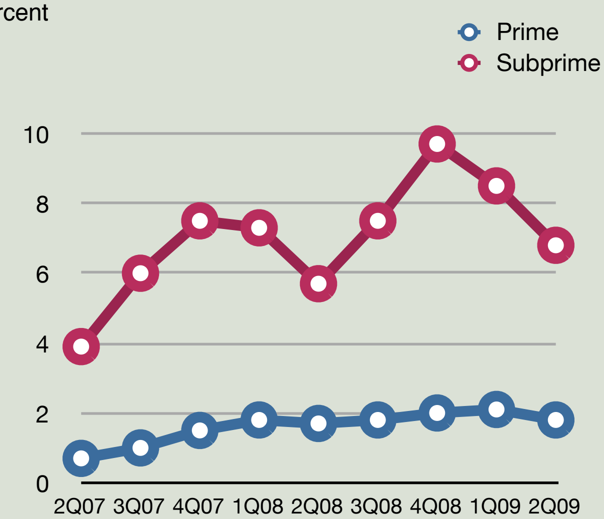

Source: GMAC; Cambridge Winter

[7] Most large captives own industrial loan companies ("ILCs"), but in general those deposit charters facilitated dealer "floorplan" loans, rather than consumer loans. In any event, ILCs tend not to attract low-cost transaction deposit accounts; they rely on more rate-sensitive CDs and saving accounts. Notably, policy-makers are considering eliminating the ILC charter. *See generally* Raj Date, *Industrial Loan Companies and Shadow Banking*, Cambridge Winter Center (August 10, 2009), available at http://www.cambridgewinter.org/Cambridge_Winter/Program_B_files/ILCs%20and%20shadows%20081009.pdf.

*Figure 5*

**Auto Finance Net Credit Losses, 2Q07-09**

Percent

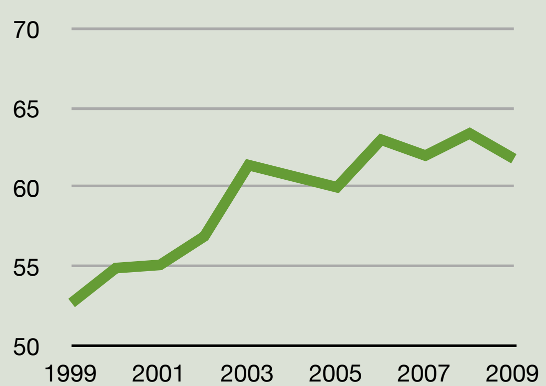



Note: Prime and Subprime data are for Fitch ABS Indices
Source: Fitch

*Figure 6*

**Average Term for New Car Loans, 1999-8/09**

Months




Note: Average maturity for finance companies
Source: Federal Reserve; Fitch

small banks' loans and securitized) is problematic as well, because it would typically require severing an ongoing servicing relationship with an existing, multi-product customer.

## 3.3 Impact of the Bubble and Crisis

Not surprisingly, auto lending has suffered mightily since the onset of the credit crisis. Credit deterioration has afflicted both prime and subprime auto loans. *(See Figure 5).*

Like other consumer lending categories, subprime constitutes a meaningful component of overall auto lending, and a greater component of industry profitability. But unlike in mortgage, the auto finance industry did not particularly expand its level of subprime borrowing during the course of the bubble. The fraction of overall lending attributable to subprime remained roughly constant: approximately 20% of loans to borrowers below FICO 660.[8]

This is an intuitive result: for lower-income Americans, in most parts of the country, car ownership is often a practical requirement to commute to and from work. Unlike subprime homeownership, subprime car ownership was not a one-time luxury transformed into an attainable "necessity" by the availability of easy credit. Rather, subprime car ownership has actually been a necessity, not a luxury, all along.

