Unsafe at Any Bureaucracy, Part III:
The CFPB's Vitiated Legal Case Against Auto-Lenders

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HON. JEB HENSARLING, CHAIRMAN

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Executive Summary

This is the third installment in a series of staff reports examining the Bureau of Consumer Financial Protection's (CFPB's) Equal Credit Opportunity Act (ECOA) enforcement actions against indirect auto financers. Part I showed, using internal CFPB documents, that the CFPB's ECOA actions against auto financers were knowingly premised on a suspect legal theory and a fundamentally flawed statistical methodology for estimating the race of borrowers. Part II showed, again using internal CFPB documents, that the CFPB's theory of liability for auto financers cannot meet the legal test for disparate impact.

Part III in this continuing series makes additional CFPB documents available to the public. These documents discuss the CFPB's disparate-impact methodology in more detail. They also reveal potential legal deficiencies in the issuance of the CFPB's major rule authorizing it to supervise the larger participants of the auto lending market.

Part III also demonstrates that under recent Supreme Court precedent, if the CFPB were to rely upon the legal theory it deployed in previous enforcement actions against auto financers, its claims would not survive judicial scrutiny.

Background

The original Staff Report entitled *Unsafe at Any Bureaucracy I* analyzed the questionable legal basis of the CFPB's disparate-impact enforcement of ECOA against indirect auto financers. Since the release of that report, judicial decisions, including by the U.S. Supreme Court, have further demonstrated the legal insufficiency of the CFPB's position. It is now apparent that the CFPB's auto-lending enforcement actions have been grounded in a fundamental misapplication of the law.

As set forth in detail in previous Committee Staff Reports, most auto dealers offer vehicle financing as a convenience to customers, some through indirect auto financers, sometimes called "indirect auto lenders,"[1] which are assignee creditors that may be banks, captive finance companies,[2] independent finance companies, or credit unions. Prospective car buyers can finance their car through the dealer if they wish. After negotiating the terms of the financing, they execute a contract known as a "Retail Installment Sale Contract" (RISC) that memorializes these terms.

Either before or after entering into a RISC with a car buyer, dealers solicit competitive bids from indirect auto financers to purchase the RISC.[3] Dealers are able to obtain a "wholesale" interest rate for the purchase of a RISC from indirect creditors because of the large volume of credit applications they originate and the origination costs they save for the creditors. Dealers try to maintain a retail margin to cover the costs of their origination operation and provide a return. The difference between the retail rate accepted by the buyer and the wholesale rate quoted by creditors to the dealer is known as "dealer participation" or "dealer reserve," and constitutes the dealer's retail margin.

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[1] CFPB documents describe these finance companies as "indirect auto *lenders*," although they are more appropriately described as creditors rather than lenders pursuant to state laws.

[2] Captive finance companies are subsidiaries whose purpose is to provide financing to customers buying the parent company's product.

[3] Purchasing the RISC means extending financing in exchange for the future income stream of finance payments made by the car buyer. The assignee becomes the owner of the RISC.

The CFPB brought a series of disparate-impact actions against auto finance companies, none of which have yet been challenged in a federal court, and several of which ended in negotiated agreements or public settlements. Disparate impact is a controversial legal theory of liability. Unlike a disparate treatment case, where a "plaintiff must establish that the defendant had a discriminatory intent or motive, a plaintiff bringing a disparate impact claim challenges practices that have a disproportionately adverse effect on minorities and are not otherwise justified by a legitimate rationale."[4] In other words, disparate impact theory states that a law or regulation may prohibit a practice that is discriminatory in effect because it has a disproportionately negative impact on a protected class, even if the defendant has no intent to discriminate and the practice appears neutral on its face. The CFPB has collected some $200 million in penalties that the public knows of from companies in disparate impact enforcement actions related to ECOA, without ever having to set foot in federal court.[5]

The CFPB has claimed that various indirect auto financers are legally liable for disparities in the dealer-participation on RISCs for minority borrowers relative to non-Hispanic white borrowers, despite the fact that auto-dealers (not financers) set their own dealer participation for each RISC they retail.[6] As examined in detail in the Staff Report entitled *Unsafe at Any Bureaucracy I*, the CFPB refused to consider these auto financers' showings that the purported disparities were in fact correlated to and caused by relevant

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[4] *Texas Dep't of Hous. and Comty. Affairs v. Inclusive Communities Project, Inc.*, 135 S.Ct. 2507, 2513 (2015) (quoting Ricci v. DeStefano, 557 U.S. 557, 577 (2009) (internal quotation marks omitted) (hereinafter "*Inclusive Communities*, Supreme Court"); *see also Unsafe at Any Bureaucracy*, at 8.

[5] *See* Consent Order, *In the Matter of Toyota Motor Credit Corporation*, No. 2016-CFPB-0002 (CFPB Feb. 2, 2016) *available at* http://files.consumerfinance.gov/f/201602_cfpb_consent-order-toyota-motor-credit-corporation.pdf ($21.9 million); *In the Matter of Fifth-Third*, No. 2015-CFPB-0024 (CFPB Sept. 28, 2015), *available at* http://files.consumerfinance.gov/f/201509_cfpb_consent-order-fifth-third-bank.pdf ($18 million); Consent Order, *In the Matter of American Honda Finance Corp.*, No. 2015-CFPB-0014 (CFPB Jul. 14, 2015), *available at* http://files.consumerfinance.gov/f/201507_cfpb_consent-order_honda.pdf ($24 million); Consent Order, *In the Matter of Ally Financial Inc.*, No. 2013-CFPB-0010 (CFPB 19 Dec., 2013), *available at* http://files.consumerfinance.gov/f/201312_cfpb_consent-order_ally.pdf ($80 million); CFPB, Supervisory Highlights, 4 (Summer 2014), http://files.consumerfinance.gov/f/201409_cfpb_supervisory-highlights_auto-lending_summer-2014.pdf ("[T]ogether with the DOJ, the Bureau took public enforcement action against Ally Financial Inc. and Ally Bank (collectively, Ally) in December 2013, requiring Ally to pay $80 million to address harm to about 235,000 borrowers. Supervisory resolutions with several other auto lenders will account for the remaining approximately $56 million. . . . ").

[6] Dealer participation is capped at a maximum of 175-250 basis points industry-wide.

characteristics of the RISCs' terms and circumstances and relevant borrower credit characteristics, not the race of the borrower.

Now, case law applying recent Supreme Court precedent has demonstrated again how weak the CFPB's legal case is. In *Texas Department of Housing and Community Affairs v. Inclusive Communities Project, Inc.*,[7] a case involving disparate impact claims under the Fair Housing Act, the Supreme Court set forth rigorous legal tests for disparate-impact liability, including an exacting burden of proof to establish a *prima facie* case of disparate impact.[8] Application of those standards to the enforcement actions brought by the CFPB against auto financing companies would result in almost certain dismissal of those claims.

