CENTER FOR RESPONSIBLE LENDING

December 9, 2015

Dear Chairman Hensarling and Ranking Member Waters:

The Center for Responsible Lending has reviewed the November 24, 2015 majority staff report and its accompanying documents regarding the Consumer Financial Protection Bureau's enforcement activity related to auto lending. While the report cites many documents and materials, it omits critical information necessary to fully evaluate this issue. When that information is included, the record shows that CFPB has properly and carefully acted to reduce and remedy discrimination in auto lending.

The Report Mischaracterizes the Auto Lending Market and Omits Evidence of Widespread and Persistent Discrimination.

The report assumes that auto lending operates in a fair and transparent manner, but fails to acknowledge the overwhelming evidence that discrimination in auto lending is widespread and persistent.

Auto lenders provide dealers with an interest rate that takes into account the borrower's credit score, the particular car being purchased, and other details of the transaction for a particular potential borrower. Because this is the interest rate at which the lender is willing to purchase the contract from the dealer, it is known as the "buy rate." The lender allows the dealer to add additional interest to the buy rate and allows the dealer to keep most of the difference as compensation. The amount of the markup is not disclosed to the consumer, and surveys consistently show that consumers are unaware that the dealer has a financial interest in selling consumers a higher interest rate.[1]

This type of discretionary markup was found to produce widespread racial discrimination in mortgage lending.[2] It has produced the same discriminatory impact in auto lending. Discrimination due to dealer interest rate markup was raised in a series of court cases in the 1990's and 2000's against the largest auto finance companies in the country. These cases revealed that African American and Latino car buyers were more likely to have their interest rates marked up than white borrowers, and paid on

[1] For example, see http://www.responsiblelending.org/other-consumer-loans/auto-financing/research-analysis/CRL-Auto-Non-Neg-Report.pdf

[2] *See* Burlingame, Laurie and Jackson, Howell E., *Kickbacks or Compensation: The Case of Yield Spread Premiums* (February 19, 2009). Stanford Journal of Law, Business & Finance, Vol. 12, p. 289. *Also see* http://www.responsiblelending.org/mortgage-lending/tools-resources/rr011-Unfair_Lending-0506.pdf

PO Box 3638, Durham NC 27702-3638 • 302 W. Main Street, Durham NC 27701 • Phone 919.313.8500 • Fax 919.313.8595
910 17th Street NW, Suite 500, Washington DC 20006 • Phone 202.349.1850 • Fax 202.289.9009
1330 Broadway, Suite 604, Oakland CA 94612 • Phone 510.379.5500 • Fax 510.893.9300
www.responsiblelending.org

average twice the amount of markup as white borrowers. The auto lenders agreed to settlements in which they paid over $100 million in damages, and they agreed to limit the amount of additional interest dealers could add to the buy rate at 2-2.5%. While most lenders still impose these caps, the time limit on the settlement has expired. As such, there is no legal requirement for lenders to keep the caps in place.

The data from those lawsuits showed, however, that there was still discrimination occurring even under the agreed-to caps on dealer interest rate markup, just not at the same level as that above the caps.[3] The CFPB reviewed lender data to see whether discrimination against borrowers of color still exists under these caps, which led to the 2013 guidance warning lenders of potential liability under ECOA and the resulting attempts to stop the resulting enforcement actions.

Indeed, one of the documents the Committee released shows that the CFPB's attention to this issue is well warranted:

> *There is good reason to believe that stereotypes based on race and ethnicity play a role in dealer markup decisions. In a meeting with [name redacted] and me, the chief lobbyist for the [name redacted] suggested that auto dealers "size up" consumers in deciding how to approach the markup negotiation, and without skipping a beat noted that there are racial and ethnic differences in negotiation ability.*[4]

The report actually cites a portion this document, but fails to include this important point.

<u>The Report's Attack on the ECOA and Disparate Impact Analysis Does Not Reflect Prevailing Law.</u>

A large portion of the report is devoted to attacking the use of disparate impact analysis to enforce ECOA and the legal basis on which the CFPB relies. The report argues that the language and legislative history of ECOA do not provide the basis for the use of disparate impact. While the report acknowledges the long history of ECOA and its regulatory and judicial application, the report argues that the CFPB should disregard it in favor of the view espoused in a single federal court case. Legal and regulatory history shows that disparate impact analysis is widely and properly used in ECOA enforcement.

A considerable portion of the Majority staff report is devoted to criticizing the CFPB for using disparate impact analysis to enforce ECOA, arguing that neither the law nor legislative history provide for this approach. However, while some dislike the use of disparate impact, it has been widely used by courts and regulators for decades. And, as the report notes, the United States Supreme Court rejected a very similar challenge to its use in enforcing the Fair Housing Act.

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[3] Cohen, Mark A., *Imperfect Competition in Auto Lending: Subjective Markup, Racial Disparity, and Class Action Litigation,* Vanderbilt University, Dec 2006.

[4] http://financialservices.house.gov/UploadedFiles/April_2013_Draft_Memorandum_-_Choice_of_Estimation_Methods_for_Indirect_Auto_Lending_Markup_Disparities_Draft_2.pdf at 2.