Other underwriting criteria, however, did slip -- including loan-to-value ratios and, especially, the length of loan terms. *(See Figure 6).* Cars, of course, depreciate

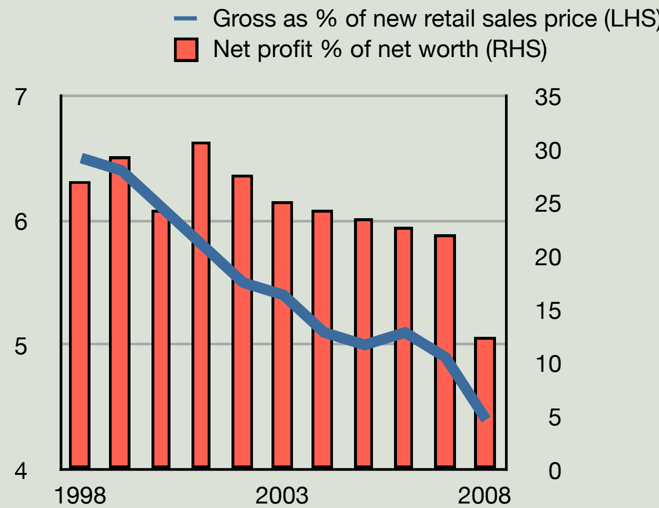
[8] *See* Himanshu A. Patel and Eric J. Selle, *Auto Finance Outlook*, J.P. Morgan, slide 16 (March 12, 2008) (*citing* JD Power PIN).

quickly over time. Because older cars are worth a good deal less than newer cars, when a borrower defaults near the end of a long loan term, the resale value of the repossessed vehicle is typically significantly less than the unpaid principal balance owed. Lower recoveries on repossessed cars, in turn, mean worse loss severities, and, therefore, higher net credit losses.

*Figure 7*

**New Car Margin and Dealer Profitability, 1998-2008**

Percent




Source: National Automobile Dealers Association

Beyond the credit deterioration of existing portfolios, the bubble-era's widespread availability of permissive LTVs and loan terms had a second, more subtle, and potentially more corrosive effect. By temporarily boosting auto dealers' sales volume, and especially their lending profitability, the credit bubble may well have forestalled actual structural change within the auto dealer sector.

At first glance, it would appear that, for years, auto dealers were able to defy free-market gravity. The industry suffered a 200-basis point decline in new car gross margins over the past 10 years. This would seem crippling, given that selling cars is a brutally thin-margin business, and dealerships tend to run only 150-basis point pre-tax net profit margins, even in good times.[9] And yet, somehow, dealerships remained remarkably profitable -- running net profits at 20-25% of net worth throughout their industry's top-line collapse. Dealerships even turned a profit during the otherwise calamitous 2008. *(See Figure 7).*

The explanation for this other-worldly performance is actually quite simple: As gross margins in the auto sales business deteriorated over the past decade, auto dealers managed to dramatically increase their sales of high-margin consumer loans, service contracts, and other profitable ancillary services. *(See Figure 8).*

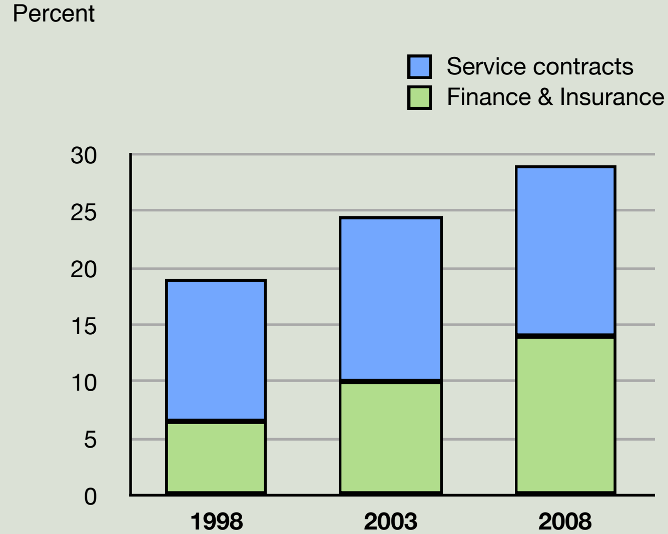
By the end of the credit bubble, in other words, the financial viability of American auto dealers had become critically depend-

[9] National Automobile Dealers Association, *NADA Data 2009,* available at [www.nada.org/nadadata](http://www.nada.org/nadadata), accessed November 15, 2009, pages 2 and 10.

ent on serving as a financial middleman, marking up loans between money-losing captive finance companies on the one hand, and their increasingly cash-strapped and wary customers on the other. Over the course of the bubble, auto dealerships -- employers of more than 1 million Americans[10] -- had managed to steer themselves into a strategic and financial dead end.