Disparate Impact

Under Current Case Law, The CFPB Cannot Make A *Prima Facie* Case Of Disparate Impact Against Auto Financers

The Text of the Equal Credit Opportunity Act Does Not Give Rise to Disparate Impact Liability

The CFPB employs a "disparate impact" theory of discrimination when enforcing ECOA despite the lack of a valid legal or statutory basis for doing so.[9] One searches the text of ECOA in vain for any language giving rise to a disparate impact theory of liability. The Staff Report entitled *Unsafe at Any Bureaucracy I* highlighted the absence of any case law supporting the CFPB's attempt to import disparate impact theory into ECOA, and showed that the operative language in other statutes that courts have construed to imply disparate-

[7] This case considered whether the Fair Housing Act gave rise to disparate-impact liability.
[8] *See Inclusive Communities*, Supreme Court.
[9] *See* Consumer Financial Protection Bureau, Bureau Bulletin 2012-04 (Fair Lending) (Apr. 18, 2012), *available at* http://files.consumerfinance.gov/f/201404_cfpb_bulletin_lending_discrimination.pdf ("[T]he CFPB reaffirms that the legal doctrine of disparate impact remains applicable as the Bureau exercises its supervision and enforcement authority to enforce compliance with the ECOA and Regulation B.").

impact liability is nowhere to be found in ECOA. Yet that has not stopped the CFPB from charging ahead with multiple cases against auto financers under a baseless legal theory.

In the absence of a Supreme Court case on ECOA, the CFPB has analogized to cases interpreting laws with different statutory text and context from ECOA, most notably, the Fair Housing Act (FHA). At a March 2016 hearing before the House Financial Services Committee, Representative Randy Hultgren explained that the *Inclusive Communities* holding that disparate impact was cognizable under the FHA "rested primarily on the unique congressional history of FHA — history that is plainly inapplicable to ECOA." CFPB Director Richard Cordray responded by claiming that the FHA and ECOA "have been applied hand in glove for decades."[10] A review of the relevant legal landscape contradicts Director Cordray on this point.

In *Griggs v. Duke Power* and *Smith v. City of Jackson*, the Supreme Court inferred disparate impact liability from the text of the Civil Rights Act and the Age Discrimination in Employment Act, respectively, with the *Griggs* Court holding that Congress had "directed the thrust of the Act to the *consequences* of employment practices, not simply the motivation."[11] The Court applied the rule *Griggs* and *Smith* established to reach the same conclusion about the FHA in the *Inclusive Communities* case, after examining the language of the FHA and holding that its "results-oriented language counsels in favor of recognizing disparate-impact liability."[12]

By contrast, ECOA contains no such consequences-based language, but focuses solely on the intent of the actor. A textual comparison of ECOA and the Fair Housing Act illustrates this critical distinction.[13] The FHA expressly prohibits an actor from acting in any way that results in any person being denied housing on the basis of race: "It shall be

[10] *The Semi-Annual Report of the Bureau of Consumer Financial Protection: Hearing Before the H. Comm. On Fin. Servs.*, 114th Cong. (2016) (statements of Rep. Hultgren and Director Cordray).
[11] *Griggs v. Duke Power Co*., 401 U.S. 424, 432 (1971) (emphasis added); *see Smith v. City of Jackson*, 544 U.S. 228 (2005). For further analysis, see *Unsafe at Any Bureaucracy.*
[12] *Inclusive Communities*, Supreme Court, at 2518.
[13] *See Unsafe at any Bureaucracy*, at 14.

unlawful . . . [t]o refuse to sell or rent after the making of a bona fide offer, or to refuse to negotiate for the sale or rental of, *or otherwise make unavailable or deny*, a dwelling to any person because of race, color, religion, sex, familial status, or national origin."[14] This is the results-oriented statutory language the Court relied on in *Inclusive Communities* to hold that disparate impact claims were cognizable under the FHA. ECOA's text, on the other hand, contains no such results-oriented provision. Instead, it prohibits an actor from *discriminating* on the basis of race: "It shall be unlawful for any creditor to discriminate against any applicant, with respect to any aspect of a credit transaction . . . on the basis of race, color, religion, national origin, sex or marital status, or age. . . ."[15] Due to the absence of results-oriented statutory language, under *Inclusive Communities*, disparate impact is not cognizable under ECOA.

The FHA's legislative history provides additional grounds for differentiating it from ECOA on the issue of disparate impact. In the case of the FHA, prior to the Supreme Court's holding in *Inclusive Communities,* the lower courts issued a series of opinions holding that the FHA authorized disparate-impact liability.[16] Subsequently, Congress amended the FHA to exempt certain activities that could only have violated the law if the FHA authorized disparate-impact.[17] The Court in *Inclusive Communities* interpreted Congress' amendment as a ratification of those prior holdings finding disparate impact liability.[18] However, Congress has made no such amendments to ECOA.

New Case Law Shows the CFPB Could Not Make a *Prima Facie* Case Against Indirect Auto Financers Under *Inclusive Communities*

Even if ECOA authorized disparate impact enforcement actions, which it does not, the CFPB still could not make a legally valid case for its enforcement actions against auto financers. As outlined in greater detail below, in *Inclusive Communities*, the Supreme Court set an exacting burden of proof to establish a *prima facie* case of disparate impact. On

[14] 42 U.S.C. § 3604(a).
[15] 15 U.S.C. § 1691(a).
[16] *Id.* at 2520-21.
[17] *Id.* at 2520-21.
[18] *Id.* at 2520-21.

remand, the district court applied that standard and ruled that discretion does not constitute a policy pursuant to a disparate-impact theory. The CFPB's entire theory of liability against indirect auto financers is premised on the claim that individual auto dealers' ability to set discretionary dealer participation constitutes a policy on the part of the auto financer — a theory that *Inclusive Communities* conclusively refutes.

The facts underlying *Inclusive Communities* pertain to a housing authority in Dallas that granted tax credits to builders of low-income housing on a discretionary basis. The federal government provided tax credits to the states to distribute to developers, which Texas did in this case through the defendant housing authority.[19] Developers could then apply for the tax credits which could be "sold to finance construction of a housing project," which the housing authority granted on a discretionary basis.[20] Any developers who received these housing tax credits were required by law to accept recipients of Section 8 housing vouchers.[21] The plaintiff in the case alleged that the housing authority's allocation of tax credits in Dallas had "a disparate impact on the location of low-income housing in the area."[22] Specifically, the plaintiffs alleged that the housing authority's "use of discretion in the aggregate resulted in an approval rate for units located in Caucasian areas of nearly half the approval rate for units located in minority areas," and that the housing authority's "decisions to deny or approve applications for specific applications for . . . tax credits" was "evidence of disparate impact."[23]

The Supreme Court opinion in *Inclusive Communities* focused primarily on the parameters of a disparate impact claim. First, the Court noted the three-step burden-shifting test that the Department of Housing and Urban Development had adopted by regulation and the Fifth Circuit Court of Appeals applied below, as follows: (1) the plaintiff must "make a prima facie showing of disparate impact," which requires meeting the "burden of proving that a challenged practice caused or predictably will cause a

[19] *Id.* at 11-12.
[20] *Id.* at 11-12.
[21] *Id.* at 11-12.
[22] *Id.* at 11-12.
[23] *Id.* at 11-12.

