ally 440 S. Church St.
Charlotte, NC 28202

Confidential Treatment Requested
Supervisory Material Pursuant to 12 CFR § 1070.2(i)

February 11, 2013

Mr. Brian Kreiswirth
Counsel
Office of Fair Lending and Equal Opportunity
Consumer Financial Protection Bureau
[redacted]

Dear Mr. Kreiswirth:

Enclosed is the Response of Ally Financial Inc. and Ally Bank (collectively, "Ally") to the Proposed Action Response Requested letter dated January 15, 2013, addressed to Mr. Michael A. Carpenter and Ms. Barbara Yastine (the "PARR Letter").

Ally is committed to combating discrimination in all of its business activities. To paraphrase the mandate of the Office of Fair Lending and Equal Opportunity of the Consumer Financial Protection Bureau (respectively, the "Office" and "CFPB"), we seek to provide "fair, equitable, and nondiscriminatory access to credit." Consistent with the Equal Credit Opportunity Act ("ECOA"), we do not inquire about the race, color, religion, national origin or sex of an applicant in connection with extensions of credit for automobile purchases.

As we show in the Response, Ally has not violated ECOA, and, regardless of whether the CFPB accepts this proposition, an enforcement action should not be brought as a matter of public policy. We ask that, following your review of this Response, the Office re-assess the evidence, re-examine the legal theories that would support an enforcement action, and re-evaluate the policy implications of proceeding with a public enforcement action or referral to the DOJ. We submit that this reevaluation should lead to a decision not to take these actions.

We request the opportunity to meet with the Office and others at the CFPB to discuss this matter that is very significant for Ally, for the automotive finance industry, and, we trust, for the CFPB as well.

We are prepared to work with the Office to address fair lending concerns about indirect retail vehicle financing in the industry as a whole. Given the structure of the automobile purchase financing process that we describe in our Response, a single provider of automobile purchase financing has only limited, if any, ability to affect dealer behavior. As explained in the Response, despite these concerns and our firm belief that we have not violated ECOA, Ally has been working for some time to design a dealer monitoring and education initiative within our fair lending program that goes beyond our current capabilities. We welcome the opportunity to discuss this initiative further.

If you have any questions, please contact me at [redacted] or our counsel at [redacted]

Sincerely,

Daniel D. Soto
Chief Compliance Officer
Ally Financial Inc.

cc: Mr. Michael A. Carpenter
Ms. Barbara A. Yastine
[redacted]

Confidential Treatment Requested
Supervisory Material Pursuant to 12 CFR § 1070.2(i)

RESPONSE OF ALLY FINANCIAL INC. AND ALLY BANK TO JANUARY 15, 2013 LETTER

SUMMARY

Consumers negotiate the annual percentage rate ("APR") and other financing terms with a dealer, not with Ally, when financing their vehicle purchase through the dealer. Ally typically does not know the consumer's APR until after it has committed to take assignment of the financing contract. Nor does Ally know the racial or ethnic background of the consumer when it offers to take assignment of the contract. Dealers have numerous options in deciding whether to assign a contract to Ally in this very competitive business, and the dealer is not Ally's agent with respect to the consumer's financing.

Based on the facts, the CFPB cannot make out a *prima facie* "disparate impact" claim. There is no "specific policy or practice" adopted by Ally that should be recognized under the law as a predicate for a claim under ECOA. The "policy or practice" in question – the practice of acquiring retail installment sales contracts from vehicle dealers on mutually beneficial terms where the vehicle purchaser and the dealer separately negotiate an APR – is not a "policy or practice," much less a "specific" policy or practice. Rather, it is the essence of engaging in sales finance.

Nor is there sufficient evidence of a disparate impact on a protected group. The preliminary statistical analysis described in the PARR Letter is not sufficiently reliable, does not control for critical non-discriminatory explanatory factors, and does not assert large enough disparities to support such a claim.

As a matter of policy, an enforcement action or referral to the DOJ in this matter is not an appropriate way to address the CFPB's concerns about fair lending in retail vehicle financing.

Given the structure of this business, and the limitations on Ally's acquisition of information on the racial or ethnic backgrounds of the consumers who purchase their vehicles through dealer financing, Ally has only very limited unilateral ability to identify and monitor dealers for possible discrimination.

Even though Ally has only limited ability to effectively identify and monitor dealers for possible discrimination, Ally is fully prepared to work with the CFPB in developing and implementing a dealer monitoring and education initiative.

DISCUSSION

I. The PARR Letter

The PARR Letter concerns Ally's business of purchasing retail installment sales contracts ("RISCs"[1]) from vehicle dealers. As noted, the PARR Letter finds no fault with the prices that Ally pays the dealers for these contracts – the "Buy Rate" – or with our decisions to approve the purchase of the RISCs. Instead, the PARR Letter preliminarily concludes – relying on a statistical analysis of the "difference between each borrower's contract rate and Ally's buy rate" on approximately one million accounts – that in the portfolio as a whole there were racial or national origin disparities ranging from 14 to 29 basis points, separately set out for "subvented" (*i.e.*, subsidized by the manufacturer) and "non-subvented" contracts.[2]

The PARR Letter states that the analysis was performed using proxies for assigning customers to protected classes and control groups. The proxies, according to the PARR Letter,

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1 We use the term "retail installment sales contract," or "RISC," rather than "loan" to be consistent with the terminology used by state laws regulating such credit sales. Those state laws often explicitly recognize the business of purchasing and selling these instruments at prices agreed upon between the seller of the contract (here, the dealer), and the purchaser (here, Ally and its competitors). *See* footnote 10.

2 The examiners requested certain files for a "matched pair" review, but we have not seen the results of the review. The results are also not referenced in the PARR Letter. Accordingly, we do not discuss the "matched pair review" in this response.

were constructed using both geographical and surname coding. Direct information concerning racial and national origin background is not collected by Ally and was unavailable to the CFPB.

The PARR Letter states that "[i]n general, the only limitation that Ally imposes on dealer markup is capping the maximum [APR] amount" above the Buy Rate that the dealers can negotiate with vehicle purchasers on RISCs that Ally buys. It also notes the CFPB considered other factors that can "directly" affect rate spreads[3] but alleged that the disparities "remained substantial."

The PARR Letter attributes the racial and ethnic disparities in dealer rate spreads to "a combination of Ally's policies and practices, including Ally's policy of allowing automotive dealers to mark up Ally's risk-based Buy Rate and compensating them for those rate spreads, as well as the limited nature of Ally's controls and monitoring."

The PARR Letter does not include a detailed legal analysis. However, the "policies and practices" cited as the reasons for the disparities are facially neutral, and there is no allegation of a discriminatory intent on the part of Ally. Accordingly, we read the PARR Letter as basing the asserted violation on a "disparate impact" theory, rather than on any preliminary finding of overt discrimination or discriminatory treatment, as described in CFPB Bulletin 2012-04 (Fair Lending), April 18, 2012.[4]

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3 Ally's understanding based on the November 7 Preliminary Examination Exit Meeting is that the "other factors" controlled for only (i) whether the term (*i.e.*, length) of the RISC was greater than 60 months, or 60 months or less and (ii) the effect of a two percentage point cap in dealer markup for RISCs in the two lowest of Ally's six creditworthiness tiers, rather than the two and a half percentage point cap that would otherwise apply to RISCs with terms of 60 months or less.

4 Please let us know promptly if our understanding of the underlying legal theory is incorrect so that we may appropriately supplement this response.