*Figure 8*

**Aftermarket Income as Percent of New- and Used-Department Gross Profit**




Source: National Automobile Dealers Association

## 4.0 Evaluating the CFPA Exemption for Auto Dealers

It is within that industry context that the House Financial Services Committee voted to exclude auto dealers from the CFPA's rule-making and enforcement scope.[11] And it is within that industry context that the wisdom of the exemption should be gauged.[12]

Notably, evaluating the wisdom of the dealer exemption (or any other exemption, for that matter) need not first determine whether the CFPA itself is a good or bad idea. Because it is an exemption being evaluated, the creation of the CFPA is an assumption of the analysis. And given the lengthy substantive debate among policy-makers regarding the CFPA, the logical

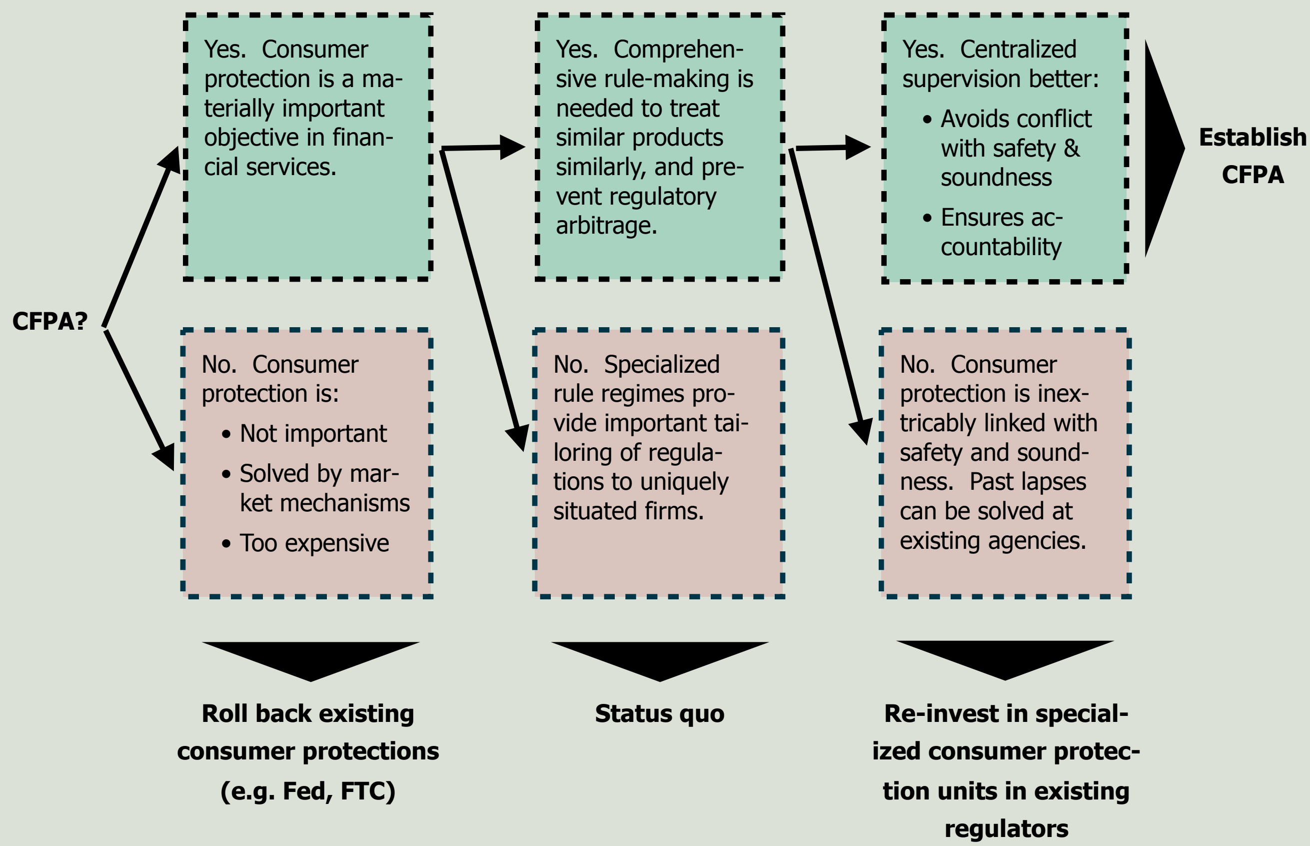
[10] National Automobile Dealers Association, Driving the US Economy, available at *http://www.nada.org/NR/rdonlyres/E51CEDC3-E39D-4C70-AD75-3ACCB5685251/0/StateeconomiesAnnualContributions_2009.pdf*, accessed November 15, 2009.