discriminatory effect";[24] (2) if the plaintiff makes out a *prima facie* case, "the burden shifts to the defendant to prov[e] that the challenged practice is necessary to achieve one or more substantial, legitimate, nondiscriminatory interests";[25] (3) if the defendant proves the practice served a legitimate interest the burden shifts back to the plaintiff to "prov[e] that the substantial, legitimate, nondiscriminatory interests supporting the challenged practice could be served by another practice that has a less discriminatory effect."[26]

Turning to the heart of the case, the Court found that disparate-impact liability "has always been properly limited in key respects."[27] A key limitation on disparate-impact liability is that plaintiffs must establish a defendant's "policy or policies caus[ed] this disparity."[28] This requires a twofold showing: both that the defendant had a policy in place, and that the policy caused the disparity at issue. The holding stressed the "robust causality requirement" needed to show that a policy of the defendants caused the disparity.[29] The Court emphasized two purposes of such a robust requirement. The first is to avoid incentivizing the use of racial quotas and causing entities to create policies that "in fact, tend to perpetuate race-based considerations rather than move beyond them."[30] The second is to "protect[] defendants from being held liable for racial disparities they did not create," and "protect potential defendants against abusive disparate impact claims."[31]

In addition to establishing plaintiffs' *prima facie* burdens, the opinion held that courts must give both government and private defendants "leeway to state and explain the valid interest served by their policies . . . analogous to the business necessity standard

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[24] *Id*. at 4-5; *see also Inclusive Communities Project, Inc., v. Texas Dep't of Hous. and Comty. Affairs*, Nos. 12–11211, 13–10306., slip op. (5th Cir., Mar. 24, 2014) (hereinafter "*Inclusive Communities*, 5th Circuit").
[25] *Inclusive* Communities, Supreme Court at 2514-15; *see also Inclusive Communities*, 5th Circuit.
[26] *Inclusive* Communities, Supreme Court at 2514-15 (internal quotation marks and citations omitted); *see also Inclusive Communities*, 5th Circuit.
[27] *Inclusive Communities*, Supreme Court, at 2522.
[28] *Id.* at 2523.
[29] *Id.* at 2523. The Court highlighted in particular that "a disparate-impact claim that relies on a statistical disparity must fail if the plaintiff cannot point to a defendant's policy or policies causing that disparity." *Id.*
[30] *Id.* at 2524.
[31] *Id.* at 2523-24.

under Title VII."[32] This leeway is because defendants must "be allowed to maintain a policy if they can prove it is necessary to achieve a valid interest."[33]

The Supreme Court decided *Inclusive Communities* in 2015 and remanded the case to the appellate court, which in turn remanded it to the district court for disposition consistent with the Supreme Court's holding. In August 2016, the District Court for the Northern District of Texas stated that its prior conclusion that the plaintiff had made a *prima facie* case was "reached without the benefit of the Supreme Court's decision in this case," and changed its decision in light of the Supreme Court's holding.[34] It found that the plaintiff could not state a *prima facie* case of disparate impact under the Supreme Court's opinion.

Discretion is not a "policy" and therefore cannot be used to make out a prima facie *case of disparate impact liability*

The District Court held that the plaintiff had failed to meet the burden of proof the Supreme Court requires to show disparate impact because discretion is not a cognizable policy under disparate-impact analysis. The District Court held that as a matter of law a generalized policy of discretion is not a specific policy or practice that can be said to cause the alleged disparity, but rather a series of "cumulative effects."[35] Indeed, it held that if "the plaintiff establishes a subjective policy, such as the use of discretion, has been used to achieve racial disparity, the plaintiff has shown disparate treatment," *not* disparate impact.[36] Disparate impact, by contrast, requires the plaintiff to "establish[] that the existence of the policy itself, rather than how the policy is applied, resulted in a racial disparity."[37] The court went on to find that because the plaintiff was merely complaining

[32] *Id.* at 2522.
[33] *Id.* at 2523.
[34] *Inclusive Communities Project, Inc.*, v. *Texas Dep't of Hous. and Comty. Affairs*, No. 3:08-CV-0546, slip op. at 3, 32 (N.D. TX, Aug. 26, 2016) (hereinafter "*Inclusive Communities,* District Court").
[35] *Id.* at 15.
[36] *Id.* at 18.
[37] *Id.* at 17.

about the "results of [the defendant]'s discretion, not the exercise of discretion," it had failed to demonstrate a *prima facie* case of discrimination.[38]

Because the CFPB's case against indirect auto financers is premised on the claim that discretion is a policy,[39] it would also fail under an application of the Supreme Court's rigorous *Inclusive Communities* standard. The CFPB has pointed to auto financers' "policy" of discretion whereby the dealers, not the financers, have the discretion to determine whether and how much dealer participation to charge.[40] However, because discretion is not a specific policy, it cannot give rise to disparate impact liability.

The CFPB would likely point to an ancillary point made by the District Court opinion in an attempt to salvage its argument. The court noted that the plaintiff was properly understood as bringing a disparate treatment claim rather than a disparate impact claim, because the relief the plaintiff sought was not an order eliminating the housing authority's ability to exercise discretion but rather an order forcing the housing authority to exercise that discretion to reduce racial segregation in low-income housing.[41] The CFPB would likely argue that because it seeks to cap the level of discretion that car dealers may exercise, not force auto dealers to exercise their discretion in a particular way, discretion constitutes a "policy" in its cases against the auto financers.

There are several flaws in this line of reasoning. First, the court merely pointed to the relief sought as an illustration of the point it had already arrived at through the application of precedent and logic. Namely, that discretion is not in itself a policy capable

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[38] *Id.* at 18.

[39] *See e.g.* November 19, 2014, Decision Memorandum, 'Authorization to Seek a Settlement or Commence Litigation', at 11, ("As described above, Honda, Toyota, and Nissan each maintain a specific policy and practice that provides dealers discretion to mark up borrowers' interest rates above each institution's established buy rates, and compensates dealers for those markups.").

[40] *See e.g.*, Consent Order, *In the Matter of Toyota Motor Credit Corporation*, No. 2016-CFPB-0002, ¶11 (CFPB Feb. 2, 2016) *available at* http://files.consumerfinance.gov/f/201602_cfpb_consent-order-toyota-motor-credit-corporation.pdf ("With respect to non-subvented retail installment contracts, Respondent maintains a specific policy and practice that provides dealers discretion to mark up a consumer's interest rate above Respondent's established risk-based buy rate.").

[41] *Inclusive Communities*, District Court, at 18.

of creating a disparate impact, but rather an absence of a policy, and instead the ad hoc discretionary decisions either are motivated by an intention to treat minorities differently (and therefore illegal because they are disparate treatment, not disparate impact), or are not (and therefore are not illegal). Second, the fact that the plaintiff in *Inclusive Communities* sought to address its complaints about the "results of [the defendant]'s discretion" by seeking to make the defendant exercise that discretion to secure different results does not change the baseline conclusion that the results of discretion simply cannot be defined as the results of a policy. Third, none of the consent orders resolving the CFPB's actions against auto financers had the effect of eliminating the discretion of a dealer to charge a dealer participation, but rather imposed lower ceilings on how much reserve dealers can charge. Fourth, if anything, the fact pattern in indirect auto lending is still further removed from a "specific policy." In *Inclusive Communities* the discretion was actually exercised by the defendant in the case. By contrast, indirect auto financers are not the parties that exercise the discretion to set dealer participation; that discretion is exercised by auto dealers. Thus financers' relationship to the results of discretion is even more attenuated than that of the housing authority in *Inclusive Communities*.