ECOA was enacted in 1974 to ensure equal access to the credit markets.[5] In 2010, Congress transferred authority to enforce the provisions of ECOA to the CFPB from the Federal Reserve. Disparate impact uses statistical analysis to show that a particular group is negatively impacted by a particular policy or practice. Under ECOA, to prove disparate impact the CFPB must show that a particular practice or policy has a discriminatory effect on a protected class, that the practice or policy is the cause of the discrimination and that there is an available alternative that is less discriminatory and meets the business' need. A company can defend against disparate impact claims if the company can show that the practice or policy has a legitimate business justification and that the available alternative does not meet that need.[6] This balances the prevention of discrimination with the needs of companies. This approach has been used in a wide range of circumstances, including housing, employment and lending.

The Federal Reserve and other financial regulators have recognized the use of disparate impact under ECOA for decades.[7] The report uses a line of argument that many lenders have used in court cases – that the language in ECOA does not contain the exact language used in other statutes that permit the use of disparate impact. However, courts have repeatedly rejected this view.[8] Most recently, the United States Supreme Court considered an argument that disparate impact was not permitted in a challenge under the Fair Housing Act (FHA) in the case of *Texas Department of Housing and Community Affairs v. Inclusive Communities Project.*[9] The Court rejected these arguments, upholding the use of disparate impact under the FHA. Many of the arguments that are made in the report against the use of disparate impact under ECOA were raised in this disparate impact housing case. While, as the report notes, the lending industry still argues that this Supreme Court decision should not extend to ECOA, the report's reliance on a single federal court case shows the weakness of these arguments. The longstanding weight of law is even more on the side of upholding disparate impact in lending cases after the Supreme Court decision.

Another criticism of the report is the CFPB's use of proxies in its disparate impact analysis. Law enforcement has to be able to identify whether borrowers are part of a protected group in order to determine whether that group has been disproportionately impacted by a particular lending practice, policy or decision. Under Regulation B, which implements ECOA, creditors are prohibited from collecting certain information, including race, from individual borrowers. To determine whether borrowers are likely to be included in a protected group, law enforcement uses a statistical method in which certain

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[5] 15 U.S.C. 1691 et seq.

[6] 12 CFR Part 1002 Supp. I Sec. 1002.6(a)-2.

[7] See 12 CFR Part 1002 Supp. I Sec. 1002.6(a)-2. (Regulation B reference to legislative history reflecting effects test), Interagency Task Force on Fair Lending, *Policy Statement on Discrimination in Lending,* 59 Fed. Reg. 18,266 (Apr. 15, 1994) (online at www.occ.treas.gov/news-issuances/federal-register/94fr9214.pdf) (further reflecting Regulation B and legislative history supporting use of disparate impact and reflecting agreement of all bank regulators on that approach).

[8] See *Guerra v. GMAC LLC,* 2009 WL 449153 (E.D. Pa. Feb. 20, 2009) ("No court has applied Smith to find that disparate impact claims are not cognizable under the FHA or the ECOA. To the contrary, numerous courts have squarely rejected the argument set forth by Defendants here.), *Ramirez v. GreenPoint Mortgage Funding Inc.,* 2008 WL 2051018 (N.D. Cal. 2008), *Masudi v. Ford Motor Credit Co.,* 2008 WL 2944643 (E.D.N.Y 2008), *Zamudio v. HSBC North America Holdings, Inc.,* 2008 WL 517138 (N.D. Ill. 2008).

[9] 576 U. S. ____ (2015)

proxies are used. This analysis, referred to as proxy analysis, is not new. As the report notes, it has been used extensively in healthcare to determine disparities in care. More recently it has been used as a tool in financial services. In fact, financial services providers routinely use proxy analysis in their own internal fair lending testing.

The report mischaracterizes the CFPB's decision to use a particular proxy methodology, accusing the CFPB of using a "methodology it knew to be faulty and unreliable." In making this claim, the report seizes on a statement made in a draft CFPB document in which CFPB staff stated that some proprietary methods using non-public data could be more accurate than the CFPB's model, although those proprietary methods also have risk of errors. What the report ignores is that the CFPB already showed that its model is statistically valid. What the CFPB staff did in this memo is what we would hope every regulatory agency would do – explore different options, weigh them, and determine the best and most cost-effective path forward for all involved. The reason the CFPB chose its methodology is that it uses publicly available data obtainable at little to no cost. Alternative proprietary methods would not be available to many lenders or members of the public who could not afford to pay for them. While using proprietary data might, in some cases, improve the granularity of the data, it comes at a significant cost. The CFPB had already shown that its method is accurate and fair. Further, either method still shows discrimination in auto lending exists and causes many borrowers to pay unnecessarily higher interest rates, a point the report fails to acknowledge.