II. Retail Automotive Financing Through Dealers

Ally is among the largest providers of new and used retail automotive financing in the United States. Our competitors include large and small banks, credit unions, captive manufacturer-owned financing subsidiaries, and other financial institutions, operating within local markets and nationally.[5] We understand the dealer financing steps described below are similar for our competitors.

Installment Sales by Dealers: Many purchasers of new and used vehicles finance the acquisition on an installment sale basis through their dealer. They do so by entering into RISCs with dealers. The dealer agrees to sell a vehicle to the consumer, and the consumer agrees to pay some or all of the price to the dealer in installments over time, with finance charges. The retail buyer thus contracts for the financing with the dealer.[6] Typically, the dealer negotiates the credit terms with the vehicle purchaser, including the amount to be financed, APR, the length of the RISC, and the monthly payment schedule. These credit terms, as negotiated between the dealer and purchaser, are reflected in a RISC between those two parties. The APR to which the vehicle purchaser agrees is called the "Contract Rate." Ally is not a party to any RISC and does not deal with the retail buyer during the application or the contracting process.

Assignees of RISCs: The dealer generally will submit a credit application to multiple financial institutions who are prospective assignees of the RISC, soliciting whether they would purchase a RISC entered into between the dealer and the vehicle purchaser. This process can begin either before or after the buyer and dealer have entered into a RISC.

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5 *Ally Financial, Inc. 2011 10-K* at 2, available at http://www.sec.gov/Archives/edgar/data/40729/000004072912000011/gjm20111231l0k.htm.

6 *See* Federal Trade Commission, "Understanding Vehicle Financing," http://www.consumer.ftc.gov/articles/0056-understanding-vehicle-financing.

After receiving a completed application from a dealer, the prospective assignee decides whether it is willing to purchase from the dealer a RISC executed or to be executed by the retail buyer. Once the prospective assignee has completed its evaluation of the application, it informs the dealer whether or not it would be willing to purchase the RISC and, if it is willing to do so, at what price. The dealer sells the RISC to the assignee of its choice. The dealer has a strong incentive to sell to the financial institution with the lowest Buy Rate. Ally books an average of approximately [redacted] out of every [redacted] RISCs that it approves, including both subvented and non-subvented (non-subsidized) contracts.[7] Ally does not have access to information on either the Buy Rates or the Contract Rates for individual transactions that the dealer assigns to other financial institutions.

If the Buy Rate (the rate at which Ally is willing to take assignment) is less than the Contract Rate (the APR that the customer pays), the RISC is sold at a discount and the dealer receives from the assignee the portion of the finance charge attributable to the difference (as described in more detail below) as a component of the purchase price for the RISC. Alternatively, if the Buy Rate is greater than the Contract Rate, the dealer will not be able to sell the RISC unless it pays the assignee an amount equal to the portion of the finance charge attributable to the negative rate spread. In either case, the assignee usually does not become aware of the Contract Rate until after the dealer and the buyer of the vehicle have already entered into the RISC, with the buyer agreeing to pay the Contract Rate. Ally currently declines to purchase RISCs if [redacted]

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7 This ratio may be derived from data provided to the CFPB during the examination.

Dealers typically submit a credit application to several prospective assignees and often receive responses from them prior to entering into a RISC. In a material percentage of transactions, however, the dealer will enter into a RISC and deliver the subject vehicle to the retail buyer prior to receiving responses from prospective assignees. The resulting scenario is commonly referred to as a "spot delivery." In many of those cases, the consumer will have entered into the RISC at a particular Contract Rate (and been permitted to drive the vehicle off the lot) before the dealer and a financial institution have agreed upon a Buy Rate.[8]

Regardless of the relative timing of the consumer's execution of the RISC and its assignment to Ally, there are two distinct arms-length negotiations that occur – the "retail" financing transaction between the vehicle purchaser and the dealer, and the sale of the resulting financial asset from the dealer to a financial institution, such as Ally.

Notably, the RISCs that Ally purchases specifically disclose two important items: the consumer is told that the APR is negotiable with the dealer, and also informed that the dealer may assign the RISC and retain some of the finance charge that the customer agrees to pay – *i.e.*, the dealer earns revenue on the financing portion of the transaction.

Ally Makes Underwriting and Pricing Decisions Without Knowledge of the Vehicle Purchaser's Race and National Origin: Prospective assignees of RISCs do not see, or even deal directly with, the vehicle purchaser who is applying for credit.[9] Only the dealer interacts directly with the vehicle purchaser, and, because of that personal contact, is in a position to know the person's race and other protected classifications.

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8 In some of those cases, the dealer may have the right to cancel the installment sale if the RISC cannot be assigned at a satisfactory Buy Rate.

9 In limited circumstances, Ally will interview certain applicants just prior to contract booking (*i.e.*, after approving or conditioning the application) for fraud mitigation purposes, but at no time are the applicant's personal characteristics (*e.g.*, race, national origin, etc.) requested or discussed.

Additionally, Regulation B generally prohibits Ally, and the dealer with whom the buyer contracts, from collecting information about the race, color, religion, national origin or sex of an applicant for credit. 12 C.F.R. § 1002.5(b). Therefore, Ally generally is not in a position to know and legally may not ask about the vehicle purchaser's race or national origin.

Dealer Compensation: Ally's agreements with dealers specify the financial arrangements concerning the disposition of the revenue from the dealer rate spread. In one standard form alternative, [redacted] We understand that these arrangements are similar to the arrangements that most dealers have with other financial institutions.

III. Legal and Factual Issues

A. Ally Has Not Violated ECOA

To establish a *prima facie* case for a disparate impact claim, the CFPB must: (1) identify a specific policy or practice adopted by Ally; (2) demonstrate a disparate impact on a prohibited basis; and (3) show a causal relationship between the challenged practice and the alleged disparate impact.[10]

1. The PARR Letter Does Not Cite Any Policies or Practices That Constitute a Basis for a Disparate Impact Claim

The Office has not identified a specific Ally *policy or practice* that would support a disparate impact claim. Instead, the PARR Letter states that "allowing" independent, unaffiliated dealers to exercise "subjective decision-making authority" with respect to negotiating dealer rate spreads resulted in statistically significant racial and national origin disparities. This is not a specific "policy or practice," but a decades-old industrywide business model engrained in the fabric of commercial law.

At its core, the sales finance business – the business of acquiring RISCs from retail sellers – relies on buying RISCs at a discount. Indeed, the ability of a sales finance company to purchase RISCs from dealers on mutually agreeable terms is a fundamental aspect of the law governing retail installment sales financing.[11] An attempt to characterize the acquisition of RISCs at a discount as a "policy or practice" of the assignee would be wholly inappropriate, because acquiring RISCs at a discount is the very essence of the automotive sales finance business. Ally's conduct of this statutorily authorized line of business cannot alone serve as the

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10 *See Smith* v. *City of Jackson*, 544 U.S. 228, 241 (2005).

11 *See, e.g.*, N.Y. Banking Law § 491(7) (defining a "sales finance company," in relevant part, as "a person engaged . . . in the business of purchasing or otherwise acquiring retail installment contracts . . . made by and between other parties."). There is nothing suspect in dealers negotiating higher APRs with purchasers than the finance company is willing to offer. *Anderson* v. *GMAC*, 476 F. Supp. 2d 624, 626 (N.D. Miss. 2007), *aff'd mem.*, No. 07-60288, 269 F. App'x 452 (5th Cir. Mar. 11, 2008) (per curiam).

foundation of a cognizable disparate impact claim – a plaintiff must identify a *specific* policy or practice to allege a successful claim.[12]

This asserted "policy or practice" has no effect, discriminatory or otherwise, absent intervening conduct by independent dealers. What the PARR Letter cites is not a "policy or practice," much less a *specific* policy or practice. The PARR Letter stretches the term beyond its permissible meaning by arguing that a failure to take certain actions regarding what an independent counterparty is permitted to do is a "policy or practice."