[11] The amendment passed 47 to 21, with 19 Democrats joining 28 Republicans in favor of the exemption. House Financial Services Committee Record vote no. FC-64, available at *http://www.house.gov/apps/list/speech/financialsvcs_dem/111th_fc_record_vote_--64.pdf*, accessed November 13, 2009.

[12] Beyond the industry context, the political context is notable, although not particularly relevant for the purposes of this analysis. There are more than 20,000 auto dealerships spread across the country, in every Congressional district, operating in an industry whose taxpayer-funded survival simultaneously benefits both organized labor and Wall Street interests. As a result, auto dealers have almost uniquely powerful political attributes, and, therefore, can rightfully boast that they have helped shape one of the most expansive corporate welfare initiatives in American history: "Auto dealers from around the country have traveled to Washington numerous times and have been instrumental in lobbying on key measures, including securing government bridge loans for General Motors and Chrysler, arguing against drastic dealer cuts at congressional hearings, and helping enact two federal auto stimulus programs." National Automobile Dealers Association, Press Release (September 21, 2009).

*Figure 9*

**CFPA Logic Tree**




Source: Cambridge Winter

premises that underpin the assumed creation of the agency are clear.

There are three such premises. The CFPA will be enacted if, and only if, Congress decides that: (1) consumer protection is a materially important objective in financial services; (2) comprehensive rule-making is superior to rules based on charter-type or other formal distinctions; and (3) centralized supervision and enforcement of consumer protection is better than a more decentralized approach tied to prudential regulation. *(See Figure 9).*

If there is a CFPA, then, the only exemptions from the CFPA's authority should be in those cases where the premises that justify the agency's creation do not apply.

Because auto dealers do not have prudential regulators (like banks), the third stage of the framework is not relevant.[13] Apply-

[13] As a comparison, the third prong would be a relevant inquiry into the exemption of community banks from the supervision and examination powers of the CFPA.

ing the first two prongs, though, makes clear that the exemption is profoundly wrong-minded.

## 4.1 Importance of consumer protection in the dealer channel

Given the industry structure detailed above, consumer protection seems a critical regulatory concern with respect to auto dealers.

### 4.1.1 Role of dealers

Auto dealers are the dominant distribution channel in auto finance, and auto finance is the largest category of consumer credit outside of mortgage. Far from being passive administrators with respect to auto finance, auto dealers actively market and price borrowers' loans.

Moreover, the dealers' business model with respect to auto finance bears several red flags of potential abuse. They routinely mark up loan offers, typically collecting the equivalent of half of the resultant excess finance charges as a bounty[14]; they have the ability to obscure pricing among the several moving parts of an auto transaction (new car price, trade-in value, loan rate, loan fees, "garbage" fees, aftermarket services); they often receive incentives from lenders, or pay "dealer discount"[15] to lenders, further clouding price transparency; their customer interaction often takes place not on recorded call center lines or supervised branch environments, but -- literally -- in back rooms on car lots.

In many of these ways, dealers' F&I functions bear a striking resemblance to mortgage brokers; both warrant consumer protections.[16]

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[14] The potentially discriminatory impact of markup practices has been described in numerous sources. *See, e.g.*, Consumer Federation of America, *The Hidden Markup of Auto Loans* (January 26, 2004), available at *http://www.consumerlaw.org/issues/cocounseling/content/cfa_autofi_release.pdf*, accessed November 15, 2004. Other materials ably and colorfully describe the cultural norms of the dealer F&I business. *See, e.g.,* Philip Reed and Nick James, *Confessions of an Auto Finance Manager,* Edmunds, available at *http://www.edmunds.com/advice/buying/articles/125308/article.html*, accessed November 15, 2009.