Further support for the holding that discretion is not a policy comes from another case decided by a federal district court in the aftermath of the *Inclusive Communities* Supreme Court case. In *City of Los Angeles v. Wells Fargo & Co*, plaintiffs alleged that Wells Fargo had violated the Fair Housing Act's disparate impact prohibition by issuing mortgages that imposed different terms or costs on minority borrowers.[42] In that case the plaintiff did not claim that the defendant had a policy of discretion per se, but it claimed that the defendant's "inadequate monitoring policies resulted in the disparate issuance of [h]igh-[c]ost loans to minority borrowers."[43] The court summarized this position as an argument that "a *lack* of a policy produced the disparate impact."[44] In other words: discretion. The court ruled that the plaintiff failed to make a valid disparate impact claim

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[42] *City of Los Angeles v. Wells Fargo & Co*., No. 13-09007, at 2 (C.D. Calif. Jul. 17, 2015).
[43] *Id*. at 16.
[44] *Id.* at 16 (emphasis in original).

because the plaintiff could not meet *Inclusive Communities*' requirement to identify an "actual policy" of the defendants as part of the causation showing.[45]

<u>*The CFPB could not meet the robust causality standard of* Inclusive Communities</u>

The District Court in the *Inclusive Communities* remand case next turned to the question of causation. The District Court found that even if, *arguendo*, discretion were a policy, the plaintiff would still have no actionable claim against the housing authority because it had "not proved that it was [the defendant]'s exercise of discretion — and not something else — that caused" the disparity.[46] So even if disparate-impact actions were cognizable under ECOA, and even if discretion were a policy for the purposes of making out a *prima facie* case, the CFPB still could not prove that dealer discretion to set dealer participation caused the alleged disparity because it cannot prove that the exercise of discretion caused the disparities it observed.

In the *Inclusive Communities* opinion, the Supreme Court articulated a "robust causality requirement" designed to "ensure[] that [r]acial imbalance . . . does not, without more, establish a prima facie case of disparate impact and thus protect[] defendants from being held liable for racial disparities they did not create."[47] The Court incorporated this protection because if it did not, "disparate-impact liability might displace valid governmental and private priorities," which would in turn "set our Nation back in its quest to reduce the salience of race in our social and economic system," whereas disparate-impact liability must properly be applied to "remov[e] . . . artificial, arbitrary, and unnecessary barriers."[48] The Court further held that if the plaintiff could not meet its burden to show a causal connection between a defendant's policy and a disparate impact, it "should result in dismissal of this case."[49]

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[45] *Id.* at 16.
[46] *Inclusive Communities,* District Court, at 19. The court also held that providing the requested relief of forcing the plaintiff to "monitor relevant data" and "correct the disproportionate issuance" of high-cost loans to minorities "is a roundabout way of arguing for a racial quota," which is explicitly prohibited by the *Inclusive Communities* decision due to the Constitutional issues it would raise. *Id.* at 16-17.
[47] *Inclusive Communities,* Supreme Court, at 2523 (internal quotation marks and citation omitted).
[48] *Id.* at 2524 (internal quotation marks and citation omitted).
[49] *Id.* at 2524; *see also Inclusive Communities,* District Court, at 20-21.

Applying the Supreme Court's "robust" causation standard, the District Court found that the plaintiff failed to make a *prima facie* case of disparate impact.[50] It first noted that there is no evidence the statistical disparity would have been eliminated had the housing authority been forced to use a particular points-system for awarding tax credits rather than exercising discretion.[51] The court then found that that the plaintiff did not show causation because it failed to account for "other potential causes of the statistical disparity."[52] The Supreme Court had recognized that in this case it "may be difficult to establish causation because of the multiple factors that go into investment decisions about where to construct or renovate housing units."[53] The District Court pointed out that there were multiple potential causes of the disparity alleged in the case, such as developers' considerations, local governments' preferences, and federal laws mandating preferences for low-income communities in awarding tax credits.[54] Therefore the plaintiff failed to meet its burden to prove that the housing authority's "exercise of discretion — and not other factors — caused the statistical disparity."[55] Because the plaintiff failed to meet its burden to show that it was the housing authority's exercise of discretion that caused the disparity, it could not have made out a disparate impact case even if discretion were a policy as a matter of law.

Nor could the CFPB make a sufficient showing of causation if its auto-lending enforcement strategy were ever exposed to scrutiny by a federal court. As the previous Staff Reports have demonstrated, the CFPB was informed time and again of factors other than race that completely or almost completely accounted for the disparities in dealer participation the CFPB alleged it found in various indirect auto financers' portfolios.[56] These factors included the credit score, the new or used status of the vehicle, the term of

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[50] *Inclusive Communities,* District Court, at 6, 10, 19, 25, 30.
[51] *Id.* at 19.
[52] *Id*. at 20.
[53] *Inclusive Communities,* Supreme Court, at 2523-24; *see also Inclusive Communities,* District Court, at 20-21.
[54] *Inclusive Communities,* District Court, at 19-23.
[55] *Id.* at 21. The plaintiff attempted to prove that some of the potential factors were not causes of the disparity but its analysis suffered from methodological problems, such as comparing the cumulative results of annual tax credit awards over many years rather than comparing tax credit awards within each year against one another as the housing authority did when reaching its decisions. *Id.* at 22.
[56] *Unsafe at any Bureaucracy*, at 38-39.

repayment, the dealer, and the geographical area.[57] The Supreme Court viewed a robust *prima facie* causality showing as a necessary step in safeguarding valid business and other priorities. Each of the above factors represents a potential valid business priority. For example, a borrower with a lower credit score may be less appealing to financers, and the dealer may have to expend significantly more time and effort to find him or her financing. Under the robust standard of causation set forth in *Inclusive Communities*, the CFPB must consider each of these factors and any other relevant factors and prove that each one did not cause the disparity in order to meet its burden to show that a policy of the financers did cause the disparity. However, based on its internal documents, it appears the CFPB does not even consider these factors when making a showing of correlation, much less causation.

In order to make a valid comparison between the dealer participation charged to consumers of different races one should compare consumers only with other similarly-situated consumers. For example, RISCs of borrowers seeking a 5-year car repayment term should be compared only against RISCs of other borrowers seeking the same repayment term, not the RISCs of consumers with a 7-year repayment term, in order to tell if there is really a difference in dealer participation between people of different races or only between people who select different terms. But, as extensive internal CFPB documentation has revealed,[58] when determining whether differences in dealer participation are correlated to race the CFPB does not regress out other variables to assess whether the differences in dealer participation are truly correlated to race or whether they are in fact correlated to some other relevant borrower characteristic (like geographical area, credit score, or term).