Indeed, the alleged discrimination does not arise from direct application of the alleged "policy or practice," unlike an employment test in a Title VII employment discrimination matter, for example. It appears that the gravamen of the claim is that Ally simply should be liable for possible discriminatory conduct on the part of an especially hard-to-identify subset of the more than 10,000 dealers from whom it purchases RISCs. If that is the case, then the Office would be advancing indirectly a claim that Ally has a "non-delegable duty" or is otherwise vicariously liable for alleged discrimination by the dealers from which Ally purchases RISCs. The United States Supreme Court held, however, in *Meyer* v. *Holley* that, absent an expression of contrary intent by Congress, whether a person may be held liable for the violations of another in a discrimination matter is governed by ordinary agency principles,[13] and it is well-established that

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12 *See, e.g.*, *Wal-Mart Stores, Inc.* v. *Dukes*, 131 S. Ct. 2541, 2554 (June 20, 2011) ("The only corporate policy that the plaintiffs' evidence convincingly establishes is Wal–Mart's 'policy' of allowing discretion by local supervisors over employment matters."); *see also Barrett* v. *Option One Mortg. Corp.*, No. 08-10157, 2012 WL 4076465 (D. Mass. Sept. 18, 2012) (decertifying a plaintiff class alleging a discretionary pricing claim based on a disparate impact theory because "plaintiffs do not allege any specific common practice that the brokers used in exercising that discretion").

13 *Meyer* v. *Holley*, 537 U.S. 280, 286 (2003) ("And Congress' silence, while permitting an inference that Congress intended to apply *ordinary* background tort principles, cannot show that it intended to apply an unusual modification of those rules.").

the dealers from whom Ally purchases RISCs are not its agents.[14] The Supreme Court has also expressly rejected any such "non-delegable duty" doctrine, absent express statutory language, which ECOA lacks.[15]

Nor does the PARR Letter allege that Ally may be held liable for any possible acts of discrimination by dealers. Ally is only a "creditor" under Regulation B, to the extent of making a credit decision that offers to take assignment of a RISC at the Buy Rate. Regulation B's "multiple creditor" liability rule states that, "[a] person is not a creditor regarding any violation of the Act or this regulation committed by another creditor unless *the person knew or had reasonable notice of the act, policy, or practice that constituted the violation* before becoming involved in the credit transaction."[16]

Ally has neither knowledge, nor reasonable notice, of any such discriminatory acts or practices by the individual dealers who sell it RISCs. In fact, it is impossible for Ally to determine definitively in any particular transaction at the time it commits to offer the Buy Rate what APR the dealer and the consumer would agree upon.

The PARR Letter also asserts that Ally has insufficient controls (presumably referring to a dealer monitoring program that ideally would result in a reduction of racial or ethnic dealer rate spread disparities to zero), and that this constitutes a specific "policy or practice." Yet, this is

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[14] *See Coleman* v. *GMAC*, 220 F.R.D. 64, 93 (M.D. Tenn. 2004) ("[C]ourts are nearly universal in finding that auto dealers are not agents of auto financing companies, even given evidence almost identical to the evidence proposed by the plaintiffs in this case.") (collecting cases).

[15] *See Meyer*, 537 U.S. at 289-90.

[16] 12 C.F.R. § 1002.2(*l*) (emphasis added). We understand that some unreviewed district court decisions have held otherwise with respect to the multiple creditor rule, because of language in section 1002(*l*) that assignees who participate in credit decisions are "creditors." *E.g., Jones* v. *Ford Motor Credit*, 2002 U.S. Dist. LEXIS 1098 (S.D.N.Y.). We respectfully submit that those decisions, issued at preliminary stages of litigation and without detailed explication, were wrongly decided and should not be followed.

just another way of arguing for vicarious liability, because neither ECOA nor Regulation B requires financial institutions to institute such monitoring programs. Indeed, the prohibition on collection of racial and ethnic information would seem to indicate regulators' discomfort with such a regime.[17] Congress could have added such a requirement to ECOA, as it has done with other laws that financial institutions must follow, such as anti-money laundering requirements.[18] But Congress did not do so, so it would be anomalous to create an implied statutory requirement that a financial institution that purchases RISCs have a dealer monitoring program. Refraining from an action that is not required by statute or regulation should not be considered a "policy or practice" sufficient to state a cognizable disparate impact claim. Moreover, as explained below, it will be difficult to construct a dealer monitoring "control" that is effective and practicable, as well as consistent with ECOA's mandate that Ally not collect information about an applicant's race or national origin.

A failure to establish a monitoring requirement as the essence of a disparate impact claim is particularly problematic, if not dubious. There is no basis on which a court could determine, in the absence of generally applicable regulation or published regulatory guidance, whether a dealer monitoring program is sufficient so that it is no longer a prohibited "policy or practice."

In short, the PARR Letter does not identify a *specific* policy or practice that can serve as the basis for a disparate impact claim.

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17 *See* Testimony of Sandra Braunstein, Director, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System before the Subcommittee on Oversight and Investigations, Committee on Financial Services, House of Representatives, July 17, 2008, *available at* http://democrats.financialservices.house.gov/hearing110/braunstein071608.pdf.

18 *See* 12 U.S.C. 1818(s) (requiring banking regulators to issue regulations to ensure financial institutions establish and maintain procedures reasonably designed to assure and monitor compliance with anti-money laundering requirements).

2. The Office's Preliminary Statistical Analysis Significantly Overstates Disparities by Omitting Explanatory Factors and Not Assessing Other Sources of Error

In addition to not properly identifying a specific policy or practice as the predicate for a disparate impact claim, the preliminary analysis described in the PARR Letter does not set forth a statistical analysis that is robust enough to support a disparate impact claim under ECOA. We have not yet had an opportunity to review the details of the regression analysis that the Office has prepared, so our critique is necessarily preliminary. However, based on our understanding of the Office's analysis, and our efforts to replicate the structure of that analysis, the analysis was unduly restrictive in scope, and the Office, in interpreting the results, neither considered important limitations nor accounted for sources of error and exaggeration.[19]

The PARR Letter states that the Office's analysis results in:

- Statistically significant disparities in rate spreads of 29 basis points on average between similarly situated African-Americans and Non-Hispanic Whites on non-subvented transactions;
- Statistically significant disparities in rate spreads of 20 basis points on average between similarly situated Hispanics and Non-Hispanic Whites on non-subvented transactions; and
- Statistically significant disparities in rate spreads of 21 basis points on average between similarly situated Asian/Pacific Islanders and Non-Hispanic Whites on non-subvented transactions.[20]

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[19] We welcome the opportunity to review the Office's analysis in more detail, if this matter proceeds further.

[20] The PARR Letter also represents that there were statistically significant, though smaller, disparities on subvented financing. Ally carries out numerous subvented programs under contract to manufacturers. The financing subsidies in those programs vary considerably, as do other requirements of the programs. These aspects of the program, by their nature, have significant effects on dealer and vehicle purchaser behavior. We do not believe that the Office considered these myriad differences in its regression analysis. During the examination, we offered to brief the examination team on the operation of subvented programs. The examiners did not accept the offer. We renew that offer so that the examination team may have a better understanding of the intricacies of analyzing subvented RISC programs. We submit that the results of a regression analysis of disparities in dealer spreads in subvented programs almost certainly include even more significant omissions of non-discriminatory explanatory factors than the analysis of non-subvented RISCs that we point out in this response.