[15] "Dealer discount" is a seldom-discussed feature of the subprime auto finance market. It involves the payment of a fee from the dealer to the lender, and in light of which the dealer typically raises the overall cost of the vehicle and aftermarket services. In effect, this lowers the actual cash balance advanced by the lender, and thereby raises the effective return on the loan, often higher than state usury caps might permit. Unlike straight "origination fees", "dealer discount" typically need not be calculated and disclosed as part of effective APR. As a result, borrowers can easily underestimate the true credit cost of the transaction. A more transparent approach would be to bar dealer discount, or include it within disclosed APR calculations, and relax usury caps instead. Importantly, eliminating dealer discount, but keeping usury caps, is quite likely to make many subprime loans non-economic.

[16] This is not to say, of course, that auto dealers somehow caused the mortgage crisis. The auto dealers' trade association has argued that it should be exempt from the CFPA because "there is no connection between subprime mortgage lenders and auto financing" and that "auto dealers did not cause the credit meltdown." NADA, *Key Points on Dealer Assisted Financing and Financial Reform*, available at *http://www.nada.org/legislativeaffairs/economy-financial/dealerfinance.htm*. This argument seems to misapprehend the objective of the proposed CFPA. None of its proponents argue that the CFPA is meant to mete out vengeance upon those who caused the financial crisis. *See* Treasury White Paper, *supra* note 3, at pages 55-70.

### 4.1.2 Market-based forces insufficient

Recent history suggests that market-based forces alone -- that is, the vigilance and skepticism of auto lenders and borrowers -- are insufficient to reliably ensure those consumer protections.

For example, it is certainly theoretically true that lenders should prevent dealers from levying excessive after-market fees, or exorbitant loan markups. After all, cash that flows from the borrower to the dealer is cash that is not available to support the new loan obligation. Moreover, customers that find themselves susceptible to high aftermarket fees are also an adversely selected credit pool (among two seemingly identical borrowers, the one who buys undercarriage protection, statistically, should be a worse credit risk than the one who declines that add-on product). But, theory aside, and despite notable progress especially as competition eased during the credit crisis, markup remains a common practice. Indeed, some of most pronounced reform of markups has come through state legislation (e.g. California), not lender-enforced discipline. The free-market tension between lenders and dealers is simply not up to the task of consumer protection.

Given the funding model associated with the dealer channel, there is even less hope for a market-based check on dealer excesses. Dealer-originated loans are, more often than not, purchased by captive finance companies and the largest national banks, and then funded through Wall Street firms in the asset-backed securities markets. As demonstrated in the last credit bubble, the asset-backed markets are not particularly credible checks on originators' excesses.

### 4.1.3 Little impact on availability or cost of credit

Regulated industries are in the habit of protesting that customers' costs and access to services will increase under the weight of incremental regulatory protections; auto dealers have made the same argument here.[17]

In most cases, that is at least a conceptually valid argument. But it has virtually no bearing here: Auto dealers sell loans that other lenders have already approved -- and they do so at a markup, at a cost to consumers that is, definitionally, higher than the ultimate lender itself is willing to accept. In other words, dealers are more or less neutral to access, and actually *increase* costs.[18] There is, of course, some measure of convenience to the point-of-sale financing that dealer F&I offices certainly provide. But it is difficult to see how comprehensive rule-making on consumer protection should make a customer's experience in an F&I office particularly less convenient.

[17] National Automobile Dealers Association, Press Release (September 21, 2009) ("This overly burdensome new bureaucracy will decrease access to and ultimately increase the cost of credit for our customers").

[18] It is true that some dealers, typically in the deep subprime market, retain loans they have originated. But those "buy here pay here" dealers are excluded from the exemption. Campbell Amendment, *supra* note 4, at (g)(2)(B)(ii).

## 4.2 Regulatory arbitrage

Exempting auto dealers also creates precisely the potential for regulatory arbitrage that the CFPA is intended to prevent -- and invites the potential for further unintended weakening in the industry's structure.

### 4.2.1 Market distortion

Exempting one class of market participants from consumer protection rules of general applicability creates the risk that those participants will use their special status to distort the marketplace in their favor, and to consumers' detriment.