<u>The Report Inaccurately Describes the CFPB Settlements, Their Impact on Consumers, and Impact on the Market.</u>

The report argues that the CFPB actions are harmful to consumers and unfair to lenders. The record shows that the settlements promote a fairer and more transparent market, reduce discrimination, save borrowers money and provide a more competitive market. As noted above, more than two decades of court cases and enforcement actions show that borrowers of color pay higher interest rates due to car dealer interest rate markup. The CFPB/DOJ settlements and the CFPB's car lending guidance appropriately focus on preventing this discrimination. These settlements greatly reduce discrimination in auto lending and widely benefit borrowers by reducing their financing costs.

The Committee report selectively cites the CFPB materials to eliminate any mention of the benefits of the CFPB and DOJ enforcement approach. In fact, an examination of the full record shows that borrowers would benefit overall from the recent settlements. For example, the report cites a *Wall Street Journal* article on the CFPB's settlement with Honda Finance to support its' claim that the settlement could result in higher interest rates for consumers. As such, the report claims, the CFPB doesn't understand the market, because if the CFPB did it would not pursue this settlement. The next paragraph in that article, which is not included in the report, states:

> *For borrowers who are getting a lower dealer markup now compared with what they would have received before the change, the effect may be less significant or even result in cost savings. The*

> *new higher wholesale rate can also be reduced in some cases, including for borrowers who arrive at the dealership with a lower-rate loan from another lender.*[10]

In fact, a recent CRL analysis of the data included in the report the American Financial Services Association (AFSA) commissioned from Charles River Associates, (which the Committee staff report cites extensively) indicates that that a sizeable majority of car loan borrowers would save money under alternative auto loan pricing.[11]

The CFPB/DOJ settlements are likewise fair to auto lenders. Contrary to repeated statements in the report, the settlements do not mandate flat fees, and instead provide dealers with substantial continued pricing discretion. The report also does not mention that the CEO of a large, publicly-traded dealer group praised the CFPB and DOJ settlement with Honda as positive. According to *Automotive News*:

> *AutoNation Inc. CEO Mike Jackson has endorsed the settlement between the Consumer Financial Protection Bureau and American Honda Finance Corp. for preventing discrimination in auto finance, calling the agreement a "workable template" that other retailers and lenders should follow. "I think this is a very enlightened solution," Jackson told Automotive News. "This is a win-win-win."*[12]

Other Criticisms in the Report of the CFPB's Actions are Unsupported

In addition to the criticisms of the CFPB discussed above, the report makes numerous other attacks which, when analyzed, are without support.

First, the report spends considerable time attacking the CFPB for trying to limit markup through single enforcement actions. The report claims that requiring certain lenders to reduce the amount of interest rate markup allowed would put those lenders at a competitive disadvantage compared to other lenders who are not bound by that requirement. Later, the report attacks the CFPB for attempting to craft a settlement with multiple lenders that would be adopted across the whole market, creating a level playing field. This is a classic catch-22. According to the report, the Bureau is wrong for enforcing the law against individual lenders who are found to have violated the law because doing so would make those lenders less competitive in the market, and the CFPB is also wrong for pursing a broader enforcement action that would create an industry-wide standard and provide a level playing field for lenders and consumers.

Similarly, the report argues that since the CFPB legal staff discussed that it was possible that a court could rule against the CFPB's enforcement actions, the CFPB should have dropped the whole matter. Of course the CFPB staff identified possible arguments that the industry would likely raise and outlined potential outcomes and risks. The CFPB staff would have been irresponsible not to discuss them and

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[10] http://www.wsj.com/articles/crackdown-on-racial-bias-could-boost-drivers-costs-for-auto-loans-1441038864

[11] http://www.responsiblelending.org/other-consumer-loans/auto-financing/research-analysis/crl_flat_fee_savings_nov2015.pdf

[12] http://www.autonews.com/article/20150720/FINANCE_AND_INSURANCE/307209963/autonation-ceo-endorses-cfpb-honda-finance-pact

fully consider them before committing agency enforcement resources. The CFPB reasonably concluded that the harm caused by auto discrimination is substantial and outweighs the potential risks of enforcement. The CFPB reasonably concluded that efforts to address it are justified and worthwhile.

Finally, the report relies heavily on reports from lenders and lenders' associations fighting the CFPB enforcement actions. For example, it cites the Charles River Associates/AFSA study to suggest that the CFPB's analysis is flawed. AFSA is the trade association for a number of the largest indirect auto lenders in the country, including members under investigation by the CFPB and DOJ for discrimination. This is a group with a vested interest in discrediting the CFPB, not an unbiased source. Another source the report relies upon uses data submitted by an unnamed lender also under investigation -- again, a source with a vested interest in disputing the methodology the CFPB uses to determine discrimination. When neutral sources are examined, as shown above, the report's repackaged criticisms are unconvincing.

Conclusion

ECOA is a vital law that ensures all Americans are treated fairly in the credit markets. Discrimination has a long and persistent history in the car lending market. The data show it still exists today. As detailed above, the CFPB is appropriately enforcing ECOA in a way that reduces discrimination, widely benefits consumers and is fair to auto lenders.

Sincerely,

Chris Kukla
Senior Vice President