As described in detail below and in the accompanying exhibits, a statistical analysis that includes quantifiable factors that explain non-discriminatory reasons for observed disparities reduces the disparities to one-third or less of those set forth in the PARR Letter. Beyond the inflation in disparities that we can quantify, there is additional inherent error in the analysis because of the use of proxies in the absence of positive identification of racial and national origin groups. The validity of the analysis is further reduced by the structure of the indirect vehicle financing business industrywide: the Office's preliminary analysis has not accounted (and probably cannot account) for the impact of the fact that Ally books only a fraction of any individual dealer's RISCs, thereby creating a distorted perception of the disparities in a single dealer's RISCs. Nor does the model account for the totality of the consumer's purchase transaction – the interplay among profit on the vehicle, any profit in connection with a trade-in by the purchaser at the time of a vehicle purchase, and the revenue the dealer gains from the dealer rate spread in the financing transactions.

As discussed, the legal theory of violation set forth in the PARR Letter is not viable. In any event, we do not believe that the size of the 14 to 29 basis point disparities, themselves, are sufficiently large to make out a *prima facie* ECOA disparate impact claim. But, even if the results of the preliminary analysis could support taking action, the Office must consider the significant explanatory factors and other limitations described below.[21] When these factors are considered (even if the Office recognizes the validity of only some of our critiques), the Office

[21] *Radue* v. *Kimberly-Clark Corp.*, 219 F.3d 612, 616-617 (7th Cir. 2000) ("'Statistical evidence which fails to properly take into account nondiscriminatory explanations does not permit an inference' of discrimination," *quoting from Furr* v. *Seagate Tech., Inc.*, 82 F.3d 980, 987 (10th Cir. 1996)).

should conclude that there is an insufficient factual basis to support an enforcement action by the CFPB or referral of the matter to the DOJ.

a. Quantifiable Adjustments

Exhibit A sets forth an illustrative regression specification containing several additional, non-discriminatory explanatory factors regarding the rate spread.[22] Each of these factors is a component of the purchase and financing transaction that could logically be expected to affect the size of the rate spread that the dealer and vehicle purchaser agreed upon. Based on this relatively simple regression analysis, the alleged disparities are reduced from the 29 basis point disparity observed for African-Americans in the Office's preliminary analysis to approximately nine basis points, and from 20 basis points for Hispanics[23] to approximately five basis points. For Asian/Pacific Islanders, the disparity is reduced from 20 basis points to approximately 11 basis points. Two of these factors bear further discussion:

i. Creditworthiness

There is a relationship between credit score and dealer rate spread that is likely based on the increased effort required by dealers to sell RISCs where an applicant has lower than average credit, as well as the relative ability of applicants with lower credit to obtain alternative, less expensive sources of financing. Industry data shows that the higher the credit score, the lower the average dealer rate spread (except for the lowest credit score category):

[22] These specifications are illustrative of factors that demonstrate that the Office should have considered other available explanatory variables, but they are not necessarily comprehensive. As described below, just a few of these factors significantly reduce the asserted disparities. With additional analysis, we may be able to refine or supplement these factors.

[23] Our analysis produces an unadjusted disparity for Hispanics that is somewhat lower than the 20 basis point amount reflected in the PARR Letter. Should the Office decide to proceed further, we request the opportunity to review the details of the analysis that the Office performed.

TABLE A

Variation in Rate Spread Industry-Wide Based on Credit Score	
Credit Score	*Average Rate Spread*
800-999	0.56%
740-799	0.58%
700-739	0.71%
680-699	0.80%
660-679	0.87%
640-659	0.91%
620-639	0.96%
600-619	1.01%
550-599	1.03%
0-549	0.98%
Source: Power Information Network® Data, April 2011 - March 2012, Industry, New, All Terms, No Buy Rate Filters (*i.e.*, includes subvented transactions); Experian ScoreEx Plus^{sm} data.	

Regardless of the precise cause, this data shows that rate spread, in fact, does vary based on a customer's creditworthiness (regardless of race or national origin), which is consistent with the illustrative regression that Ally has offered. In our model, it appears that this non-discriminatory factor alone – creditworthiness of the borrower, as measured by credit tier and credit score – explains a substantial portion of the observed rate spread disparities, especially between the African-American and Hispanic groups, and the non-Hispanic White control group.

We respectfully submit that the failure of the preliminary analysis to control for creditworthiness in the preliminary analysis cited in the PARR Letter significantly undermines the credibility of the analysis.

ii. Dealer-by-Dealer Rate Spread Variations

Our model also controlled for whether the particular dealer generally negotiates high, medium, or low rate spreads in the RISCs sold to Ally across all of the dealer's customers. Table

B is a simplified illustration of the potential exaggeration caused by looking only at Ally's portfolio as a whole, without controlling for the dealer's overall rate spreads. The reason for the exaggeration is that protected groups may patronize higher rate spread dealerships in higher proportions than they patronize dealerships with lower rate spreads. In such a situation, if the assignee's portfolio is analyzed in the aggregate (combining the variations *among* different dealers), then such an analysis would show, falsely, that minority applicants receive less favorable rates *even though minority and non-minority applicants ultimately negotiate exactly the same rates* with the particular dealer from whom they choose to purchase a vehicle.

TABLE B
Hypothetical Illustration of Distortion from Failing to Control for Average Rate Spread by Dealers

Scenario Assumptions:

	Uniform Rate Spread[24]	*Probability that the Dealer Customer Is a Minority Customer*	*Dealer's RISCs by Assignee*
Dealer 1	1.00%	15%	100
Dealer 2	1.50%	25%	100

Perceived Differences Due to Inter-Dealer Variation:

	Number	*Observed Average Rate Spread*
Assignee Customers-Control Group	160 (85 from *Dealer 1* and 75 from *Dealer 2*)	1.23%
Assignee Customers-Minority Group	40 (15 from *Dealer 1* and 25 from *Dealer 2*)	1.31%
	Observed Difference Based on Assignee Analysis	0.08%
	Actual Difference in Dealer Treatment	0%

Our model results showed that controlling for this non-discriminatory explanatory factor appears to explain a substantial portion of the disparities. In other words, a substantial portion of Ally's rate spread differences may be the result of differences in average pricing *among* dealers, rather than differences in prices negotiated by customers of a *particular* dealer. This criticism of

24 Note that the assumed rate spread negotiated between the dealer and its customer is the same for all customers regardless of whether they are minority or non-minority customers.

portfolio-wide analysis has similarly been noted in connection with fair lending analyses of mortgage brokers.[25]

b. Qualitative Limitations

There are several other factors which are not readily susceptible to quantification that introduce error into the Office's statistical analysis. Taking into account error of this sort is especially important, because the alleged disparities between groups have already been substantially explained by non-discriminatory factors (reduced by two-thirds for African-Americans and Hispanics, and by one-half for Asian/Pacific Islanders to nine, five and 11 basis points, respectively). The unaccounted for potential for error stems from several sources:

i. The Use of Proxies to Assign Purchasers to Groups Introduces Error

The PARR Letter acknowledges that Ally does not know or collect data regarding the race or national origin of the vehicle buyer. The PARR Letter cites two journal articles concerning the use of proxies, substituting surnames and census tract data for direct information about racial or national origin classification. Neither of the articles asserts that the proxy methods set forth produce classifications that are nearly as reliable as direct information (such as