Court documents demonstrate one theory the CFPB likely relied on to try to justify its decision to ignore these variables. The Department of Justice (DOJ) filed a complaint

[57] *Id.* at 38-39.
[58] *See generally Unsafe at any Bureaucracy; Unsafe at any Bureaucracy II.*

(later settled) against Toyota on the basis of the CFPB's decision to "refer[] Toyota to the United States Department of Justice pursuant to ECOA."[59] The complaint alleged:

> The United States's and the CFPB's markup analyses focused on the interest rate difference between each borrower's contract rate and each borrower's buy rate set by Toyota. Toyota considers individual borrowers' creditworthiness and other objective criteria related to borrower risk in setting the buy rate . . . . The dealer markups charged by Toyota to consumers are based on dealer discretion and are separate from, and not controlled by, the adjustments for creditworthiness and other objective criteria related to borrower risk that are already reflected in the buy rate. Toyota's markup policy provided for dealer discretion and did not include consideration of these factors. Because the analysis focused on only the difference between each borrower's contract rate and buy rate, it did not make additional adjustments for creditworthiness or other objective criteria related to borrower risk.[60]

In other words, the DOJ and CFPB's analysis treated factors such as credit score, geography, new/used status, term of the loan, etc. as if they were irrelevant to setting dealer participation. The apparent rationale is that the agencies believed the factors were relevant only to risk-based pricing of the buy rate and were therefore already "baked in" to the buy rate, rendering it unnecessary or even double-counting to consider them in analyzing dealer participation.

The CFPB's internal documentation shows that this theory was applied internally as well. In one memorandum to Director Cordray, CFPB staff justified its decision not to control for relevant potentially explanatory variables by claiming:

[59] Complaint, *U.S. v. Toyota Motor Credit Corp.*, No. cv-16-725, ¶16 (Feb. 2, 2016, C.D. Cal.).
[60] *Id*. at ¶20.

> Given the fact that Honda, Toyota, and [Institution C]'s buy rate on any given transaction already accounted for characteristics associated with the borrower's creditworthiness, the characteristics of the vehicle, and the timing, location, and structure of the deal, such factors were not included as controls in the analysis, which focused on dealer markups.[61]

This reasoning closely tracks an approach promoted by Professor Ian Ayres, suggesting that the CFPB may be relying on or incorporating his theory in its own position. This theory is known as "included variable bias" theory, which is the opposite of the standard and accepted statistical "omitted variable bias" analysis. Ayres has written several articles on the subject, and served as an expert witness for the plaintiffs in a 2004 class-action lawsuit against Honda's financing arm, a case that was ultimately settled (prior to a ruling on class certification) on terms including an agreement to cap dealer participation at 250 basis points (2.5 percentage points).[62] For that case, Ayres wrote a report supporting class certification, arguing that "[i]ncluding controls for non-race factors that do not represent legitimate business justifications can bias the estimate of whether a decisionmaker's policies produced an unjustified disparate impact."[63] Whereas "omitted variable bias" refers to the idea that failing to control for factors other than the one being tested for — here, race or ethnicity — creates a statistical bias, "included variable bias" theory holds that "[i]t is inappropriate to control for these non-race factors in the regression under a disparate impact theory, because the statistician wants to see whether these non-race factors produce racially disparate outcomes."[64] However, this misunderstands the legal analysis required, which is to determine whether the defendant's policy produces racially disparate outcomes, not whether other non-race factors produce racially disparate outcomes.

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[61] November 19, 2014, Decision Memorandum, 'Authorization to Seek a Settlement or Commence Litigation', at 13.
[62] *See* Settlement Agreement at ¶9.1, Jan. 21, 2005, *Willis et al. v. American Honda Finance Corp.*, class action, No. 3-02-0490 (M.D. Tenn.); *see also* Docket, *Willis et al. v. American Honda Finance Corp.*, class action, No. 3-02-0490 (M.D. Tenn.).
[63] Expert Report Of Ian Ayres at 7, Jun. 30, 2004, *Willis et al. v. American Honda Finance Corp.*, class action, No. 3-02-0490 (M.D. Tenn.).
[64] *Id*. at 6.

Ayres further argued that in that particular case Honda's "centralized credit scoring process . . . base[s] credit determinations on arms-length, non-subjective criteria" and that because Honda "exclusively bears the risk of non-repayment of its principal and . . . it bases its lending and buy-rate decisions exclusively on information that is embedded in its available databases, it is disingenuous to argue that dealerships (who are not bearing any risk of non-repayment of principal) are nonetheless making risk-based decisions."[65]

Ayres' argument ignores the fact that these factors do not only predict risk of non-repayment of principal, but also directly reflect the origination costs dealers face when working to find financing for their customers. Dealers have to make a significant investment to obtain financing for borrowers and that investment varies depending on the borrower. For example, a dealer must expend significantly more time and effort to find financing for buyers with poor credit or buyers who wish to enter into RISCs with terms that are more complicated or companies are less eager to finance, such as longer repayment periods. The dealer has to factor in the real costs, time-cost, overhead cost, opportunity cost, etc. to the retail pricing decision. None of this pricing is contingent on the risk of non-repayment of principal, but rather on the cost of originating or retailing the RISC. In addition, the dealer must also price in risk in some circumstances. Where the dealer issues a RISC to a borrower before securing financing and then sells the RISC after the fact (called a "spot delivery"), the dealer must in fact price in risk of non-repayment of capital. And, on all RISCs the dealer must price in the risk of losing his compensation if the borrower defaults within the first 90 days of the loan period.

Ayres also argued that "[u]nder a disparate impact theory, it is necessary to intentionally exclude (that is, "omit") non-race variables from a regression to test whether those variables produced a disparate racial impact."[66] This argument is convincing to a point, as it would seem to make little sense to control for variables that bear no reasonable relation to the cost or price of assigning or originating a RISC, especially if they are

[65] *Id*. at 26.
[66] *Id*. at 5.

correlated with race or ethnicity. To use a simplistic example, a person's eye color has no reasonable bearing on the ease or difficulty a dealer may have in obtaining financing for that person or any other cost or credit-risk factors, but it may be correlated with race or ethnicity, so it would be self-defeating to control for eye color in a disparate impact case and inappropriate to include it in the *prima facie* analysis. Similarly, whether the person is a dog or a cat owner, while having nothing to do with race, is an inapposite control because it has no plausible connection with the cost (including time-cost, overhead cost, risk pricing, etc.) of assigning a RISC.

However, Ayres took this argument past its logical extreme by arguing that in a disparate impact case regarding dealer reserve, the "qualified pool is simply the class of Honda Finance borrowers" without regressing out any non-racial characteristics. Under this approach, a fact-finder should "simply compare the average finance markup charged" to minority versus non-Hispanic white borrowers.[67] His reasoning was that "Honda Finance's own willingness to lend to this class is direct evidence that these borrowers were deemed by Honda Finance to be qualified borrowers."[68]

This argument has several flaws. First, it ignores the fact that there is not simply a binary choice between qualified and unqualified borrowers but a spectrum of financing rates and terms that various applicants will be qualified for depending on multiple pertinent factors, which in turn will make each applicant more or less difficult and costly for the dealer to obtain financing for. This in turn will affect the retail price of the RISC. Second, the fact that some characteristics are plainly irrelevant does not refute the point that many factors like those discussed above *are* relevant and must be controlled for to reach an accurate picture of whether disparate impact has in fact occurred. Third, this argument fails to account for the heightened burden the courts have placed on plaintiffs to make a *prima facie* case, as in *Inclusive Communities*. A *prima facie* case must prove that the

[67] *Id.* at 9.
[68] *Id*. at 9.

plaintiff's policy and not some other factor (such as creditworthiness, geography, etc.) caused disparate impact.