This risk is particularly acute in the case of auto dealers.

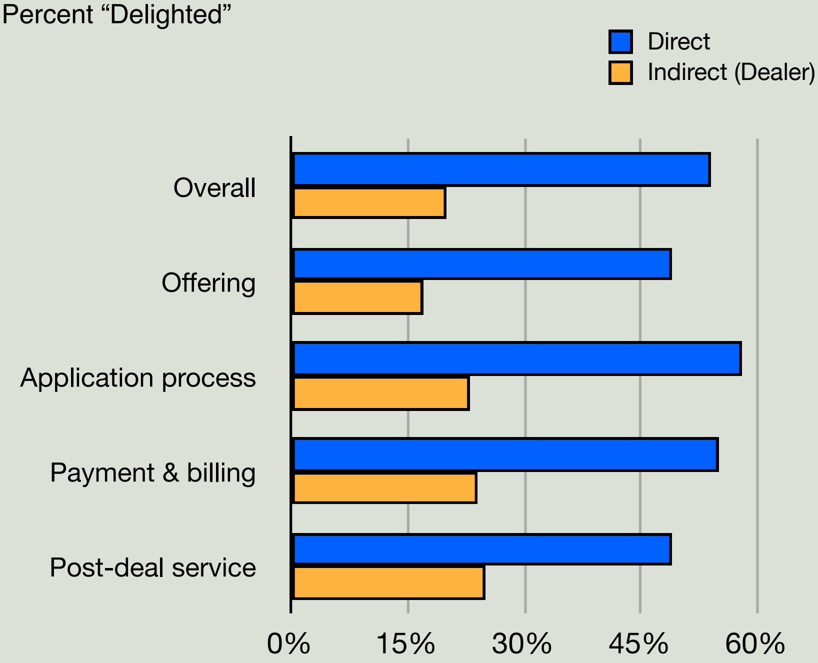
Dealers are already the dominant channel in auto finance, and their F&I business model already carries with it an array of features that make it susceptible to abuse. Given a special, less-demanding consumer protection regime, it is difficult to conceive of why the already-dominant dealer channel would not quickly squeeze other, more transparent business models further to the periphery of the business.

Ideally, more transparent, more customer-friendly business models would out-compete more dubious practices over time. Such business models -- principally at credit unions and smaller banks -- are possibly, even now, slowly taking root with customers. *(See Figure 10).* Essentially, the regulatory exemption risks artificially crippling more customer-friendly business models, instead of letting them compete on an even playing field.

*Figure 10*

**Customer Satisfaction by Channel, 2007**

Percent "Delighted"




Source: J.D. Power

### 4.2.1 Market instability

The Wall Street-dominated funding of the auto dealer-originated loans has a longer-term destabilizing impact away from issues of consumer protection. As the crisis has demonstrated, capital markets funding can be extraordinarily fickle, particularly in the asset-backed markets. When policy-makers artificially favor Wall Street-funded businesses over traditional deposit-funded banks (e.g. through TARP capital infusions to the largest banks; through TALF leverage for asset-backed securities; through

TLGP's FDIC debt guarantees for finance companies; and now, through a special regulatory regime for auto dealers) they are risking rebuilding precisely the same unstable shadow banking system that just proved in its own frailty.

* * *

Even by the low analytical standards applied to hastily arranged, crisis-driven corporate welfare initiatives, the exemption of auto dealers from the CFPA is ill conceived.

Most obviously, the exemption is an affirmative step in the wrong direction for consumer protection in auto finance. It seeks to protect the players with the most dubious customer practices, and it discriminates against the relatively customer-friendly direct channel strategies pursued by community banks and credit unions.

The exemption also offends even the most basic principles of regulatory equity. Free-market adherents should be dismayed by the notion of special regulatory treatment for some classes of market participants (car dealers, national banks, Wall Street firms) over others (community banks, credit unions) that appear equally distressed in the current crisis.

Perhaps even more troubling than the auto dealer exemption itself, given the large, bipartisan majority of the House Financial Services Committee that supported it, is what it implies more broadly: The bipartisan zeal for, and growing comfort with, special interest subsidies that distort free markets in favor of the largest and most politically entrenched participants.