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25 *See* Longhofer & Calem, *Mortgage Brokers and Fair Lending*, Economic Commentary, Federal Reserve Bank of Cleveland, 2 (May 15, 1999) ("'Cross-broker disparities' result when minority borrowers tend to apply at brokers that charge higher fees, while white borrowers tend to apply at brokers that charge lower fees; despite this difference in pricing across brokers, however, no individual broker actually treats its own minority and white customers differently. In order to hold lenders accountable for cross-broker disparities, regulators would need to prove that the cause of the disparity was differential treatment of borrowers based on their race, and not cost or other legitimate factors. This would be very difficult. Indeed, there are many conceivable reasons why individual brokers might charge more or less for their services than other brokers and why some brokers specialize in lending to a particular segment of their community. For example, a cross-broker disparity might be observed if higher-fee brokers provide a fuller array of services, such as spending more time with customers, and minority borrowers tend to prefer these brokers. As a result, we argue that regulators should not view cross-broker disparities on their own as evidence of illegal discrimination."), *available at* http://www.clevelandfed.org/Research/commentary/1999/0515.pdf.

would be the case with Home Mortgage Disclosure Act data). Both acknowledge error in relying on proxies. The preliminary analysis cited in the PARR Letter does not take into account or otherwise correct for this inevitable error. Indeed, the "potential for error" in examiners relying on name or geographic coding in non-mortgage fair lending examinations has been specifically acknowledged by the Government Accountability Office.[26] The Office should acknowledge this potential for error when evaluating the results.

ii. Variation in RISCs That Dealers Offer to Ally Introduces Error

In addition to variation among dealers, the Office's preliminary analysis does not (and cannot) consider variation in the RISCs that dealers choose to offer to Ally. Dealers do not simply offer Ally a random sample of their RISCs such that Ally's portion is representative of the whole. Rather, dealers determine where Ally is most competitive relative to other RISC purchasers and sell RISCs to Ally where it is making the best offer for those RISCs.

As Longhofer and Calem explain with respect to the analogous problem with mortgage brokers,[27] "because an individual broker typically deals with multiple lenders, the loans the broker sends to any one lender may not be representative of the broker's overall activity . . . Thus, while the data from a given lender may indicate a within-broker disparity, the broker's total activity may show no evidence of discrimination."[28]

Ally (and the CFPB, as far as we know) only has data for the fraction of contracts that we purchase from a particular dealer. We do not have data that would permit a calculation of any

26 Testimony of Orice M. Williams, Director Financial Markets and Community Investment, Government Accountability Office, before the Subcommittee on Oversight and Investigations, Committee on Financial Services, House of Representatives, July 17, 2008 at 9, *available at* http://democrats.financialservices.house.gov/hearing110/williams071708.pdf.

27 Unlike a mortgage loan, a retail installment sale transaction is a sale made by a retailer of its own asset (the vehicle) on a deferred payment basis. Its terms therefore are influenced by both sale considerations and financing considerations.

28 *Mortgage Brokers and Fair Lending, supra* n. 26.

one dealer's overall rate spread disparity between protected groups and the control group. Without that information, the results of the preliminary analysis should be viewed with even more caution.

iii. The Vehicle Purchase Transaction as a Whole Introduces Error

The preliminary analysis does not account for the fact that the revenue generated by the rate spread is only one component of the profit that the dealer may achieve with respect to the entire transaction. For example, the following aspects of a retail installment sale transaction may affect its profitability:

- The cash sale price of the vehicle relative to its acquisition cost to the dealer (including any "hold back");[29]
- The trade-in value assigned to a trade-in vehicle relative to the price that the dealer is likely to receive for the sale of the trade-in vehicle;
- The price at which the dealer sells ancillary products and services, such as insurance or GAP protection, as part of the transaction (the dealer typically receives a commission or otherwise derives revenue from the sale of such products and services); and
- The finance income that the dealer derives from the sale of the RISC.

Because the vehicle sale price, the trade-in value, the sale of any ancillary products and services and the vehicle financing are component parts of a single transaction, the dealer rate spread should not be analyzed in isolation. It is not and cannot be properly considered on an individualized basis in light of the multi-faceted dynamics of the particular transaction in question.

iv. R-Squared Issues

We do not have information about the R-squared value produced by the Office's regression analysis. A low value would require additional care in interpreting the results. Based

[29] A "hold back" is a percentage of the wholesale invoice amount that is reimbursed to the dealer by the manufacturer over a period of time. Another consideration is that more expensive vehicles often generate more profit for dealers than less expensive models.

on our own internal analysis, it would not be surprising if the R-squared in the Office's analysis was relatively low. In linear regression, the R-squared can be interpreted as the percentage of variation being explained by the model. This, in turn, suggests that there are many other factors, not necessarily captured in the Office's modeling approach, driving the actual rate spread found in a transaction. Therefore, the Office's modeling approach and results must be assessed with heightened caution for this reason as well.

While the results of the statistical analysis must be adjusted to include the quantifiable, relevant explanatory variables that we describe above, the qualitative factors are not susceptible to easy measurement. This means that such factors are not practically susceptible to regression analysis.

3. The Disparities Are Not Substantial or Reliable Enough to Support a Finding that There is a Causal Link Between the Alleged Policy or Practice and a Disparate Impact

Given the very large number of transactions that are analyzed in the model, the disparities that are labeled as technically statistically significant do not have sufficient practical or legal significance to support a violation. Courts and agencies are sensitive to this distinction.[30] Moreover, the error implicit in the analysis described above makes the statistical significance calculation misleading by implying a precision that does not exist.[31]

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30 *See, e.g.*, *Waisome* v. *Port Authority of New York and New Jersey*, 948 F.2d 1370, 1376 (2d Cir. 1991) (affirming the district court's finding of no disparate impact where the alleged disparity was statistically significant, but of "limited magnitude"). It is noteworthy that the Equal Employment Opportunity Commission has long used a practical significance standard in appropriate circumstances when evaluating disparate impact claims. *See* 29 C.F.R. § 1607.4.D (discussing the "four fifths" rule where selection rates for protected groups that are more than eighty percent of the rate for the group with the highest selection rate will generally not be regarded as evidence of adverse impact).

31 *Watson* v. *Fort Worth Bank & Trust*, 487 U.S. 977, 996 (1988) ("Nor are courts or defendants obliged to assume that plaintiffs' statistical evidence is reliable . . . Without attempting to catalog all the weaknesses that may be found in such evidence, we may note that

Indeed, the disparities cited in the PARR Letter (29 basis points or less on average) are not themselves substantial enough to base a claim of disparate impact discrimination – even assuming the viability of the legal theories asserted. The average customer APR for non-subvented RISCs in the transaction data provided to the CFPB is roughly [redacted]%.[32] A 29 basis point increase in the APR equates to a little less than one-twentieth (1/20th) of the average contract APR of [redacted]% and would equate to an increase of slightly more than three and a half dollars ($3.50) in the monthly payment of a RISC with an amount financed of $[redacted] Regardless of whether the disparities set out in the PARR Letter justify further action, with only the quantifiable explanatory factors described above added to the analysis, the disparity for African-Americans is reduced to approximately nine basis points, equating to roughly $1.06 in the monthly payments, five basis points for Hispanics, equating to roughly $0.57 per month and 11 basis points for Asian/Pacific Islanders, equating to roughly $1.27 per month. When the non-quantifiable error is considered, the likelihood that there is any true disparity may be reduced to the vanishing point.