Moreover, even Ayres conceded that some variables should be considered in disparate impact analysis, even if he advocated against using such variables to analyze dealer participation. He argued that "a variable should be presumptively excluded from the statistical analysis unless the defendant can demonstrate separate from the regression that the variable was required and affected performance."[69] In other words, he appears to believe that the inclusion of variables should be the defendant's burden, presumably falling under the business necessity prong of the three-step burden-shifting analysis. But this is inconsistent with the standard articulated by the Supreme Court in *Inclusive Communities*.

Internal documentation of the CFPB's process shows that not only did the CFPB fail to conduct appropriate regression analysis to make out its *prima facie* case under the first stage of the burden-shifting test, it also refused to accept the reasonable regression analysis proposed by auto financers under the second stage of the burden-shifting test. In a memorandum for the Director, the CFPB nominally considered and summarily dismissed potentially explanatory non-racial factors only under the first prong of the test (ultimately deciding not to control for such factors for the reasons discussed above) and did not even raise these factors under the "Legitimate Business Need" (or, stage two) section of the memorandum.[70]

Indeed, the CFPB had ample actual and constructive knowledge of such factors and their explanatory value. It was presented on multiple occasions with potentially explanatory factors along with explanations for their relevance.[71] Yet the CFPB refused to

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[69] *Id*. at 7 (internal quotations marks and brackets omitted).
[70] November 19, 2014, Decision Memorandum, 'Authorization to Seek a Settlement or Commence Litigation', at 13, 19.
[71] *See e.g.* November 19, 2014, Decision Memorandum, 'Authorization to Seek a Settlement or Commence Litigation', at 13, 19; January 17, 2013, Institution A PARR/NORA Submission, 3 (included in February 14, 2014 CFPB Referral of Institution A Matter to DOJ); April_2013 Draft Memorandum, "Choice of Estimation Methods for Indirect Auto Lending Markup Disparities," Draft 1, 1-2; April_2013 Draft Memorandum, "Choice of Estimation Methods for Indirect Auto Lending Markup Disparities," Draft 2, 1-2.

control for those factors.[72] And, at least as early as 2007 the DOJ entered into well-publicized consent orders settling disparate impact cases,[73] which recognized seven variables as valid "competitive reason[s] that are consistent with ECOA" under a disparate impact theory and that would cause dealers to set different dealer participation.[74] Yet nowhere did the CFPB control for those factors either.

If, as appears to be the case, the CFPB were relying on Ayres' theory, *Inclusive Communities* would eliminate any doubt that such analysis is insufficient to show disparate impact. As discussed above, both the Supreme Court and the District Court made it clear that in a disparate-impact suit the CFPB would have a robust initial burden, both to show that a disparity actually exists (here, by comparing similarly-situated borrowers) and to show that any disparity is caused by the policy itself and not by various market or other forces. Moreover, even under the burden-shifting test an auto financer would be easily able to show that its policy was needed to meet legitimate, non-discriminatory, interests, as discussed above and in previous Staff Reports.[75] While the CFPB could not meet its heightened burden to show that the auto financers' "policy" caused the disparate impact, the auto financers could show that their policy met several legitimate business interests.

If the CFPB brought such an action in federal court (setting aside the dispositive fact that discretion is not a policy) using the models and factors it currently considers in applying disparate impact, it could not set forth a case that would satisfy the standard established by Supreme Court precedent. Nothing less than considering all relevant

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[72] *See e.g.* id; *see also* January 17, 2013, Institution A PARR/NORA Submission, 3 (included in February 14, 2014 CFPB Referral of Institution A Matter to DOJ); April_2013 Draft Memorandum, "Choice of Estimation Methods for Indirect Auto Lending Markup Disparities," Draft 1, 1-2; April_2013 Draft Memorandum, "Choice of Estimation Methods for Indirect Auto Lending Markup Disparities," Draft 2, 1-2.

[73] *See* Consent Order, *United States v. Pacifico Ford, Inc.*, No. 2:07-cv-03470-PBT (E.D. Pa. Aug. 28, 2007); Consent Order, *United States v. Springfield Ford*, No. 2:07-cv-03469-PBT (E.D. Pa. Aug. 28, 2007).

[74] Those seven reasons are: (1) "a lower cap imposed by the lender for the particular transaction;" (2) "a constraint on the customer's ability to satisfy monthly payment requirements;" (3) "a statement by the customer that he or she has access to an equal or more favorable offer from another dealer or lender;" (4) "a special promotional offer extended to all customers on the same terms;" (5) "the fact that a particular transaction is eligible for . . . [a manufacturer] Credit or other subvened interest rates;" (6) "the fact that the transaction is eligible for . . . [the dealer's] employee incentive program"; or (7) "documented inventory reduction considerations related to specific vehicles." *Pacifico Ford.* at ¶7(b); *Springfield Ford* at ¶7(b).

[75] *See Inclusive Communities*, Supreme Court, at 2514-15.

explanatory factors will do, i.e., the traditional "omitted variable bias" analysis advocated by the targets of the CFPB's actions. The CFPB could not meet its burden of proving that the defendant's "exercise of discretion — and not other factors — caused the statistical disparity,"[76] and, even if it could, it would have to overcome the auto financers' showings of a legitimate business need.

This sheds light on yet another significant problem with the CFPB's case that is related to causation, namely that causation is so attenuated here that it may not be sufficient to confer standing on the CFPB to sue the auto financer in the first place because the *dealer* exercises the discretion over what dealer participation to charge, not the auto financer.[77] The "irreducible constitutional minimum" required to show standing includes "a causal connection between the injury and the conduct complained of" whereby the injury is "fairly . . . trace[able] to the challenged action of the defendant, and not . . . th[e] result [of] the independent action of some third party not before the court."[78]

When the District Court in the *Inclusive Communities* case addressed causation, although it was not considering standing, it is nonetheless highly telling that the entire focus of its inquiry was whether the housing authority's *exercise* of discretion caused the disparity. Car dealers exercise the discretion to set dealer participation in the auto-lending context, not financers. Even if there were legal grounds for the CFPB to sue, the appropriate defendants would be the car dealers, not the auto financers. However the CFPB cannot sue car dealers because the Dodd-Frank Act expressly forbids it from doing so.[79] To circumvent this statutory prohibition, the CFPB concocted an elaborate and

[76] *Inclusive Communities,* District Court, at 21.

[77] The dealer has discretion to set his own dealer participation within the parameters of the common industry caps of 175-200 basis points maximum.