When the disparities are as modest as they are here, quantifiable and non-quantifiable explanatory factors fully impeach the value of the statistical analysis as evidence of discrimination. In short, the "statistical evidence [is not] of a kind and degree sufficient to show that the practice in question has caused [the disparity] *because of* their membership in a protected group."[33]

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typical examples include small *or incomplete data sets* and inadequate statistical techniques") (emphasis added).

32 This approximate figure is for standard-rate RISCs acquired by Ally from April 2011 to March 2012, excluding recreational vehicle contracts.

33 *Watson*, 487 U.S. at 994 (applying Title VII in employment matters) (emphasis added).

4. Ally's Business Model Has a Legitimate Business Purpose

We have so far addressed the problems with the proposed legal basis for determining that there was a disparate impact violation, and the infirmities of the statistical analysis. Even if these fundamental problems are ignored, however, Ally's business model that results in dealers receiving a rate spread that the dealers negotiate with their customers serves a legitimate business purpose – a defense to a claim that policy or practice has an otherwise actionable disparate impact.

Ally currently declines to purchase RISCs if the Contract Rate exceeds the Buy Rate by two and a half percentage points or two percentage points in the case of, respectively, [redacted] payments or less, and [redacted] payments or more. It unilaterally cannot further reduce these rate spread limitations – applicable without regard to race, national origin or other protected class – without substantial risk to its business. Attempts to do so will simply cause dealers to offer their RISCs to Ally's competitors, rather than Ally.[34]

Indeed, past unilateral attempts to substantially restrict dealer finance income have met with failure. For example, a declaration submitted by Nissan Motor Acceptance Corporation ("NMAC") in connection with the *Cason* automotive ECOA rate spread litigation describes how Nissan dealers reacted to an attempt by NMAC to impose an innovative "Customer First Financing" program under which Nissan dealers received a specified percentage of the amount financed under RISCs that were written at the Buy Rate. (*See* J. French Decl. ¶¶ 8-12, Oct. 1, 2002, attached as Exhibit B.). Nissan dealers rejected this unilateral attempt to impose an

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[34] *See Smith* v. *Chrysler Fin. Co.*, 2004 WL 3201002, at *3 (D.N.J. Dec. 30, 2004) ("Additionally, Defendant argues that any injuries Plaintiffs may have suffered will not be redressed by injunctive relief because dealers are still permitted to sell retail finance contracts to buyers other than Defendant and will not change their conduct. This Court finds itself compelled to agree.") (internal citation omitted).

innovative restriction on their finance income, thereby causing an immediate and significant loss of business to NMAC when dealers began assigning their RISCs elsewhere. (French Decl. ¶ 13.). It became readily apparent to NMAC that it could not sustain its business operations under that program as initially conceived. NMAC thereupon modified the program to offer dealers a choice between the traditional dealer finance income practice of negotiating APRs and selling RISCs at a discount or receiving a flat fee in exchange for RISCs written at the Buy Rate. (French Decl. ¶¶ 14-15.). The overwhelming majority of dealers rejected the flat fee alternative, and NMAC eventually discontinued the program. (French Decl. ¶ 15-16 (asserting that, if NMAC were to again attempt to adopt a flat-rate pricing program, "NMAC's modest market share and its inability to dictate pricing terms to dealers would render any such change detrimental and potentially fatal to NMAC's operations.")).

Dealers sell their RISCs to the banks or other financial institutions that best serve their – i.e, the dealers' – business interests. Automotive sales finance companies compete vigorously for dealers' business on various bases, including service, dealer revenue opportunities, and ability to purchase RISCs in a manner that best helps the dealer achieve its sales goals. No single purchaser of RISCs can dictate significant restrictions on dealer finance income. Moreover, any attempt to do so would result in antitrust scrutiny.[35]

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[35] In *United States* v. *General Motors Corp.*, 121 F.2d 376 (7th Cir. 1941), GM and Ally (then known as GMAC and a GM affiliate) were held liable for policies designed, among other things, "to restrain and interfere with the right of General Motors dealers to finance cars sold by them in whatever manner they see fit." *Id.* at 383. That judgment mandated that "General Motors Corporation shall not enter into any contract or agreement with any dealer . . . which requires the dealer to observe any General Motors Acceptance Corporation plan or rate of financing [for] the purchase and sale of automobiles." *United States* v. *General Motors Corp.*, Civil No. 2177, 1952 Trade Cas. (CCH) ¶ 67,324, 1952 U.S. Dist. LEXIS 1932, at *6-7 (N.D. Ill. July 28, 1952), judgment terminated, 1983-2 Trade Cas. (CCH) ¶ 65,614, 1983 WL 1870 (N.D. Ill. Aug. 15, 1983) (order granting motion to terminate final judgment).

Further, while some have argued that only creditworthiness considerations may constitute a legitimate business justification, this position is directly at odds with existing regulatory guidance.[36] Accordingly, the profitability and, indeed, viability of Ally's retail auto finance business are legitimate business justifications that must be taken into consideration in connection with the adjudication of a disparate impact claim. Consequently, even if a *prima facie* case for disparate impact could be made, the defense of business justification would negate any finding of an ECOA violation.[37]

5. Courts Are Unlikely to Uphold Disparate Impact Claims Under ECOA

The CFPB has taken the position that the legal doctrine of disparate impact applies to ECOA.[38] Nevertheless, as the CFPB is no doubt aware, the viability of this theory of violation with respect to ECOA has been called into substantial question as a result of the Supreme Court's decision in *Smith*.

In *Smith*, the Supreme Court noted that when determining whether the Age Discrimination Employment Act of 1967 ("ADEA") supports a disparate impact claim, the primary question is whether the text of the statute "focuses on the *effects* of the action on the

36 *See, e.g.*, Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18266 (1994) ("When an Agency finds that a lender's policy or practice has a disparate impact, the next step is to seek to determine whether the policy or practice is justified by 'business necessity.' . . . Factors that may be relevant to the justification could include cost and profitability").

37 *Cf. Watson*, 487 U.S. at 999 ("In the context of subjective or discretionary employment decisions, the employer will often find it easier than in the case of standardized tests to produce evidence of a manifest relationship to the employment in question. It is self-evident that many jobs, for example those involving managerial responsibilities, require personal qualities that have never been considered amenable to standardized testing. *In evaluating claims that discretionary employment practices are insufficiently related to legitimate business purposes, it must be borne in mind that courts are generally less competent than employers to restructure business practices, and unless mandated to do so by Congress they should not attempt it.*") (internal quotation and citation omitted) (emphasis added).

38 CFPB Bulletin 2012-04 (Fair Lending) (Apr. 18, 2012).

[protected person] rather than the motivation for the action of the [defendant]." A plurality in *Smith* stated that while their opinion in *Griggs* v. *Duke Power Co.*[39] – the Supreme Court case that held that Title VII of the Civil Rights Act supported a disparate impact claim – "relied primarily on the purposes of [Title VII of the Civil Rights Act], buttressed by the fact that the [Equal Employment Opportunity Commission] had endorsed the same view, [the Supreme Court has] subsequently noted that [its] holding represented the better reading of the statutory text as well." *Smith* has called into question whether the Supreme Court would find that ECOA's language supports a disparate impact claim. The operative provision of ECOA (*i.e.*, "discriminate against . . . on the basis of") is very similar to the "first prong" of the operative provision of ADEA, but there is no "effects" language in ECOA as there is in ADEA. The U.S. Court of Appeals for the District of Columbia Circuit subsequently questioned whether ECOA supports a disparate impact claim in light of *Smith.*[40]

The recent experience with *Magner* v. *Gallagher* is instructive. That case involved a similar question as to whether the Fair Housing Act ("FHA") authorized disparate impact claims.[41] City officials in the City of St. Paul, Minnesota, after losing an argument in the Eighth Circuit that the FHA does not support a disparate impact claim in light of *Smith*, presented the Supreme Court with the issue.[42] The Supreme Court granted review and briefs were filed, including an amicus brief from the United States. Shortly before the Supreme Court was scheduled to hear arguments, the City of St. Paul withdrew its appeal on the stated rationale that

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39 401 U. S. 424 (1971).

40 *Garcia* v. *Johanns*, 444 F.3d 625, 633 n.9 (D.C. Cir. 2006) (noting that ECOA lacks the "effects" language that the plurality in *Smith* held was the basis for holding that ADEA supports a disparate impact claim).

41 The text of FHA has similar "to discriminate against . . . on the basis of race . . ." language as ECOA, and also lacks any "effects" language.

42 *Magner* v. *Gallagher*, 636 F.3d 380 (8th Cir. 2010).

"while Saint Paul likely would have won in the United States Supreme Court, a victory could substantially undermine important civil rights enforcement throughout the nation."[43] The City of St. Paul went on to note that "[t]he City of Saint Paul, national civil rights organizations, and legal scholars believe that, if Saint Paul prevails in the U.S. Supreme Court, such a result could completely eliminate 'disparate impact' civil rights enforcement, including under the Fair Housing Act and the Equal Credit Opportunity Act."[44]

We do not seek to litigate this important issue through our response to the PARR Letter, and thus will not elaborate on it at length at this time. We do note, however, that the substantial legal question as to whether the fundamental theory of violation is viable under ECOA is an added factor militating against the CFPB proceeding against Ally, particularly where, as we set out in this response, there are other very significant factual and legal weaknesses.

IV. As a Policy, Matter the CFPB Should Decide Not to Proceed by Enforcement Action or Referral to DOJ

Our arguments that Ally has not violated the law should not be taken as minimizing or dismissing the CFPB's concerns about fair lending in dealer retail vehicle financing. We respect the Office's mandate to promote "fair, equitable, and nondiscriminatory access to credit" and want to do our best to foster it. In our view, however, an enforcement action against Ally and referral to the DOJ is not the right way to proceed to address these concerns. Individual automotive finance companies, like Ally, have limited ability to police dealers in the absence of an industrywide solution – a solution that must make the dealers responsible for their own actions and provide an effective mechanism for regulatory oversight. As noted above, Ally's ability to change dealer behavior in a fashion that will prevent discrimination is circumscribed by

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43 Office of the Mayor, City of Saint Paul Seeks to Dismiss United States Supreme Court Case Magner vs. Gallagher (Feb. 10, 2012), http://www.stpaul.gov/index.aspx?NID=4874.

44 *Id.*

the structure of the industry. To avoid Ally's oversight, whether they discriminate or not, the dealers who sell RISCs to Ally would only need to stop doing business with Ally. They can transmit applications to other finance companies that have not yet (and may not ever) come under the scrutiny of the CFPB or other agencies. We have also pointed out that any dealer monitoring that we undertake will be highly difficult and uncertain to ensure that it will reliably and consistently identify discriminating dealers without falsely identifying dealers whose conduct is not discriminatory.

The policy question is how best to go about addressing these concerns. We note that the Federal Trade Commission, which has jurisdiction over auto dealers, has initiated a project to gather information on motor vehicle sales, finance, and leasing, including the role of dealer rate spreads in financing transactions. The Office has participated in that project.[45] Frankly, it seems ineffective to require individual financial institutions to police dealers through their purchase of RISCs, rather than direct regulation or enforcement by the agencies entrusted with that responsibility. We also note that an effective solution should be based on accurate information about the extent of discrimination industrywide. As we demonstrate, analysis of a single finance company's portfolio can (and we believe does) lead to misleading results. Currently, because of ECOA's prohibitions, reliable information is not readily available that would permit an accurate assessment of dealers' practices. Some thought should be given to the information-gathering issue, before consideration is given to bringing enforcement actions against automotive finance companies like ours who do not discriminate, but are being held accountable when some dealers with whom we do business are alleged to be discriminating.

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[45] http://www.ftc.gov/bcp/workshops/motorvehicles/.

In short, the perceived problem of dealer rate spread discrimination is an industrywide one, and is most appropriate for an industrywide assessment, bringing together industry participants and their regulators for a candid discussion to ascertain the significance of the issue and the best ways to address it without restricting the availability of automotive financing.

Nevertheless, we have been exploring how to implement a dealer monitoring and education program for some time. We have firmly decided to proceed, notwithstanding the concerns expressed above. We will be pleased to share these plans with the Office. We know that our program will have to be carefully thought out and implemented in stages, with lessons-learned applied as we proceed through each stage.

CONCLUSION

Ally believes firmly that it did not violate ECOA. For factual, legal, and policy reasons, the CFPB should not bring an enforcement action and should not refer the matter to DOJ. We reiterate our request for the opportunity to meet with the Office and others at the CFPB, to discuss the critical statistical analyses that we have outlined here, or to discuss more generally the issues discussed above. This matter is very significant for Ally, for the automotive finance industry, and, we trust, for the CFPB as well.

To the extent there are discrimination issues relating to dealer rate spreads, we reiterate that they should be addressed at the dealer level where any discriminatory conduct occurs, or otherwise on an industrywide basis. As noted above, Ally would be pleased to participate in any discussions concerning these issues with the CFPB and other regulators.

Exhibit A
Dealer Finance Income Regression Model[46]

Data Set and Model Construction[47]

Scope:

- Retail installment sale transactions within the [redacted] timeframe.

Exclusions:

- Subvented transactions
- RV transactions

Proxy Construction:[48]

- Presumed Hispanic Applicants – name-based proxy constructed using an 80% threshold relative to the percentage of people using the applicant's surname who are Hispanic (or white non-Hispanic in the case of the control group).
- Presumed African-American Applicants – geographic-based proxy constructed using an 80% threshold relative to the percentage of people who are African-American in the census tract to which the applicant's address is geocoded (or white non-Hispanic in the case of the control group).
- Presumed Asian/Pacific Islander Applicants – name-based proxy constructed using an 80% threshold relative to the percentage of people using the applicant's surname who are Asian (or white non-Hispanic in the case of the control group).

Model Construction:

The rate spread (*i.e.*, the customer's contract APR less Ally's Buy Rate) was regressed against the proxy variable described above and the following additional explanatory factors:

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46 As noted in the text of Ally's response, this model is intended to be demonstrative and is not necessarily the optimal regression specification for the issue at hand (to the extent that an accurate model is feasible in the first place). Indeed, Ally would characterize this regression specification as relatively simple, given the limited time to respond. Ally reserves the right to offer different and/or additional statistical results and critiques of the CFPB's statistical results as the parties' discussions continue and in the event of further supervisory action or an enforcement action.

47 In the interest of readability, Ally has omitted some technical details from this description (*e.g.*, Information Warehouse field names). If useful to the CFPB, Ally and the CFPB can further discuss the specifics of how this regression model was constructed.

48 Since the CFPB represented in the November 7 Preliminary Examination Exit Meeting that its results were not sensitive to the method of proxy construction, Ally opted to use relatively simple threshold-based proxies for this illustrative regression specification.