[78] *See e.g. Lujan v. Defenders of Wildlife,* 504 U.S. 555, 561-61 (Jun. 12, 1992) (internal citations and quotation marks omitted).

[79] Dodd–Frank Wall Street Reform and Consumer Protection Act § 1029(a), 12 U.S.C. § 5519(a) (2012). It is also important to note that the CFPB's case against car dealers would be plagued by all the same legal and evidentiary deficiencies as its case against auto financers, such as the lack of statutory authorization to pursue disparate impact claims, inability to make a prima facie showing of causation, and inability to rebut the legitimate business needs defense.

unfounded legal theory of liability so it could go through auto financers in an attempt to attack the car dealers indirectly.

The CFPB's Test For Harm In Indirect Auto Lending Makes The Same Errors The Court Rejected In Inclusive Communities

The CFPB has not only pursued disparate impact actions against auto financers, it has forced several to settle their claims using an invalid calculus of consumer harm. As noted in *Unsafe at Any Bureaucracy II*, the CPFB's definition of harm, which it uses to determine eligibility for remuneration,[80] is incorrect. When distributing the funds from the disparate-impact settlement it reached with Ally, the CPFB considered borrowers who entered into RISCs financed by Ally during the relevant time period to be eligible for monetary relief if: (1) "at least one borrower on the contract . . . [is believed by the CFPB to be] African American, Black, Latino, Hispanic, of Spanish origin, Asian, Native Hawaiian, and/or other Pacific Islander";[81] and (2) the borrower was "identified by the . . . [CFPB and DOJ] as having been overcharged."[82] The CFPB defined "overcharged" as "paying more than the non-Hispanic white average" dealer participation.[83] The CFPB appears to have used this definition of "overcharged" widely in its auto-lending settlements; internal documents show it used this approach to quantify the costs of the alleged disparities for the purposes of discussing proposed settlements with at least three other auto financers.[84]

The same deficiency that was revealed at several points in the CFPB's assessment of liability also undermines the legitimacy of its assessment of harm and recovery, namely, the failure to be specific. By asking only whether a minority borrower paid more than the

[80] CFPB Staff has informed Committee staff that the CFPB did not attempt to determine whether potential claimants to the Ally settlement were "harmed" but merely whether they met the criteria to receive a check from the settlement. In light of the CFPB's insistence that it did not assess whether the consumers it directed be mailed checks were actually harmed by Ally, this report notes that fact here to avoid misstating any facts.
[81] Letter from Director Cordray to Chairman Hensarling (Aug. 31, 2015).
[82] *Id.*
[83] *Id.*; *see also* CFPB PowerPoint #1 at 10; CFPB PowerPoint #2 at 7; Ally Distribution Draft – Draft 1, at 1; *see generally* Ally Distribution Draft – Draft 2; Ally Distribution Draft – Draft 3; Ally Distribution Draft – Draft 4.
[84] November 19, 2014, Decision Memorandum, 'Authorization to Seek a Settlement or Commence Litigation', at 3; June 16, 2015, Decision Memo, at 3.

non-Hispanic white average, the CFPB does not accurately assess whether he or she was actually harmed by disparate impact. An accurate assessment of harm would determine whether the minority borrower paid more than a similarly-situated non-Hispanic white borrower for the entire purchase of the car, including not only the price of financing but also the vehicle price, trade-in value, dealer-installed options, and "add-on" products that the dealer and buyer negotiate at the same time as part of the total cost of the car.[85] At a bare minimum, an accurate inquiry would compare the dealer participation included in the RISC for a minority borrower against the average dealer participation for similarly-situated non-Hispanic white borrowers, not all non-Hispanic white borrowers.

For example, as described above, a dealer may set a higher dealer participation for customers with low credit scores, because it is more difficult, time-consuming, and costly for the dealer to find an auto-financer who is willing to accept a RISC from a less creditworthy borrower. If an African-American borrower had a credit score of 780, he or she should be compared against non-Hispanic white borrowers with similar credit scores to determine whether and how much he or she was overcharged. If his or her dealer participation is compared with the dealer participation of all non-Hispanic white borrowers, and their average credit scores are closer to 550, they may have been charged significantly higher dealer participation. That African-American borrower therefore would fall at or below the non-Hispanic white average, and would be unable to recover settlement remuneration. Whereas, if he or she were compared with non-Hispanic white borrowers with equally high credit scores, it might be revealed that he or she was charged more than they, and was therefore entitled to receive remuneration. Conversely, if that borrower had a credit score of 500 and he or she was charged a higher dealer participation than the non-Hispanic white average, that borrower might not be entitled to remuneration if it turned out that his or her dealer participation was the same or lower than the average for non-Hispanic white borrowers with a similar credit score. Comparing similarly-situated consumers is the only way to draw meaningful conclusions, and it is the only way to satisfy the legal requirement to show causation.

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[85] *Unsafe at Any Bureaucracy*, at 20.

It is certainly true that a borrower could be entitled to damages in excess of the difference between his or her dealer participation and the average for similarly-situated non-Hispanic white borrowers if *arguendo* disparate impact were cognizable under ECOA; the statute authorizes not only actual damages but also punitive damages.[86] Nonetheless, only a minority borrower who was actually harmed could recover damages. And, only a minority borrower who was charged more than the average for similarly-situated non-Hispanic white borrowers could make a showing of harm.

Fuzzy logic and false comparisons are unfortunately prevalent in the CFPB's auto-lending actions. In every aspect of the CFPB's auto-lending actions, the CFPB's lack of rigor leads to unsupported and unreliable conclusions.

Rulemaking

The CFPB Likely Violated The Administrative Procedure Act, Against Its Attorneys' Advice, When Issuing Its Recent Rule Governing Auto Financers

ECOA is not the only legal standard the CFPB has likely sidestepped. It also failed to take steps that its attorneys advised the Director to undertake to comply with the Administrative Procedure Act (APA) when issuing a major rulemaking governing the larger participants in the auto-lending market.

The APA governs the procedures for rulemaking by federal agencies. As CFPB lawyers acknowledged in internal memoranda, section 553 of the APA "requires agencies to publish 'notice' of 'either the terms or substance of the proposed rule or a description of the subjects and issues involved' to 'give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments.' Courts have held that to satisfy the requirements of section 553 agencies must provide an opportunity

[86] Equal Credit Opportunity Act, §1691e(a), (b).

for the public to comment on data and technical studies used to support a rule."[87] An agency must provide data supporting its conclusions, and if it fails to do so it must publish the data and re-open its comment period.[88]

The Dodd-Frank Act authorizes the CFPB to enact a rule classifying certain auto financers as "larger participants" in the consumer auto-lending market and subjecting them to supervision.[89] In October 2014, the CFPB published a proposed rule that defined "larger participants" in the market for automobile financing, and thereby "extend[ed] the Bureau's supervisory authority over larger participants of the defined automobile financing market . . . to supervise for compliance with the Equal Credit Opportunity Act" and other consumer laws,[90] and "include[d] certain automobile leases in the Dodd-Frank Act definition of 'financial product or service' [which] would subject those leases to the prohibition on unfair, deceptive, or abusive acts or practices."[91]