- The amount financed of the retail installment sales contract.
- The advance rate (*i.e.*, amount financed to wholesale collateral value for used or invoice for new).
- Indicators for whether the vehicle financed was (a) new or (b) used and the vehicle model year was (i) no more than two years older than the current model year, (ii) between three to five years older than the current model year and (iii) six or more years older than the current model year.
- Indicators for the Ally credit tier assigned (*i.e.*, S through E).
- Indicators for the applicant's credit bureau score by quartile, along with an indicator for missing credit bureau scores.
- Three indicators for instances where the contract date (i) was on the same day as the application date, (ii) was on a day prior to the application date or (iii) was on a day after the application date.
- An indicator for whether the term was greater than 60 months or 60 months or less.
- Indicators for the average rate spread of dealers (as determined by Primary Dealer Number ("PDN")) for contracts assigned to Ally in the data set for dealers where such average was less than 0.5 percentage points, greater than or equal to 0.5 percentage points, but less than 1.5 percentage points, and greater than or equal to 1.5 percentage points.

Regression Specification Results

Presumed Hispanic Applicants

Count of Presumed Control Group Applicants	386,798
Count of Presumed Hispanic Applicants	[redacted]
Coefficient of the Presumed Hispanic Proxy Variable	0.05016 percentage points
R-Squared for the Regression Model	0.1992

Presumed African-American Applicants

Count of Presumed Control Group Applicants	338,594
Count of Presumed African-American Applicants	[redacted]
Coefficient of the Presumed African-American Proxy Variable	0.0875 percentage points
R-Squared for the Regression Model	0.2090

Presumed Asian Applicants

Count of Presumed Control Group Applicants	386,798
Count of Presumed Asian Applicants	[redacted]
Coefficient of the Presumed Asian Proxy Variable	0.1054 percentage points
R-Squared for the Regression Model	0.2072

Exhibit B
Declaration of John French

Exhibits to Exhibit B Available Upon Request

**IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF TENNESSEE
AT NASHVILLE**

BETTY T. CASON, ROBERT F. CASON, DONALD SNEAD, WANDA SNEAD, STEPHANIE A. VAUGHN, CHAWNECY D. VAUGHN, MARY CHEATHAM, and CLYDE CHEATHAM on behalf of themselves and all others similarly situated	)	**No. 3-98-0223**
Plaintiffs,	)	**Judge Campbell** **Magistrate Griffin**
NISSAN MOTORS ACCEPTANCE CORPORATION	)	**Class Action**
Defendant.	)	

DECLARATION OF JOHN FRENCH

John French states as follows:

1. I am Vice President of Corporate Planning for Nissan Motor Acceptance Corporation ("NMAC").

2. From approximately 1990-1992, I was the Director of Marketing for NMAC. From approximately 1992-1995, I was the Vice President of Sales and Marketing for NMAC.

3. While I had responsibility for NMAC's marketing department, I was involved in the development and implementation of NMAC's marketing practices and policies that relate to the purchase of retail installment contracts from automobile dealers. A primary objective of the marketing department is to persuade dealers to sell retail installment contracts to NMAC under terms and conditions that are acceptable to NMAC.

4. While I had responsibility for NMAC's marketing department, the terms and pricing programs we offered to dealers were described in detail in Dealer Bulletins, or communications that were published through our marketing department to the dealers. The programs were changed often to meet both the demands of competition in the auto finance industry, and the competitive and marketing needs of Nissan North America when trying to market or encourage sales of particular vehicle models.

5. Nissan and Infiniti dealers have no contractual or other obligation to do any business with NMAC. NMAC competes with other finance companies, credit unions, and banks for the dealers' business.

6. While I had responsibility for NMAC's marketing department, NMAC routinely monitored the pricing structure of its rival banks and finance companies. Through its sales force – financial service managers who visit dealerships on a regular basis – NMAC gathered information from dealers, such as our competitor's dealer bulletins and rate sheets.

7. Yield-spread pricing is used to pay dealers for retail installment contracts, and is a pricing system based on the difference between two interest rates – the Annual Percentage Rate ("APR") on the retail installment contract, and the "buy rate" established by NMAC for a particular category of risk. The difference between the two rates is known as "markup". Our competitive analysis then showed that NMAC and NMAC's competitors all purchased contracts from dealers under a yield-spread pricing system, except for limited circumstances, such as discounted APR programs, where a flat fee would be paid in lieu of a yield spread.

8. In November, 1992, NMAC decided to radically transform the manner in which it purchased retail contracts from dealers. NMAC's experience was that the higher the markup, the greater the incidence of defaults and expense to NMAC.

9. To eliminate the undesirable aspects of yield-spread pricing, NMAC instituted a flat-rate pricing program known as Customer First Financing. The initial dealer bulletins outlining Customer First Financing are attached to this declaration as Exhibit 1.

10. To my knowledge, NMAC's Customer First Financing program was the first of its kind in the industry by any national captive finance company. I personally designed the program in consultation with the Nissan National Dealer Advisory Board. The program was not modeled on any of our competitors, but instead was intended to be a departure from business as usual, *i.e.*, yield-spread pricing.

11. Under the Customer First Financing Program, the APR and the buy rate were always the same rate. There was no markup paid to the dealer. Rather than calculating compensation on the basis of a yield-spread, dealers were paid for the assignment of contracts using a calculation that took into account the car buyer's credit tier, the amount financed, and the term of the contract. High volume dealers (those who met certain penetration targets as outlined in the bulletin) received additional compensation.

12. An example of the formula is set forth in Exhibit 1, using a car buyer whose credit score was in the "Gold" tier. If that car buyer financed a $15,000 purchase over 60 months, NMAC would pay a high volume dealer 4.00 % of the amount financed, or $600. A standard dealer would receive 2.5% of the amount financed, or $375.

13. The Customer First Financing program did not achieve the desired results due to negative dealer reaction. An article from the February 15, 1993 edition of *Automotive News* chronicling some of this negative reaction is attached to this declaration as Exhibit 2. That article may actually understate how negative the dealer reaction was to the Customer First Financing Program. The Nissan dealer body rejected the program, causing an immediate and

significant loss of business for NMAC. It was made readily apparent that NMAC could not sustain its business operations under such a program.

14. Given the dealers' rejection of the Customer First Financing program, on March 1, 1993, NMAC instituted a dual program for the purchase of contracts – the "APR Program" and the "Buy Rate Program." Basically, it gave dealers a choice between an offer by NMAC to purchase retail installment contracts on a flat rate system (the APR Program), or an offer to purchase retail installment contracts through a yield spread system (Buy Rate Program). The APR Program was a flat-rate pricing program that was essentially a continuation of Customer First Financing. The Buy Rate Program was a yield-spread pricing program. The initial dealer bulletins relating to these programs are attached as Exhibit 3.

15. Each month, dealers could elect to sell contracts to NMAC under one of the two pricing programs. The overwhelming majority of dealers continued to reject the flat-rate pricing program (the APR Program), and it was eventually discontinued in January 1995 as a failed program.

16. If NMAC were to adopt a flat-rate pricing program today, my opinion is that such a program would again be a failure. NMAC's rival banks and finance companies continue to offer yield-spread pricing options that provide flexibility to dealers when negotiating with

their customers that cannot be matched under a cost-effective flat-rate system. As in 1992 – 1993, NMAC's modest market share and its inability to dictate pricing terms to dealers would render any such change detrimental and potentially fatal to NMAC's operations.

Under 28 U.S.C. § 1746, I declare under penalty of perjury that the foregoing statements are true and correct to the best of my knowledge.

Dated: October 1, 2002

John A French

John French