The CFPB's definition of "larger participants" is based upon "quantitative information on the number of market participants and their number and dollar volume of originations" taken from Experian's AutoCount database.[92] During the comment period the CFPB received multiple requests for a list of the institutions that it believed the rule would cover and "a number of comments pertaining directly or indirectly to the Experian list."[93] The CFPB did not respond with the requested information because it "understood that Experian regarded the AutoCount data and information derived from that data, including

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[87] February 10, 2015, Briefing Memorandum for the Director, "Meeting on Auto LP Rule," at 5 (quoting 5 U.S.C. §§ 553(b), (c)) (citing *Connecticut Light and Power Co. v. NRC,* 673 F.2d 525, 530-31 (D.C. Cir. 1982) (finding that integral to the notice requirement is the agency's duty "to identify and make available technical studies and data that it has employed in reaching the decisions to propose particular rules .... An agency commits serious procedural error when it fails to reveal portions of the technical basis for a proposed rule in time to allow for meaningful commentary."); *Am. Radio Relay League v. FCC*, 524 F.3d 227, 236, 237 (D.C. Cir. 2008)).
[88] *See id.*
[89] *See* 12 CFR 1090.100 (2014).
[90] Defining Larger Participants of the Automobile Financing Market and Defining Certain Automobile Leasing Activity as a Financial Product or Service, 79 Fed. Reg. 60,762, 60,773 (proposed Oct. 8, 2014).
[91] *Id.*at 60,774.
[92] *Id.* at 60,774.
[93] February 10, 2015, Briefing Memorandum for the Director, "Meeting on Auto LP Rule," at 2-4.

the names of the entities the Bureau estimates would be newly subject to supervision, as proprietary."[94]

The public comment period on the proposed rule closed on December 8, 2014. Internal documents reveal that after the comment period ended, Experian informed the CFPB that "it had no objection to releasing the list of entity names that the Bureau estimated would be covered under the Bureau's proposed threshold as well as the relative market share for each listed entity."[95]

On February 10, 2015, CFPB attorneys wrote a memorandum to Director Cordray "recommend[ing] publication of the Experian non-proprietary data and reopening of the comment period for the Auto LP proposed rule . . . to comment on the released data," and warning that "there is a cognizable risk that a court would conclude" that the APA required the CFPB to do so.[96] After explaining the legal analysis supporting their conclusion that the CFPB should re-open the comment period, the attorneys outlined the possible negative outcomes of doing so, including the risk of "Congressional scrutiny,"[97] the prospect that it would "raise questions about whether the four prior Larger Participant rules were procedurally defective since the Bureau did not solicit public comment on the identities of the entities that would qualify for supervision[,]"[98] and the likelihood that "[t]he Bureau might feel the need to manage . . . expectation[s] by providing a detailed explanation in future rulemakings of exactly why the identities of potential larger participants are not being released, which might draw attention to potential limitations of the dataset utilized to support the rule.[99]

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[94] *Id.* at 2.
[95] *See id.* at 2, 5. The internal CFPB memo also implies that Experian never regarded this information as proprietary in the first instance, as the memo refers to it throughout as "non-proprietary data." *See id.* at 2 ("Following the close of the comment period, Experian authorized the Bureau to release the requested names in order of number of originations and each entity's percent market share ('Experian non-proprietary data')."); *id*. at 5,7-14.
[96] *Id.* at 2; *see id.* at 7-11.
[97] *Id.* at 13.
[98] *Id.* at 13.
[99] *Id.* at 12-13.

Despite the risk that the CFPB's data would be exposed as inadequate if made transparent, the attorneys advised that: "Although it would be difficult to avoid these collateral consequences entirely, *they, of course, do not provide a defense against § 553's notice and comment requirements*. Moreover, it bears note that failure to release the Experian non-proprietary data would create oversight risk. . . ."[100]

Later memoranda Committee Staff reviewed on the subject omit any mention of the lawyers' conclusion that the Administrative Procedure Act required the CFPB to release the underlying data and reopen the comment period or the risk that greater transparency would expose flaws in the dataset used. A June 3, 2015 memorandum signed by Director Cordray and prepared by David Silberman, the Assistant Director for Research, Markets, and Regulations, and one of his senior counsels recommended that the Director issue and publish the final rule.[101] Nowhere does that memorandum (or any of the other prior legal memoranda on the rule attached to that memorandum) mention Experian's clarification that much information was non-proprietary or raise the possibility of re-opening the comment period.

Although none of the documents the Committee has reviewed reflect whether Director Cordray responded to this legal concern, it is known that Director Cordray did express policy misgivings about the rule. An internal memorandum to Director Cordray from his staff states: "We understand from our meeting on February 11, 2015, that you are concerned that the proposed threshold . . . may be too low, given our limited supervisory resources and the fact that it would include participants that are responsible for a small percentage of market activity and that could be small businesses."[102]

Rather than provide a substantive or policy justification for the low threshold established by the proposed rule, CFPB staff admitted that CFPB had acted similarly before

[100] *Id.* at 13 (emphasis added).
[101] June 3, 2015, Decision Memorandum for the Director, "Issuance and Publication of Final Rule."
[102] March 23, 2015, Briefing Memorandum for the Director, "Meeting on the Auto Finance Larger Participant Rule," at 3 (attached to June 3, 2015, Decision Memorandum for the Director, "Issuance and Publication of Final Rule").

and informed the Director that the CFPB had used thresholds low enough to define small businesses paradoxically as "larger participants" in previous rulemakings: "[W]e have acknowledged the fact that other larger participant rules could capture small businesses, and in fact, estimated in the international money transfer rulemaking that 10 of 25 larger participants would be small businesses."[103] And, they added, the rulemaking would bolster the CFPB's data-collection efforts: "the Bureau may be able to gather some information through supervisory activities . . . [that are] less resource-intensive . . . [so that] it may be able to gather information from a larger number of entities in this market each year."[104]

Despite the legal implications of failing to re-open the comment period flagged by his lawyers — and the policy risk of failing to alter the rule to avoid burdening small businesses by regulating them as "larger participants" — Director Cordray approved issuing the Final Rule on June 3, 2015, and signed the final rule on June 5.[105] The Final Rule was published on June 30, 2015[106] — without disclosure and public comment on the data underlying the rulemaking.

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[103] *Id.* at 4. At no point in the memorandum did the lawyers revisit whether the size of the businesses affected would impact the Regulatory Flexibility Act analysis, which requires additional analysis of rules affecting small businesses. *Id.*; *see generally* September 15, 2014, Decision Memorandum for the Director, "Proposed Rule . . . and the Regulatory Flexibility Act" (attached to June 3, 2015, Decision Memorandum for the Director, "Issuance and Publication of Final Rule").
[104] *Id.* at 5.
[105] June 3, 2015, Decision Memorandum for the Director, "Issuance and Publication of Final Rule"; Signed Final Rule (attached to June 3, 2015, Decision Memorandum for the Director, "Issuance and Publication of Final Rule").
[106] *See* Defining Larger Participants of the Automobile Financing Market and Defining Certain Automobile Leasing Activity as a Financial Product or Service, 80 Fed. Reg. 37496 (Jun. 30, 2015).